

“Do No Significant Harm” as a Core Principle in Sustainable Finance Regulation in the ASEAN Draft and Singapore Taxonomies

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Do no significant harm (DNSH) as a concept is central to not only the EU Taxonomy Regulation, but also the sustainable finance taxonomies that have followed it. Two such examples are the draft taxonomies for the Association of Southeast Asian Nations (ASEAN) and Singapore, which both feature a strong objective for regional application in Southeast Asia. This study identifies the need for a harmonized interpretation and application of DNSH in the ASEAN context on the basis that a wide interpretive scope, such as including environmental, socioeconomic, and/or governance dimensions, dilutes the application of the DNSH principle within sustainable investment regulations, especially among countries at different stages of development.

Keywords Sustainable investment, taxonomy regulation, ESG investment, do no significant harm

INTRODUCTION

The European Union (EU) adopted the Taxonomy Regulation (EU 2020/852) in July 2020—an invariably crucial step in advancing the practice of sustainable investment in foreign portfolio investment. The purpose of the Taxonomy Regulation is to identify “environmentally sustainable economic activities based on technical screening criteria” against which entities seeking to make an investment under the jurisdiction of the regulation are met with an obligation to disclose both financial and nonfinancial key

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performance indicators such as environmental impact.¹ These disclosures fall under the remit of related regulations such as the EU Sustainable Finance Disclosure Regulation (SFDR) and are performed in an “ecosystem of sustainable finance tools, including standards, labels and access to a coherent and relevant set of sustainability data.”² At the centre of that ecosystem, the Taxonomy Regulation identifies which economic activities, such as investment, qualify as being environmentally sustainable (Petrisor and Ligenza, 2021).

However, the EU Taxonomy Regulation, as the largest cross-border governance mechanism seeking to establish legally binding standards of sustainable investment, has been met with resistance within its jurisdiction.³ While the EU Taxonomy Regulation is still undergoing refinement, it would be difficult to deny its proliferating influence in non-European contexts where sustainable investment is experiencing rapid growth, such as in Asia.⁴ The People’s Bank of China—the central bank of China—for instance, formalized a partnership with the EU to develop shared standards of sustainable investment (Li and Yu, 2021). The EU Taxonomy Regulation has been subject to study in application to compatibility with Islamic finance (Azizuddin, 2021a). The Member States of the Association of Southeast Asian Nations (ASEAN) have decreed to design a sustainable investment taxonomy for the bloc to complement “their respective national sustainability initiatives and serving as ASEAN’s common language for sustainable finance.” (AFMGM, 2021)

This study posits that as a fundamental precept of the taxonomy,⁵ the principle of do no significant harm (DNSH) is an inseparable element to the mechanics of sustainable financial regulation and, as such, will be woven into future taxonomies promulgated in

¹ Under Article 8 (“Disclosure rules common to all financial undertakings and non-financial undertakings”) of the Taxonomy Regulation.

² Delegated Act supplementing Article 8 of the Taxonomy Regulation, *C(2021) 4987* (6 July 2021), p 1–3.

³ For instance, the inclusion of nuclear energy in the Taxonomy has been a controversial issue between environmental experts and the energy sector across the EU. See, for instance, ‘Unions Repeat Call for Nuclear’s Inclusion in EU Taxonomy’ *World Nuclear News* (27 July 2021) <<https://www.world-nuclear-news.org/Articles/Unions-repeat-call-for-nuclear-s-inclusion-in-EU-t?feed=feed>> accessed 28 July 2021; Khalid Azizuddin, ‘EU Experts Threaten to Quit over Changes to Taxonomy’ *Responsible Investor* (6 April 2021) <<https://www.responsible-investor.com/articles/eu-experts-threaten-to-quit-over-changes-to-taxonomy>> accessed 28 July 2021.

⁴ In a survey by Citi Asia Pacific involving 259 institutional investors, 94% responded that they either had or will implement ESG policies within up to five years from 2021 (‘A Time for Action: Opportunities for Asia to Further a More Sustainable Future’ [Citigroup 2021] 19). Financial institutions and corporations have also been upscaling their ESG engagements. See, for instance, Kelly Ng, ‘For Asia’s next-Generation Leaders, ESG Is a Strategy to Push for Change’ *The Business Times* (7 July 2021) <<https://www.businesstimes.com.sg/banking-finance/futureproof-an-esg-series/for-asias-next-generation-leaders-esg-is-a-strategy-to>> accessed 28 July 2021.

⁵ It is here noted that the EU is also in the process of extending the Taxonomy Regulation to the social dimensions of sustainable development, identifying that like the green taxonomy; the purpose would be to provide guidance to investors in understanding the types of activities that are socially sustainable (Platform on Sustainable Finance, ‘Draft Report by Subgroup 4: Social Taxonomy’ [European Commission 2021] 15). The focus of this study remains on existing taxonomy, or the “green taxonomy,” though applications of DNSH in the draft social taxonomy are mentioned.

Asia. Building from that preposition, this study identifies the legal and policy aspects of DNSH as a means to help inform evolving engagement in sustainable investment across Asia. Despite being only one of the aspects of taxonomy regulations, DNSH remains a central normative concept that this study argues is likely to be universal in likeminded regulations. In that context, this study provides a reflection on the transference of DNSH as a principle into the ASEAN context under the broader question of what challenges exist in that process of crossover across different economic and regulatory settings.

The work concludes that when taxonomies function under a wide interpretive scope, such as by including environmental, socioeconomic, and/or governance dimensions, the centrality of the DNSH principle is very much dependent on the extent of regulatory harmonization regarding certain standards on environmental and socioeconomic performance such as in the EU. These standards provide the contours within which firms may function in a self-regulatory basis, in which they may decide their commitment but against a regulatory threshold that prevents backtracking against established environmental and/or socioeconomic standards. However, without the supplementary regulation that harmonized environmental and/or socioeconomic standards as seen in the EU, the DNSH principle must be phrased with a narrower scope to retain its core function of preventing back-pedaling in taxonomy regulations outside of the EU or similar regulatory environments.

To that effect, this study examines how DNSH was transferred into two taxonomies in the ASEAN. The first is the Green Finance Industry Taskforce (GFIT) commissioned by the Monetary Authority of Singapore (MAS) and is one of the earliest attempts at drafting a taxonomy in the region. The second is the ASEAN Taxonomy for Sustainable Finance by the ASEAN Taxonomy Board (ATB), which is the only taxonomy drafted for regional application. Examining DNHS in the ASEAN context is of particular interest not only because the regional bloc is composed of economies at such diverse stages of economic development and with reliance on foreign capital inflows, but also because of the increase in regulatory attention given to sustainable finance in line with the enlarging role of green finance in the region's energy transition.⁶

For instance, Indonesia, which houses a thriving capital market recording 206% growth from 2020 to 2021, launched its Green Taxonomy in January 2022 (Financial Services Authority, 2022). The Green Taxonomy lacks clear standards for what would constitute as causing significant harm to the environment within its three-tier “traffic light” classification. This means that a fossil fuel burning power plant may then be classified as “yellow” rather than “red” if it meets other environmental performance criteria, which would then make it eligible to receive transitional financing from the government. Notable here is that the objective of the Green Taxonomy was, in part, to assist the country's economy recover from the prolonged impacts of a global pandemic. As a result, its lack of hard standards has been viewed as pursuing a tenuous balance between maintaining its lucrative capital market while motivating financial flows to pursue environmental ambitions (Ng, 2022). Molding taxonomies to respond to present

⁶ See, for instance, Kriti Jain, Medha Gangopadhyay and Kakali Mukhopadhyay, ‘Prospects and Challenges of Green Bonds in Renewable Energy Sector: Case of Selected Asian Economies’ (2022) *Journal of Sustainable Finance & Investment* 1.

circumstances is not, however, unique to the ASEAN. The same is the case with the EU Taxonomy Regulation, which now faces obstacles that were likely unpredictable during its drafting and implementation.⁷

Starting from a shared point of departure, such as DNSH, facilitates an examination of taxonomy regulations that begins with deconstructing the taxonomy to then re-engage with them organically from core concepts like DNSH. This is meaningful in understanding the elements of diverging taxonomy regulations that can be loosely identified as general principles to a taxonomy regulation, which may in turn help lay the road toward greater interoperability and harmonization of sustainable finance laws and policies.

In the subsequent section, this study first examines DNSH in its original habitat—the EU Taxonomy Regulation. This is followed by a similar overview of the GFIT and ASEAN Taxonomy in Section 3. Subsequently, DNSH is examined as an interoperable concept in the ASEAN and, furthermore, as a crucial correlation between taxonomy regulations with otherwise highly variant objectives.

DNSH PRINCIPLE IN THE EU TAXONOMY REGULATION

As the most advanced intergovernmental sustainable finance taxonomy regulation to have been implemented, it is helpful to base this study on the EU Taxonomy Regulation. Understanding the DNSH principle in the Taxonomy Regulation, in turn, requires to first appreciate the elaborate setting in which it was formed.

Article 9 of the Taxonomy Regulation identifies six environmental objectives: (a) climate change mitigation, (b) climate change adaptation, (c) sustainable use and protection of water and marine resources, (d) transition to a circular economy, (e) pollution prevention and control, and (f) protection and restoration of biodiversity and ecosystems. In advancing these objectives, the purpose of the Taxonomy Regulation is to identify environmentally sustainable economic activities, including both goods and services. The Taxonomy Regulation makes clear that economic activities that result in a “substantial contribution” to any of its six environmental objectives qualify under this criterion in application to the lifecycle (from production to end of life) of the product and/or service in question. For example, under objective (d), transition to a circular economy, a substantial contribution would include reducing the use of resources and

⁷ For example, the renewed concerns of energy security in Europe, resulting in controversial adjustments such as the Complementary Climate Delegated Act (‘EU Taxonomy: Complementary Climate Delegated Act’ [Press Release] <https://ec.europa.eu/commission/presscorner/detail/en/ip_22_711> accessed 27 May 2022), which identified natural gas and nuclear power as transitional sources of energy that are conditionally compliant with the EU Taxonomy Regulation. See, for example, Kate Abnett, ‘EU Lawmakers Move to Block Green Investment Label for Gas and Nuclear’ *Reuters* (20 May 2022) <<https://www.reuters.com/business/sustainable-business/eu-lawmakers-move-block-green-investment-label-gas-nuclear-2022-05-20/>> accessed 27 May 2022; Kate Abnett, ‘Germany to Reject EU Green Investment Label for Nuclear Power’ *Reuters* (16 May 2022) <<https://www.reuters.com/business/germany-reject-eu-green-investment-label-nuclear-power-2022-05-16/>> accessed 27 May 2022.

production of waste or increasing reuse and recycling.

Investment is also included as an economic measure and, in addition to substantial contribution, can be assessed as an “enabling activity,” which Article 9 defines as “directly enabling other activities to make a substantial contribution to one or more of those objectives,” or otherwise contributes directly to an environmental objective. The difficulty of the latter is that an investment’s direct contribution would have to be based on pre-contractual objectives concerning how the investment will be managed followed by the actual development impact disclosures post fact, or “comply-or-explain” (TEG, 2020: 37-38). In this sense, the Taxonomy Regulation shapes a fairly specific role for international investment: its commitments toward contributing to the environmental objectives leading up to the investment must be compliant with the Taxonomy Regulation and the impact assessment of the result of the investment.

Specifically, Article 9(a) of the Taxonomy Regulation specifies how an investment should not lock-in the investible asset from potentially taking on characteristics that are enabling or substantially contributing to the environmental objectives. Therefore, if an investment would deter a fossil fuel company from scaling up its assets in sustainable energy generation, such an investment would not be taxonomy-aligned. Article 9(b) further identifies the need for “substantial positive environmental impact” of an investment, emphasizing the importance of nonfinancial disclosures surrounding the investment and its impacts on the environmental objectives. For instance, the connection between the investment and an environmentally sustainable economic activity would not share a clear correlation if it were made in a fossil fuel company whose net expenditures in transitioning to sustainable energy sources are not only lesser than the investment value, but also far outweighed by an upscaling of hydrocarbon-based energy generation.

For much of the Taxonomy Regulation, environmentally sustainable economic activities, whether they are goods, services, or investments, embody a form of affirmative compliance (May, 2004: 43-44). The extent to which economic measures—or, for that matter, economic actors such as corporations when receiving investment—are taxonomy-aligned is determined largely by their commitment to contribute to the environmental objectives set out in the Taxonomy Regulation. Put differently, environmentally sustainable economic activities are rendered by economic actors that are already committed to substantial contribution, thereby placing the Taxonomy Regulation as a standard for assessing that commitment.

An inseparable dimension of this commitment is self-regulation. The self-regulatory behavior of these firms—self-imposing and self-monitoring the extent to which they and/or their activities contribute to the economic objectives—is then measured against the threshold set by the Taxonomy Regulation to ensure that they are “substantial” in advancing the environmental objectives pursuant to 9(b). For financial products such as investments, while pre-contractual and post-fact monitoring is in place, the Taxonomy Regulation lacks comprehensive technical screening criteria concerning delegated acts to measure either commitment or post-investment impact, and instead refer to other EU or international standards in place such as the Green Bond Standards (TEG, 2020: 42).

It is within this context that the DNSH principle finds its place. DNSH is identified in Article 3b of the Taxonomy Regulation, which states the following:

For the purposes of establishing the degree to which an investment is environmentally sustainable, an economic activity shall qualify as environmentally sustainable where that economic activity [...] does not significantly harm any of the environmental objectives [...]

When this reading is applied in the context of the six environmental objectives of the EU Taxonomy Regulation, an economic activity, such as investment, would be in violation of the DNSH principle if it is proven to have done significant harm to any of the following:⁸

- (1) Climate change mitigation, such as by resulting in an increase in the amount of covered emissions;
- (2) Climate change adaptation, such as by resulting in reduced adaptive capacities of societies and ecosystems and exacerbating the adverse impacts of climate change;
- (3) Sustainable use and protection of water and marine resources, such as by resulting in the detriment of the status and/or potential of bodies of water;
- (4) Circular economy, such as by resulting in reduced circularity over the lifecycle of the good(s) and/or service(s) involved;
- (5) Pollution prevention and control, such as by resulting in increased pollution of air, water, or land; and
- (6) Protection and restoration of biodiversity and ecosystems, such as by resulting in detrimental effects to the condition, resilience, and/or conservation of habitats and ecosystems.

DNSH was a primary concern in the Recovery and Resilience Facility, which involved the EU Member States providing EUR 672.5 billion in “loans and grants available to support reforms and investments” to not only “mitigate the economic and social impact of the coronavirus pandemic,” but also “make European economies and societies more sustainable, resilient and better prepared for the challenges and opportunities of the green and digital transitions” (European Commission, 2021). One dimension of the Recovery and Resilience Facility was to ensure that the measures included, such as any investment therein (European Union, 2021: 3), did not violate the DNSH principle. The European Commission rightly noted that while any single investment may partly contribute to one of the environmental objectives, that same investment may consequently be detrimental to another of the objectives. To guide the process of assessing each measure for compliance with the DNSH principle, the European Commission introduced broad interpretative guidance wherein a measure that satisfies any of the following conditions was likely deemed compliant (European Union, 2021: 3-4).

- (1) The measure by design presents clear benefits to one of the environmental objectives while presenting “no or an insignificant foreseeable” negative impact on any of the other environmental objectives.

⁸ Adapted from ‘Technical Guidance on the Application of “Do No Significant Harm” under the Recovery and Resilience Facility Regulation’ (European Union (EU) 2021) Commission Notice C(2021) 1054 final 2.

- (2) The measure is tracked with a “100% coefficient” as supporting either a climate change or environmental objective.
- (3) The measure “contributes substantially” to an environmental objective as defined in the Taxonomy Regulation.⁹

Where these conditions are inapplicable, compliance with DNSH requires that the measure in its outset integrates certain guidance principles. Compliance with DNSH should thus be made clear before the measure is implemented or investment admitted, such as the promissory or negotiation stage. These guidance principles can be summarized into the following (European Union, 2021: 6-8):

- (1) Does the measure have direct environmental impact resulting from the economic activity itself? Or does it have “primary indirect” impacts, such as increased future emissions resulting from the use of the economic activity once it is complete?
- (2) Does the measure take into consideration the whole lifecycle of the good or service?
- (3) Does the measure promote greater climate-neutral energy infrastructure through electrification as a means of climate change mitigation?
- (4) Does the measure have a technologically and economically feasible alternative that is closer in its environmental impact to taking no measure at all? If not, does the measure follow the “best available environmental performance” in its sector?

Determining the extent to which these guidance principles are followed rely on technical criteria that are defined through other EU regulations (European Commission, 2021). For instance, determining the direct or primary indirect impacts of a measure in connection to the use and protection of water and marine resources is in accordance with Directive 2000/60/EC (October 23, 2000) on a framework for action in the field of

⁹ Whether an economic activity makes a substantial contribution to an environmental objective finds broad definition in Articles 10 to 16 of the Taxonomy Regulation. For instance, Article 13(k) identifies an economic activity as “contributing substantially to the transition to a circular economy, including waste prevention, re-use and recycling, where that activity [...] avoids and reduces litter.” The lack of more granular criteria set out by the Taxonomy Regulation has regularly been flagged by both EU Member States and private sector organizations, particularly in fear of widespread greenwashing. For instance, the European Supervisory Authorities (ESAs) sought more specific clarification on how goods and services promote environmental and social characteristics and whether a threshold level of sustainable investments is needed for a fund to comply with the Taxonomy Regulation (ElzaHolmstedt Pell, “A Lot of Questions Were Not Answered”: Market Reacts to Long-Awaited EU Response on Sustainable Finance Disclosures’ *Responsible Investor* [27 July 2021]). At the national level, the Federal Financial Supervisory Authority (BaFin) of Germany, for instance, as a means to prevent greenwashing proposed that for a fund to be considered sustainable, at least 75% of the assets in a fund must pursue a clear ESG investment strategy and observe exclusionary criteria that did not permit investments in nuclear energy, shale oil, and oil sands (Dominic Webb, ‘German Regulator Consults on Greenwashing Rules for ESG Funds’ *Responsible Investor* [4 August 2021]).

water policy for the European Community.¹⁰ This, in turn, defines sufficient monitoring of the impact of anthropogenic activity and the types of pollutants to be monitored in determining whether the “good status” of water is compromised. Consequently, “good status” can be understood as compliance with the limitations of certain pollutants that can be present in water, such as mercury (in accordance with Council Directive 82/176/EEC of 22 March 1982 (“Maximum concentrations of certain industrial Mercury discharges”), and the capacity of the European Community to achieve progressive ambition in its water policy, that is, reduction of pollution and promotion of sustainable water use according to Article 1 of European Parliament and Council Directive 2000/60/EC of October 23, 2000 (“Establishing a framework for Community action in the field of water policy”).

Where specific EU criteria may not exist or are otherwise incomplete in guiding the application of the DNSH principle, the Taxonomy Regulation takes a science-based approach—an approach that is common in science-based targets for private sector entities trying to reduce their environmental impact.¹¹ This is demonstrated in the general criteria for DNSH to climate change adaptation, which guides the assessment of climate change adaptation against the threshold of the “state-of-the-art science for vulnerability and risk analysis and related methodologies in line with the most recent Intergovernmental Panel on Climate Change reports [and] scientific peer-reviewed publications.”¹²

As this section attempted to show, the DNSH principle can overall be seen as supplementing the affirmative compliance model of substantial contribution that is arguably the mainstay of the EU SFDR. Essentially, the application of the DNSH principle is a safeguard measure that can be applied after the fact, where compliance with the DNHS can be determined retroactively, or before the fact, wherein an economic measure would be denied on the basis of not being compliant with the Taxonomy Regulation. However, the question of how the DNSH principle retains interoperability outside of the EU’s regulatory milieu still remains. EU-wide regulation and harmonized standards incubate an ecosystem that is conducive to the level of integration required to enforce a sustainable finance taxonomy, further posing the question of whether the DNSH principle as constructed in the Taxonomy Regulation can function in a similar fashion outside its natural habitat.

Affirmative compliance within the EU context, for example, is pre-empted by the existing efforts of EU-wide corporate social responsibility (CSR) regulation that emphasized closer public–private and stakeholder co-operation (Camilleri, 2015: 25). However, this is not to say that these efforts were entirely successful in harmonizing

¹⁰ See Appendix B (“Generic criteria for DNSH to sustainable use and protection of water and marine resources”). Further examples include Appendix C (“Generic criteria for DNSH to pollution prevention and control regarding use and presence of chemicals”) and Appendix D (“Generic criteria for DNSH to protection and restoration of biodiversity and ecosystems”).

¹¹ See, for instance, the Science-based Targets initiative (SBTi), a self-regulating initiative led by the private sector and broadly supported by the United Nations seeking to orient their corporate sustainability objectives on decarbonization pathways defined in the Paris Agreement and defined against a threshold of the most recent scientific research.

¹² Appendix A (“Generic criteria for DNSH to climate change adaptation”).

CSR and/or sustainable investment standards to a high degree (Nicolò, et al, 2021). Nevertheless, in continuation of those efforts, the DNSH principle is part of a larger suite of regulation that seeks to introduce harmonized standards of what qualified as CSR, or sustainable investment for that matter, into an already existing trend of growing CSR and sustainable investment participation (Halkos and Nomikos, 2021: 106). More generally, a longer history of CSR and/or sustainable finance regulation and legislation has been seen to generally correlate with a higher CSR and/or the environmental, social, and governance (ESG) performance of firms (Singhania and Saini, 2021).

The centrality of the DNSH principle within the context of the EU Taxonomy Regulation provides valuable foresight into how DNSH, in general, may be applied in the sustainable investment taxonomies of other states. While the implementation of a taxonomy regulation within a single state would not have the same international law implications as the regional jurisdiction of the EU SFDR, this study makes the argument that its international law implications largely seem invariable. In other words, it would be safe to assume that several key dimensions of the DNSH principle created through the EU SFDR and Taxonomy Regulation will be carried over into similar regulatory endeavors of other states, particularly those that involve regional harmonization and standardization. However, a major exception is undoubtedly the fact that the formation of a cross-border taxonomy requires a fairly deep level of economic integration such as that seen in the EU. From that purview, it becomes easier to identify the immense challenges that such an endeavor would face in other regions, such as in Asia.

ASEAN MODEL TAXONOMY AND THE SINGAPORE GFIT

The development gap between the Member States of the ASEAN remains one of its largest challenges to meaningful regional integration with Cambodia, Laos, and Myanmar—the newest members to the ASEAN—remaining the least developed. Attempts at economic integration in the presence of such large development gaps may not only deepen those gaps, but also impose challenging restrictions on a member state’s capacity to shape the national development policy (Cuyvers, 2019). The latter of these is particularly important given the prominent role of industrial policy in Asian growth models, which rely on government-led structural upgrading and shielding national champions from foreign competition (Chang and Zach, 2018)—both of which move against the current of integration in principle. Perhaps, one of the most vivid demonstrations of industrial policy in Asian development planning is that of Viet Nam, which has enjoyed rapid economic growth riding on rapid capital inflows while continuing to deal with low quality investments that provide limited long-term contribution to national development (Hanh, et al, 2017).

Amid these challenges, Singapore has taken the first steps in introducing a taxonomy regulation with its sights set on regional applicability in the ASEAN. Unlike other taxonomies that have been released in Asia, Singapore’s draft taxonomy regulation (Smith and Bramoulle, 2021) was designed for regional implementation. While this is partly due to the transnational operations of Singaporean financial institutions, the

drafters—the GFIT¹³—recognized that any taxonomy would need to be interoperable and compatible with other taxonomies to the greatest extent possible to retain a high level of operability. For that reason, one of the core values of the GFIT is the extent to which the taxonomy is functional across a wide scope of jurisdictions (Smith and Bramoulle, 2021: 6). To that effect, it identifies the EU Taxonomy Regulation as a clear benchmark for such endeavors (Smith and Bramoulle, 2021: 14) while also recognizing that lucrative trade and investment opportunities with the EU will now depend on compliance with the SFDR. The draw-in effect of the EU SFDR has already had a ripple effect on Asian regulation. For instance, it has been reported that “70–80% of the Chinese standards for green products meet the EU taxonomy standards” (Lai, 2020).

Another noteworthy aspect of the GFIT taxonomy is its recognition that deference to the specific conditions faced by each country is essential to any taxonomy seeking regional or even cross-border application. A Singaporean financial institution operating outside Singapore may follow a Singaporean taxonomy, but will ultimately be liable to the laws of the country that hosts it—and this much is also recognized in the GFIT taxonomy (Smith and Bramoulle, 2021: 23). For that reason, the GFIT taxonomy emphasizes the importance of core principles that would be indispensable to any sustainable finance regulatory framework, such as DNSH, irrespective of the peculiarities of the regulatory landscape that hosts the investor. The recognition of DNSH as a principle in the GFIT taxonomy resembles that of the EU Taxonomy Regulation. The GFIT identifies four environmental objectives,¹⁴ but with the precondition that any economic measure would not be compliant if it violates DNSH. However, one dimension to the DNSH condition that the GFIT added was that in addition to the interpretation of DNSH in the EU Taxonomy (“do no significant harm to any other environmental objective”), any measure that “contributes significantly to one of the listed environmental objectives but has a negative impact on the well-being of the communities in ASEAN” would also be in noncompliance (Smith and Bramoulle, 2021: 23). This means that the applicable scope of DNSH in the GFIT taxonomy extends beyond environmental objectives and social and governance dimensions.

Following the GFIT draft taxonomy, the ATB released the *ASEAN Taxonomy for Sustainable Finance* in November 2021. Unlike the GFIT Taxonomy in which Singaporean institutions would serve as transmission nodes through their operations in the region, the ASEAN Taxonomy recognizes upfront that any attempt to formulate a “one-size-fits-all” taxonomy would not be viable for the region given the wide divergences between the Member States. Instead, the taxonomy “must consider the specific situation of the [ASEAN Member States], many of which are in a state of development and growth” (ASEAN Taxonomy Board, 2021: 18). This sentiment is a central theme in the ASEAN Taxonomy in an effort to include regional entities,

¹³ The GFIT was commissioned by the Monetary Authority of Singapore (MAS) as an industry-led initiative to develop a taxonomy for Singapore-based financial institutions. See Monetary Authority of Singapore (MAS), ‘Accelerating Green Finance: Guide for Climate-Related Disclosures and Framework for Green Trade Finance’ Media Releases (19 May 2021) <<https://www.mas.gov.sg/news/media-releases/2021/accelerating-green-finance>> accessed 18 August 2021.

¹⁴ They are climate change mitigation, climate change adaptation, protection of biodiversity, and promotion of resource resilience.

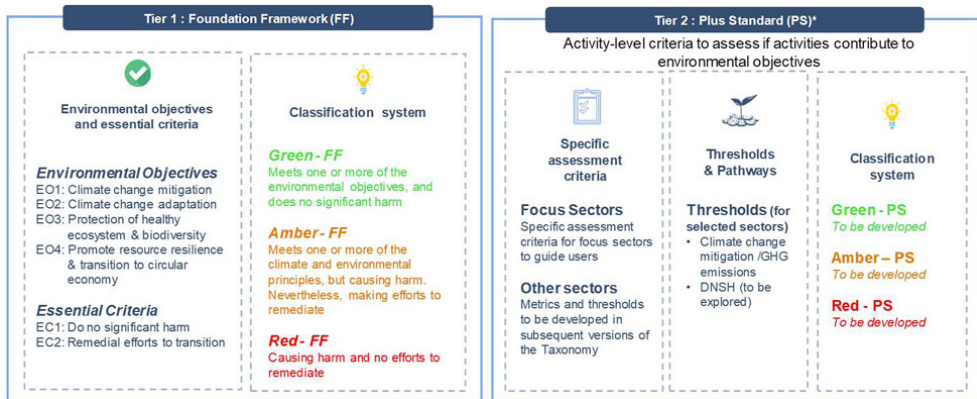


Figure 1. Multitiered taxonomy design (source: ASEAN Taxonomy for Sustainable Finance, p 21)

particularly small- to medium-sized enterprises, while seeking to avoid barriers to entry for transnational firms seeking investment (ASEAN Taxonomy Board, 2021: 48).

To achieve this, the ASEAN Taxonomy observes five “high level principles” as a means to “cater to the different stages of ASEAN economies, financial systems, and transition paths” (ASEAN Taxonomy Board, 2021: 20). In sum, these principles emphasize the core function of the ASEAN Taxonomy—a shared language of sustainable finance across the ASEAN Member States that are, “where appropriate,” science-based (ASEAN Taxonomy Board, 2021: 20). In this manner, unlike the GFIT Taxonomy, common but differentiated responsibilities are built into the ASEAN Taxonomy resulting in a “multitiered” design—a less ambitious but more inclusive tier (Foundation Framework) and a more granular, metric-based tier (Plus Standard). Figure 1 borrows a graphical representation of the multitiered system from the draft report.

Applicable to all ASEAN Member States and stakeholders is the first tier, or the “Foundation Framework,” which is constituted of three environmental commitments, four environmental objectives, and two essential criteria. The environmental commitments are to limit global temperature rise to well below 2°C, make each Member State climate resilient, and protect the environment. Economic activities to be in compliance with the Foundation Framework must satisfy at least one of the following four environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. Protection of healthy ecosystem and diversity
4. Promotion of resource resilience and transition to circular economy.

The ASEAN Taxonomy further requires all covered acts to observe the two essential criteria: DNSH and remedial measures to transition (ASEAN Taxonomy Board, 2021: 23). Overall, the Foundation Framework does not involve the use of metrics or performance thresholds in an effort to increase “inclusivity that will allow every

[ASEAN Member State] as well as users of capital of all sizes to be part of the region's sustainability agenda" (ASEAN Taxonomy Board, 2021: 49). The ASEAN Taxonomy recognizes that its first draft remains underdeveloped, particularly in application to DNSH, which is accompanied only with the explanation that it would undergo continued development and "take into consideration parallel activities elsewhere, including the EU" (ASEAN Taxonomy Board, 2021: 28).

The second tier of the ASEAN Taxonomy, the "Plus Standard," provides a classification of economic activities based on whether they significantly contribute to or enable one of the environmental objectives. Unlike the Foundation Framework, the Plus Standard employs metrics and thresholds to benchmark those activities. While there is no separate formulation of metrics, a list of guiding principles articulates the criteria to their selection. In sum, they emphasize science- and data-based metrics under the conditions of DNSH (specifically the least harmful alternative) and progressive ambition.

Finally, both the Foundation Framework and Plus Standard classify activities into three bands: red, amber, and green. Within the Foundation Framework, an economic activity is classified as green if it results in mitigation (decarbonization) or "carbon lock in" (reduced carbon activities). An activity is considered amber when it fails to meet DNSH at the first instance but mitigates the resultant harm thereafter. Red indicates that the activity does not satisfy any of the environmental objectives and is not expected to contribute to transitional progress.

Economic activities assessed within the Plus Standard are classified through a "stacked approach" composed of sector-weighted tiers. These thresholds are divided into three tiers. The lowest of these, Tier 3 ("Entry"), is transitional in nature with a goal and timeframe based on an agreed metric, such as emissions. The entity is expected to graduate from this tier based on an agreed timeline. Tier 1 ("Advanced") is the most ambitious threshold based on either achieving net zero by 2050 or compliance with "other major international taxonomies" that are based on the Paris Agreement. Tier 2 ("Intermediate") sits between those two tiers (ASEAN Taxonomy Board, 2021: 45). The explanation for this sub-tier was to permit—not crowd out—certain sectors with "ambitious distant goals" from taking action (ASEAN Taxonomy Board, 2021: 47). As per the latter, the ASEAN Taxonomy Plus retires performance thresholds over time to compel entities to embrace more ambitious goals.

DISCUSSION: INTEROPERABILITY OF DNSH

While the GFIT and ASEAN Taxonomies embody different motivations, with the former seeking rigorous environmental standards and the latter emphasizing greater inclusion, both systems carve out a central position for DNSH, that is, facilitate transboundary, harmonized application. In doing so, both taxonomies prioritize additionality, seeking to both expand the number of sustainable investments and impose standards on existing investments. Building upon the descriptive analysis of the DNSH principle as it exists in both the EU Taxonomy and ASEAN Draft Taxonomy and Singapore GFIT, this study turns to examine the broader questions of the challenges to the interoperability of

DNSH.

Perhaps, understanding the broad objective of a sustainable finance taxonomy as seeking to achieve the objective of continued capital flows through foreign direct and portfolio investment, both for the host and home states, remains the foremost challenge. This is particularly apparent in the ASEAN Taxonomy, with its multitiered and gradualist approach to expanding sustainable investment. Meanwhile, alongside more capital flows also comes higher quality investment, which is the functional purpose of a taxonomy regulation. This was present in the preparatory works leading to the EU Taxonomy Regulation, which is to fill the financing gap to reach its energy and emissions reductions targets by 2030 by creating a “new financial ecosystem” that could “mobilize substantial financial resources” that were fit to purpose (Claringbould, Koch and Owen, 2019: 15). However, the challenge of establishing a balance between upscaling financial resources by satisfying the objectives of the investor while achieving environmental policy goals remained. This balance embarks from a single materiality view of sustainable finance: how do environmental benchmarks affect financial return? The problem with this view is that it assumes that the progress in advancing an environmental objective can be converted into a monetary value that can fit within the single materiality matrix of net value (Chiu, 2022: 98-99). The consequence of this is a “corporate-centric,” self-regulatory framework of performance metrics (Chiu, 2022: 104) that may have compromised functionality in the ASEAN, which lacks the harmonizing network of the EU directives that exist in Europe. Furthermore, the extent to which a taxonomy regulation will be able to maintain a double materiality view in the ASEAN context while maintaining attractive investment destinations remains to be seen, especially with the three-tier format of the ASEAN model taxonomy, which nominally functions on a single materiality basis in its lower tiers. Thus, checking significant backpedaling on a taxonomy’s ambition in serving its sustainable development objectives becomes the challenge.

In the context of that balance, both taxonomies reach a similar conclusion in terms of the applicability of DNSH in the ASEAN: it must represent unity amid a poignant lack of unity in different levels of development. In doing so, DNSH—as it is phrased in both taxonomies—regularly refer to an international understanding of DNSH as a concept. In that respect, a sensible conclusion that DNSH is viewed within the ASEAN context in its longer timeline of no-harm as found in international law, which represents both the code of conduct on matters related to environmental harm (Dupuy, 2016) and due diligence to prevent such environmental harm from taking place (French, 2014: 3-5). In this understanding of the code of conduct within international law, one can find a clear connection between this expected role of DNSH in the GFIT and ASEAN taxonomies with a juridical understanding of no-harm and due diligence that found substantiation through international disputes. For example, in *Pulp Mills on the River Uruguay* (2010), while deliberating an obligation to prevent pollution and preserve the environment, the International Court of Justice (ICJ) recognized that respect for the environment, both within and beyond the national control of a sovereign state, has been established as a general obligation in international law (*Pulp Mills*, 2010: para 93). This general obligation, in turn, finds further definition in reference to other such principles such as Principle 15 of the Rio Declaration (precautionary principle) in practicing

“abundant caution”¹⁵ and proportional degree of care when involving in activities with a “high probability of causing significant harm” (ILC, 2001: art 3(3)). Altogether, when embodying such general obligations, DNSH seeks to accentuate the common but differentiated responsibilities of states in ensuring that international investments minimize transboundary environmental harm while providing an opportunity to domestic entities to remain competitive, both economically and in being able to participate in and benefit from the shift to sustainable investment.

If DNSH serves as a means for the regional application of a taxonomy for the ASEAN, maintaining proportionality not only between an environmental and a non-environmental key performance indicator, as the GFIT taxonomy permits, but also between the impact of economic activities across borders that account for development gaps, which is emphasized in both taxonomies, will be a challenge. This added complexity to the DNSH principle, that is, beyond exclusively environment-related criteria, allocates considerable discretionary powers to the authority charged with operating the taxonomy at the regional level in implementing balanced application in the different levels of development across Southeast Asia. Until there is greater clarity regarding how these different considerations weigh against one another, particularly in less granular constructs like the ASEAN Taxonomy’s Foundation Framework, international investors will be left guessing about how to approach due diligence assessments.

For instance, by adding extra dimensions of complexity, such as a social or governance layer, DNSH is not solely the extent to which one measurable contribution to environmental objectives weighs against another measurable contribution to the same set of objectives. Instead, a measure such as an investment that may provide a substantial contribution to the predefined set of environmental objectives will have to be assessed for its DNSH compliance against a set of social or governance objectives that may not have necessarily been identified in the taxonomy. In this regard, it becomes more important to clarify the way in which DNSH—in application to a set of environmental objectives—interacts with a different matrix of objectives to prevent one being used as a means to dilute the ambition of the other.

A relevant example here may be the positioning of coal in China’s taxonomy, wherein the “clean utilization of coal” remains a key performance indicator in the category of “pollution prevention and control” (OECD, 2020). This inclusion of clean coal has been targeted by international criticism. While clean coal has since been excluded from China’s list of eligible financing with green bonds, coal power generation continues to expand in the country given its indispensable role in the country’s economic growth and creating regional employment. One may argue that an austere reading of DNSH in application to environmental objectives would prevent overstretching what “clean coal” necessarily entails (Liu, 2020). When DNSH is put into this three-dimensional format of ESG, it necessarily faces a similar trade-off between

¹⁵ Principle 15 of the Rio Declaration (1992) reads, “In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.”

a wide scope of interpretation and more stringent enforceability. While a wider scope provides greater coverage for the vast multidimensionality of sustainable development as a process, it also comes with challenges of equivalence between those dimensions that are difficult to reconcile.

Yet, unlike its substantial contribution that seeks to elevate standards of sustainable investment, DNSH—at its core—is a safeguard against measures harmful to the environment (or the progress of sustainable development). By adding extra layers of regulatory complexity, the capacity of DNSH to serve that safeguarding function becomes compromised, and may have contradictory results in a worst-case scenario.¹⁶ In such a scenario, while a taxonomy regulation may have been meant to encourage substantial contributions through measures like investment, if the means to enforce certain dimensions of those contributions, such as through DNSH, remain weak, the entire regulation may have contradictory results. If the safeguarding role of the DNSH principle is debilitated, it will quickly be revealed that the entire regulatory structure of the taxonomy is nothing more than a Potemkin village—a perfect regulatory void for those self-regulating firms¹⁷ that, in actuality, seek to free ride (while ultimately undermining) the necessity and promise of sustainable investment.

CONCLUSION

The observations made in this paper concerning DNSH as a key principle in taxonomy regulations spell out a precautionary tale. While a thematically broad DNSH is more enforceable in application to member states at similar levels of development, a limited interpretation of DNSH (restricted to an environmental scope) would exhibit greater enforceability when member states demonstrate highly different levels of development. Both taxonomies examined in this study looked to the EU Taxonomy Regulation for inspiration, and it may be fitting to see how that regime continues to overcome

¹⁶ A highly complex DNSH regulatory structure would seem to fall under several regulatory paradoxes identified by Sunstein (1990). For instance, regulation that is strict yet insensitive to trade-offs results in reluctance by both private sector and administrative actors (“the agency”) to comply, pursue sustainable investment at all, or be willing to comply with disclosure requirements. Sunstein’s observation that overregulating can result in underregulating as the overburdened agency is less likely to pursue stringent enforcement, the levels of which reflect the agency’s reluctance (Cass Sunstein, ‘Paradoxes of the Regulatory State’ (1990) 57 *University of Chicago Law Review* 412–416).

¹⁷ In reference to what Short (2013) described as self-regulating firms operating in a regulatory void, or the lack of a “judicious regulatory regime [...] with shared understandings about the rules of the game, adequate regulatory resources to implement and enforce the rules, and sufficient judgement to exercise restraint in deploying those resources” (Jodi L Short, ‘Self-Regulation in the Regulatory Void: “Blue Moon” or “Bad Moon”?’ (2013) 649 *The Annals of the American Academy of Political and Social Science* 22, 26). Short defined the “regulatory void” to “describe spaces in which government regulation, in particular, is perceived to be deficient” resulting in “bad moon self-regulation.” Of the types of voids identified, a weakened DNSH mechanism would most likely fall somewhere between a knowledge void (“limited availability of information and strategic ways actors construct and understand it”) and institutional voids (“there is consensus on the rules or norms [but] competent institutions to enforce them may be lacking”) (ibid 27–28).

its limitations and evolve. For instance, when the SFDR was first implemented, the increased administrative burden required by the DNSH principle and SFDR resulted in lax enforcement, which was compounded by asset managers exaggerating their ESG performance to elude financial regulators (Schwartzkopff, Comfort, and Buttler, 2021). EU Member States were largely left to their own devices in implementing the Taxonomy Regulation, further adding questions of conflict of laws. EU asset managers were (and largely continue to be) required to assess substantial contributions themselves (self-regulation), resulting in considerable legal uncertainty as these firms employ disparate methodologies in determining an economic level of compliance (Ochoa, 2021).

Both GFIT and ASEAN Taxonomies shall inevitably encounter this challenge of maintaining a wide interpretive scope across the ESG factors in an incredibly diverse set of development agendas and states of development represented by the ASEAN Member States. Ultimately, however, any sustainable finance regulatory framework, whether it means to enhance the quality of contributions that investment can make toward sustainable development or enforce safeguards against sustainable development-adverse impacts, should prioritize its primary directive, that is, mobilize finance toward where it is the most needed to advance sustainable development—a universal public interest.

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