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CLIMATE
Connecting Climate Change and the Law

April 28, 2023

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The "Pro-ESG" Empire Strikes Back

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Senior finance officials from 18 states, as well as hundreds of investors, public and private companies and climate-focused nonprofits, **joined together** to urge policymakers to reject efforts by certain, primarily Republican state and federal legislators to preclude consideration of ESG factors in investment or company decision-making. Led by the financial industry climate group **Ceres**, the signatories to the investor/company letter state that they "remain wholly committed to sustainability and addressing the financial impacts of climate change because we factor relevant considerations in our business, investment, and risk management decisions that have a material impact on our own operations and investments." They add that "climate change poses a threat to the safety of our communities and the long-term value creation of the economy, and addressing its risks upholds investors' fiduciary duty." Taking on directly the "anti-ESG" side of the discussion, the signatories write that "our consideration of material environmental, social, and governance (ESG) factors is not political or ideological. Incorporating these issues into financial decision-making represents good corporate governance, prudent risk management, and smart investment practice consistent with fiduciary duty. We factor financially material considerations, including the impacts of climate change, into our standard investment and risk management decisions, in order to protect our operations and our investments."

The state finance official letter adopts a similar position, arguing that "blacklisting financial firms" based on their consideration of ESG factors "reduc[es] competition and restrict[s] access to many high quality managers," which will impose "real costs that ultimately impact" taxpayers. According to these signatories, states that adopt such an "anti-ESG" approach "refuse to acknowledge, in the face of sweltering heat, floods, tornadoes, snowstorms and other extreme weather, that climate change is real and is a true business threat to all of us." The better course, they say, is "disclosure, transparency, and accountability," which "make companies more resilient by sharpening how they manage, ensuring that they are appropriately planning for the future," including by evolving their business models and their internal processes to "better address the long term material risks that threaten their performance."

Taking the Temperature: The consideration of ESG factors, and in particular climate-related issues, by companies, asset managers, investors and other capital market participants has become the subject of much controversy, as well as litigation in the United States, mostly along partisan lines. As the Freedom to Invest site notes, and as

we have commented on previously, Republican lawmakers in states across the country have introduced legislation to prohibit consideration of ESG factors in making business, legal and investment decisions. In January, 25 Republican state attorneys general, along with two energy companies, also filed suit seeking to invalidate the U.S. Department of Labor (DOL) "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" rule permitting (but not requiring) retirement plan managers to consider climate change and other ESG factors in their investment decisions. And, last month, the Republican governors of 19 states announced an alliance aimed at "push[ing] back against President Biden's environmental, social, corporate governance (ESG) agenda that is destabilizing the American economy and the global financial system." In their joint statement, the governors specifically mentioned the DOL rule and President Biden's then-intention (which he subsequently acted on) to veto H.J. Res. 30, the congressional measure to repeal the rule.

The partisan fighting has made its way to Congress, of course. In addition to H.J. Res. 30, House Republicans have established 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." The group was formed in part as a response to the establishment of the Democrat-led Congressional Sustainable Investment Caucus in January.

While we do not foresee a quick resolution of this debate, we have observed certain cracks forming in the strictly partisan nature of the discussion. Recently, officials in certain Republican-controlled state governments have pushed back against proposed legislation or other efforts to penalize financial institutions in connection with ESG-related issues. Likewise, echoing points made by the state finance official letter, the Kansas Public Employees Retirement System recently urged state legislators to reject key aspects of "anti-ESG" bills as both unnecessary and costly to plan participants. The Indiana Chamber of Commerce recently adopted a similar stance.

In our view, corporations and financial institutions will benefit from the depoliticization of ESG so that they can freely determine the underlying factors and criteria that are material to governance and management of the company (for a board) or investment decisions and analysis (for an asset manager). Companies need to consider and report on material risks, developments and opportunities, whether arising from climate issues, social impact movements, or other forces. Asset managers need to consider those same issues when making investment decisions as well as reporting on the sustainability characteristics of their investment portfolios – issues that have put them at the forefront of calling for greater issuer disclosure on ESG-related matters.

Only 5% of FTSE 100 Have "Credible" Net Zero Plans, Says Report

April 28, 2023

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A **new report** by professional services firm EY has found that only 5% of FTSE 100 companies have disclosed "credible" and sufficiently detailed transition plans to become net zero by 2050.

EY's analysis finds that while 78% of FTSE 100 firms have published partially developed net zero plans, they have not yet addressed key questions on strategy and execution. Additionally, 17% of FTSE 100 companies are still in the early stages of plan development. The report suggests that companies need to do more work before their published plans fully align with guidance from the UK's Transition Plan Taskforce (TPT). The TPT was launched by the UK Treasury in April 2022 to develop the "gold standard" for private sector climate transition plans, building on "international disclosure standards." Even among the 5% of companies that have disclosed detailed plans, many still have gaps across a range of areas such as financial planning or the publication of defined financial metrics and targets.

The **TPT Framework** outlines five key elements for creating a credible net zero transition plan: Foundation (objectives, priorities, interim targets and milestones); Implementation Strategy (a roadmap of short, medium and long-term actions to achieve stated objectives); Engagement Strategy (engagement with the company's value chain for support and feedback); Metrics & Targets (disclose metrics and targets used to assess progress towards stated objectives); and Governance (disclose arrangements for board governance over the transition plan). FTSE 100 firms scored best (with a 78% adherence) on the initial Foundation stage in the TPT Framework, which requires companies to publish transition objectives and priorities, as well as implications for business modelling. However, FTSE 100 businesses scored weakest (11%) with respect to the TPT Framework's Implementation Strategy element, which requires companies to disclose how they intend to adapt business planning and operations, as well as outline proposed changes to products and services. The report highlights the need for more detailed and actionable transition plans as the UK government is set to mandate that all UK-listed businesses and financial institutions publish decarbonization plans by later in 2023.

Taking the Temperature: We have previously discussed the TPT Disclosure Framework, including observing that companies that conduct business in multiple jurisdictions need to navigate, at times, conflicting regulatory schemes. The challenge for boards and management raised by the TPT Disclosure Framework and its analogs in other jurisdictions is to take action based on applicable guidance and manage conflicting

regulatory initiatives to the extent the company is subject to more than one regulatory scheme. Nonetheless, the TPT Disclosure Framework is likely to finalized this year, particularly given the positive feedback it received in the recently conducted “independent review of net zero and government progress towards achieving it” conducted by MP Chris Skidmore.

Relatedly, there has been increasing shareholder and regulatory activity focused on net zero-related aims that arguably are in conflict with each other: Certain shareholders have sought to require companies to articulate net zero or other carbon reduction goals, while at the same time, and in tension with those efforts, other shareholders are challenging whether companies that make net zero commitments are taking concrete steps to make those objectives realistically achievable.

To navigate successfully between this seeming Scylla and Charybdis, directors and officers should consider: (i) the establishment of processes (or the quality of how those processes function) for identifying, assessing, and making decisions regarding climate-related risks and opportunities, including risks to physical assets and transition risks; (ii) periodically testing the adequacy of these processes; (iii) even if not directly applicable, taking into account guidance in other jurisdictions regarding governance or disclosure in order achieve a best-in-class approach; (iv) carefully considering data collection and assessment issues, and (v) rigorously assessing the risks associated with potential challenges for greenwashing or, its corollary, greenhushing.

New York Congressional Delegates Urge Governor Hochul to Include Additional Clean Energy Provisions in Executive Budget

April 28, 2023

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Several members of the New York congressional delegation have **written a letter** urging Governor Kathy Hochul to amend her fiscal year 2024 budget to incorporate certain elements of the New York Build Public Renewables Act (BPRA) in order to better position New York to "benefit from additional [Inflation Reduction Act (IRA)] funding." The BPRA, recently passed by the New York Senate and included in the Senate budget proposal, outlines how [the New York Power Authority (NYPA)] "can be fully harnessed as a vehicle for climate action." At a high level, **the BPRA** would require the NYPA "to provide only renewable energy and power to customers; requires such authority to be the sole provider of energy to all state owned and municipal properties; requires certain New York power authority projects and programs pay a prevailing wage and utilize project labor agreements."

First, the letter encourages Governor Hochul to support BPRA's "comprehensive set of labor provisions," which would ensure that "green jobs are actually good jobs." The BPRA provides for retraining fossil fuel workers to transition to clean energy jobs. Workers would maintain wages, seniority and benefits during the transition process.

Second, the letter encourages Governor Hochul to include in her budget provisions requiring the NYPA to "retrofit the state's public schools and public housing by 2035, with priority for those located in disadvantaged communities." The letter explains that decarbonizing and upgrading public infrastructure of the state's public schools and housing in disadvantaged communities "represents one of the IRA's most profound opportunities to invest in communities that have been left behind, and to make President Biden's Justice40 Initiative a success," and "enhance New York's eligibility for a range of environmental justice programs in the IRA."

Finally, the letter urges Governor Hochul to "consider including BPRA's mandate for the NYPA to build renewable energy generation." In particular, the BPRA would require the NYPA to "only generate" or "purchase, acquire, plan, design, engineer, finance and construct" renewable energy generation facilities starting January 1, 2030, or have its trustees attest to a need to continue using certain non-renewable energy sources.

The letter's signatories point out that if Governor Hochul makes certain adjustments to her budget proposal, it would allow New York to maximize funding opportunities created by the Inflation Reduction Act (IRA), including its clean energy tax incentives: the Investment Tax Credit and Production Tax Credit. As a tax-exempt public entity, the NYPA can monetize incentives under the IRA's "direct pay" provisions. This provision would also ensure that New York can meet its legally mandated emission reduction goals.

Taking the Temperature: Public investment to drive development of clean energy is a hot topic globally, as evidenced by the recent passage of the Inflation Reduction Act, which includes approximately $370 billion in climate- and energy-related provisions, including $121 billion of investment and production tax credits and the establishment of a $27 billion Greenhouse Gas Reduction Fund to be administered by the Environmental Protection Agency (EPA), and the European Commission's adoption of the Green Deal Industrial Plan, which is widely viewed as a response to the IRA. The European Commission also recently has approved substantial state subsidies to support companies investing in sustainable practices.

The New York congressional members who wrote the letter to Governor Hochul emphasize that "when New York leads, the nation follows." According to the letter, New York's landmark Climate Leadership and Community Protection Act (CLCPA), enacted in 2019, helped encourage changes in federal climate policy. Proponents of the BPRA also assert that its core pillars—public ownership of clean energy, emissions mitigation, and racial and economic environmental justice—would position it as a model for other states to follow.

Climate Action 100+ Announces New Iteration of Benchmarking Program

April 28, 2023

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Climate Action 100+, a climate-focused investor initiative, last month announced an updated framework designed to help investors assess and engage with public companies on climate-related issues. Its March 23 statement announced the **upcoming launch** of the third iteration of its Net Zero Company Benchmark, somewhat confusingly named Benchmark 2.0.

Billed as an assessment tool, the Benchmark uses public data, as well as self-disclosed company information, to evaluate the efforts of 166 focus companies to achieve a net zero transition relative to three objectives: taking action to reduce emissions, implementing strong corporate governance and accountability around climate-related risk, and enhancing climate-related financial disclosures.

According to Climate Action 100+, the particular companies selected for assessment and, more to the point, for engagement by the initiative's investor signatories were chosen because they will drive the global net zero emissions transition. Generally operating in emissions-heavy industries—commercial aviation, automotive manufacturing, energy, mining or chemical manufacturing, among others—the focus companies collectively account for 80% of global corporate industrial greenhouse gas emissions. Focus companies are further classified as either one of the largest 100 greenhouse gas emitting companies globally or part of the "plus list" (more than 60 other companies that have been identified by investors as either contributing climate-related risks to investor portfolios or representing a significant opportunity to drive the transition to net zero emissions, although they are not otherwise identified by emissions data as a top emitter).

The **Benchmark** provides two different analyses for each of the companies, both of which are publicly accessible: the Disclosure Framework and the Alignment Assessments.

The current Disclosure Framework uses publicly available information to assess the adequacy of each company's climate-related disclosures relative to 10 listed "disclosure indicators" that Climate Action 100+ describes as "key actions companies can take to align their businesses with the Climate Action 100+ and Paris Agreement goals." These indicators are:

- Net zero GHG Emissions by 2050 (or sooner) ambition

- Long-term (2036 to 2050) GHG reduction target(s)
- Medium-term (2026 to 2035) GHG reduction target(s)
- Short-term (up to 2025) GHG reduction target(s)
- Decarbonization Strategy (Target Delivery)
- Capital Alignment
- Climate Policy Engagement
- Climate Governance
- Just Transition
- Task Force on Climate-Related Financial Disclosures (TCFD) Disclosure

Companies are rated with a "traffic light" score (green/yellow/red) for whether they meet, partially meet, or do not meet the criteria. Specific and granular sub-indicators and metrics underpinning the assessment are provided for each of these indicators. Companies are given the opportunity to provide factual feedback on their Disclosure Framework assessments prior to publication on the site.

As part of the rollout of Benchmark 2.0, an additional indicator—Disclosure Indicator 11: Historical Emissions Reductions—will be added. The upcoming iteration will also include what the initiative calls "significant amendments" to certain of the indicators (Decarbonization Strategy, Capital Allocation, Climate Policy Engagement and Just Transition) and minor amendments related to other indicators (related to long-, medium- and short-term reduction targets).

The second framework, the Alignment Assessments, includes independent evaluations of the alignment and adequacy of company actions with the goals of Climate Action 100+ and the Paris Agreement based on the company's financial statements, related disclosures and auditor reports. The site provides scores and underlying data for three sets of factors: climate accounting and audit; capital allocation alignment; and climate policy engagement alignment. The criteria underpinning the capital allocation alignment assessment vary and are relative to sector-specific climate change scenarios.

The planned Benchmark 2.0 retains the three sets of factors and includes expanded data categories, provides revisions to how certain assessments are made and communicated (e.g., traffic light scores rather than yes/no indicators, and the addition of letter grades A+ through F), and offers industry-specific changes to indicators and assessment scenarios for the capital allocation alignment assessments for companies in the automobile and oil and gas sectors.

Climate Action 100+ plans to release assessments using Benchmark 2.0 in Fall 2023.

Taking the Temperature: Climate Action 100+ is noteworthy for a number of reasons, including the size of its investor constituency (700 investors with over $68 trillion in assets under management), the global reach of that constituency and the investor networks involved (its work is coordinated by five regional investor networks, including Ceres and Principles for Responsible Investment), and the longevity of the initiative,

which was conceived in September 2016 following the 2015 Paris Agreement, and launched in December 2017.

We have reported extensively on the work of and, at times, controversy surrounding, industry-specific climate-related initiatives, particularly in the financial services and insurance sectors. Recently, three large insurance providers announced their exit from the Net-Zero Insurance Alliance, citing, among other things, material antitrust risks and the opportunities to more efficiently pursue decarbonization goals independently. At the same time, other stakeholders are challenging decisions on the part of asset managers to leave such coalitions or perceived steps by these groups to water down membership requirements, such as complaints that were raised over the decision by the Net-Zero Banking Alliance declining to impose binding limitations on fossil fuel financing or decisions by the Glasgow Financial Alliance for Net Zero regrading its relationship to the UN-supported Race to Zero campaign.

In addition, Climate Action 100+ itself (along with Ceres and CalPERs) is the subject of an inquiry by Republican members of the House Judiciary Committee regarding antitrust compliance.