CADWALADER

The ESG Factor

January 31, 2022

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2022 and Beyond – The Rise of ESG in the UK and Europe

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ESG considerations is a key theme that has heavily influenced investments over the past few years and which will no doubt play an even more prominent role in the 2020s. We touched on this briefly in our 2021 closing **article** in *REF News and Views* with respect to de-carbonisation of existing buildings, as the world is more focused on climate change initiatives. With all market participants increasingly adopting and adjusting to the need to comply with the ever-increasing appetite for ESG investments, we look here at some of the key recent developments in Europe and the UK regarding ESG in the financing market.

Call for regulation as to standardised ESG assessment

With increasing appetite for corporates and the financial sector to invest in ESG products, there are concerns about the labelling and regulation around what would constitute an ESG investment, along with standards in assessing the ESG rating of such companies. At this point in time, the standards around ESG labelling, disclosures and marketing are largely unregulated, leading to greenwashing concerns. Although ESG certification/ratings can be conducted by various agencies, and some companies do go through the process to certify or obtain an independent opinion/rating on their ESG compliance, this is not compulsory as part of the marketing/disclosures with respect to financial products. Furthermore, there is no prescribed standard by regulators as to ESG assessments, and so often how ESG is assessed can differ. Regulators are increasingly aware of this issue, and ESG regulation is an area of focus as we head into 2022.

In the UK, the FCA published a consultation paper on climate disclosures by listed companies. This paper also addressed ESG rating providers, with respect to general guidance on using ESG data and ratings, and also consideration of a Best Practice Code to encourage voluntary, industry-led adherence to a minimum standard of conduct so as to ensure consistency across the industry. It is expected that the FCA's final policy on the consultation will be published in the first half of 2022.

In Europe, the European Commission is expected to commence consultation in 2022 with respect to ESG ratings and the impact of these ratings and the players in the market. One of the key focuses is to look at the reliability and comparability of ESG ratings by different providers, and whether introduction of regulations would be appropriate.

ESG bonds

Green, social, sustainable and sustainability linked bond issuances continue to increase with full steam as we head into 2022. The year 2021 was a big year for ESG linked bonds, which includes green, social and sustainable bonds, and also transition bonds and sustainability-linked bonds. One of the key criteria in being classified as an "ESG bond," in addition to ESG rating, is the use of proceeds from the bond issuance towards an "ESG purpose." This sector of the market continues to evolve, with regulators such as the European Commission publishing a proposal for EU Green Bond Standard to prescribe the use of proceeds of such bonds towards "green" purposes, and the International Capital Market Association adopting key recommendations to increase transparency with respect to the use of proceeds.

Furthermore, the EU Commission published a proposal for the regulation of Green Bonds in 2021, and this proposal requires all green bonds issued to European investors and marketed as a "European Green Bond" to comply with the European Green Bond Standard. The standard prescribes a set of common rules for issuers to use the designation of "European Green Bond," and the proceeds from the issue must be used exclusively towards activities that meet the EU Taxonomy Regulation. Issuers will also have to publish on their website (in accordance with a prescribed template) a European green bond fact sheet, and their annual reports confirming the use of the proceeds, along with an environmental impact report from the use of such proceeds.

The Task Force on Climate-related Financial Disclosures (TCFD)

Various countries are taking steps to encourage or mandate TCFD implementation. In the UK, the FCA has mandated that from 1 January 2021, all UK premium-listed companies must state, in their annual report, whether their disclosures are consistent with TCFD recommendations or, if not, explanations as to the reasons. The FCA is going to apply this to standard listed companies for financial years from 1 January 2022, and large companies and LLPs will also become subject to this reporting.

For asset managers and asset owners, the FCA published a policy statement in December 2021 which requires that they disclose how they take climate-related risks and opportunities into account in managing their investments, as well

as climate-related characteristics of their products. This requirement is implemented in stages, depending on the amount of assets under management.

Sustainability Disclosure Requirements (SDR)

In November 2021, the FCA published a discussion paper on SDR and investment labelling. The discussion paper include two key topics:

(i) the need for real economy companies (which includes listed issuers, asset managers and asset owners) to report on their sustainability risks, opportunities and impacts. The regime will be largely built on the existing measures under TCFD, but expanding the scope to cover wider sustainability topics beyond climate change.

(ii) sustainable investment labels – certain investment products will be required to display a label reflecting their sustainability characteristics, which will be developed and implemented by the FCA.

The consultation is expected in Q2 2022. The full text of the discussion paper can be accessed **here**.

One of These Things Is Not Like the Other: New York State Court Upholds Commercial Reasonableness of Mezzanine Sale

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On November 10, 2021, the owner of the State Street Financial Center in Boston, Massachusetts defaulted on its debt, consisting of a mortgage loan in the amount of $535,000,000 and three mezzanine loans in the aggregate amount of $350,000,000. The day after the loans defaulted, the second mezzanine lender (the “Defendant”) sent a notice for the sale of the collateral securing its loan, which was a pledge of the equity interests in an indirect owner of the property (the “Plaintiff”), and the sale was subsequently scheduled for December 20, 2021. The third mezzanine lender also scheduled a mezzanine sale for December 21, 2021. The Plaintiff filed a motion in the Supreme Court of the State of New York looking to stay the foreclosure, arguing that the mezzanine sale was not commercially reasonable and that it would suffer irreparable harm if the mezzanine foreclosure proceeded because it would lose its property and monetary damages would not be insufficient. **[1]**

Section 9-627(b) of the New York Uniform Commercial Code states that “[a] disposition of collateral is made in a commercially reasonable manner if the disposition is made . . . in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.”**[2]** The Plaintiff argued that the Defendant failed to meet this standard because, among other things, (1) the timeline was complicated by Christmas and New Year's resulting in decreased attendance and chilled bidding at the foreclosure sale, and (2) the Defendant was seeking to “rush” the sale to take place one day prior to the scheduled sale of the most junior mezzanine lender and that this would create confusion for the bidders.**[3]** The court quickly disposed of the argument about the holidays, emphasizing that the notices were publicized on November 11, 2021 and stating that “[t]he mere fact the actual sale is a few days before a holiday and might interfere with an overarching and extended holiday season does not mean the sale is commercially unreasonable as a matter of law….[D]etailed information about vacation habits, flight availability and reduced work hours do not have any bearing on notices sent in early November. To argue otherwise would virtually eliminate most of the year as appropriate for scheduling a sale….”**[4]** The court was equally as dismissive of Plaintiff’s argument that the most junior mezzanine lender’s foreclosure scheduled for the day after the Defendant’s sale would create confusion for the bidders because, for example, they could assume that the Defendant’s notice of sale was just a re-noticing of the other lender’s sale. The court stressed the sophistication of the parties involved, noting that “only a sophisticated bidder would be interested in such an expensive property,” that such bidders would be “extremely well counseled” and that it was “difficult to imagine a sophisticated bidder…could make such elementary and easily verifiable mistakes.”**[5]**

After the discussion on the commercial reasonableness of the sale, the court switched gears and examined the Plaintiff’s argument that it would suffer irreparable harm if Defendant were to proceed with the foreclosure because the foreclosure would “result in a loss of property which cannot be replaced with any monetary damages.”**[6]** The opinion detailed the differences between owning and operating real property and owning an equity interest in another entity and the fact that a mezzanine loan is secured by a pledge of equity interests rather than a mortgage on real property. The court then went on to unequivocally state that an entity which owns equity in the owner of real estate does not own real property, noting that “[t]here are no cases that hold that ownership interest in such an entity is the equivalent of an ownership interest in real property sufficient to render the interest unique and thereby entitle the party to injunctive relief.”**[7]**

The court in this case understood the fundamental differences between mortgage and mezzanine loans and maintained the status quo with respect to foreclosure of mezzanine loans. Mezzanine lenders who make large loans to sophisticated parties should be particularly pleased with this ruling given that this case involved a significant and well-known property and the court gave great weight to the sophistication of the parties when determining whether or not the notice of the foreclosure sale was commercially reasonable.

There have been quite a number of decisions over the past few years addressing mezzanine enforcement and borrower’s efforts to thwart the lender’s exercise of remedies. Suffice it to say that, while there have been some delays due to COVID, the courts have been very “commercial” in upholding lender’s rights and remedies. We will continue to monitor this area and provide updates as they arise.

[1] *Lincoln St. Mezz II LLC v. One Lincoln Mezz 2 LLC*, Index No. 530492/2021 (N.Y. Sup. Ct., December 8, 2021).

[2] U.C.C. § 9-627(b).

[3] *Lincoln St. Mezz II LLC*, Index No. 530492/2021 at 2.

[4] *Lincoln St. Mezz II LLC*, Index No. 530492/2021 at 4.

[5] *Id.* at 3.

[6] *Id.* at 5.

[7] *Id.*

Recent Transactions

January 31, 2022

Here is a rundown of some of Cadwalader's recent work on behalf of clients.

- Represented the lender in a $381 million loan intended for a single asset securitization for 21 industrial properties located in multiple states.
- Represented the lender in three crossed loans aggregating to a $455 million loan on multiple industrial properties located in New York.
- Represented the lender in a $200 million loan for a large office property in Minneapolis, Minnesota.
- Represented the lender in a $79 million mortgage loan to acquire a commercial shopping center located in West Palm Beach, Florida.
- Represented the lender in a $49.8 million mortgage loan and a $25.6 million mortgage loan to refinance existing debt secured by two neighboring office buildings in Columbia, Maryland.