Updates
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COP26: Corporate Impacts and Opportunities

The 26th United Nations Climate Change Conference of the Parties (COP26), wrapped up earlier this month in Glasgow, Scotland, after two weeks of negotiations. While attention was focused on national pledges to reduce emissions consistent with the goals established in the 2015 Paris Agreement, there were many related agreements and announcements that will affect specific industries and global finance, as well as create business risks and opportunities. This update discusses how international agreements and U.S. policy announcements coming out of COP26 will affect businesses and provide opportunities in the months and years ahead.

From Paris to Glasgow

Almost every country in the world signed the 2015 Paris Agreement and pledged to develop nationally determined contributions to limit greenhouse gases. These efforts are designed to prevent global temperatures from rising more than 2?C above pre-industrial levels, with the aim of limiting warming to no more than 1.5?C. The Paris Agreement calls for countries to update their pledges and conduct a global stocktake of greenhouse gases every five years. COP26 was scheduled for 2020 to coincide with this provision. After a one-year postponement due to the COVID-19 pandemic, national delegates, business representatives, and other stakeholders gathered in Glasgow to discuss new emissions reductions pledges and negotiate related agreements to reduce and avoid climate change impacts. Beyond lofty goals and ambitious language, COP26 resulted in a number of concrete developments that reflect a renewed sense of urgency and commitment to addressing the impacts of climate change.

A Step Forward for Adopting Uniform Sustainability Standards

The International Financial Reporting Standards (IFRS) Foundation announced the formation of the International Sustainability Standards Board (ISSB) that will develop a comprehensive global baseline of sustainability disclosure standards. The new IFRS Foundation will consolidate two existing standards-setting bodies, the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF), to develop a global framework for sustainability reporting. Along with rolling out the new ISSB, the IFRS issued a prototype for climate disclosure requirements jointly developed by the International Accounting Standards Board (IASB), the Task Force on Climate-related Financial Disclosures (TCFD), the World Economic Forum, and other entities. This prototype sets the stage for the new ISSB disclosure standards anticipated to be issued in late 2022.

While the impact of the ISSB will ultimately depend on how widely its disclosure standards are adopted, companies may find that investors and consumers will soon demand that companies adopt an internationally recognized set of standards for measuring and reporting on environmental, social, and governance (ESG) factors and sustainability issues. Movement towards a generally accepted and respected set of metrics would represent real progress and go a long way toward addressing the problems posed by the current lack of definition and uniformity. One such problem that is increasingly on the radar of both regulators and potential class action litigants is sustainability and ESG "greenwashing." Absent a universal framework and commonly defined vocabulary, stakeholders are too often left in the dark when it comes to differentiating between marketing hype and sustainability achievements. The U.S. Securities and Exchange Commission (SEC) has likewise flagged concerns that companies are not doing enough to assess and report on the material impacts of climate change and that the ESG and sustainability claims they are making must be accurate and defensible. For these reasons and others, the new combined ISSB sustainability reporting framework may be an important tool for corporate sustainability, climate change, and ESG compliance and reporting.

Support for the Growing Global Carbon Offsets Marketplace

One of the most welcomed agreements coming out of COP26 is aimed at fostering a global market for carbon offset credits. Specifically, the new agreement put in place the framework for global pricing and trading systems that was first envisioned under Article 6 of the Paris Agreement. Countries and companies participating in the growing voluntary carbon offsets market pushed for a deal to make trading carbon credits uniform and legitimate across national borders. The final COP26 agreement creates a system of rules on international emissions trading through a U.N.-controlled market that will run in parallel to the existing voluntary markets. As countries work to meet zero emissions targets, this new market will grow, and it is likely that the rules of this new market will spill into the voluntary carbon offsets market as well.

The new agreement also "taxes" some offsets projects by charging a commission that will be put into a new adaptation fund to assist developing countries. No commission, however, will be charged for bilateral offset trades between countries. These bilateral trades will allow countries to purchase carbon credits as a way to meet their own zero emission targets and will likewise spur new investments. Observers estimate that these bilateral offset trades could result in trillions of dollars for forest protection, renewable energy development, and other carbon reduction projects. The voluntary offset market already ballooned to $100 billion in 2020 and is expected to continue expanding, meaning businesses looking to engage in the offset market should consider projects that involve bilateral offset trades and opportunities in the new U.N.-controlled market for expanding business.

Public-Private Commitments to Combat Deforestation

In a separate public-private agreement, more than 140 countries, with combined jurisdiction over more than 90% of the world's forests, joined with dozens of companies in a pledge to end deforestation by 2030. The commitment includes billions of dollars in public and private funding to restore damaged land in developing countries, combat wildfires, and support local communities. Dozens of countries committed to combatting deforestation by focusing on the effects that producing globally traded agricultural products (e.g., palm oil and cocoa) have on the destruction of forests. As part of this effort, more than 30 global financial companies committed to ending investment in activities linked to deforestation. Although the commitment did not include details on execution, the new pledge may lead to a greater push for financial companies to adopt concrete no-deforestation policies and investigations of supply chain activities linked to tropical deforestation.

New Actions and Rules to Reduce Methane Emissions and Fossil Fuel Subsidies

Other announcements will affect specific industries, including energy production, carbon capture technology development, and agriculture. Early in the conference, more than 100 countries announced their agreement to the Global Methane Pledge, a commitment to collectively cut methane emissions by more than 30% in the next 10 years. Although the Global Methane Pledge still requires many large emitting countries' support to come to fruition, the United States has firmly committed to the project as one if its founding sponsors. The United States' commitment coincides with the Biden administration's Methane Emissions Reduction Action Plan. As part of the plan, the Environmental Protection Agency announced proposed rules to strengthen standards for new and existing oil and gas facilities, including new rules for preventing pipeline leaks, and the U.S. Bureau of Land Management (BLM) announced rulemaking to discourage gas flaring on public lands. The U.S. Department of Agriculture (USDA) is also looking at ways to encourage alternative manure management systems, climate-smart agricultural practices, and on-farm renewable energy from methane.

The United States also joined 20 other countries in pledging to halt public financing for "unabated" coal power projects by the end of 2022 but declined to join a pledge to phase out coal altogether. The United States' commitment signals continued support for coal plants equipped with carbon capture and storage technology, while the broader agreement could shift billions in international finance from fossil fuels to clean energy. The U.S. Department of Energy (DOE) announced a significant investment in carbon direct removal research and development, with the goal to lower the price of removal to less than $100/ton of CO2e.

All of this shines a spotlight on businesses with large-scale direct emissions, but it likewise increases the pressure on all businesses to assess the effects of their operations and reduce all tiers of their emissions—not just those most readily apparent. The days of only focusing on carbon emissions are likely over, as governments and the public alike are increasingly focused on the impacts of methane.

State and Local Government Role in Climate Change Regulation

While most of the policy announcements from COP26 were at the national level, states and local governments will be active participants in climate-related regulatory developments. White House climate envoy, John Kerry, announced the formation of a new federal inter-agency group to support and promote state and local governments' greenhouse gas reductions and climate change adaptation policies. The Sub-National Leadership Initiative for Climate is consistent with announcements by multiple governors in attendance at COP26, including Governor John Bel Edwards of Louisiana, who touted the opportunities in shifting to a clean energy economy, and Governor Jay Inslee of Washington, who emphasized that states and provinces around the world can frequently act more quickly and ambitiously. The U.S. Climate Alliance, made up of governors representing more than half the U.S. population and 43% of U.S. emissions, identified eight priority policy areas for subnational regulation, including power, transportation, industry, and climate resiliency. California went even further by joining the "Beyond Oil & Gas Alliance" (BOGA), a coalition of countries and subnational governments committed to promoting a "just transition away from oil and gas production." Businesses should expect states and local governments to continue to develop ambitious climate-related regulation, in addition to any regulation at the national level.

United States-China Joint Declaration on Enhancing Climate Action

One of the biggest surprises from Glasgow was a joint declaration on combatting climate change from the United States and China, the two largest greenhouse gas emitters. This declaration has significant precedent—in 2014, the United States-China joint declaration on climate change ahead of the 2015 Paris negotiations helped energize global negotiations. The Glasgow joint declaration is similar, with the two countries committing to cooperate on a number of initiatives. Most notably, the United States and China agreed to cooperate on harmonizing regulatory frameworks and environmental standards related to reducing emissions, collaborate on policies to encourage decarbonization and electrification of end-use sectors, and importantly, work together to deploy and apply technologies such as carbon capture, utilization, and storage (CCUS) and direct air capture. Businesses should thus be on the lookout for new cross-border regulations and policies between the United States and China. These commitments could also present businesses with new opportunities, particularly in green energy and CCUS technology.

The Bottom Line

COP26 ended with all participating countries negotiating and agreeing to a final decision document that, for the first time, called for "phasing down" fossil fuel subsidies. Countries recommitted to the goal of limiting global temperatures from rising more than 1.5?C from pre-industrial levels, and the decision document urges countries to continue developing plans to achieve net-zero emissions by 2050. These commitments will undoubtedly lead to more government regulation. The SEC, by way of example, appears poised to develop new rules regarding climate disclosures for public companies. It will also lead to more opportunity, from investment to financing to carbon trading, and an increased interest in renewable energy and offset projects. For some, COP26 may appear to be more talk than action, but even if viewed more skeptically, the wide-ranging commitments on the part of corporate and government leaders may well leave those who do not have a plan to reduce their carbon footprints out in the cold and at greater risk. Consumers are increasingly concerned, investors are increasingly aware, and regulators are increasingly empowered to take action that could affect everyone's bottom line.

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