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Survey: Companies Preparing to Comply with SEC's Proposed Climate Disclosure Rule Even Though Not Final

April 7, 2023

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According to a new survey, most large companies are preparing to comply with the Securities and Exchange Commission's (SEC) **proposed climate disclosure rule** even though it is not final, but many business leaders are concerned about having adequate resources to do so. Workiva and PwC surveyed 300 executives at U.S.-based public companies with at least $500 million in annual revenue. The resulting report, "**Change in the Climate**," released earlier this year, revealed that most companies already have implemented some environmental, social, and governance (ESG) reporting and plan to voluntarily disclose ESG data, but "are not yet fully prepared to meet the expected disclosure requirements" of the new rule.

The proposed disclosure rule has been the subject of **substantial commentary** since it was introduced last year. In short, it would **require companies** to include certain climate-related information in their registration statements and periodic reporting (e.g., Form 10-K), including climate-related risks and opportunities and their actual or likely financial or operational impacts; governance concerning risks and opportunities arising from climate change; greenhouse gas emissions data, which in certain cases would be subject to third-party assurance; and climate targets and goals, and green transitions plans, if any. The SEC received so many comments on the proposed rule—nearly 15,000—that the agency pushed back the release of the final rule until April, which, the SEC has **signaled**, may reflect changes from the initial proposal based on the comments.

The "Change in the Climate" report indicates that 89% of companies responding already are reporting some ESG data, and 70% of executives responded that they will commence compliance regardless of when the regulation is finalized. Nearly all executives surveyed said they will obtain independent third-party assurance (a requirement in the proposed rule for Scope 1 and Scope 2 emissions data) to manage risk and meet the rule's requirements, whether required by the final rule or not. According to the survey, 70% of executives responded that they already use independent assurance and would continue to do so.

Nonetheless, companies anticipate significant compliance costs and challenges. Appropriate technology was by far the greatest concern. Nearly all (97%) of those surveyed acknowledged that technology will play an important role in climate assessment and disclosure, but most (85%) also responded that their organizations currently lack that technology. The concern

seems to be well placed, considering that nearly one-third (32%) of respondents state that their company is not currently utilizing technology to assist with their ESG reporting, and only 40% report that their company has made any investment in ESG reporting technology.

The situation appears similar in terms of human resources, with 36% of the executives indicating that they do not believe their companies are staffed appropriately to meet the rule's requirements. Cost was also a concern, with more than half (61%) saying they believe compliance with the SEC rule, whenever effective, will cost upwards of $750,000 in the first year, which is more than the $640,000 estimate provided by the SEC. More than a quarter (27%) of respondents estimate spending more than $1 million on compliance.

Taking the Temperature: Like most climate-related issues in the U.S., the SEC's proposed climate disclosure rule has engendered controversy and sparked threats of litigation. As we previously reported, Patrick McHenry, the Chair of the House Financial Services Committee, announced the establishment of a nine-person Republican ESG Working Group to "combat the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals." In a February 22 letter to SEC Chair Gary Gensler, McHenry, Tim Scott (Ranking Member of the Senate Committee on Banking, Housing and Urban Affairs) and Bill Huizenga (Chairman of the Subcommittee on Oversight and Investigations of the House Committee on Financial Services) asserted that the SEC lacks authority to issue the proposed rule.

But existing regulations in Europe and Asia and, arguably, current disclosure requirements under U.S. securities laws already require disclosure of certain of the information covered by the proposed rule. The proposed rule, like disclosure regimes that have been implemented in other jurisdictions, adopts many of recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD"). Therefore, companies with operations outside of the United States likely already are in the process of or preparing to collect, analyze, and report on information that is subject to the SEC rule. With respect to existing U.S. reporting requirements, some commentators contend that existing materiality-based disclosure requirements are adequate to cover climate change issues, obviating the need for specific climate guidance. However, as we have indicated, whatever the content of the final SEC rule, the current Chair and Staff have articulated their views on required disclosure, and companies ignore that guidance at their peril, at least with respect to the many "traditional" areas of corporate operations and performance addressed by the proposed rule and which already typically are subject to disclosure, including aspects of governance, risk and opportunity assessment, and actual or anticipated material financial impact.

EU Aims to Reduce Net Emissions and Protect Biodiversity through Adoption of Carbon Sinks Goal

April 7, 2023

By Duncan Grieve
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On March 14, 2023, the European Parliament gave its final approval for member nations to implement stricter national targets relating to emissions reduction and the protection and expansion of CO2-absorbing natural ecosystems known as "**Carbon Sinks**." The new targets are part of a **broader package** of legislative proposals setting out how the EU intends to achieve carbon neutrality by 2050 and also aims to promote biodiversity in line with the European Green Deal.

The EU 2030 targets are set out in **proposed amendments** to EU Regulation 2018/841. They apply to net greenhouse gas removals in the land, land use change and forestry sector (LULUCF). The targets aim to compel EU Member States to improve natural carbon sinks and reduce greenhouse gases, with sanctions for non-compliance. Targets are imposed for each Member State based on GDP per capita and cost-effectiveness. Member States will be required to ensure that they do not exceed their GHG emission allocation for the LULUCF sector across a four-year budget period running between 2026-2029.

Under the proposed targets, Member States will be required to undertake corrective action if progress towards their target is insufficient. The proposals will allow Member States to trade emissions credits under existing frameworks including the Effort Sharing Regulation. The accompanying press release states that, "monitoring, reporting, and verification of emissions and removals will be improved, including by using more geographical data and remote sensing, so that EU countries' progress towards achieving their targets can be followed more accurately."

The law has to be formally endorsed by European Council, and then will be published in the EU Official Journal and "enter into force 20 days later."

Taking the Temperature: The proposed EU legislation represents a continuation of the EU's ongoing legislative program aimed at achieving carbon neutrality by 2050. The development is notable because, although it is primarily focused on emissions-reduction, it also requires EU Member States to consider biodiversity and climate issues jointly by encouraging the preservation of CO2-absorbing natural ecosystems (such as forests). The incorporation of biodiversity preservation in emissions reduction aligns with the EU's biodiversity strategy for 2030. As we have reported, while for years climate change mitigation and adaptation drew the lion's share of attention, in recent years legislators, regulators, NGOs and companies have increasingly been taking biodiversity impacts into account, recognizing the nexus among climate change, the resulting impacts on nature, and the corresponding actual or potential effects on business.

This increased nature-related focus accelerated as a result of the Kunming-Montreal Global Biodiversity Framework (GBF) agreed to at the December 2022 United Nations Biodiversity Conference (COP15) in Montreal, Canada. Among other things, the GBF commits participating countries to protect at least 30% the planet’s lands, inland waters, coastal areas and oceans by 2030 (known as the “30x30” target). Also last year, Sylvie Goulard, Deputy Governor of the Banque de France, the French central bank, stated that central banks need to take more aggressive action regarding nature-related risk. And, in November 2022, the Global Reporting Initiative (GRI) launched a consultation on the latest draft of their biodiversity disclosure standard which is expected to be published in the second half of 2023.

Dow Jones Announces Changes to Sustainability Index

April 7, 2023

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On December 9, 2022, S&P Dow Jones Indices (DJI) **announced** the results of its **2022 Dow Jones Sustainability Indices (DJSI) Annual Review**.

The top five worldwide additions by market capitalization added this year are: energy and petroleum multinational, TotalEnergies SE; Canadian Pacific Railway Limited; ratings agency, Moody's Corporation; energy exploration and production company Hess Corporation; and chemicals company, Dow Inc. The top five worldwide deletions by market capitalization are: the construction equipment manufacturer, Caterpillar Inc.; pharmaceutical and healthcare company, Sanofi S.A.; aerospace and defense technology company, Northrop Grumman Corporation; Zurich Insurance Group AG; and metals and mining company, Rio Tinto Group. All decisions are made pursuant to the **Dow Jones Sustainability Indices Methodology**.

Launched in 1999 as the first series of global sustainability benchmarks, the DJSI are float-adjusted, market capitalization-weighted indices that measure selected companies' sustainability performance using ESG criteria, including publicly available data information and "continuous controversy monitoring" of constituent companies.

In addition to the DJSI World, S&P Dow Jones also publishes regional and country sustainability indices, covering North America, Europe, Asia Pacific, Latin America, Korea, Australia and Chile, as well as an emerging markets index.

Taking the Temperature: According to DJSI, more organizations than ever before participated in the 2022 CSA, perhaps reflecting the significant and growing importance placed by multinational companies on obtaining and maintaining recognized sustainability-linked ratings both for attracting investment and broader business reputation. The addition of TotalEnergies is noteworthy given the controversy sparked by its new planned pipeline, which would run from Uganda to the Tanzanian coast passing through many acres of farmland and the Murchison Falls National Park, a habitat that is dense with animal life. We recently reported on a French court's decision to dismiss an action filed by six French and Ugandan NGOs aiming to force the suspension of the project. The NGOs based their case to suspend the pipeline project on Article L. 225-102-4.-I of the French Commercial Code, the Corporate "Duty of Vigilance Act," which requires companies to establish a "Vigilance Plan" to "identify and

prevent risks of severe violations of human rights and fundamental freedoms, health and safety of people and to the environment in their entire sphere of influence."

In a longer article published in October, we analyzed the decision to drop Tesla Inc. from the S&P 500 ESG index and used this as a point of departure to survey the ESG ratings marketplace and the ranking criteria used by leading ratings providers to arrive at their ESG scores. The article highlights significant issues with the existing ESG ratings marketplace. First, the fact that ratings providers use different methodologies often results in assigning divergent rankings to the same company. Second, a number of ratings providers group "E" and "S" together, or, at times, all of the different issues within each of these categories, which can obscure the rationale for a particular company's rating. The at times low correlation among ranking scores, the lack of granular information as to the basis of the rating, and, more generally, concerns around the transparency of ESG ratings processes have led some to question the value, or how to best make use, of ESG ratings.

There are concerns that sustainability ratings also suffer from a comparable lack of transparency. In the case of the DJSI, organizations that opt not to submit data through the CSA are evaluated on publicly available data. This potentially introduces bias in that companies choosing to participate will likely volunteer more favorable data to improve their results.

Regulators increasingly recognize the importance of the ESG-ratings marketplace and its various issues. Accordingly, authorities in the U.S., UK and EU are starting to develop rules in this area. In the U.S., the Securities and Exchange Commission (SEC) announced its plans to standardize climate-related disclosures by public companies which, it is hoped, will have a positive knock-on impact on the accuracy of ESG ratings, as we have discussed. In the EU, the European Securities and Market Authority (ESMA) is considering increased regulation of the ESG ratings sector. In the UK, the Financial Conduct Authority (FCA) has opined that low correlation among ESG ratings is not, in itself, harmful, provided that ratings providers are transparent about their methodology and the data they use and have robust governance processes. We have previously discussed that the FCA also created a group to develop a voluntary Code of Conduct governing ESG data and ratings providers to bring about greater transparency. The Board of the International Organization of Securities Commissions (IOSCO) has also published recommendations for ESG ratings providers. Industry bodies such as the International Financial Reporting Standards Foundation launched the International Sustainability Standards Board, with the aim of delivering a "comprehensive global baseline of sustainability disclosures focused on the needs of investors and the financial markets."

NGOs Urge EC Not to Label Certain Agriculture and Livestock Practices as Sustainable

April 7, 2023

By Sukhvir Basran
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On March 8, 2023, 25 organizations **wrote** to the European Commission concerning its treatment of agriculture in the forthcoming Taxonomy Delegated Act, urging them to follow the advice published by their own expert group. The signatories "urge the [EC] to closely follow the advice of its expert group in producing an EU Taxonomy on agriculture particularly as regards the benefits of integrated crop-livestock production that does not lead to agriculture expansion."

In October 2022, the EC's expert group, the **Platform on Sustainable Finance (PSF)** published **technical screening criteria**, adding to its earlier March 2022 proposals, under the EU taxonomy to decide which animal production practices make substantial contributions to biodiversity and ecosystems. The PSF comprises 35 members and 14 observers and "brings together world leading sustainability experts across all stakeholder groups: private stakeholders from financial, non-financial and business sectors, NGOs and civil society, academia and think tanks, experts in personal capacity, as well as public and international institutions."

The letter asserts that it "is vital that the taxonomy Delegated Act does not recognize industrial livestock production as an environmentally sustainable economic activity" because it "causes substantial environmental harms both in the vicinity of the farm and through the upstream activities of producing cereals . . . to feed the animals." The letter goes on to state that certain practices lead to "soil degradation, biodiversity loss, overuse and pollution of water, as well as air pollution."

The letter highlights the import of soybeans for purposes of animal feed and its connection with deforestation. A **recent study** indicates that global food consumption may add almost 1°C of warming by 2100, primarily driven by high methane emissions, particularly from certain products such as beef, lamb and dairy. The letter concludes by stating that if the EC is not prepared to "fully align with the PSF proposal, we would prefer there to be no Delegated Act on agriculture than a greenwashed one."

Taking the Temperature: Classifications of certain products or industries within sustainability taxonomies remain controversial. For instance, the EC Taxonomy characterizes gas-fired power and nuclear energy as sustainable, and last month, the UK government announced that nuclear power would be classified as environmentally sustainable in the UK's green taxonomy. The UK has also announced, in December 2022, a delay in the implementation of its taxonomy following stakeholder engagement and in light of the complexity inherent in the taxonomy. However, notwithstanding disparities among different countries' taxonomies and controversies over classification decisions, taxonomies are critical to help companies and investors to understand what businesses

or products are consistently deemed sustainable among different jurisdictions. As a result, efforts will continue globally to advance sustainability taxonomies and, we anticipate, ultimately to harmonize classifications at least among countries where the world's major business centers are located.