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EDITOR'S NOTE: THE CANADA CAP

Victoria Prussen Spears

THE CANADA CAP: CANADA TO CAP OIL AND GAS EMISSIONS STARTING IN 2026

Peter Forrester and Alan Harvie

EUROPEAN GREEN BONDS: A NEW HIGH-QUALITY BENCHMARK IN A WORLD DOMINATED BY CLIMATE CHANGE

Jean-Quentin De Cuyper and Jolien De Troyer

FEDERAL ENERGY REGULATORY COMMISSION INITIATES NEW PROCEEDING TO REVIEW ITS POLICY ON FEDERAL POWER ACT SECTION 203(a)(2) BLANKET AUTHORIZATIONS, POSING POTENTIAL RAMIFICATIONS FOR ESG INVESTING

Nicholas Gladd and Max Learner

HIGHLIGHTS OF SECTION 48 INVESTMENT TAX CREDIT PROPOSED REGULATIONS

Martha G. Pugh, France Beard Johnson and Rebecca J. Kim

RECENT TREASURY PROPOSED REGULATIONS' APPLICATION TO QUALIFIED OFFSHORE WIND PROPERTIES

Martha G. Pugh, Theodore J. Paradise and Rebecca J. Kim

ANTITRUST DEVELOPMENTS IN THE ENERGY AND CHEMICAL SECTOR

Darren Tucker, Jason M. Powers and Tyler Somes

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VOLUME 24

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Editor's Note: The Canada Cap Victoria Prussen Spears	73
The Canada Cap: Canada to Cap Oil and Gas Emissions Starting in 2026 Peter Forrester and Alan Harvie	75
European Green Bonds: A New High-Quality Benchmark in a World Dominated by Climate Change Jean-Quentin De Cuyper and Jolien De Troyer	80
Federal Energy Regulatory Commission Initiates New Proceeding to Review Its Policy on Federal Power Act Section 203(a)(2) Blanket Authorizations, Posing Potential Ramifications for ESG Investing Nicholas Gladd and Max Learner	86
Highlights of Section 48 Investment Tax Credit Proposed Regulations Martha G. Pugh, France Beard Johnson and Rebecca J. Kim	91
Recent Treasury Proposed Regulations' Application to Qualified Offshore Wind Properties Martha G. Pugh, Theodore J. Paradise and Rebecca J. Kim	97
Antitrust Developments in the Energy and Chemical Sector Darren Tucker, Jason M. Powers and Tyler Somes	102

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European Green Bonds: A New High-Quality Benchmark in a World Dominated by Climate Change

*By Jean-Quentin De Cuyper and Jolien De Troyer**

In this article, the authors discuss the European Commission's proposal for a European Union regulation on European green bonds.

A final compromise text on the European Commission's (the Commission) proposal for an EU Regulation on European Green Bonds (the Regulation) has been agreed upon by the Council's Permanent Representatives Committee.¹ The basis for this text was the provisional agreement on European Green Bonds that was reached by the European Parliament and the Council in February 2023.²

On January 14, 2020, the European Commission had proposed the creation of a standard for environmentally sustainable bonds as part of the European Green Deal Investment Plan.³ With such an EU green bond standard, the Commission aimed to increase investment opportunities and facilitate the identification of sustainable investments through clear labels for a variety of sustainable investment products. The Regulation also represents an important step forward towards meeting the Paris Agreement's objective of aligning finance flows consistent with the Union's target of climate neutrality by 2050 and climate-resilient development.

The EU Regulation on European Green Bonds will make it possible for both EU and non-EU issuers to use the high-quality label of European Green Bonds (or EUGBs). The Regulation aims to lay down uniform requirements for issuers of bonds that wish to use the designation European Green Bonds for environmentally sustainable bonds that are aligned with the EU taxonomy and

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¹ Proposal for a Regulation of the European Parliament and of the Council on European green bonds, COD(2021) 0191 (hereafter the EU Regulation on European Green Bonds or the Regulation).

² Council of the EU, Sustainable finance: Provisional agreement reached on European green bonds, available at <http://www.consilium.europa.eu/en/press/press-releases/2023/02/28/sustainable-finance-provisional-agreement-reached-on-european-green-bonds> (last accessed September 21, 2023).

³ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions, Sustainable Europe Investment Plan, European Green Deal Investment Plan, COM(2020) 21 final.

made available to investors in the EU. It will create harmonized rules to decrease fragmentation and ambiguity caused by the diverging definitions of environmentally sustainable bonds within the EU. The label will also make it easier for investors to compare environmentally sustainable bonds and make an informed investment decision.

KEY CHARACTERISTICS OF EUROPEAN GREEN BONDS

Voluntary Character

When an issuer aims to issue green bonds in the EU market, there is no obligation to use the European Green Bond label. However, when an issuer chooses to make use of the designation European Green Bond, it is obliged to observe the standards and requirements of the EU Regulation on European Green Bonds.

Prospectus Requirement

The designation European Green Bond can only be used⁴ for bonds for which the issuer has published a prospectus in accordance with the EU Prospectus Regulation.⁵

The prospectus should indicate that the bonds are designed as European Green Bonds throughout the prospectus and that the European Green Bonds are issued in accordance with the EU Regulation on European Green Bonds.

Allocation of Net Proceeds

The proceeds of European Green Bonds should be used exclusively and fully to finance environmentally sustainable activities, in line with the taxonomy requirements (as specified in the EU Taxonomy Regulation),⁶ before maturity of the bond.

Under the Taxonomy Regulation, an economic activity qualifies as environmentally sustainable if it complies with all of the following criteria:

⁴ By way of derogation from this requirement, the designation EUGB may be used for bonds issued by (a regional or local authority of) an EU member state, public international bodies of which one or more EU member states are members, the ECB or central banks of EU member states, or for bonds unconditionally and irrevocably guaranteed by (a regional or local authority of) an EU member state.

⁵ Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ L168/12 (the EU Prospectus Regulation).

⁶ 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 [2023] OJ L198/34 (the EU Taxonomy Regulation).

- It contributes substantially to one or more of the environmental objectives;⁷
- It does not significantly harm any of the environmental objectives;
- It is carried out in compliance with the minimum safeguards for alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights; and
- It complies with the Commission's technical screening criteria (i.e. technical screening criteria developed in delegated acts with specific environmental performance requirements for each economic activity considered).

The proceeds can only be allocated to one or a combination of the following types of assets and expenditures:

- Fixed (in) tangible assets that are not financial assets;
- Capital expenditures;
- Operating expenditures;
- Financial assets that were created no later than five years after the issuance of the European Green Bonds; and/or
- Assets and expenditures of households.

The proceeds of European Green Bonds may be allocated on a bond-by-bond basis or on the basis of a portfolio approach if issuers demonstrate in their allocation reports that the total value of taxonomy-aligned assets in their portfolio exceeds the total value of their outstanding European Green Bonds.

The Regulation provides for a “flexibility pocket” allowing up to 15% of the net proceeds of a European Green Bond to be allocated towards economic activities that do not comply with the technical screening criteria, but comply with all other Taxonomy requirements.

CapEx Plan

When the proceeds are allocated to capital expenditures (the CapEx) and/or operational expenditures (the OpEx) that will meet the taxonomy requirements, the issuer is required to publish a CapEx plan.

⁷ The environmental objectives of the EU Taxonomy Regulation are the following:

- (i) Climate change mitigation;
- (ii) Climate change adaptation;
- (iii) Sustainable use and protection of water and marine resources;
- (iv) Transition to a circular economy;
- (v) Pollution prevention and control; and
- (vi) Protection and restoration of biodiversity and ecosystems.

The CapEx plan needs to specify a deadline by which all the CapEx and OpEx funded by the European Green Bonds shall be taxonomy-aligned, before the European Green Bonds reach maturity.

The CapEx plan is subject to the assessment of an external reviewer in relation to taxonomy-alignment of CapEx and OpEx that are included in the CapEx plan.

Technical Screening Criteria and Grandfathering

Proceeds of European Green Bonds should be allocated in alignment with the technical screening criteria that apply when the bond is issued. In case the technical screening criteria are amended after the issuance of the bond, the proceeds must be allocated in alignment with the amended technical screening criteria within a period of seven years if they are either unallocated or if they are covered by a CapEx plan.

Specific Pre- and Post-Issuance Disclosures

Pre-Issuance Green Bond Factsheet

Prior to issuing a European Green Bond, issuer should complete a European Green Bond factsheet. The factsheet is subject to a pre-issuance review by an external reviewer.

An annex to the Regulation provides a template for the factsheet. Based on the annex, the factsheet should include information on general aspects of the bond, the environmental strategy and rationale of the issuer, the intended allocation of bond proceeds, the environmental impact of bond proceeds, the reporting, and the CapEx plan.

Post-Issuance Allocation Report

Issuers of European Green Bonds should publish annual allocation reports until the proceeds have been fully allocated and until the completion of the CapEx plan, where applicable. The allocation report needs to demonstrate that the proceeds of the European Green Bonds have been allocated in accordance with the EU Regulation on European Green Bonds. The allocation report is subject to a post-issuance review by an external reviewer.

An annex to the Regulation provides a template for the allocation report.

Post-Allocation Impact Report

Issuers of European Green Bonds should publish an European Green Bond impact report on the environmental impact of the use of the bond proceeds after the full allocation of the proceeds and at least once during the lifetime of the bond. Issuers may choose to obtain a review by an external reviewer of the impact report, but this is not mandatory, contrary to what is the case for the pre-issuance factsheet and the post-issuance allocation report.

An annex to the Regulation provides a template for the impact report.

Publication of Certain Information on the Issuer's Website

Issuers of European Green Bonds should publish certain information on their website for transparency reasons. These should include:

- The factsheet, including the pre-issuance review;
- The annual allocation reports, including the post-issuance reviews;
- The CapEx plan;
- The impact report and the related review; and
- A link to the website where the prospectus can be consulted.

This information should be available on the website until at least one year after the maturity of the bonds.

Optional Disclosure Regime for Other, Non-Labelled Green and Sustainability-Linked Bonds

The Regulation provides an optional sustainability disclosure regime for non-labelled bonds marketed as environmentally sustainable and sustainability-linked bonds in the EU.

The European Commission will publish guidelines with a view to establishing templates for pre-issuance and post-issuance disclosures for issuers of bonds marketed as environmentally sustainable and sustainability-linked bonds.

External Reviewers

The EU Regulation on European Green Bonds establishes a review mechanism for European Green Bonds through the deployment of external reviewers.

The external reviewer must be registered with and supervised by the European Securities and Markets Authority (the ESMA). ESMA will therefore be mandated to develop draft regulatory technical standards to further specify the criteria on which it can assess an application for registration by an external reviewer, for example, regarding the management of conflicts of interest.

Supervision

Issuers of European Green Bonds will be supervised by the national competent authority. The national competent authority will have various powers to exercise this mandate. By way of illustration, the national competent authority can oblige issuers to comply with the various transparency requirements and suspend an offer or admission to trading on a regulated market of European Green Bonds when certain requirements have not been observed.

EXPECTED DATE OF APPLICATION

The EU Regulation on European Green Bonds is currently in the final stages of the EU legislative process and will soon be subject to a first reading by the

European Parliament. After final approval, the Regulation will be published in the Official Journal of the European Union and will apply 12 months later. More concretely, the Regulation is expected to apply as from autumn 2024 at the earliest.

CONCLUSION

The EU Regulation on European Green Bonds creates a high-quality benchmark for green bonds in the EU market. Although the use of the label European Green Bond is a voluntary choice of the issuer, the EU Regulation on European Green Bonds imposes strict requirements for issuers that wish to use this label. It will require more efforts from issuers than the existing green bond standards, such as the voluntary Green Bond Principles (the GBP) of the International Capital Market Association (the ICMA).

European Green Bonds have the potential of becoming an attractive investment product because due to the label European Green Bond, investors will know that the high-quality standards of the EU Regulation on European Green Bonds have been met. Adherence to these strict rules demonstrates the issuer's commitment to the environmental objectives of the EU Taxonomy Regulation. It should also be noted that the issuance of European Green Bonds comes with many disclosure obligations that must be observed, which creates transparency towards investors and allows them to make an informed investment choice.

The strict disclosure requirements may however create a large administrative burden for companies that wish to issue bonds labelled as European Green Bonds. It is no secret that many companies want to avoid having to publish a prospectus because of the preparatory work and additional costs associated with it. In addition, there are numerous other transparency obligations in the EU Regulation on European Green Bonds that issuers will have to comply with and that will also require additional work and costs, such as the preparation of a fact sheet, allocation report and impact report.

It remains to be seen what the impact of the EU Regulation on European Green Bonds will be in the market and how popular the Regulation will become among issuers, as well as what value will be attached to European Green Bonds by investors. If European Green Bonds will become the new and sole standard for high-quality green bonds in the future, then issuers will have no choice but to follow the Regulation when they consider the issuance of green bonds. Despite the optional nature of the disclosure regime for non-labelled green and sustainability-linked bonds, it is also still unclear how important the use of these templates will become in the market.