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EU Value Chain Due Diligence Directive Not Endorsed

Following four years of attempting to progress and approve the Corporate Sustainability Due Diligence Directive (CSDDD), the European Council failed to give the agreement final approval on February 28, 2024. The long-anticipated, and at times controversial, CSDDD obligated in-scope companies to address their negative impacts on human rights and the environment both in their direct operations and their (upstream and downstream) value chain. The CSDDD would have had mandatory application for all companies with 500 employees or more. The CSDDD was objected to by several countries, including Germany, which expressed concerns about the overly burdensome nature of the obligations upon companies; France, which tried to reduce the impact on companies by requiring that the rules only apply to entities with more than 5,000 rather than 500 employees; and Italy. The CSDDD incorporated requirements such as integrating due diligence on impacts into corporate policies and risk management systems, including descriptions of the approach, processes and code of conduct. Companies would also have had to adopt transition plans which outlined alignment with the Paris Agreement. Companies would also have to engage with stakeholders, including those who are affected by their business activities, and implement a complaints system of supervision and sanctions. In addition, Member States were required to set up national authorities to supervise, monitor and enforce the provisions of the CSDDD. Penalties included "naming and shaming" non-compliers and imposing fines of up to 5% of annual global revenue.

A statement published by the Belgian Presidency of the Council read in part, "[w]e now have to consider the state of play and will see if it's possible to address the concerns put forward by member states, in consultation with the European Parliament." The CSDDD is not thought to have been permanently dispensed with, but given the reservations of those Member States that objected to its approval, we may see a version of the directive with less onerous requirements emerge.

SEC Climate Reporting Rules Relaxed

Scaling back appears to be a global trend. At a **March 6 meeting**, the Securities and Exchange Commission (SEC) approved scaling back GHG emissions disclosure requirements for public companies. **As we discussed in April 2023**, many companies had already begun to prepare under the proposed rules. Under the previous iteration of the rules, public companies would have been mandated to make a swathe of additional climate-related disclosures, including Scopes 1 and 2 GHG emissions metric, both broken out by constituent greenhouse gases (eight different greenhouse gasses are specified in the proposal) and also presented in the aggregate; and Scope 3 greenhouse gas emissions metrics, if material, or if the registrant has set a greenhouse gas emissions reduction target or goal that includes its Scope 3 emissions.

The Scopes 1 and 2 requirements have been scaled back such that disclosures would only be mandatory if companies deem them material. The disclosure of the Scope 3 emissions was contentious, with lobbying groups claiming the requirements were excessively burdensome; the

SEC has eliminated this requirement and significantly scaled back the Scopes 1 and 2 reporting which will now apply only to large filers, and only when material. More time will also be provided so that reporting can be provided in the second quarter report, rather than annual reports. Another contentious element of the proposed rules was that, where a company's financial results were affected by more than 1% and the cause was climate "impacts", this would need to be disclosed in their financial impacts. But, without accurate, quantitative methods to calculate this, stakeholders who submitted comments to the SEC on the proposals criticized the rule. This requirement has now been replaced with less burdensome reporting.

Scope 3 emissions disclosures relate to emissions generated from a company's value chain. The failure to approve the CSDDD as discussed above, was in part due to the excessive burden that adequate due diligence on the climate impacts across the value chain would place on companies. It would seem that for now, both jurisdictions are considering scaling back that burden for companies.

Thinking Beyond The Value Chain

Despite the challenges faced by companies to accurately report on emissions across their value chain, the Science Based Targets Initiative (SBTi) is encouraging them to look beyond the challenges. **In two reports** published on February 28, 2024, SBTi suggests that companies should take measures to reduce GHG emissions, even if those measures are not related to their Scope 1, 2 and 3 emissions. As an example, the SBTi cites a manufacturing company funding the restoration of coastal ecosystems near its production facilities, noting that this would mitigate the risk of cost increases or revenue losses as a consequence of extreme weather events damaging its facilities. Its so-called "beyond value chain mitigation (BVCM) is important, according to the SBTi to "catalyse private sector finance to mitigate emissions that occur beyond corporate value chains" that are not provided adequately for by traditional financing. SBTi does not plan to validate BVCM claims, since organisations such as the Voluntary Carbon Market Integrity Initiative are already doing this work. However, the reports do provide a set of recommendations for designing BVCM strategies that encompass setting a net zero target, making a BVCM pledge and measuring its commitment.

Although SBTi states that BVCM initiatives should not distract from Scope 1, 2 and 3 emissions efforts, practically, companies and regulators alike are grappling with striking the right balance in respect of such reporting and it is difficult to envisage how BVCM claims can begin to be implemented until Scope 1, 2 and 3 reporting and disclosure are properly entrenched.

European Parliament Agrees to Extend Environmental Crimes Register

On February 27, Members of the European Parliament (MEP) **extended the list of environmental offences and sanctions** to include illegal timber trade, depletion of water resources, serious breaches of EU chemicals legislation, and pollution caused by ships. Perpetrators can face up to ten years in prison, while companies can have fines imposed upon them to the value of up to 5% of global turnover or 40 million euro. Member States are required to organize specialist training for enforcement officials such as police, judges and prosecutors, prepare national strategies and raise awareness of environmental crime. MEPs required that whistle blowers reporting environmental offences should be given support and assistance. The directive will enter into force on the 20th day following publication in the EU Official Journal. Member States will have two years to transpose the legislation.

The ESG Dilemma for Legal Counsel

Research by Bloomberg Law has shown that in-house counsel are increasingly facing challenging discussions with executive teams and boards to clarify company values in relation to ESG. Discussions are being driven by the divide on ESG issues between Republican- and Democratic-led states. **We have frequently discussed** the push-and-pull between the two sides. Bloomberg Law reports that counsel have to ensure that complying with the law of one state does not violate the law in another, with the additional burden of having to keep themselves apprised of and in compliance with ESG regulatory developments at a federal level. The lack of alignment but obligation to comply presents considerable legal risk. **As we have discussed**, companies are confronted with lawsuits from a myriad of groups, including **attorneys general**, **shareholders** and consumers, who seek to challenge the company's stance and direction on ESG issues. Such issues include diversity and inclusion policies, non-competes and non-solicits. In **Norton Rose Fulbright's 2024 Annual Litigation Trends Survey**, 24% of respondents said that their ESG dispute exposure increased in the last year, with 27% expecting this to increase this year. Identifying the drivers behind this trend, 40% cited pro-ESG regulatory pressures and 37% cited anti-ESG sentiment. Greenwashing in particular is a concern. In this context, companies must deal not only with the legal risk, but the reputational risk too. A particular hurdle in the greenwashing space is ensuring that green claims can be substantiated, and are not made simply to induce a consumer into purchasing or investing in a service or product. Another consequence of the competing pressures between Republican- and Democrat-led ESG policy is that some companies have scaled back ESG participation or communications, often referred to as "greenhushing". Given the intricacy and rapidity of ESG policies, legislation and regulation, corporate counsel will need to continue monitoring developments closely, assessing the necessary steps to be taken, and constantly evaluating whether the company's response is compliant.

Bank of England Urged to Stop Accepting Fossil Fuel-Backed Assets as Collateral

Positive Money called on the Bank of England to integrate environmental risks into its collateral framework by not accepting assets by fossil fuel companies to be used as collateral against loans made to them. The central bank's continued acceptance from such companies results in, according to Positive Money, a disproportionate benefit to the polluting sector. Positive Money proposes that the Bank of England: (i) develop a science-based framework for the assessment of environmental impact of assets and their issuers, and define activities with the most harmful impact; (ii) negatively screen for and exclude assets from issuers whose main activity is incompatible with environmental goals; (iii) introduce higher haircuts to assets based on their environmental impact; and (iv) increase transparency over the Bank of England's current collateral operations, including the environmental footprint of its buildings. Positive Money is a UK-based campaign group which aims for a money and banking system that enables a "fair, sustainable and democratic economy."

Inflation Reduction Act Pays Dividends

On February 28, the **US Environmental Protection Agency reported** that the Inflation Reduction Act of 2022 made the agency $3 billion which it will use to fund zero-emission port equipment and infrastructure, and contribute towards climate and air quality planning at US

ports. Companies are able to apply for funding until May 28. In total, the Inflation Reduction Act is estimated to have approximately $369 billion in climate-related measures.