Clients&FriendsMemo

"Sustainable" Companies Face Increased Pressure to Justify the Sustainability Label Amid Investor Challenges and Demands for Greater Risk Assessment and Disclosure

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The recent IPO for Rivian Automotive Inc., the electric pick-up truck manufacturer whose shares increased 29% on the day following the offering, resulting in an enterprise valuation of more than $86 billion[1] – more than the market values of every other automaker except Tesla, Toyota, and Volkswagen – is evidence that investors may place a significant premium on certain companies that are at the forefront of addressing (and potentially seizing opportunities resulting from) climate change and related sustainability issues. The fact that Rivian has only produced 156 vehicles to date and has never demonstrated the ability to mass produce electric vehicles apparently did not faze investors.[2]

The Rivian IPO and investor enthusiasm generally for companies perceived to be at the forefront of the "green" economy provide strong incentives for companies to promote their sustainability bona fides. But along with marketplace rewards there has been increasing investor and regulatory scrutiny of whether ostensibly (or self-proclaimed) "sustainable" companies merit the designation.

As we have recently discussed,[3] there is significant momentum in the U.S. and abroad for companies to provide sustainability disclosure that is reliable, consistent, and comparable. Certain members of the Securities and Exchange Commission ("SEC" or "Commission") repeatedly have signaled the importance of clear, consistent, and accurate disclosure when it comes to climate-related impacts.[4]

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[1] Peter Eavis & Neal E. Boudette, *Rivian I.P.O. Is Embraced by Investors Looking for Another Tesla*, N.Y. TIMES (Nov. 10, 2021), https://www.nytimes.com/2021/11/10/automobiles/rivian-stock-price-ipo.html.

[2] *Id.*

[3] Jason Halper *et al.*, *Investors and Regulators Turning up the Heat on Climate-Change Disclosures: Attempting to Make Sense of the State of Play in the US, EU, and UK*, CADWALADER, WICKERSHAM & TAFT LLP (Sept. 14, 2021), https://www.cadwalader.com/resources/clients-friends-memos/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures--attempting-to-make-sense-of-the-state-of-play-in-the-us-eu-and-uk# (discussing the increased focus on climate-change related disclosures).

[4] Allison Herren Lee, *Remarks at the PRI/LSEG Investor Action on Climate Webinar*, SEC (Oct. 20, 2021), https://www.sec.gov/news/speech/lee-remarks-prilseg-investor-action-climate-webinar-102021; *see also* Jason Halper, *et al.*, *Financial Stability Oversight Council Issues Key Report Declaring Climate Change as an Emerging Threat to U.S. Financial Stability*, CADWALADER, WICKERSHAM & TAFT LLP (Oct. 25, 2021), https://www.cadwalader.com/resources/clients-friends-

Although the SEC has not updated its corporate disclosure guidance in more than a decade, it has solicited comments regarding the possibility of a mandatory climate-related disclosure regime and we expect the Commission to pursue such an approach in the near term.[5] In the meantime, the existing, well-established materiality standard applies, whereby information is material and must be disclosed if there is "a substantial likelihood" that a reasonable investor would view a particular fact as "significantly alter[ing] the 'total mix' of information made available."[6] But, as Commissioner Herron Lee and others have observed, application of that standard in the ESG context has resulted in significant variability in terms of the quality and quantity of disclosure provided by issuers, yielding investor complaints, regulatory scrutiny and issuer confusion.

These challenges are well illustrated in the context of recent issues involving some well-known "sustainable" companies. One such company is Allbirds, Inc., the sustainable footwear and attire company that recently filed for its initial public offering.[7] Allbirds, a certified B Corporation and Delaware Public Benefit Corporation,[8] claims that it manufactures its products with approximately 30 percent less carbon impact than other shoe manufacturers. In addition, in its IPO registration statement, Allbirds emphasized its commitment to ESG and committed to adhere to a novel "sustainability principles and objectives framework" (referred to as a "SPO framework"), which included a commitment to report the company's climate impact and to reduce its impact on the environment by cutting emissions and requiring suppliers to address environmental issues.[9] According to the Allbirds website:

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memos/financial-stability-oversight-council-issues-key-report-declaring-climate-change-as-an-emerging-threat-to-us-financial-stability# (discussing the FSOC's finding that climate change is an emerging threat to U.S. financial security and noting that, among other initiatives, financial regulators should "promote enhanced climate-related disclosures.").

5 Allison Herron Lee, *Public Input Welcomed on Climate Change Disclosures*, SEC (May 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

6 *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *see also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (applying the TSC Industries Court's definition of materiality to a Rule 10b-5 securities fraud case); SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,151 (Aug. 19, 1999) (observing that the Supreme Court's definition is substantially identical to the FASB's definition: "The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.").

7 Sanford Stein, *As Shoemaker Allbirds Files for IPO, It May Become the First 'Sustainable Public Equity Offering'*, FORBES (Aug. 31, 2021), https://www.forbes.com/sites/sanfordstein/2021/08/31/allbirds-may-become-the-first-sustainable-public-equity-offering-or-spo/?sh=3e504b052058.

8 Delaware public benefit corporations are for-profit corporations created "to produce a public benefit or public benefits and to operate in a responsible and sustainable manner." Michael R. Littenber *et al.*, *Delaware Public Benefit Corporations-Recent Developments*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 31, 2021), https://corpgov.law.harvard.edu/2020/08/31/delaware-public-benefit-corporations-recent-developments/.

9 Allbirds, Inc., Registration Statement (Form S-1), at 149-151 (Aug. 31, 2021), https://www.sec.gov/Archives/edgar/data/0001653909/000162828021017824/allbirdss-1.htm#ib1df9298e23644a2a22972a8f1925ea1_2910/.

> As a Delaware public benefit corporation and a certified B Corporation we strive to prioritize positive outcomes, not only for our stockholders, but for all stakeholders, including employees, customers, the community, and the environment. The Business Roundtable's August 2019 statement on the purpose of a corporation articulated that stakeholder-based capitalism will shift from being the exception to the rule.[10] We believe that shift is already underway. That is why we believe it is important that we clearly articulate for all stakeholders our performance against, and commitment to, a set of environmental, social, and governance, or ESG, criteria, which we call the Sustainability Principles and Objectives Framework, or the SPO Framework. We believe that stakeholders will benefit from knowing that we have been assessed by one or more independent third parties as having satisfied objective, clearly defined ESG criteria and that we are committed to meeting high ESG standards across our business. The SPO Framework was created in conjunction with, and supported by, an Advisory Council coordinated by BSR, several cross-sector thought-leaders, market participants, and stakeholders from the private and public sectors.

But in an updated prospectus, Allbirds walked back its commitment to the "SPO framework"—references to "SPO framework" in later SEC filings were noticeably reduced, and language that Allbirds was "conducting this offering while following the SPO framework" was removed.[11] The amended filings followed a lawsuit filed in the United States District for the Southern District of New York by a consumer claiming violations of the New York Consumer Protection Statute, breaches of express warranties, fraud, and unjust enrichment based on Allbirds' alleged "misleading environmental claims."[12] Specifically, the plaintiff alleged that Allbirds' advertising, which is "heavily based on its Products' environmental impact," is false and deceptive because Allbirds' disclosures related to its environmental impact were insufficient and misleading.[13] Allbirds has moved to dismiss the case, arguing that many of the statements were non-actionable puffery and that the plaintiff offered no factual support for her allegations.[14] Allbirds began publicly trading on November 3, 2021. Allbirds was expected to be the first "sustainable public equity offering," but was forced to drop the

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[10] *See also* Larry Fink, *2021 Letter to CEOs*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited Nov. 29, 2021); Cyrus Taraporevala, *CEO's Letter on Our 2021 Proxy Voting Agenda*, STATE STREET GLOBAL ADVISORS (Jan. 11, 2021), https://www.ssga.com/us/en/individual/mf/insights/ceo-letter-2021-proxy-voting-agenda.

[11] Nicholas Megaw and Kristen Talman, *Allbirds Walks Back 'Sustainable IPO' Claims Ahead of Market Debut*, FINANCIAL TIMES (Oct. 5, 2021), https://www.ft.com/content/27dc4a15-c313-4238-90fc-9e7a2b1c8ca0.

[12] Amended Complaint, *Dwyer v. Allbirds, Inc.*, No. 7:21-cv-05238-CS, ECF No. 14 (S.D.N.Y. Aug. 25, 2021).

[13] *Id.*

[14] Motion to Dismiss, *Dwyer v. Allbirds, Inc.*, No. 7:21-cv-05238-CS, ECF No. 18 (S.D.N.Y. Aug. 25, 2021).

label[15] after the SEC objected to the phrasing.[16] Allbirds' shares surged 90% when they hit the market, resulting in a valuation of roughly $4.1 billion.[17]

Like Allbirds, Beyond Meat—a plant-based food company that went public in 2019—is facing increased scrutiny over its climate-related disclosures. Beyond Meat strives to "positively affect the planet, the environment, the climate and even ourselves" by facilitating a shift from animal to plant-based food products.[18] Critics have taken issue, however, with Beyond Meat's failure to disclose the total amount of greenhouse gas emissions across its operations, supply chain, and consumer waste.[19] Researchers have observed that the plant-based industry, which purports to be sustainable and environmentally friendly, "is really a black box."[20] The challenges associated with measuring and then accurately reporting carbon emissions are by no means limited to Beyond Meat. All companies most likely will have to confront having to measure and accurately disclose Scope 1, Scope 2 and Scope 3 emissions, with the latter category posing possibly the most difficult issues in terms of the hurdles involved in accurately measuring emissions across any one company's supply chain.[21]

Companies like Allbirds and Beyond Meat, in touting their sustainability bona fides, also become targets for challenges by investors and regulators to the accuracy of such statements. Their experiences, therefore, provide important lessons for companies navigating increased demand for, and scrutiny of, climate-related disclosure.

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[15] In Allbirds' registration statement, it described the phrase "sustainable public equity offering" as "an expression of [Allbirds'] belief and commitment that [its] environmental credentials are not in conflict with phenomenal financial outcomes." Allbirds, Inc., Registration Statement (Form S-1), at 106 (Aug. 31, 2021), https://www.sec.gov/Archives/edgar/data/0001653909/000162828021017824/allbirdss-1.htm#ib1df9298e23644a2a22972a8f1925ea1_2910/.

[16] Megaw, *supra* note 11.

[17] Lauren Thomas, *Allbirds Shares Surge 90% in Eco-Friendly Shoe Maker's Market Debut*, CNBC (Nov. 3, 2021), https://www.cnbc.com/2021/11/03/allbirds-ipo-bird-to-start-trading-on-the-nasdaq.html.

[18] *Mission*, BEYOND MEAT (last visited Nov. 1, 2021), https://www.beyondmeat.com/mission/.

[19] Julie Creswell, *Plant-Based Food Companies Face Critics: Environmental Advocates*, N.Y. TIMES (Oct. 15, 2021), https://www.nytimes.com/2021/10/15/business/beyond-meat-impossible-emissions.html; *see also* Michael Corkery and Julie Creswell, *Corporate Climate Pledges Often Ignore a Key Component: Supply Chains*, N.Y. TIMES (Nov. 2, 2021), https://www.nytimes.com/2021/11/02/business/corporate-climate-pledge-supply-chain.html (discussing the lack of climate-related disclosures related to corporations' supply chain).

[20] Creswell, *Plant-Based Food Companies Face Critics: Environmental Advocates*, *supra* note 19.

[21] Scope 1 emissions are the direct emissions from a company's operations, owned or controlled sources. *See* Eric Rosenbaum, Climate Experts Are Worried About the Toughest Carbon Emissions for Companies to Capture, CNBC (Aug. 18, 2021), https://www.cnbc.com/2021/08/18/apple-amazon-exxon-and-the-toughest-carbon-emissions-to-capture.html. Scope 2 emissions refers to indirect emissions from purchased or acquired electricity, steam, heat, and cooling. *Id.* Scope 3 emissions—which make up between 65% and 95% of a company's carbon impact—encompass the greenhouse gas emissions from other companies in a company's supply chain. *Id.* Scope 3 emissions are more difficult to measure and report because it involves emissions of entities outside the control of the reporting company. *Id.*

1. **End-to-end climate impact matters**. Though U.S. regulators have not provided formal guidance on what ESG-related disclosures will be required going forward, companies should be assessing their environmental impacts for a variety of purposes, including risk management and disclosure. In so doing, as evidenced by the Allbirds and Beyond Meat situations, companies should be mindful that "sustainability" is an end-to-end concept. Emissions from manufacturing, supply chains, and consumer waste have a significant impact on the overall assessment of whether a company operates in a sustainable fashion and should be factored into climate-related disclosures. By most accounts, Allbirds has been a success story—the company has consistently promoted long-term sustainability and has been rewarded for it, raising $300 million in its initial public offering.[22] But even well-intentioned companies are not insulated from challenges and scrutiny. For example, the Allbirds lawsuit alleges that Allbirds, while touting its sustainability and lower carbon footprint, misleadingly failed to take into account the environmental impact of its supply chain, as well as the wool it sources from sheep in New Zealand, which purportedly account for 90% of New Zealand's methane emissions. And although Beyond Meat's mission involves "positively affect[ing] the planet, the environment, the climate and even ourselves," and claims to use "significantly less water, land and energy" and "generates fewer Greenhouse Gas Emissions than a beef burger," it recently received a zero sustainability rating from one tracking agency, which stated that "[w]e don't feel we have sufficient information to say Beyond Meat is fundamentally different from JBS," an animal-based protein company.[23] The criticism stems from the fact that Beyond Meat does not disclose the total amount of greenhouse gas emissions across all of its operations, supply chains or consumer waste. Companies should consider their end-to-end operations when assessing and disclosing its environmental impact.

2. **Companies can and should take certain steps to mitigate the challenges and therefore risks arising from efforts to provide accurate and thorough disclosure.** Companies should take precautions to ensure their climate-related disclosures are sufficiently fulsome and accurate. Failure to do so may result in costly litigation. While obviously important for B corporations like Allbirds, whose corporate purpose is to produce a public benefit, the all-encompassing nature of the risks and opportunities presented by climate change imply that certain disclosures in this area will be material for virtually all companies.[24] While there is no way to render climate disclosure risk-free, adhering to an

[22] Lauren Debter, *Allbirds Valued At Over $4 Billion After Stock Surges In IPO*, FORBES (Nov. 3, 2021), https://www.forbes.com/sites/laurendebter/2021/11/03/allbirds-shares-soar-after-shoemaker-raises-over-300-million-in-ipo/?sh=725f43d76902.

[23] Creswell, *Plant-Based Food Companies Face Critics: Environmental Advocates*, *supra* note 19.

[24] A common argument against the SEC issuing updated climate-related disclosure guidance is that the disclosure requirements already cover ESG matters. *See* Gabriel Rosenberg, Margaret Tahyar, and Betty Huber, *Commenters Weigh in on SEC Climate Disclosures Request for Public Input*, Harv. L. Sch. F. on Cor. Governance (July 24,

established third-party disclosure framework can mitigate risk by providing a rationale for, and guidance in terms of, the company's disclosure. We previously discussed these frameworks,[25] but the guidance provided by the Financial Stability Board's Task Force on Climate-related Financial Disclosure ("TCFD") in particular has been gaining traction with regulators and investors. The TCFD, the mostly widely endorsed framework, recommends that companies across all industries disclose: (i) "the organization's governance around climate-related risks and opportunities"; (ii) "the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material"; (iii) "how the organization identifies, assesses, and manages climate-related risks"; and (iv) "the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material."[26] For companies that tout themselves as "sustainable," the EU Taxonomy also provides helpful guidance for U.S. companies considering how or what to disclose in connection with their activities. To be considered an environmentally sustainable economic activity under the EU taxonomy, the activity must, among other things, contribute to at least one of six environmental objectives—climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, or the protection and restoration of biodiversity and ecosystems—and do no significant harm to any of the other environmental objectives.[27] By defining what constitutes an environmentally sustainable activity, the EU Taxonomy necessarily requires companies, if they claim to engage in such conduct, to make associated disclosures supporting that claim in line with EU Taxonomy's elements.[28]

3. **Companies should monitor regulatory developments**. U.S. regulators have made it clear that they intend to address ESG disclosure issues. Securities regulators in the UK and EU already have provided guidance, but continue to update and supplement that guidance given the rapidly evolving nature of climate-related issues and analysis.[29] Companies should

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2021), https://corpgov.law.harvard.edu/2021/07/24/commenters-weigh-in-on-sec-climate-disclosures-request-for-public-input/; Letter, U.S. Senate Committee on Banking, Housing, and Urban Affairs to SEC, *Re: Public Input on Climate Change Disclosures* (June 13, 2021), https://www.banking.senate.gov/imo/media/doc/banking_committee_republicans_letter_to_sec_on_climate_disclosures.pdf.

[25] Halper, *supra* note 3.

[26] TCFD, Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans (June 2021), https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf.

[27] Technical Expert Group on Sustainable Finance, SPOTLIGHT ON TAXONOMY, https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-spotlight_en.pdf.

[28] European Commission, What is the EU Taxonomy?, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en (last visited Sept. 12, 2021).

[29] Halper, *supra* note 3.

continue to be vigilant in monitoring updated rules from regulators with respect to climate-related disclosures to ensure their disclosures sufficiently detail the impact of their operations on the environment.

4. **Demand for ESG products is soaring—but so is scrutiny**. Consumer demand for ESG products is exponentially increasing.[30] Despite criticisms concerning its supply chain sustainability, Allbirds closed its first day with its price up more than 90 percent.[31] After Beyond Meat went public in 2019, its shares surged 163 percent on its first day of trading—the "best-performing large IPO in the U.S. in more than a decade."[32] But companies should not take excess comfort in the apparent unwavering public support for Allbirds and Beyond Meat, which have sustainability as part of their core mission. Regulators are keeping a close eye on so-called "greenwashing," or "branding something as eco-friendly, green or sustainable when this is not the case."[33] Given heightened awareness around ESG issues and the demand for sustainable products, companies will find it increasingly difficult to make vague statements about sustainability without substantiating the claim. Regulators, investors, and even consumers are becoming increasingly wary of such exaggerated claims, and holding companies accountable.[34]

5. **Ostensibly sustainable companies are not immune from challenges to their ESG bona fides**. Companies or industries that often are viewed as "green" are not immune from challenges over their true environmental impact. Some contend that "clean" energy sources such as wind, solar, and nuclear power, for instance, have hidden carbon footprints associated with their construction and manufacture. Nuclear plants and wind turbines require concrete and steel for construction, which in turn are significant contributors to greenhouse gas emissions. In a similar vein, the batteries in electric vehicles charge on electric power, which is often powered by fossil fuels. The point is not that electric vehicles over their life are less environmentally friendly than combustion engine automobiles or that the operation of clean energy sources results in as much carbon emission as fossil fuels.

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[30] *Beyond Compliance: Consumers and Employees Want Business to do More on ESG*, PWC, https://www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/consumer-and-employee-esg-expectations.html (last visited Nov. 29, 2021).

[31] Debter, *supra* note 22.

[32] Deena Shanker, *Impossible and Beyond Slash Prices as Fake-Meat Market Heats Up*, BLOOMBERG, (Apr. 16, 2021), https://www.bloomberg.com/news/articles/2021-04-16/beyond-meat-bynd-impossible-foods-battle-over-future-of-fake-meat-industry.

[33] Beth Timmins, *Climate Change: Seven Ways to Spot Businesses Greenwashing*, BBC, (Nov. 8, 2021), https://www.bbc.com/news/business-59119693.

[34] Beau River, *The Increasing Dangers Of Corporate Greenwashing In The Era Of Sustainability*, Forbes, (Apr. 29, 2021), https://www.forbes.com/sites/beauriver/2021/04/29/the-increasing-dangers-of-corporate-greenwashing-in-the-era-of-sustainability/?sh.

Rather, the issue is accurate assessment and disclosure of Scopes 1, 2, and 3 emissions even for "sustainable" companies and their products.

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