American Airlines Moves to Dismiss Suit Challenging Inclusion of ESG Funds in Retirement Plan

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In August 2023, American Airlines, Inc. moved to dismiss a class action lawsuit filed against the airline for allegedly jeopardizing employees' retirement savings by investing in environmental, social and governance (ESG) funds managed by BlackRock and others. The **complaint**, filed by an American Airlines pilot, alleges that the airline's ESG investment strategy violates the Employee Retirement Income Security Act (ERISA) by pursuing a political agenda in breach of ERISA's fiduciary duties requiring companies to maximize financial benefits for retirement plan participants.

Seeking to represent a class of participants in the airline's 401(k) plan, the pilot filed suit against both American Airlines and the American Airlines Employee Benefits Committee. According to the complaint, many of the ESG funds included in the plan are more expensive than, and underperform, similar non-ESG investment funds. According to the complaint, "The ESG funds and investments Defendants included and retained as investment options have been largely imprudent holdings that should be removed from the Plan." The suit also alleges that the defendants breached their fiduciary duties by failing to investigate and monitor the fund managers' proxy voting and shareholder activism.

In support of its claims, the proposed class **referred to a letter** penned by 19 Republican attorneys general sent to BlackRock CEO Larry Fink in August 2022, stating, among other things, that the fund's support for ESG was putting retirement funds at risk and violating federal benefits laws.

In the **Motion to Dismiss**, American Airlines argued that the pilot lacked standing to sue because he did not invest in the ESG funds listed in his complaint. Standing aside, American Airlines also argued that the complaint failed to state a claim on the grounds that the challenged ESG funds are accessible only through a self-directed brokerage account (SDBA), which enables participants who do not want to be restricted to the investment options selected by the plan fiduciaries to open their own brokerage account and choose their own mutual funds, exchange-traded funds and individual stocks at their own risk. No fiduciary is responsible for the selection or monitoring of the individual investments within a participant's brokerage account, the airline argued.

Taking the Temperature: As we've frequently noted, ESG investing has become a political football in the United States, with lawmakers on both sides using it to advance their own agendas; BlackRock's CEO said that he had stopped using the acronym "ESG" as it had been weaponized by political figures on both sides of the ESG discussion. More recently, House Republicans on the Financial Services Committee introduced four bills targeting business and market activities that implicate ESG issues. Other efforts to hobble ESG-related considerations in investing have included the withdrawal of billions in assets under management in Republican-controlled states, the alliance of 19 Republican governors to oppose the Department of Labor rule that permits retirement plan fiduciaries to consider ESG-related factors in their decision-making, and the passing of laws by Republican state legislatures mandating divestment of state funds from asset managers deemed to "boycott energy companies" or restricting investment managers from casting proxy votes for the purpose of furthering "non-pecuniary interests." In a report on its 2022-2023 proxy voting year released on August 23, BlackRock disclosed that it supported approximately 7% of the ESG-related shareholder proposals submitted in the past proxy year. In fact, median shareholder support for ESG shareholder proposals in the U.S. fell from 25% in the 2021-22 proxy year to 15% in the 2022-2023 proxy year. BlackRock said its analysis showed that nearly 70% of ESG proposals received less than 25% support.

The American Airlines putative class action demonstrates yet another approach to opposing ESG investments. ERISA litigation may be an effective mechanism to pressure companies to reconsider how they invest retirement funds. Indeed, the claims alleged against American Airlines will require a fact intensive inquiry, meaning that the ultimate determination of the case will be left to the trier of fact at trial. In addition to costly and time-consuming litigation, American Airlines, if the motion to dismiss is denied, will have to defend the claims in a venue (Texas) that has largely been supportive of the anti-ESG movement, a factor Plaintiff likely considered before initiating his action. More broadly, this type of 'non-climate aligned' litigation is an emerging trend, especially within the U.S.

Transition Plan Taskforce Publishes the Final Disclosure Framework

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On October 9, 2023, the Transition Plan Taskforce (TPT) published the **Disclosure Framework** providing good practice recommendations for companies to enable them to make "high quality, consistent and comparable transition plan disclosures." A key feature of the TPT Disclosure Framework is that it has been developed with the support of the Financial Conduct Authority (FCA) and is designed to be consistent with the leading voluntary international disclosure frameworks.

The TPT, a cooperative project led by the private sector, was initially introduced during COP26, held in Glasgow in 2021. During the conference, the UK pledged to become the world's net zero-aligned financial center, and committed to ensure that market participants had all of the information and tools they needed to align with their climate and nature goals. To help achieve its ambitions, HM Treasury assembled the TPT in April 2022 comprising Aviva, Legal & General Investment Management, NatWest and Unilever, various UK government departments, the FCA, and activist organizations such as ShareAction.

The TPT Disclosure Framework is based on two major reporting and disclosure models. On one side, it is designed to be consistent with the International Sustainability Standards Board (ISSB) standards, which serve as a baseline of sustainability disclosures for capital markets; on the other side, the TPT Disclosure Framework is also aligned with the transition plan guidance developed by the Glasgow Finance Alliance for Net Zero (GFANZ). The framework therefore supports and endorses international standards and guidance.

The aim of the TPT Disclosure Framework is to provide principles and strategies to assist the transition planning to net zero. To this end, the TPT Disclosure Framework revolves around three main guiding principles, under which sit five key elements of a good practice transition plan (according to GFANZ guidance):

Ambition - the urgency to act:

1. *Foundations:* an entity should disclose, inter alia (i) its objectives and priorities for reducing its Scope 1, 2 and 3 GHG emissions in either its operations or value chain, and for enhancing its resilience to the changing climate and responding to the risks and opportunities that arise from the transition to low-GHG emissions; (ii) whether and how it has identified, assessed and taken into account the impacts and dependencies of the

transition plan on its stakeholders; and (iii) any short, medium and long-term targets and milestones it has set to measure progress.

Action - turning the ambition into concrete steps:

2. *Implementation Strategy:* an entity should disclose the steps it is taking within its business operations, products and services, policies and conditions to realize its strategic ambition. This disclosure should also encompass the resulting impacts on the entity's financial position, financial performance, and cash flows.
3. *Engagement Strategy:* an entity shall disclose information about any engagement activities with other entities in its value chain that it is undertaking or plans to undertake in order to achieve the strategic ambition of its transition plan.

Accountability - defining roles and responsibilities in the commitment to deliver a robust transition plan:

4. *Metrics & Targets:* an entity should disclose any information about the governance, engagement, business and operational metrics and targets that it uses to drive and monitor progress towards the strategic ambition of its transition plan.
5. *Governance:* an entity should disclose how it is integrating its transition plan into its governance structures and organizational arrangements to achieve the strategic ambition of its transition plan.

Each of the above described elements is in turn divided into 19 sub-elements. The interaction among the three core principles, the five elements described thereunder and relevant sub-elements, is what forms the TPT Disclosure Framework which, if implemented and complied with, is intended to help companies with the realization of credible and solid transition plans.

Taking the Temperature: It is hoped that the Disclosure Framework will promote and endorse the transition to decarbonization, low GHG emissions, climate-resilient economies and climate-related risk management. By developing and implementing transition plans following the recommendations by the TPT, entities will not only be enabled to direct strategy, promote coordinated, purposeful actions, and support an organizational transformation, but will also enhance the information available to investors and lenders, allowing them to price risk and make capital allocation decisions. If implemented and utilized effectively, disclosures made under the framework will act as a reference point for financial instruments and products directed towards financing the climate transition.

A key advantage of the TPT Disclosure Framework is its alignment with globally recognized standards of ISSB and GFANZ. We frequently discuss the importance of global alignment when it comes to reporting and disclosure frameworks in order to achieve their entire purpose in the first place – that is, to bring order, consistency, transparency, comparability and reliability to the plethora of ESG-related information and data available to investors. TPT's recognition of this underscores how crucial that is, as regulatory bodies and other standard setters start to do the same. As we noted earlier this year, EFRAG and GRI have also undertaken comparable alignment initiatives.

The TPT Disclosure Framework is not mandatory, at least for the moment. However, the fact that the TPT Disclosure Framework is supported by the FCA is a strong indication of the future direction of travel. In August 2023, the FCA announced its intention to consult on rules and guidance for listed companies to disclose in line with the ISSB Standards and the TPT Disclosure Framework. That consultation is due to take place in 2024.

California Sues Big Oil for Denying, Downplaying Impact of Fossil Fuels on Climate Change

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On September 16, 2023, California Attorney General Rob Bonta **filed a lawsuit** against five of the world's largest oil and gas companies for allegedly denying or downplaying the harm caused by fossil fuels on climate change. Along with Governor Gavin Newsom, Bonta filed a seven-count, 135-page **complaint** in state court in San Francisco against the defendants for "engaging in a decades-long campaign of deception and creating statewide climate change-related harms in California."

California asserts that the companies have known for decades that burning fossil fuels would result in climate change. For example, a 1968 report commissioned by API and its members concluded "[s]ignificant temperature changes are almost certain to occur by the year 2000, and . . . there seems to be no doubt that the potential damage to our environment could be severe." The complaint alleges that the defendants' deceptive conduct has been a substantial factor in the increasingly frequent and intense climate change impacts including extreme heat, drought, wildfires, storms and flooding, degradation of air and water quality, agricultural damage, rising sea levels, and habitat and species losses. Accordingly, the complaint asserts claims for public nuisance, damage to natural resources, false advertising, misleading environmental marketing and products liability. It also requests the assessment of damages and penalties against the defendants; the creation of a special fund to finance climate mitigation and adaptation efforts; and injunctive relief to protect California's natural resources from pollution and prevent the defendants from making any further false or misleading statements about the contribution of fossil fuel combustion to climate change.

In a **statement to *The New York Times*** about the suit, API described it as "nothing more than a distraction," adding that "[c]limate policy is for Congress to debate and decide, not the court system."

Taking the Temperature: This lawsuit marks yet another step California is taking to address the impacts of climate change. California is the largest economy in the U.S. and one of the largest in the world, and claims to have spent billions of dollars responding to climate-related events. As we have previously discussed here and here, California has positioned itself as a leader, particularly in the U.S., in supporting the global push for mitigating the risks posed by climate change, including through enhanced reporting and disclosures for climate-related risks and opportunities.

This litigation also signals an accelerating global trend of litigation, both in climate-related litigation generally and in suits brought against industries perceived to be the biggest contributors to greenhouse gas emissions, in particular energy companies and

airlines. In June 2023, we discussed the lawsuit filed by, among others, Greenpeace and 12 Italian citizens against ENI S.p.A. alleging that ENI knew of the detrimental effect of fossil fuel burning since around 1970 but through "lobbying and greenwashing" continued to encourage extraction, thereby contributing to climate change. Relatedly, we covered a similar suit filed by the state of Oregon against more than a dozen large oil, gas, and coal companies.

California Attorney General Bonta has supported several states and cities in filing their own, similar suits, including by filing an amicus brief in similar litigation on behalf of the City of Honolulu, the County of Maui, the City of Baltimore, the state of Rhode Island, the state of Minnesota, the District of Columbia, the City of Oakland and the City and County of San Francisco.

ECB Stress Test: Bank’s Credit Risk Doubles by 2030 under Slower Climate Transition

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In September 2023, the European Central Bank (ECB) published its **second economy-wide stress test**, shedding light on the credit risks that European banks may face as a result of the ongoing climate transition. The test analyzed the resilience of banks, firms and households to three transition scenarios, which differ in terms of timing and ambition:

- an **“accelerated transition,”** which frontloads green policies and investments, leading to a reduction in emissions while limiting global temperature increases to 1.5ºC by 2030 in line with the goals of the Paris Agreement;
- a **“late-push transition,”** which continues on the current path whilst the “real” transition begins around 2026 with a weaker economy but achieves emissions reductions similar to the accelerated scenario; and
- a **“delayed transition,”** which is compatible with a temperature increase of around 2.5ºC by the end of the century, but is not sufficiently ambitious to reach the Paris Agreement goals by 2030.

“The results show that – all other things being equal – the earlier the transition happens, the smaller the financial risk, and consequently the less policy support is required to mitigate the costs.” The accelerated scenario assumes a significant increase in energy costs in the near term, rising to €2 trillion by 2025, however, the ECB found that the “accelerated” transition scenario resulted in the lowest long-term financial physical risk.

One of the key findings of the stress test indicates that banks’ credit risk could increase by more than 100% by 2030 under the late-push scenario. Banks’ loan portfolios could become more vulnerable and in response to the heightened credit risk, banks will likely need to reassess their lending practices, which may involve adopting more stringent criteria for evaluating potential borrowers, particularly those operating in high carbon-intensive sectors.

In addition to the difficulty in accessing financing for corporations that are slow to adopt sustainable practices, the stress test results further identified mining, manufacturing, and utility industries as amongst the most severely impacted industries regardless of the scenario given their reliance on brown energy sources. These sectors face higher energy expenses and require substantial investments in carbon mitigation and renewable energy. It was further reported that the reduction in the revenues of brown energy suppliers due to the transition would be substantially larger under the accelerated and late-push transition scenarios.

The ECB's findings underscore the growing calls for corporations to transition to greener business models. Companies are being urged to enhance their risk management and disclosure practices in the transition, while banks are encouraged to embrace sustainable finance including offering green loans, investing in renewable energy projects, and actively supporting environmentally conscious businesses.

Taking the Temperature: The ECB's climate stress test highlights that the choice of transition scenario, timing of the transition, and level of investment could significantly impact long-term economic and financial outcomes. The ECB's research also emphasizes the need for coordinated efforts to mitigate climate risks, support businesses and households during the transition, and ensure the resilience of the financial sector. As financial institutions plan this transition, they will also need to consider how to disclose their transition strategy. As we have previously covered, the ECB has provided guidance on such disclosures in its 2022 assessment of climate-related and environmental risk disclosures of EU-based banks, its joint statement on climate disclosure for structured finance products, and its own climate-related financial disclosures.

Assessment of Major Banks Shows Disclosure Gaps in Finance Directed Towards Climate Solutions

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The Transition Pathway Initiative (TPI), in partnership with the Grantham Research Institute on Climate Change and the Environment, **conducted a study** "[t]racking progress with the TPI Net Zero Banking Assessment Framework." As part of its assessment process, TPI used the Net Zero Baking Assessment Framework to evaluate banks' progress in managing the low-carbon transition and mitigating the impacts of climate change. The Net Zero Banking Assessment Framework comprises ten key areas: net-zero commitments; target analysis; emissions disclosure; emissions performance; decarbonization strategy (including financing conditions and capital allocation, and climate scenario analysis); climate solutions; climate policy engagement; climate governance; just transition; and financial statement disclosure.

Among the report's key findings are:

- "Banks are making progress towards incorporating climate change into their business strategies[;]"
- "[B]anks are not including all on- and off-balance sheet activities nor all high-emission sectors in their targets[,]" meaning that "banks could continue to finance high-emitting activities in the long term[;]"
- "Banks' disclosures remain partial and selective" in that they omit "key topics" like climate related risks; and
- "A lack of external standardi[z]ed methodologies and insufficient data from clients are hindering progress on banks' climate action."

More lenders are disclosing their net zero commitments (20 of the 26 banks assessed have disclosed a net zero commitment). However, of the 26 banks assessed, none disclosed the total share of finance directed towards climate change in the last year; six disclosed a commitment to immediately end all on- and off-balance sheet activities that finance new coal capacity; and three tied financing policies to sectoral targets.

TPI made several recommendations for the future, including: (i) striving to make progress on climate action despite the challenges related to lack of standardized methodologies; (ii) expanding target coverage to include all material financing activities; (iii) formulating

comprehensive financing policies for high-emission sectors, covering all on- and off-balance sheet activities; (iv) including climate-related issues and risk analysis in annual reports and financial statements; and (v) expanding disclosure and governance structure to ensure an in-depth approach to climate action.

Taking the Temperature: As we have been reporting for the past few years, financial institutions continue to be viewed as key players in the effort to mitigate risks posed by climate change and transition to a net zero economy. While banks are increasingly incorporating climate change into their business strategies, as the TPI report makes clear, the devil is in the details, and banks are likely going to continue to be subject to scrutiny by prudential regulators, investors and climate-focused NGOs and pressure groups. For example, as we recently discussed, the Hong Kong Monetary Authority called on its banks to ramp up net zero transition planning, and in August, non-profit disclosure organization CDP concluded that financial institutions are not accounting for nature-related risks and opportunities in their financial decision making. The banks assessed in the TPI report include the world's largest banks with global operations and therefore, will likely continue to garner attention from regulators and the private sector for their climate-related strategies.