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UK GREEN TAXONOMY CONSULTATION

The City of London Law Society (the **CLLS**) represents approximately 17,000 City solicitors through individual and corporate membership including some of the largest international law firms in the world. Its specialist committees comprise leading solicitors in their respective fields. These solicitors and their law firms operating in the City of London act for UK and international businesses, financial institutions and regulatory and governmental bodies in relation to major transactions and disputes, both domestic and international.

This response to the UK Green Taxonomy Consultation published by H.M. Treasury (the **Consultation**) has been prepared by two of the CLLS specialist committees namely the ESG Committee and the Planning and Environmental Law Committee (together the **Committees**). Full details of the members of the Committees appear on the CLLS website.

In preparing this submission, the Committees have chosen to respond to those questions where we believe we can usefully provide input based upon our experience of advising clients on the application of green taxonomies, most notably the taxonomy (the **EU Taxonomy**) established by Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (the **EU Taxonomy Regulation**).

Where this response refers to the EU Taxonomy, it should be borne in mind that the EU has recently announced plans to simplify regulatory and administrative burdens, including by simplifying the EU Taxonomy (amongst other sustainability-related legislation), as part of its first 'Simplification Omnibus' package. These changes may impact the UK's view on the utility of the EU Taxonomy, either positively or negatively, and indeed the development of a UK Taxonomy itself, if the UK decides to develop one. Further details of the proposed changes are expected in late February, and therefore cannot be commented on in detail as part of this response.

Summary

In summary, our overall conclusions are as follows:

- a. We do not support the creation of a UK Taxonomy.
- b. We believe that a flexible principles-based approach to the classification of transition finance following the recommendations of the Transition Finance Market Review would provide a better means of promoting the development of transition finance.
- c. Many UK companies will already fall within the scope of the Corporate Sustainability Reporting Directive (CSRD)¹ and will therefore be obliged to report by reference to the EU Taxonomy. Other UK companies may wish to report by reference to the EU Taxonomy on a voluntary basis. We would encourage the UK to work with the European Commission to make that easier – for example, by agreeing that compliance with certain UK standards would meet the requirements of a Technical Screening Criteria under the EU Taxonomy (TSC) which specifies an EU standard; and by facilitating assurance processes that are deemed equivalent to those mandated under the CSRD (to allow EU investors to include the reported EU Taxonomy alignment in their own EU Taxonomy scores).
- d. The UK should not, however, mandate UK companies to report under the EU Taxonomy, but should leave it to companies that are not in scope of CSRD to decide for themselves whether there is benefit in doing so (for example, to attract capital from climate conscious investors).

Box 2A

Question 1

To what extent within the wider context of government policy, including sustainability disclosures, transition planning, transition finance and market practices is a UK Taxonomy distinctly valuable in supporting the goals of channelling capital and preventing greenwashing?

The Committees do not regard the creation of a UK Taxonomy as *distinctly valuable* in terms of supporting the goals of channelling capital and preventing greenwashing.

Recent experience, particularly in the context of the EU Taxonomy, has revealed legal and regulatory complexities that have impeded implementation of the EU Taxonomy framework and added to business costs. In such circumstances, a UK Taxonomy should only be prioritised if it makes a valuable contribution towards meeting the stated policy goals. However, it is not clear to the Committees that a taxonomy would help to address greenwashing more effectively than other anti-greenwashing measures. In relation to channelling capital that would not otherwise be channelled, we note that other taxonomies (including the EU Taxonomy) can be used extra-territorially in any event. Therefore, it is unclear on what basis a UK-specific taxonomy would channel further investment to UK businesses.

¹ Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting

We elaborate on this view below.

From a legal and regulatory perspective, the key issues that market participants (and their advisers) have faced in implementing the EU Taxonomy can be classified as follows:

1. Prescription and Principles

Any taxonomy will inherently face a tension between prescription and flexibility.

We acknowledge that taxonomies can appear to be beneficial in principle, in trying to give certainty as to what is, or is not considered sustainable. However, experience has shown that taxonomies can be very difficult to implement in practice, there being an inherent tension between being prescriptive enough to provide certainty (to facilitate comparison and to protect against greenwashing) and being flexible enough to cope with technological developments and the 'reality of doing business' e.g. in transition industries. By way of example, the EU Taxonomy's TSC sets out detailed technical criteria in the energy sector on meeting particular efficiency and emission thresholds. Such criteria will not, in our view, always recognise innovative or emerging sustainability practices, which may not neatly fit within TSC, and ultimately may not lead to an accurate measure of sustainability outcomes.

2. Lack of clarity and legal certainty

Our experience of the EU Taxonomy (and TSC) is that it has often been extremely complex or uncertain to apply in practice. Market participants have faced issues with the interpretation of certain concepts in the EU Taxonomy framework, resulting in the issuance of several sets of Q&As. These issues have sometimes concerned fundamental elements of the taxonomy framework, such as 'minimum safeguards' (which refer to the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, which are subject to updates and revisions) and the principle of 'Do No Significant Harm' (DNSH), which is perceived as ambiguous, qualitative, and insufficiently specific.

We have found that without detailed and easy-to-access (and navigable) guidance on the detail of the EU Taxonomy, it can be challenging to advise clients on what they have to do to comply with relevant disclosure or other related duties, including demonstrating taxonomy alignment. An example is the question of how the TSC apply to overseas activities or investments, where the criteria rely on EU legislation or concepts. For instance, the Climate Mitigation TSC category of Construction of New Buildings (paragraph 7.1) links alignment both to standards set in EU national legislation (which would not apply in the relevant non-EU jurisdiction), and energy performance established in Energy Performance Certificates (which may well not be used in that jurisdiction). In order to understand how to apply the taxonomy in such cases, entities and their advisers have to work across an unapproachable mass of detailed inter-connected, overlapping guidance and FAQs to try to resolve these types of questions (often leaving matters unresolved).

If the UK does decide to proceed with a UK Taxonomy, it should ensure that it both (i) adopts clear provisions in the taxonomy, which are capable of being applied on an international basis where appropriate, and (ii) puts in place an easy-to-navigate and comprehensive guidance framework which enables the taxonomy to be applied in a straightforward way. If, on the other hand, the UK decides not to develop a UK Taxonomy, but decides to facilitate use of the EU Taxonomy on a voluntary basis (which is our preferred option), the UK could engage with the European Commission to establish equivalence rules for some of the EU regulation that is specified in the TSC and to agree some guidance for non-EU companies, so that the EU Taxonomy is easier to apply by UK (and other non-EU) companies.

3. Interoperability with other taxonomies

As a general point, the Committees are not supportive of fragmentation between different taxonomies, and we would underline the importance of interoperability between taxonomies in order to minimise legal uncertainty, avoid driving capital towards other taxonomies, and limiting additional expense for business. As recommended by the Green Taxonomy Advisory Group, the same broad concepts, methodologies and metrics as the EU Taxonomy could be adopted where possible. Any use case needs to emphasise the need for consistency and interoperability, as well as a taxonomy that is straightforward to use. This assumes that the UK does go ahead with a taxonomy of its own, rather than, for example, adopting a principles-based approach.

4. Lack of interoperability with other EU legislation and regulation

There have been several known issues with interoperability between the EU Taxonomy and other EU legislation and regulation, illustrating the difficulty in creating a comprehensive and coherent taxonomy and raising significant questions about how requirements should be interpreted.

For example, the TSC within the EU Taxonomy often reference EU environmental laws. However, these references do not always account for exemptions or specific conditions within those laws. This lack of clarity can lead to confusion and inconsistency in application. For instance, a company might be compliant with an environmental law due to a specific exemption, but the taxonomy criteria might not recognise this exemption, leading to potential misalignment or non-compliance.

There is also uncertainty about how the EU Taxonomy interacts with other key sustainable finance regulations, such as the Sustainable Finance Disclosure Regulation (SFDR)², the CSRD, and the Corporate Sustainability Due Diligence Directive (CSDDD)³. The anticipated 'Omnibus Proposal' (expected in 2025) aims to simplify and reduce bureaucracy, but until it is published and implemented, there remains uncertainty about how these frameworks will ultimately align and interact.

Question 1a

² Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

³ Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859

Are there any other existing or alternative government policies which would better meet these objectives or the needs of stakeholders?

For the reasons stated in our response to Q1 above, we consider that there are other approaches which would better meet the stated objectives.

We believe that the flexibility offered by a principles-based approach (as opposed to a prescriptive taxonomy-based approach) would better align with policy objectives, and in particular, that of channelling capital.

Notably for transition industries, which we explore further in our response to Question 3 below, a flexible approach which incentivises measurable improvements in metrics such as reducing CO2 emissions rather than a taxonomy-based approach would be beneficial.

As stated above, we believe that a taxonomy-approach is unlikely ever to be agile enough to keep pace with technological change. We favour giving businesses more flexibility to decide how they are going to achieve an overall goal, rather than incentivising adherence to a set of rules which may in fact not lead to the desired outcomes.

However, should the UK choose to develop a UK Taxonomy, it would be prudent to align, with the potential to stay aligned, in particular, with the EU Taxonomy rather than establish a distinct UK-specific regime. This approach would help prevent fragmentation or duplicative compliance costs, which could ultimately prove counterproductive to the policy objectives of any UK Taxonomy. Such an alignment would also provide the opportunity for the UK to engage with the European Commission so that guidance could be issued to make the EU Taxonomy more usable in the UK and internationally (as suggested above).

Question 1b

We have chosen not to respond to this question.

Box 2A

Question 2

What are the specific use cases for a UK Taxonomy which would contribute to the stated goals? This could include through voluntary use cases or through links to government policy and regulation.

The consultation document explains that the government is keen to explore whether there are specific use cases for a UK Taxonomy which support sustainable growth by contributing to the following goals: (a) promoting market integrity and preventing greenwashing; and (b) mobilising capital into sectors critical for the transition. It notes that the work of the Green Technical Advisory Group (GTAG), and feedback from other taxonomies in operation, suggests there are several potential use cases, including:

1. Acting as an input to project and business finance decisions, providing consistent standards to allow meaningful comparisons over time;
2. Supporting investor stewardship and engagement;
3. Informing the development of sustainability-focused financial products;
4. Application to investment fund and investment portfolio product disclosures; and
5. Use as part of the government's wider climate and environment strategy.

Potential use cases in addition to, or in support of those listed in the consultation, might include:

Providing a common language. Taxonomies in general can provide a common language for market participants (both financial and non-financial) to use when developing and labelling sustainability-related projects, activities and products. The points of reference this offers can help promote consistency in the market where a taxonomy is sufficiently straightforward and widely used. However, this is not a benefit that would be unique to a UK Taxonomy. If market participants prefer to use other taxonomies, another taxonomy from the UK might undermine commonality of language. Steps would need to be taken to ensure that any UK Taxonomy is aligned and can be clearly mapped onto other leading taxonomies.

Helping mitigate greenwashing risk. To the extent that the taxonomy achieves a common language that is widely understood, it could act as a tool to mitigate the risks of greenwashing by decreasing the risks from language and terms being applied differently by different participants and users. However, a UK Taxonomy is unlikely to be the leading mitigation of greenwashing risk, and would need to work alongside other tools, such as the FCA's anti-greenwashing rule and wider corporate approaches sustainability reporting. Furthermore, in order to mitigate greenwashing it is likely that the UK would need to mandate companies to report under the UK Taxonomy and this would create significant additional costs for all in scope companies, and possibly also for (smaller) companies in their supply chains. Our view is that there are less burdensome ways for the UK to mitigate greenwashing that would not require a widespread reporting mandate (noting that many UK companies will have to report under the EU Taxonomy in any event, because they will be in scope of the CSRD).

Channelling financial flows towards sustainable and transitional activities. A UK Taxonomy could help define a set of activities that support the transition to net zero and/or guiding principles for market participants on what activities are 'green' or 'sustainable'. In doing so, reference should be made to the findings of the Transition Finance Market Review, whose final report ("Scaling Transition Finance: Findings of the Transition Finance Market Review") identified a taxonomy as a possible reference tool for demonstrating how transition-related financial products and strategies can have credibility and integrity. We discuss this further in our response to Question 3 below.

Question 3

Is a UK Taxonomy a useful tool in supporting the allocation of transition finance alongside transition planning? If so, explain how with reference to any specific design features which can facilitate this.

As noted in our response to Question 2, the proposed Financial Sector Guidelines for Credible Transition Finance set out in the Findings of the Transition Finance Market Review, emphasized the need for transition finance at an activity-level to be credible and suggested that one way (but by no means the only way) to support credibility was by reference to a taxonomy aligned with the Paris Agreement's temperature goals and the principle of common but differentiated responsibilities.

This is broadly the approach which has been adopted in the EU Taxonomy Regulation, which includes in Article 10(2), the ability for activities "for which there is no technologically and economically feasible low-carbon alternative" but which support transition on a pathway consistent with Paris Agreement temperature goals to fall within the EU Taxonomy as "contributing substantially to climate change mitigation" provided that the activity "(a) has greenhouse gas emission levels which correspond to the best performance in the sector or industry (b) does not hamper the development and deployment of low-carbon alternatives and (c) does not lead to a lock in of carbon-intensive assets, considering the economic lifetime of those assets." The detailed criteria with which an activity needs to comply, in order to fall within Article 10(2) are set out in the TSC. In addition, the activity must comply with the "do no significant harm" principle and the minimum safeguards set forth in Article 18.

In order for a taxonomy to support credible transition finance, the taxonomy itself needs to be credible. As noted in our response to Q1 there is a tension between a taxonomy being prescriptive enough to provide certainty and flexible enough to adapt to change. This tension is particularly acute with respect to transition finance where it is more likely that the assumptions and projections which support the inclusion of certain transitional activities within the taxonomy, will be debated. Terminology is also important. The use of a "green taxonomy" to designate transition activities as "sustainable" may give rise to a heightened risk of allegations of greenwashing. We have seen for example, that the inclusion of certain transitional activities such as fossil gas and nuclear energy and aviation, within the EU Taxonomy, has been challenged by a number of NGOs and certain European governments under the procedure of Title IV of the Aarhus Regulation and, in some cases, at the Court of Justice of the European Union.

Determination of the alignment of an activity with Paris Agreement goals requires detailed due diligence as to how the relevant activity is performed in practice, the available technology and the scientific evidence supporting claims of a pathway for that activity towards sustainability – particularly if the taxonomy is drafted on a more prescriptive and binary basis. The development of a taxonomy is thus time consuming and expensive which means that a taxonomy may not be agile enough to respond to technological and scientific developments, even where a regular review process is embedded within the taxonomy. This is particularly the case for hard-to-abate sectors where there is a danger of locking-in outdated practices and technologies and diverting funds away from new activities with the capacity to

make a greater difference to transition. Even if taxonomies are not intended to be an exhaustive list of sustainable activities, it is often the case that they are taken to be so in practice.

Given the challenges of using a taxonomy in support of transition finance, we would favour the adoption of a principles-based approach towards transition finance as outlined in our response to Question 1a. We reiterate that if the UK proceeds with its own taxonomy, then it would be important for this to be capable of mapping on to other green taxonomies and notably the EU Taxonomy. We see little value in a UK Taxonomy diverging from the EU Taxonomy as a means of channelling transition finance towards the UK.

Question 4

We have chosen not to respond to this question

Box 3A

Question 5

We have chosen not to respond to this question

Question 6

In which areas of the design of a UK Taxonomy would interoperability with these existing taxonomies be most helpful? These could include format, structure and naming or thresholds and mechanics.

We refer to our answer to Question 1a and to Question 9.

Question 7

Are there any lessons learned, or best practice from other jurisdictional taxonomies that a potential UK Taxonomy could be informed by?

As noted above, our response to this consultation focuses mainly on our experiences of advising on the EU Taxonomy Regulation. We have summarised in our response to Question 1 some of the key issues that market participants have faced when using this in practice.

Box 3B

Question 8

We have chosen not to respond to this question.

Question 9

What environmental objectives should a UK Taxonomy focus on (examples listed in paragraph 3.3)? How should these be prioritised?

Although our view is that the UK should not develop its own UK Taxonomy, if the government is minded to do so, we believe that the environmental objectives used within the EU Taxonomy are sufficiently broad to strategically guide the allocation of financial resources to projects, assets, and activities that are aligned with UK's national policies and strategies, including the net zero targets. Therefore, we would be supportive of the UK Taxonomy adopting the six environmental objectives used by the EU Taxonomy and consider that there are benefits in aligning these fundamental building blocks as between the UK and EU.

There is some merit in focusing more on climate mitigation and adaptation initially and adopting the staged approach that was taken for the EU Green Taxonomy (and indeed how the ISSB standards are rolled out). However, on balance we consider that this approach may lead to a climate focus that is out of kilter with the market's more holistic approach to sustainability and the acknowledgement of the interdependencies between the different factors (for example the links between climate and nature). Therefore we consider that the better approach is to apply equal weighting to the environmental objectives from day one.

Question 10

We have chosen not to respond to this question

Question 11

What are the key design features and characteristics which would maximise the potential of the UK Taxonomy to contribute to the stated goals? Please consider usability both for investors and for those seeking investment. This may include but not be limited to the level of detail in the criteria and the type of threshold (e.g. quantitative, qualitative, legislative)

In our view a potential UK Taxonomy would need to be:

- Drafted in a clear and user-friendly manner (with guidance to aid interpretation to be provided from the outset).
- Drafted in a manner which is capable of being mapped onto other taxonomies (notably the EU Taxonomy) so as to be inter-operable with those other taxonomies. For example, as noted in our response to Question 9, a UK Taxonomy could adopt the same environmental objectives as the EU Taxonomy.
- We believe it would be unhelpful for a UK Taxonomy to create prescriptive but diverging technical screening criteria (or an equivalent) to those set out in the EU Taxonomy. As noted in our answer to Question 1 there are flaws in the EU Taxonomy framework, however we do not

think that divergent criteria, even if these sought to correct those flaws, would channel investment to the UK – we believe that the creation of an alternative set of criteria is more likely to act as a disincentive.

- Drafted with careful thought as to how the UK Taxonomy would integrate with other areas of UK and EU sustainability legislation and regulation in order to avoid creating an additional burden on businesses and to create legal certainty. For example, it would need to be considered how the UK Taxonomy would relate to the FCA Sustainability Disclosure Requirements and investment labelling regime.
- Include a mechanism for regular updates and revisions. We discuss this further in our response to Question 13

Question 12

What are the respondents' views on how to incorporate a Do No Significant Harm principle and how this could work?

As noted in our previous responses, we believe that the incorporation of a Do No Significant Harm principle would generally need to be aligned with the approach taken in the EU Taxonomy.

Question 13

Is it likely that a UK Taxonomy would need regular updates, potentially as often as every three years? a. Do you agree with this regularity? b. Would this pose any practical challenges to users of a UK Taxonomy? c. Would this timeframe be appropriate for transition plans?

As noted above we believe that for a UK Taxonomy to work, particularly if it is to be used as a tool to support transition finance, it will require regular updates. This is to avoid the inadvertent omission of activities which would actively support climate change mitigation and the “locking-in” of outdated technology and business practices. It may also be necessary to reflect other developments such as regulatory changes and updated scientific advice. This process is likely to require significant time and resources.

The regularity of the update may depend on the level of detail in the UK Taxonomy – a more prescriptive UK Taxonomy is likely to require more frequent updates. It may also depend on the industry concerned and its anticipated pace of progress towards alignment with Paris Agreement temperature goals (bearing in mind that for some sectors this can be hard to ascertain as it will be dependent on the likely pace and availability of technological developments). It is therefore difficult to comment on a definitive timeframe for revisions and updates to the taxonomy.

Although embodying a requirement for frequent updates would be a pre-requisite for any successful UK Taxonomy to retain credibility, the practical challenge for users of the taxonomy would be in keeping up

to date with those revisions. Communication would be key. Ideally information about the UK Taxonomy would be located in one place online, would be easily searchable and would clearly identify the revision and the reasons for it.

Question 14

What governance and oversight arrangements should be put in place for ongoing maintenance and updates to accompany a UK Taxonomy?

Governance and oversight would require input from industry experts and scientists in the relevant areas of economic activity and sectors which are the focus of the taxonomy in order to ensure that the taxonomy is aligned with Paris Agreement goals, clear and practical. We would assume that a core group would be put in place with overall oversight, but which could draw on more targeted sector-specific expertise when needed. Legal input would be required to provide context to the broader regulatory environment in which the taxonomy is placed, to ensure cohesion and interoperability. There should be a broader mechanism (for example through a consultation process) to suggest revisions including new areas for inclusion within the taxonomy.