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ESG Sustainability Spotlight

Navigating the ESG Landscape: Risks, Opportunities, and Strategic Insights

In today's business world, environmental, social, and governance (ESG) issues have taken center stage, and companies, both public and private, are increasingly recognizing the significance of ESG responsibility. Today's executives, managers, and stakeholders find themselves navigating a complex landscape filled with risks and opportunities.

The ESG Imperative

ESG encompasses a broad spectrum of factors that impact a company's long-term sustainability and performance. Let's break down what each component entails:

- Environmental (E): This dimension focuses on a company's impact on the environment. It includes considerations such as carbon emissions, resource usage, waste management, and climate change resilience.
- Social (S): The social aspect encompasses how a company interacts with its employees, customers, communities, and other stakeholders, as well as the non-environmental impacts of its supply chain. Topics like diversity and inclusion, labor practices, human rights, and community engagement fall under this category.
- Governance (G): Governance refers to the systems and processes that govern a company's decision-making. It involves board composition, executive compensation, transparency, and adherence to ethical standards.

The ESG Landscape Today

- Heightened Focus: Investors, regulators, and consumers are increasingly scrutinizing companies' ESG practices. Firms that prioritize ESG are better positioned to attract capital, retain talent, and build trust with stakeholders.
- Regulatory Landscape: ESG-related regulations are evolving rapidly. Companies must stay informed about both U.S. and international requirements and restrictions to ensure compliance.
- Shareholder Proposals: Shareholders are actively pushing for greater ESG disclosure and action. Crafting effective strategies to address these proposals is essential for companies seeking to align with investor expectations.
- Political Dynamic: As ESG has grown in prominence, it has also grown more controversial. It is not enough to know the rules where a company is located, companies need to know the rules everywhere they do business.

Alston & Bird's ESG Advisory Team

At Alston & Bird, our ESG Advisory Team provides strategic guidance to companies navigating the ESG landscape. Our services include:

- Understanding ESG Dynamics: We help companies grasp the nuances of ESG and tailor their approaches accordingly.
- Regulatory Insights: Our team stays abreast of ESG-related regulations worldwide, ensuring clients remain compliant.
- Shareholder Engagement: Crafting effective responses to shareholder proposals requires expertise. We guide companies in this critical area.
- Risk Mitigation: Minimizing litigation and enforcement risk is crucial. Our strategies and materials help companies proactively address potential legal challenges.

ESG Tracker and Sustainability Spotlight

Our ESG Tracker and this publication offer valuable insights into federal and state enforcement actions, litigation trends, and shareholder proposals. They serve as a resource for companies seeking to stay informed and make up-to-date decisions on all matters related to ESG.

Kevin Minoli, Elise Paeffgen, Cara Peterman, Dave Brown

An Update to Climate Risk Disclosures Among the SEC, CA, and the EU: Navigating Next Steps

The Securities and Exchange Commission (SEC) recently adopted new climate-related disclosure rules but due to litigation, stayed the effect of these rules. Because of the stay, many public companies are contemplating how to proceed with these rules. Given the additional regulatory requirements for California, the EU's Corporate Sustainability Reporting Directive (CSRD), the SEC's 2010 guidance, and current investor expectations, public companies would be well served to continue to put in place their climate and sustainability-related programs at a measured pace.

SEC Climate Rules

On March 6, 2024, the SEC adopted the climate risk rules it initially proposed in 2022, requiring public companies to provide certain climate-related disclosures. The new SEC climate rules require disclosure on direct and indirect greenhouse gas emissions; oversight and governance; climate-related risks that have had or are reasonably likely to materially impact the business, strategy, and outlook; and recoveries as a result of severe weather or natural conditions. On April 4, 2024, due to the increasing number of petitions filed challenging the rules, the SEC voluntarily stayed its newly adopted climate rules, pending judicial review. Although the new SEC climate rules are temporarily stayed, companies must still comply with the SEC's 2010 guidance on disclosure for climate change. During the stay, the SEC will likely continue to issue comment letters based on their 2010 guidance.

California

In California, a trio of climate-related disclosure laws will impose far-reaching reporting requirements on companies that do business in the state.

The first, the Climate Corporate Data Accountability Act (CCDAA, also referred to as SB 253), will require companies that have more than $1 billion in annual revenue to disclose Scopes 1, 2, and 3 emissions. Reporting these emissions will be subject to any regulations published by the California Air Resources Board (CARB).

The second, the Climate-Related Financial Risk Act (CRFRA, also referred to as SB 261), requires companies doing business in California with more than $500 million in annual revenue to report their climate-related financial risks and measures that they are using to mitigate these risks using the Task Force on Climate-Related Financial Disclosures, or equivalent, framework.

Lastly, the Voluntary Carbon Market Disclosures Act (VCMDA, also referred to as AB 1305) requires companies that operate in California and make claims of net zero, carbon neutrality, or significant emissions reductions to substantiate them on their website. Substantiating these claims will require providing some documentation of the accuracy of the claims and means of achieving the claims or progress toward them. Moreover, the VCMDA includes additional reporting requirements for companies that purchase voluntary carbon offsets.

The timing for when each of the laws in the California trio goes into effect is staggered. The CCDAA requires Scope 1 and Scope 2 emission reporting by January 1, 2026 but delays Scope 3 reporting to 2027, within six months of disclosing Scope 1 and Scope 2 emissions. Similarly, the CRFRA requires that companies have relevant claims substantiated on their websites by January 1, 2026. The VCMDA was originally slated to take full effect on January 1, 2024 and is expected to be amended shortly to delay the disclosure deadline to January 1, 2025.

Despite the trio's goals, we have already seen pushback from businesses. Uncertainty remains around the definition of "doing business" in California under the CCDAA and the CRFRA and how far the ultimate definition will reach. As of now, CARB has not published any notices of rulemaking to promulgate regulations to implement these rules.

EU Corporate Sustainability Reporting Directive

The EU's CSRD, now in effect, imposes rules requiring certain companies to publish information across a number of sectors, including climate change, environmental impact, and societal impact. The European Union adopted the CSRD with aims of modernizing and strengthening reporting requirements on environmental and social information. The new rules are designed to equip investors with information on the impact companies have on people and the environment ("impact materiality") and the impact that climate change and other considerations have on companies financially ("financial materiality")—collectively referred to as "double materiality."

Companies will need to analyze whether their immediate entity or any other related entities are required to report under the CSRD. Reporting requirements will phase in over time.

- 2025 – Relevant EU-incorporated companies already subject to the EU's Non-Financial Reporting Directive are required to publish reports for fiscal years starting on or after January 1, 2024.
- 2026 – Large companies (including non-EU companies listed on an EU-regulated market) and parents of large EU groups (including those headquartered in the United States) are required to publish reports for fiscal years starting on or after January 1, 2025. A large company or large group is defined as a company or group that meets two out of the three following criteria: (1) net turnover of more than €40 million; (2) balance sheet total assets greater than €20 million; and (3) more than 250 employees.
- 2027 – Other small and medium enterprises (other than micro undertakings) listed on an EU-regulated market are required to publish reports for fiscal years starting on or after January 1, 2026.
- 2029 – Non-EU groups (including those headquartered in the United States) with significant activity in the EU are required to publish reports for fiscal years starting on or after January 1, 2028.

The CSRD requires reporting companies to use the European Sustainability Reporting Standards (ESRS) developed by the European Financial Reporting Advisory Group. The standards require reporting companies to report on two general "cross-cutting standards" and also to determine which of 10 "topical standards" are material to its business and accordingly report to those specific standards.

The cross-cutting standards set out sector-agnostic requirements that apply to all the topics covered by the CSRD, separated into (1) general requirements and (2) general disclosures.

The topical standards are divided into five environmental standards (ESRS E1 through ESRS E5), four social standards (ESRS S1 through ESRS S4), and one governance standard (ESRS G1). This includes Scopes 1, 2, and 3 emissions. Each standard follows the same premise: disclose any relevant risks, impacts, and opportunities that are material for the company, then disclose the policies, actions, and targets in place to mitigate those risks and impacts.

Alternatively, companies should provide an explanation stating why such standards are not material from either an impact materiality or financial materiality perspective. Groups or companies with fewer than 750 employees will have additional time to comply; for example, they will not need to include data on certain greenhouse gas emissions under ESRS E1 and, for the first two years, may disregard standards on biodiversity under ESRS E4 and all of the social standards other than ESRS S1.

The CSRD requires reporting companies to analyze under a "double materiality" assessment that requires an assessment of both (1) the impact of the undertaking on people and the environment; and (2) a financial assessment of how sustainability matters affect the undertaking, and to report accordingly. Information must be provided on the company's own operations as well as its value chain, both upstream and downstream. This materiality determination is broader than standards that focus on investor-perspective materiality.

Companies will initially need to seek "limited" assurance on information to be disclosed. When a non-EU company is subject to the CSRD, reporting should also be certified, either by a European or third-country independent auditor. This standard of assurance may be heightened going forward.

Companies should consider whether their company or any EU subsidiary falls within the scope of the CSRD. The CSRD will require disclosure beyond what is required by the SEC and California. Companies expecting to report under the CSRD should be preparing to collect relevant data to be in a position to report when required. In preparation for eventual reporting, companies should note any revisions to the ESRS.

Takeaways

While the new SEC disclosure rules are currently voluntarily stayed, the rules may later be implemented in original or modified form, creating extensive climate-related disclosure requirements for public companies. Additionally, reporting requirements under the CCDAA, CRFRA, VCMDA, and CSRD create additional requirements that go beyond the scope of the SEC rules.

Affected companies, including public companies, companies with a presence in California, companies operating in the EU, and companies with subsidiaries operating in the EU, should be proactive and not wait until the disclosure is required to begin preparations for applicable required disclosures. Affected companies should consider taking the following steps to prepare for and comply with the required disclosures under these rules. Below are some next steps companies can take in light of these disclosure rules.

- Determine which climate-related rules and regulations apply to the company to prepare to comply.
- Develop and enhance the company's existing climate-related infrastructure, including data collection and accuracy, internal controls, delegation of responsibility, and climate-related decision-making frameworks.
- Analyze climate risks' impact on the company's business operations, strategy, goals, outlook, and other planning.
- Develop definitions for and familiarize management with terms used in the various climate-related regulations, including "material," "severe weather event," and "natural conditions."
- Consider subjecting climate-related disclosures to more extensive board and auditor review, similar to financial disclosures.
- Review board committee charters to determine if there is a clear delegation of board oversight of climate-related disclosures and tracking processes. If there is no board committee charter containing climate-related responsibilities, companies should consider formalizing the board oversight processes for climate-related activities.
- Determine the materiality—in accord with the applicable disclosure standards—of Scope 1, Scope 2, and Scope 3 emissions to their business and begin to track and identify emissions sources, gather data, and synthesize information to prepare for required disclosures.
- Find third-party service providers to assist with the tracking and reporting of Scope 1, Scope 2, and Scope 3 emissions (if applicable) and any assurances required.
- Educate members of management and the board about the climate-related regulatory framework, the company's reporting obligations under the regulatory framework, and the company's climate-risk management procedures and policies.
- Evaluate the company's existing and proposed climate-related goals and identify tangible actions taken to achieve the goals.

ESG SEC Enforcement Actions

MARCH

SEC Stays Climate Disclosure Regulations Following Circuit Court Decisions

April 4, 2024 | *In the Matter of the Enhancement and Standardization of Climate-Related Disclosures for Investors*, No. 33-11280.

March 21, 2024 | *In re Securities and Exchange Commission, The Enhancement and Standardization of Climate-Related Disclosures for Investors*, MCP No. 180.

The SEC has issued a stay of its climate-related disclosure rules that were promulgated on March 6, 2024. Immediately after the final rules were published, several plaintiffs filed petitions seeking review of the rules in multiple courts of appeals. In response to the petitions, the Fifth Circuit issued an administrative stay of the final rules on March 15, 2024, which was dissolved after the Judicial Panel on Multidistrict Litigation consolidated the pending petitions in the Eighth Circuit. In its order issuing the stay, the SEC made clear that it is not departing from the view that the final rules are consistent with applicable law and within its authority to regulate corporate disclosures.

Energy Company Sues SEC over Climate Disclosure Regulations

March 28, 2024 | *Liberty Energy Inc. v. Securities and Exchange Commission*, No. 3:24-cv-00739 (N.D. Tex.).

Liberty Energy Inc., an oilfield services firm, filed suit against the SEC challenging its authority to implement climate-related disclosure rules. The suit was filed to preserve the plaintiff's rights while its challenge to the entire climate-related rule is pending in the Eighth Circuit after the Judicial Panel on Multidistrict Litigation consolidated Liberty Energy's claims with similar claims by other plaintiffs in the Eighth Circuit. The complaint alleges that the SEC's climate-related rule violates the major questions doctrine and that the SEC lacks clear authority for the rule. The complaint further alleges that the SEC's climate-related rule violates the First Amendment because it requires disclosure of political issues.

FEBRUARY

Electric Truck Manufacturer Settles SEC Enforcement Disputing Demand for Its Electric Pickup Trucks

February 29, 2024 | *In the Matter of Lordstown Motors Corp.*, No. 3-21875.

Lordstown Motors Corp., a former SPAC target, promoted itself to investors as developing the first-to-market full-size electric pickup truck in the commercial fleet market. The SEC enforcement action was built on the premise that Lordstown knew the first-mover advantage in the electric pickup truck space would be crucial to the company's success, and so misrepresented the number of pre-orders for the truck and its access to key parts in the truck's manufacturing. Lordstown claimed in investor roadshows that it had secured 27,000 pre-orders for the electric truck and that Lordstown allegedly had an agreement with General Motors that would allow Lordstown access to certain GM parts. The SEC order notes that between 40% and 71% of the pre-orders were from intermediaries that promised to influence purchases of the electric truck and did not intend to buy the electric truck themselves. The SEC order also states that Lordstown's representations about maintaining access to certain GM parts was misleading because GM had allegedly informed Lordstown that its requests for GM parts would constrain GM's supply chain and advised Lordstown to find a backup solution. Lordstown has agreed to pay disgorgement of $25.5 million to settle two pending class actions in Delaware and Ohio.

SEC Division of Enforcement Director Remarks on ESG: "We Are Merit Neutral"

February 23, 2024 | SEC Division of Enforcement, Remarks at Ohio State Law Journal Symposium 2024: ESG and Enforcement of the Federal Securities Laws.

Gurbir Grewal, director of the SEC Division of Enforcement, spoke on the SEC's ESG enforcement actions, noting at the outset that the SEC is not an environmental regulator. Grewal commented that as investors become more interested in companies' ESG considerations, companies have more incentives to exaggerate or make misleading statements about their positive ESG developments or to downplay or omit disclosures about negative ESG developments. Grewal discussed the Vale S.A. and Deutsche Bank enforcements as recent successes the SEC has had in ESG-related enforcement actions.

State Attorney General Actions

FEBRUARY

State Attorneys General Support Federal Rule on Single-Use Plastic Packaging

February 27, 2024 | Comments on GSA Proposed Regulation re: Reduction of Single-Use Plastic Packaging.

Several state attorneys general drafted a comment letter that supports the U.S. General Services Administration's (GSA) proposed rule to reduce federal purchases of single-use plastic packaging. In their comment letter, the AGs both express support for the GSA's efforts to limit the federal government's procurement of single-use plastics and urge the GSA to develop a more stringent proposed rule that would eventually permanently eliminate the federal government's ability to procure and acquire single-use plastics.

JANUARY

State Attorneys General Ask District Court to Block Federal Agencies' Net-Zero Highway Emissions Rule

January 12, 2024 | *Commonwealth of Kentucky v. Federal Highway Administration*, No. 5:23-cv-00162 (W.D. Ky.).

Several state attorneys general filed a preliminary injunction seeking to enjoin the U.S. Department of Transportation and the Federal Highway Administration (FHWA) from implementing and enforcing their highway emissions rule. The emissions rule would require states receiving funds from the FHWA to measure greenhouse gas emissions and establish declining CO_2 targets for on-road emissions to achieve net-zero emissions by 2050. The AGs challenge the rule under several legal doctrines, including that the rule is arbitrary and capricious, and ultimately assert that the rule does not adequately consider the far-reaching impacts of the rule on states with more rural areas and growing populations.

Several State Attorneys General Oppose a Draft Federal Rule on Diversity, Equity, Inclusion, and Accessibility in the Private Sector

January 8, 2024 | U.S. Department of Commerce Notice Entitled *Business Diversity Principles*, 88 Fed. Reg. 83,380 (Nov. 29, 2023), DOC-2023-0003.

Several state attorneys general drafted a comment letter that challenges the U.S. Department of Commerce's (DOC) draft "Business Diversity Principles," which seek to advance "best practices related to diversity, equity, inclusion, and accessibility (DEIA) in the private sector." In their comment letter, the AGs assert that the draft violates the Equal Protection Clause of the U.S. Constitution, Title VII of the Civil Rights Act of 1964, and other legal doctrines. The AGs oppose the DOC's rule and hope to work with the DOC to draft new guidance on DEIA practices in the private sector.

Litigation Tracking

MARCH

March 15, 2024 | *Liberty Energy Inc. v. Securities and Exchange Commission*, No. 24-60109 (5th Cir.).

The Fifth Circuit Court of Appeals granted an administrative stay of the Enhancement and Standardization of Climate-Related Disclosures for Investors Rule on March 15, 2024 in response to the petitioners' emergency motion for administrative stay and stay pending judicial review filed on March 8, 2024. The petitioners argued the stay was warranted because they are likely to prevail on the merits, the rule is arbitrary and capricious, the rule violates the First Amendment by mandating disclosures and effectively mandating discussing climate change, and the petitioners have suffered irreparable harm in the form of unrecoverable compliance costs and constitutional injuries.

On March 22, 2024, the court ordered transfer of the petition to the Eighth Circuit for consolidation and dissolved the administrative stay.

March 6, 2024 | *West Virginia v. Securities and Exchange Commission*, No. 24-60109 (11th Cir.).

Ten states petitioned for review of the Enhancement and Standardization of Climate-Related Disclosures for Investors Rule, alleging that the rule exceeds the statutory authority of the SEC and is otherwise arbitrary, capricious, an abuse of discretion, and not in accordance with law. The petitioners requested that the court declare the final rule unlawful and vacate the SEC's final action.

FEBRUARY

February 28, 2024 | *People of the State of New York v. JBS USA Food Company*, No. tc240228-23 (Sup. Ct. N.Y.).

The New York State AG filed a complaint in New York state court alleging that JBS USA Food Company, the largest producer of beef in the world, made unsubstantiated and misleading environmental marketing claims about its commitment to reducing greenhouse gas emissions in violation of New York State's consumer protection laws. The suit notes that beef production contributes significantly to climate change and alleges that JBS's "Net Zero by 2040" claims are misleading because the company's greenhouse gas emissions calculations fail to account for significant Scope 3 emissions related to the company's supply chain land use. The suit asks the court to enjoin JBS from violating the state's consumer protection laws, order JBS to disgorge profits traceable to the unsubstantiated claims, grant civil penalties, and perform independent audits of all JBS's consumer-facing publications.

February 26, 2024 | *Chattooga Conservancy v. United States Department of Agriculture*, No. 1:24-cv-00518 (D.D.C.).

The Chattooga Conservancy filed a complaint against the U.S. Department of Agriculture and the U.S. Forest Service under the National Environmental Policy Act, alleging that the agencies failed to assess the direct, indirect, and cumulative effects of logging projects authorized to fulfill annual national timber targets. The complaint asks the court to block the agencies from offering further timber sales in fiscal year 2024 and from implementing the remaining commercial timber harvest efforts for authorized projects.

February 21, 2024 | *Spence v. American Airlines Inc.*, No. 4:23-cv-00552 (N.D. Tex.).

The Northern District of Texas denied a motion to dismiss filed by American Airlines that sought to dismiss the class action complaint alleging American Airlines breached its fiduciary duty under the Employee Retirement Income Security Act (ERISA) by investing its employees' retirement savings with funds pursuing ESG goals and strategies, rather than focusing exclusively on maximizing financial benefits.

JANUARY

January 25, 2024 | *Porter v. GrafTech International Ltd.*, No. 1:24-cv-00154 (N.D. Ohio).

A purchaser of common stock filed a putative securities class action under the Securities Exchange Act against graphite electrode product manufacturer GrafTech, alleging that the company's materially false and misleading statements and omissions caused him and class members to suffer significant losses and economic damages. The complaint alleges that GrafTech made claims in IPO offering materials promoting the "more environmentally friendly" steelmaking employed by its customers as key to its claimed sustainability initiatives when its facility operations had allegedly contaminated neighboring communities.

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