

ESG: ELI Western Bootcamp Edition

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Agenda

- ESG 101
 - ESG vs. Sustainability
 - Transition from voluntary to mandatory
 - ESG as corporate strategy vs. ESG as financial risk management tool
- How companies talk about sustainability
 - Disclosures – mandatory and voluntary
 - Marketing/substantiation (greenwashing)
 - Tools of the trade
 - Third-party verification/partnerships
 - Inflation Reduction Act/government incentive programs
- How companies implement sustainability
 - Carbon-reduction initiatives (net-zero pledges)
 - Supply-chain/forced labor due diligence
 - ESG due diligence in transactions
 - Board involvement
 - Collaborating with competitors (antitrust)
- Questions



ESG 101



Breaking Down the E, S, and G

Environment

- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts

Social Capital

- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labeling



Human Capital

- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

Business Model & Innovation

- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

Leadership & Governance

- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management

Source: SASB® Standards



Established Ideas, New Vocabulary

- Reflects increased importance of stakeholder capitalism – shareholder primacy is on the wane
- Importantly, it is different from CSR – not only “feel-good” efforts but also risk management
- Real-world implications to business operations:
 - Impacts the costs of capital and access to it
 - Companies with strong practices have been found to deliver more sustainable returns
- Opportunity: demonstrate industry leadership, future-readiness
- Caution: spotlight existing financial, compliance, and reputational risks



What Is ESG? It Depends Who You Ask.

- For companies – efforts to improve performance on environmental, social, and governance metrics and embed those considerations throughout business lines, across administrative departments and their commercial transactions.
- For investors/lenders/shareholders – a way to evaluate how companies are managing emerging risks and how they contribute to stakeholders' own goals.
- For all stakeholders: ESG is no longer a “nice to have” (like CSR), but increasingly seen as a business imperative with real effects on the bottom line.



ESG and (vs.?) Sustainability



Why now? What prompted the ESG wave?

- Heightened recognition of the cause and effect relationship between ESG factors and corporate bottom line
- Increased internal and external stakeholder focus, and pressure (climate change, racial injustice, Covid-related inequities)
- Heightened governmental awareness (e.g., SEC, and identification of climate change as systemic financial risk)

The truth behind corporate climate pledges

Facing a reckoning over their contribution to the climate emergency, companies are coming out with a record number of pledges

FINANCIAL TIMES *The New York Times*

ETFs ESG investing
ESG labelling provides limited insights for investors, study says

BlackRock Seeks to Defend Its Reputation Over E.S.G. Fight




Why Now? The EU Green Deal

“The Green Deal is Europe’s Man on the Moon Moment”

European Commission President Von der Leyen



Voluntary  Mandatory

ESG Laws and Regulations (selected examples)

- **ESG Marketing Claims**
 - FTC Green Guides update
 - EU Directive Empowering Consumers for the Green Transition
 - EU Green Claims Directive
- **ESG Mandatory Reporting Requirements**
 - Human capital reporting
 - Modern slavery statements (UK, Australia, California, ...)
 - SEC and California climate disclosures
 - EU Corporate Sustainability Reporting Directive (CSRD)
- **ESG Performance Requirements**
 - Uyghur Forced Labor Prevention Act
 - EU Corporate Sustainability Due Diligence Directive
 - EU Deforestation Regulation
 - EU Circular Economy package
- **ESG Investment and Infrastructure**
 - Inflation Reduction Act (domestic labor requirements)



ESG as transactional practice

- **Energy transition transactions**

- Renewable energy purchases
- Green hydrogen
- More-sustainable fuels

- **New technology transactions**

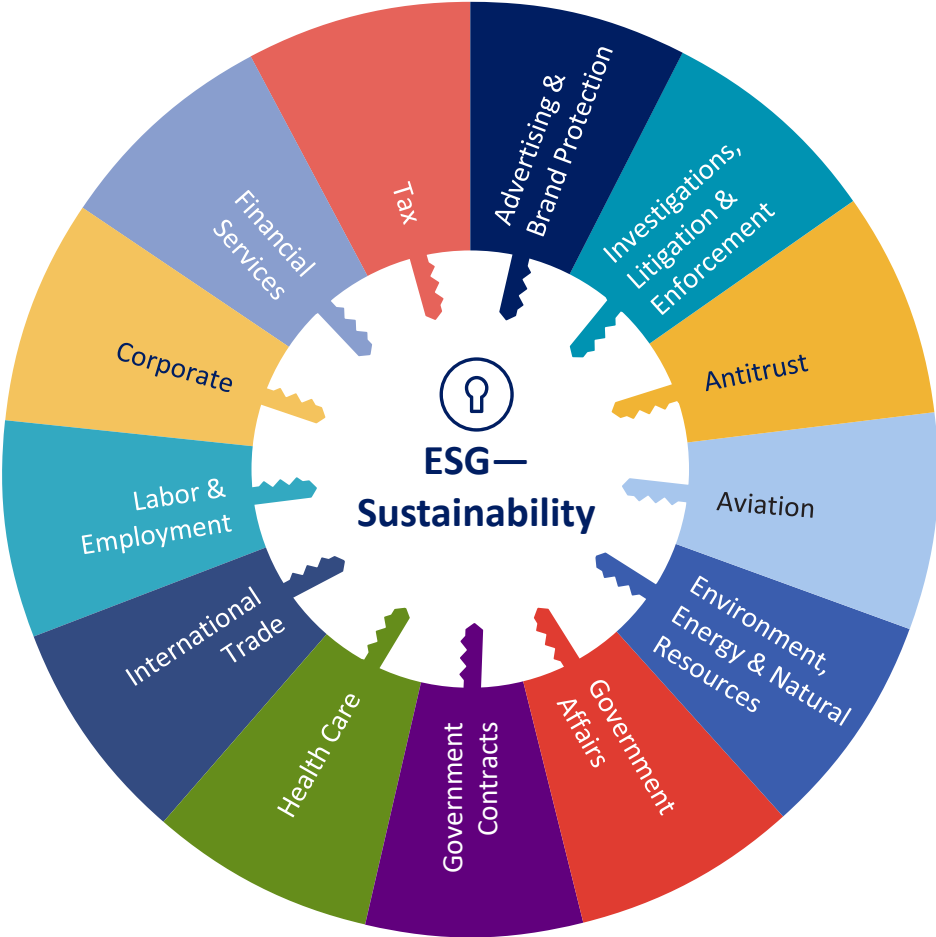
- Greentech startups (e.g., lower carbon concrete, reduced water production, energy storage, etc.)

- **Carbon neutralization/offsets transactions**

- Offsets
- Insets



ESG and the Practice of Law



ESG as Corporate Sustainability Strategy vs. Financial Risk-Management Tool



Anti-ESG Backlash Mostly About ESG *Investments and Investors*

- Animated by concern that institutional investors (i.e. Blackrock) are attempting to strongarm companies in which they invest into taking action on climate, DEI, etc. initiatives
- Concern that stakeholder capitalism is anathema to shareholder capitalism
- Often erroneously conflated with “woke” agenda



ESG Investing/Investor-Related Litigation

- Litigation regarding whether or not ESG considerations should be used for financial analysis/reporting:
 - *SIFMA v. Missouri*
 - Challenge to rule requiring investment advisers and broker-dealers to disclose when a social or other nonfinancial objective into any discretionary investment decision or advice; motion to dismiss denied
 - Significantly, the State conceded that advisors *may* legitimately view ESG-related considerations as financial
 - *Utah v. Walsh*
 - DOL retirement plan ESG investing rule upheld by conservative Texas judge
 - Does not require consideration of ESG principles, but rolls back Trump Administration rule that would have been more restrictive
 - *Exxon v. Arjuna Capital*
 - Suing shareholder group to block climate-related proxy proposal (circumventing typical informal appeal to SEC)



How Companies Talk About Sustainability



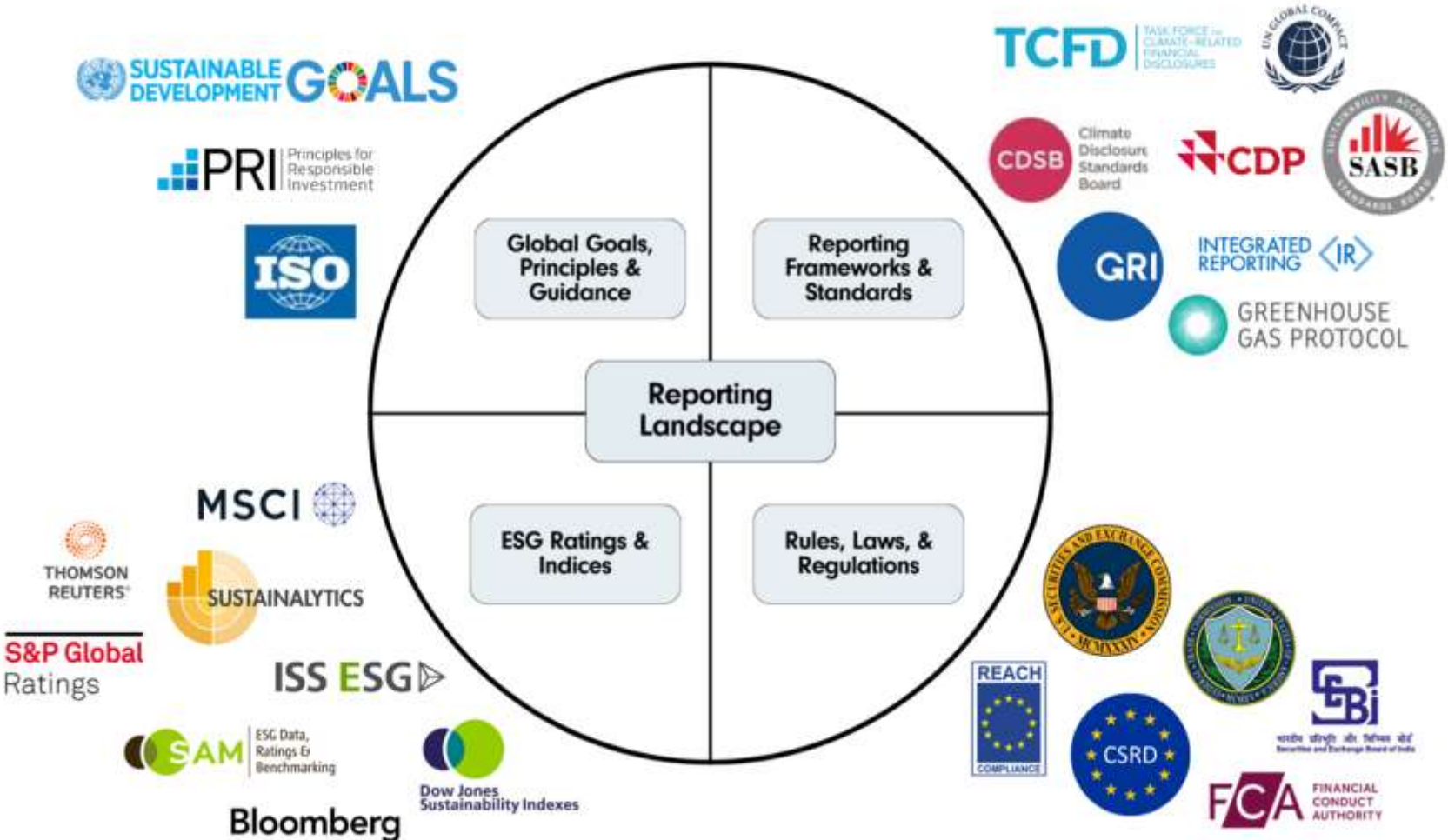
Disclosures – Mandatory and Voluntary



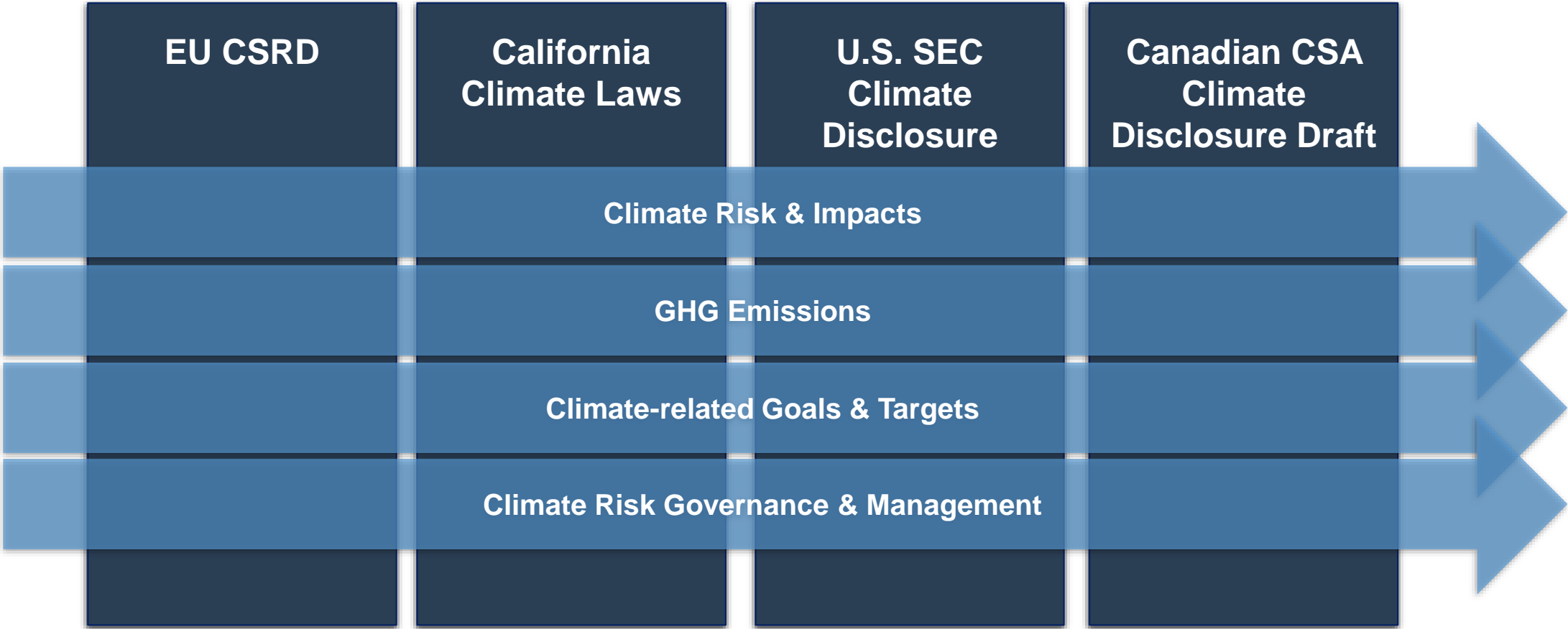
What are ESG disclosures and why do they matter?

A dramatic landscape of a glacier lagoon. The foreground is filled with numerous large, jagged icebergs of various shades of blue and white, floating in the water. In the middle ground, a small boat with several people is visible, navigating through the ice. The background features a large, dark mountain range under a sky filled with heavy, golden-brown clouds, suggesting a sunset or sunrise. The overall scene is majestic and somewhat somber, reflecting the environmental theme of the text.

Regulatory and Voluntary Reporting and Rating Frameworks



Environmental Disclosures



SEC's Climate Disclosures Rule, in a Nutshell



Government Contractor Climate-Risk Proposal

- Applicability thresholds
 - “Significant” Contractors
 - “Major” Contractors
- GHG reporting requirements – CDP/TCFD
- Target-setting mandates – SBTi



EU Regulation

- CSRD (Corporate Sustainability Reporting Directive)
 - Broad sustainability disclosures (beyond climate)
 - Applies to companies based on size, not listing status
 - Phase-in starting Jan. 1, 2024

- Deforestation-Free Products Regulation



The Corporate Sustainability Reporting Directive (CSRD)



The **Corporate Sustainability Reporting Directive (CSRD)** was proposed by the European Commission in April 2021 as an initiative to further develop corporate ESG reporting in the EU



Reporting will be based on the concept of **“double materiality”**

The CSRD will amend the existing EU ESG reporting requirements under the **Non-Financial Reporting Directive (NFRD)**, by both significantly expanding the number of companies subject to the rules and introducing considerably more detailed reporting requirements



CSRD is a Directive – therefore implementation (including scope) may differ across EU jurisdictions – this will be determined as the CSRD gets transposed into domestic legislation – Member States have 18 months to complete such transposition (July 6, 2024)



The wide scope (including in relation to certain non-EU companies) and significant reporting requirements (including a requirement to receive third party assurance) have led to considerable interest in CSRD compliance among investors and corporate leaders worldwide



EU Parent Companies will likely be required to report on behalf of their entire group

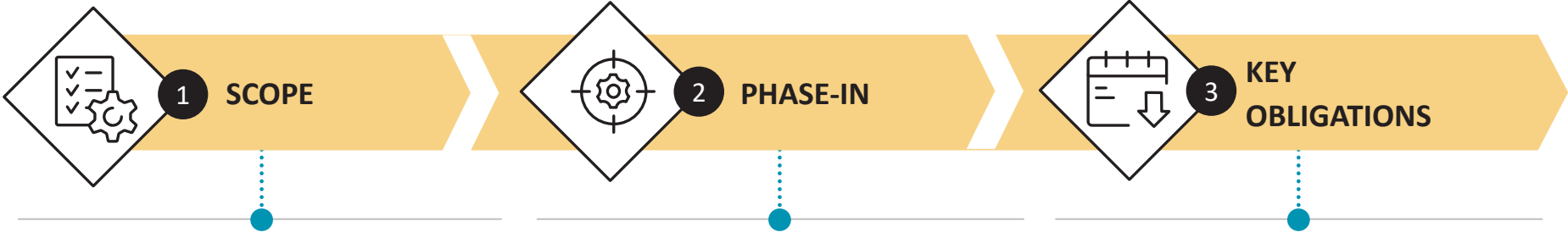
The CSRD came into force in January 2023, although the substantive requirements will only begin to impact companies later



Companies within the scope of the CSRD will also be required to report on their Taxonomy-alignment pursuant to Article 8 of the Taxonomy Regulation



CSRD Overview



- Companies fulfilling 2 out of 3 criteria:
 - > 250 employees
 - > €40m global annual turnover
 - > €20m balance sheet total
- All companies (also SMEs) listed on regulated markets
- EU-based branches and subsidiaries of companies registered in non-EU countries generating a net turnover of €150 million in the EU

- 1 January 2024 for companies already subject to the Non-Financial Reporting Directive (NFRD)
- **1 January 2025 for large companies presently not subject to the NFRD**
- 1 January 2026 for listed SMEs
- 1 January 2028 for EU-based subsidiaries/branches of non-EU companies

- Report on sustainability issues (i.e. environmental, social and human rights and governance factors)
- Double materiality
- All reporting in one place (management report)
- Consolidated report for the group is possible
- Reporting must be certified by an accredited independent auditor or certifier

Specifications of these obligations in European Sustainability Reporting Standards (ESRS)

Government and Private Enforcement

- SEC & Shareholder Enforcement

- Sending letters to issuers relating to potentially inadequate disclosures regarding climate change-related risks
- Enforcement suit against international company for alleged safety misstatements
- Settlement with BNY Mellon for alleged misstatements and omissions about ESG considerations in mutual funds
- P&G/NRDC

- NGO Activism

- Board-oversight claims
- Climate accountability
- Litigation Funding



Marketing/Substantiation



Why Be Concerned About ESG Claims?

- Governments are stepping up enforcement
- Consumers, watchdog groups, and class action litigators are bringing lawsuits
- Governments are updating regulations in this space
 - EU, US, UK and others are all updating major guidance



Greenwashing Enforcement/Litigation (selected examples)

- **20 Airlines** targeted by the EC based on their sustainability claims
- **Zalando** forced by the EC to overhaul sustainability claims
- **ASOS, Boohoo, and George at Asda** forced by the UK to overhaul sustainability claims **Delta Airlines** class action lawsuit over carbon neutrality claims
- **Exxon** sued by NY AG alleging false and misleading climate disclosures
- **Starbucks** sued over allegedly misleading ‘ethical sourcing’ claims
- **Coca-Cola** sued for statements about climate goals and recycling claims
- **Lufthansa & Etihad Airways’** environmental/sustainability claims and **HSBC’s** “net zero” claims banned by UK’s advertising watchdog
- **Kohl’s and Walmart** settle FTC greenwashing challenge for \$5.5 million



Common green claims concerns (topline takeaways)

- Consider all reasonable takeaways
- Evaluate language, visuals, context, and total presentation
- Carbon claims warrant close scrutiny (“net zero,” “carbon-neutral,” “clean energy”)
- Do not use vague terms like ‘eco’, ‘responsible’, or ‘sustainable’
- Provide clear and specific information/claims (‘organic’ or ‘recycled’)
- Remove misleading environmental/natural icons/imagery (such as a leaf or a tree)
- Ensure claims are based on aspects which are significant for the environment



FTC Green Guides (being updated): What's Covered

- **General Environmental Benefit Claims** such as “green” and “eco-friendly.”
- **The Use of Seals and Certifications** that provide (or appear to provide) an endorsement of the environmental bona-fides of a product or service.
- **Claims About the Waste**, such as “degradable,” “compostable,” and “recyclable.”
- **Claims About Impact or Toxicity of Product Use**, such as “non-toxic,” “chlorine-free” and “ozone-friendly”
- **Claims About the Impact of Manufacturing**, such as “made with recycled content,” “made with renewable materials,” “made with renewable energy,” and “carbon neutral”



FTC Update of the Green Guides

- FTC reviewing and (eventually?) updating Green Guides
 - In December 2022, the FTC launched its Green Guides review and requested public comment

Comments Requested on Specific Claims:

- Carbon Offsets and Climate Change
- “Recyclable”
- “Recycled Content”
- “Compostable”
- “Degradable”
- “Ozone-friendly,”
- “Organic,”
- “Sustainable”
- Energy and Efficiency Terms



EU Green Claims Directive (being updated) – what does it require?

Greenwashing: a problem for EU consumers



of green claims on products and services make **vague, misleading or unfounded** information



of claims have **no supporting evidence**



Consumer trust in green claims is **extremely low**

- Empowering the Consumer in the Green Transition (“ECGT”):
 - Changes to the Unfair Commercial Practices Directive on sustainability claims.
 - Displaying a sustainability label not based on a certification scheme /not registered as a certification mark or not established by public authorities = unfair.
 - Making a generic environmental claim for which the trader is not able to demonstrate recognised excellent environmental performance = unfair.
 - Making an environmental claim about the entire product when it concerns only a certain aspect of the product = unfair.
 - Green Claims Directive (“GCD”) mandates:
 - Specific substantiation of explicit environmental claims & comparative explicit environmental claims
 - Requirements for environmental labelling schemes
 - Verification and certification of the substantiation and communication of environmental claims and environmental labelling schemes

Specific Environmental Benefit Claims

- Advertiser must have **competent and reliable evidence** for claimed environmental benefits.
 - “[C]onducted and evaluated in an objective manner by qualified persons” and “are generally accepted in the profession to yield accurate and reliable results.”
 - “[S]ufficient in quality and quantity based on standards generally accepted in the relevant scientific fields”.
- Don’t imply a benefit is significant if it provides little benefit.
- Look beyond the product or packaging to the life-cycle.



Claims Must Be Narrowly Tailored

- Web app feature called “Real Foodprint”
- NAD determined that Chipotle could not support implied claims about individual consumer’s impact.
- NAD also found claim that Chipotle “[r]educed Carbon Emissions: from farm to foil, we’re reducing greenhouse gas emissions by optimizing our supply chain, compared to conventional ingredients” was unsupported.



“Sustainable”

- Sustainability claims can include economic, social, and environmental considerations.
- EU/UK enforcement efforts repeatedly target this claim as broad/vague
- Not specifically defined by the FTC Green Guides – concerns that defining sustainability is virtually impossible.
- FTC considering guidance for Green Guide updates



“Carbon neutral,” “Net Zero,” Carbon Offset

- The FTC defines “carbon neutral” as “generally describ[ing] an entity whose greenhouse gas emissions net to zero”
 - Such claims lean on carbon offsets
 - Existing FTC guidelines provide some guidance (e.g., avoid double-counting; reliable scientific and accounting methods required, etc.)
- Expect these claims to become much harder to make
 - France and California have passed laws targeting these claims
 - FTC and EU considering disclosure obligations
 - Requiring more (impossible?) disclosures



Sustainability Labels Recommendations?

Recommendation to consider the following:

- Use reputable third-party certifiers.
- Consider inputs and production processes.
- Examine the supply chain; get enforceable certifications regarding content.
- Create written, auditable standards.
- Apply standards rigorously and without exception.
- Periodically audit and update to reflect current science/practices.
- Create consumer-understandable logo and communications compliant with FTC Green Guides.



Made with Renewable Energy

- Don't make unqualified renewable energy claims if any significant part of the manufacturing energy source is powered by fossil fuels *unless* those fossil fuels are offset by Renewable Energy Certificates (RECs).
- Specify source of the renewable energy.
- Avoid double counting.



“Ozone-Safe” and “Ozone-Friendly”

- According to FTC regulations, “It is deceptive to misrepresent, directly or by implication, that a product, package, or service is safe for, or friendly to, the ozone layer or the atmosphere.”



Greenwashing/Consumer Protection Litigation & Regulation

- Trend: Increase in climate-related claims actions
 - *Evian* – “carbon neutral” claim
 - *Multiple Airlines* – “carbon neutral” and other claims
- Not just greenwashing:
 - *Starbucks* – “100% ethical sourcing” claim
 - *U.S. Gov’t’s focus on human rights issues in supply chains* (UFLPA etc.)
- Consumer Protection Goes Anti-ESG: *Tennessee v. Blackrock*
 - *Alleges that BlackRock made false or misleading representations to Tennessean consumers regarding the extent to which ESG considerations affect BlackRock’s investment strategies in violation of Tennessee’s consumer protection law*



Tools of the Trade



ESG Impacts on Corporate Issues

- Sustainability clauses and terms and conditions in contracting and lending.
- ESG's prominence in due diligence in M&A and commercial transactions.
- Trends in Board engagement, increased focus on ESG matters and Board oversight role and risk management.



Additional Trends and Developing Issues

- ESG Data – increased scrutiny
- Compensation of Executives
- Impact on Tech Companies – SVB and Crypto Collapse
- Green Energy
- Human Capital & Chief Sustainability Officers
- M&A due diligence



Intersection with Insurance

- New risks require new assessments, products, and coverage decisions
- Risks to Insureds
 - Fossil-fuel resources (e.g., coal, oil & gas)
 - D&O liability
 - Citizen/shareholder suits – greenwashing, human rights, product liability
 - Increased costs or lack of coverage due to increased climate and flood risks
- Risks to Insurers
 - Increased demands for defense/indemnification
 - Challenges in risk quantification – inadequate modeling and tracking
 - Investor/lender pressure
 - Climate-financial risk of portfolio – stranded assets, human rights
 - Inconsistent/overlapping/duplicative global regulatory requirements



How Companies Implement Sustainability



Carbon-reduction Initiatives



THE Paris...
CLIMATE 10 years
PLEDGE Early



20
40

Net Zero Carbon
Deploying our
technology and people
to reach net zero carbon
across our business by
2040.

Supply Chain/Forced Labor Due Diligence



Supply Chain Contracts – Evolving Policies

- Supply Chain Agreements and Assessment
- Due Diligence on Vendors/Suppliers
- Key Supply Chain Clauses
 - Forced Labor
 - Environmental
 - Others
- Vendors/Suppliers Code of Conducts/other Policies
- Chancery Lane Project



Supply Chain: Looking around corners

- Growing expectations regarding supply chain due diligence
 - Requirements in EU, California and other jurisdictions
- How well do you know your supply chain? And where does it lead?
 - Knowing only first tier suppliers is not enough
 - Claims of supply chain complexity will not insulate you
- Environmental issues, not just forced labor
 - Requirements for due diligence for forestry issues (legality, deforestation-free requirements)
 - Increasing need to understand carbon in your supply chain
 - Responsibility for PFAS and other ingredients
 - Some issues where env't and human rights overlap (e.g., soy, fisheries, forest products)



Supply Chain: Looking around corners

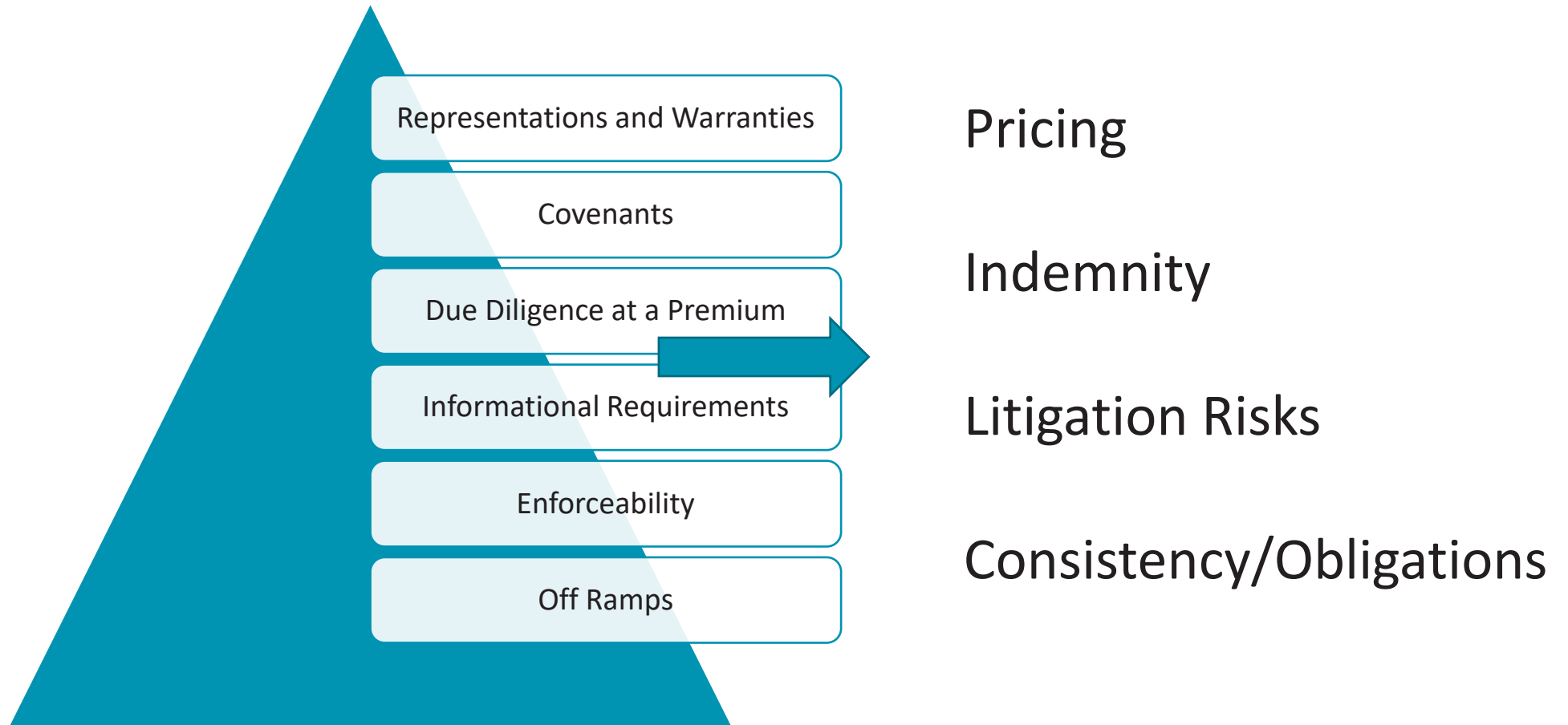
- What claims are you making that may prove problematic?
 - E.g., Starbucks – “100% ethical sourcing” lawsuit
 - Have you thought through how you will respond to the tough questions? Or what the tough questions even are?
- Do you have the right contracting in place with your supply chain
 - Ownership and shipping issues
 - Liability allocation
 - Information disclosure requirements



ESG Due Diligence in Transactions



Customer Contracts - Practical Considerations



Board Involvement



Collaborating with Competitors (Antitrust)



Questions?



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EXTRA – DO NOT USE

Anti-ESG, the States, and Congress



The States and ESG – 2023

- Anti-ESG:
 - Restrictions on Pension Investments
 - Anti-“Boycott” Bills
- Pro-ESG:
 - Requirements to consider ESG factors, integrate sustainability principles into investment decisionmaking
 - Climate-specific bills



The U.S. Congress and ESG – 2023

- The U.S. House

- House Republicans are introducing anti-ESG legislation
- House Republican led committees are starting Congressional Investigations/Inquiries
- Passed a CRA Resolution to overturn a Biden DOL Rule
- Failed to overturn a Presidential Veto of the CRA Resolution
- Financial Services Committee created Republican ESG Working Group
- Republicans blamed the SVB bank collapse on “woke” policies like ESG

- The U.S. Senate

- Passed the House CRA Resolution to overturn a Biden DOL Rule
- Republicans wrote to the SEC objecting to a proposed Climate Disclosure Rule

- The Future

- ESG is going to be a Republican v. Democrat issue for rest of 2023 and 2024
- More House Republican Committee ESG investigations expected



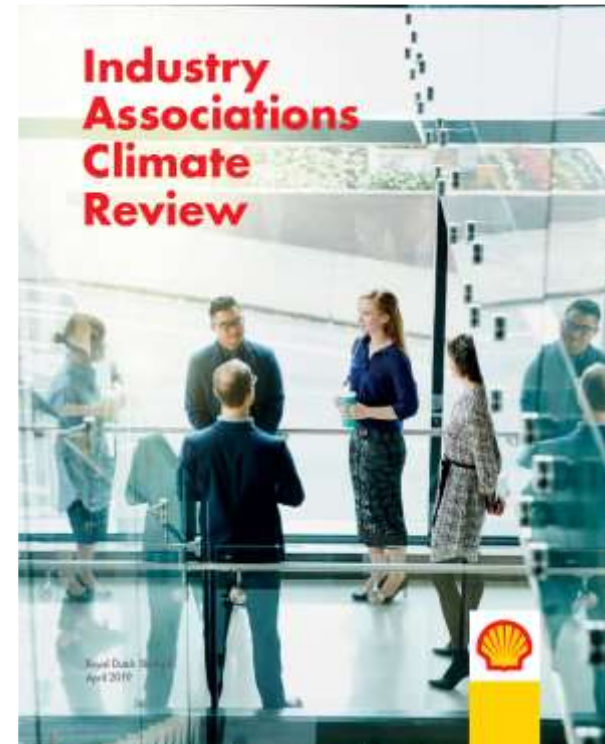
Congressional Oversight – Lobbying

- Lobbying Disclosure Act
 - “Lobbyists” required to register with Congress and file publicly available reports of lobbying activities
 - LDA filings and lobbying activity of corporations has become an area of focus for pro/con ESG groups
- Potential areas of interest by Congress and watchdogs:
 - Identification of specific lobbying issues: Alignment with company values and statements?
 - Use of former political officials and senior staff: Revolving door with political officials?
 - Reporting of affiliates, associations, and coalitions: Do trade associations reflect company values and ESG statements?
 - Amount of lobbying expenses: Ban on contractors and grant recipients using federal money for lobbying; heightened scrutiny of recipients of Bipartisan Infrastructure Law funding.
 - Semiannual report of certain political contributions: Scrutiny of donations to the 147 (now 129) Republicans who objected to certifying 2020 election.
 - Foreign ownership or involvement in lobbying: Focus on China & Russia influence and business ties.



Congressional Oversight – Lobbying

- Do actions match ESG rhetoric?
- Do lobbying disclosures align with company policy statements?
- Do trade associations reflect company values?
- Common areas of inquiry:
 - Climate science
 - Bans on financial lending to fossil fuels
 - Net-zero ambitions
 - Paris climate accord
 - Carbon tax or price
 - Diversity and inclusion employment practices
 - Customer practices
 - Litigation positions reflect ESG values



Congressional Oversight – Governance

- How is Congress Responding?
 - Depends on House vs. Senate
 - Republicans threaten investigations of ESG supporters; Democrats using Senate majority to defend ESG

The Intercept

HOUSE REPUBLICANS PLAN TO INVESTIGATE CHAMBER OF COMMERCE IF THEY TAKE THE MAJORITY

Today's GOP war on the U.S. Chamber of Commerce represents a stunning turnaround from just a few years ago.

Chuck Schumer 
@SenSchumer

The House GOP is resurrecting their doomed attempt to prevent retirement investors from considering governance ESG factors when making decisions

They talk about the free market, letting the private sector do its work—but their obsession with eliminating ESG would do the opposite

1:40 PM · Mar 23, 2023 · 32.4K Views

Republicans plan legislative assault on 'woke' ESG firms

By Nick Sobczyk | 04/07/2022 04:23 AM EDT



Congressional Oversight - Investigations

- **House Financial Services Committee**
 - Created an ESG Working Group to coordinate committee’s oversight of ESG
 - Being led by Rep. Bill Huizenga, the Chair of O&I Subcommittee
 - Targeting SEC climate disclosure rule; expect CRA disapproval vote
- **Senate Budget Committee**
 - Chaired by Sen. Sheldon Whitehouse
 - Focused on climate change
 - Expected may continue House Oversight probe of “big oil” role in climate disinformation
- **Senate HELP Committee**
 - Chaired by Sen. Bernie Sanders
 - Oversight of labor practices at Starbucks; subpoena threatened for CEO Schultz to testify



Congressional Oversight – Legislation

- ESG-Focused Legislation

- 118th Congress:

- Congressional Review Act: Disapproval of DOL Rule on ESG in retirement plans
 - Passed House 216-204 with one Democrat supporting (Rep. Golden of ME)
 - Senate passed 50-46 with two Democrats supporting (Sen. Tester of ID and Sen. Manchin of WV)
 - President Biden vetoed disapproval resolution to save rule
 - New Anti- ESG Bills Being Introduced – i.e. Advisory Committees Free of ESG Act of 2023 etc.

- 117th Congress:

- Climate Risk Disclosure Act
 - No ESG at TSP Act
 - Paris Climate Agreement Disclosure Act
 - ESG Disclosure Simplification Act
 - Corporate Governance Improvement and Investor Protection Act
 - Lobbying Disclosure Improvement Act
 - The INDEX Act
 - The Mandatory Materiality Requirement Act



U.S. Permitting & Incentives

- Prioritizing Environmental Justice
 - EPA: Increasing inspections in EJ areas; focusing enforcement resources
 - Interior: Elevated opportunities for underserved communities to participate in NEPA processes (including tribes); managing lands for subsistence
- 40x40 Initiative
- Inflation Reduction Act

