SULLIVAN & CROMWELL LLP

ESG Monthly Newsletter

June 2024

This memorandum highlights key recent developments in environmental, social and governance matters of relevance to companies globally. For more information on this evolving business and legal landscape, we encourage you to reach out to your regular Sullivan & Cromwell contact or the lawyers listed on our **ESG practice website**.

Key Developments

Supreme Court's overrule of *Chevron* deference and other recent decisions by federal courts likely to impact ESG-related lawmaking and regulation in the US.

In its recently ended term, the Supreme Court issued decisions in a number of cases that could impact U.S. federal agencies and how they approach ESG-related issues going forward. On June 28, the Supreme Court overruled the doctrine of *Chevron* deference, or judicial deference for an agency's reasonable interpretation of an ambiguous statute. Although the decision does not open up for re-examination all previous cases decided under a *Chevron* regime, the demise of *Chevron* will reduce the power of federal regulators, including by giving them less latitude to change prior interpretations of statutes. This decision, the decisions highlighted in our May 2024 newsletter and other key decisions from the Supreme Court's most recent term are covered in our annual Supreme Court Business Review, which includes critical takeaways from lawyers in our Supreme Court and Appellate practice.

In addition to the Supreme Court, recent decisions from other U.S. federal courts are likely to have implications for the ESG legal and regulatory landscape in the United States. For example, a year after the Supreme Court's decision in *Harvard* invalidating college affirmative action programs, a federal appellate court found that a company's diversity-based grant was substantially likely to violate § 1981, applying the *Harvard* decision in the private sector contracting context.

Biodiversity and nature-related efforts build momentum.

Throughout June 2024, investors, standard-setting bodies and EU lawmakers have signaled a continued focus on biodiversity conservation and nature-related issues. The Council of the European Union formally adopted a nature restoration law that aims to restore 30% of the EU's land and sea by 2030, and all ecosystems in need of restoration by 2050. Principles for Responsible Investment (PRI) announced that its nature-focused investor initiative, which aims to halt and reverse global biodiversity loss by 2030, will be engaging with 60 focus companies on nature-related issues.

To support disclosure, the Taskforce on Nature-related Financial Disclosures (TNFD) and the European Financial Reporting Advisory Group (EFRAG) have released a granular mapping that highlights the alignment between their respective standards. TNFD also published final sector guidance for eight sectors (including pharmaceuticals, chemicals and oil/gas sectors), setting out sector-specific recommendations on nature impact indicators and metrics.

Legislative and Regulatory Updates

United States

Supreme Court Overrules *Chevron* Doctrine. On June 28, the Supreme Court overruled the doctrine of *Chevron* deference—a practice whereby courts are required to defer to an agency's interpretation of an ambiguous statute that the agency is charged with implementing so long as that interpretation is reasonable—in the companion cases of *Loper Bright Enterprises* v. *Raimondo* and *Relentless, Inc.* v. *Dep't of Commerce*. The Supreme Court held instead that courts are obligated to exercise their independent judgment in determining the meaning of a statute and whether an agency has acted within its statutory authority. The demise of *Chevron* reduces the power of federal regulators in several ways, including that agencies will have to hew more closely to the statutes they interpret and will have less latitude to change prior interpretations of statutes. *See* our memo for more information.

Supreme Court blocks EPA plan to reduce air pollution from power plants and other industrial facilities across states. On June 27, the Supreme Court issued an opinion, authored by Justice Neil Gorsuch, in *Ohio, et al.* v. *Environmental Protection Agency*, which temporarily stayed enforcement under the U.S. Environmental Protection Agency's (EPA) uniform plan for reducing air pollutants in 23 states. The EPA adopted its federal plan after announcing it would reject plans developed by those states. This decision follows other recent Supreme Court decisions on the EPA's authority under, and interpretation of, U.S. environmental legislation—for example, its 2022 decision in *West Virginia* v. *EPA*, which applied the "major questions" doctrine and held that the EPA lacked the authority to implement a plan to substantially reduce carbon pollution from coal-fired power plants under the Clean Air Act.

Federal court preliminarily enjoins FTC's Non-Compete Rule, but declines to grant nationwide preliminary relief. On July 3, the U.S. District Court for the Northern District of Texas issued the first ruling in the three pending legal challenges to the Federal Trade Commission's (FTC) Non-Compete Rule. The court preliminarily enjoined the FTC from enforcing the Non-Compete Rule and stayed the Rule's effective date, but only as to those specific plaintiffs in the action. In doing so, the court determined that the plaintiffs were likely to succeed on the merits of their claims, that the FTC lacks statutory authority to promulgate the Non-Compete Rule and that the FTC's decision to ban non-compete agreements nationwide was arbitrary and capricious. The Judge stated that she expects to issue a final ruling on the merits on or before August 30, 2024, prior to the Rule's effective date of September 4. *See* our memo for more information.

European Union

ESAs issue joint opinion on SFDR. On June 18, the Boards of Supervisors of the European Supervisory Authorities (ESAs) adopted an opinion addressed to the European Commission in response to the European Commission's September 2023 consultations, which formed part of a wider assessment of the Sustainable Finance Disclosure Regulation ("SFDR") framework. The opinion states that the current disclosure regime set out in Article 8 of the SFDR—which broadly refers to financial products that promote "environmental or social characteristics"—and Article 9—which refers to products that make "sustainable investments"—have been used as "'quality labels' for sustainability" by financial market participants, which has created confusion for investors and has posed "greenwashing and mis-selling risks". To eliminate this

risk, the ESAs favor the introduction of a product classification system based on regulatory product categories and/or indicator(s) of sustainability for financial products under the SFDR. The ESAs recommend replacing the current practice of categorization in Article 8 and 9 with two new categories building on minimum criteria:

- A sustainable product category for products that invest in economic activities/assets that are already environmentally and/or socially sustainable. The ESAs opine that products in this category should comply with a minimum sustainability threshold as part of the product's investments (for environmental sustainability, in taxonomy-aligned activities as defined under the EU Taxonomy Regulation).

- A transition product category for products that invest in economic activities/assets that are not yet sustainable, but which improve their sustainability over time to become environmentally or socially sustainable. This could be demonstrated by measurable transition plans by companies engaged in harmful activities.

According to the ESAs, financial products that would not qualify for these categories could be divided into financial products that have sustainability features and those that do not have sustainability features. With respect to the former, limited disclosure about their sustainability features should be required in regulatory documents and the use of ESG or sustainability-related terms in naming and marketing should be restricted to prevent greenwashing. With respect to the latter products, a disclaimer (e.g., the one in Article 7 of the EU Taxonomy Regulation: "The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities."), potentially supplemented by minimal disclosures on negative sustainability impacts, should be required and the use of ESG or sustainability-related terms in naming or marketing should not be allowed.

In addition, the ESAs call for better alignment of sustainable investment under SFDR and taxonomy-aligned investment under the EU Taxonomy Regulation and opine that the European Commission could carefully reflect on appropriate disclosures for financial products that are currently out of scope of SFDR, such as structured products under Euro Medium-Term Note programs.

EFRAG and TNFD release correspondence mapping for nature-related disclosures. On June 20, the European Financial Reporting Advisory Group (EFRAG) and the Taskforce on Nature-related Financial Disclosures (TNFD) published the TNFD-ESRS Correspondence Mapping. In the document, EFRAG—which is responsible for developing the European Sustainability Reporting Standards ("ESRS") setting forth the detailed disclosure requirements for compliance with the EU's Corporate Sustainability Reporting Directive—and TNFD—a standard-setting initiative focused on nature-related issues—provided a granular mapping between ESRS and the TNFD recommendations, which TNFD finalized last September for companies to identify, assess, manage and, where appropriate, disclose nature-related issues. Similar to the ESRS-ISSB Standards Interoperability Guidance released in May 2024, this document was created to support comparability of the TNFD recommendations and ESRS, and facilitate the work of companies who plan to disclose under both.

On June 28, TNFD also published final sector guidance for the following eight sectors: aquaculture, biotechnology and pharmaceuticals, chemicals, electric utilities and power generators, food and agriculture, forestry, pulp and paper, metals and mining and oil and gas sectors. The guidance addresses how companies in each sector should apply the core disclosure metrics outlined in the TNFD recommendations published in September 2023, and includes a list of recommended core and additional sector disclosure indicators and metrics.

EU adopts nature restoration law. On June 17, following approval by the European Parliament on February 27, the Council of the European Union formally adopted the Regulation on Nature Restoration that is part of the EU Biodiversity Strategy. It aims to restore at least 20% of the EU's land and sea by 2030, and all ecosystems in need of restoration by 2050. The law establishes binding restoration targets for different habitat types across terrestrial, coastal, freshwater, marine, agricultural, forest, river, and urban ecosystems. By 2030, EU Member States must implement restoration measures for at least 30% of habitats listed in the law as not in good condition. Measures directed at ecosystem-specific concerns and that need to be met by 2030 include reversing pollinator population decline, enhancing the stock of organic carbon in cropland mineral soils, and ensuring no net loss in urban green spaces and tree canopy cover. Restoration of agricultural ecosystems is subject to a temporary suspension mechanism in the case of a force majeure event with severe EU-wide consequences threatening EU food consumption. The law also requires that Member States prevent significant deterioration of areas already improved by restoration or that host certain priority habitats. Member States must submit to the European Commission their national restoration plans detailing their strategy for reaching the targets, and must continue to monitor and report on their efforts. The European Commission must review the application of the Regulation by the end of 2033.

Shareholder and Proxy Advisor Updates

Global

Investors join PRI initiative to engage with companies on biodiversity. On June 26, Principles for Responsible Investment (PRI) announced the launch of the engagement process for Spring, an investor stewardship initiative focused on tackling the material financial risks of biodiversity loss by 2030. Spring's engagement commenced with 40 focus companies that have influence in countries holding "systemically significant natural capital," with 20 additional focus companies announced on June 26. Over 200 investors collectively representing $15 trillion in assets under management have publicly supported the initiative, and 66 will be actively involved in the engagements with 40 focus companies. Under this initiative, investors will engage with companies with the objective to improve the nature impacts and risks in their (1) business operation and risk management; (2) supply chain management and (3) political engagement (e.g., how the companies use their influence to tackle deforestation risks). This announcement precedes the UN's Biodiversity Conference this October (COP16), which will focus on implementing the Kunming-Montreal Global Biodiversity Framework adopted during COP15 into national action, investing and collaborating for nature to bolster resource mobilization and technical cooperation, and accelerating progress on access and benefit-sharing.

United States

Fifth Circuit vacates the SEC's rescission of notice-and-awareness requirements for proxy advisory firms. In 2020, the U.S. Securities and Exchange Commission (SEC) required proxy advisory firms to (1) make proxy voting advice about a company available to the company in advance of or concurrently with disseminating it to their clients and (2) have a mechanism for making clients aware of the company's response statement before they vote. In 2022, the SEC adopted amendments to remove these notice-and-awareness requirements. On June 26, a three-judge panel of the U.S. Court of Appeals for the Fifth Circuit vacated and remanded the SEC's rescission of these requirements. The court ruled in *National Association of Manufacturers et al.* v. *SEC* that the SEC acted arbitrarily and capriciously in removing these requirements, and therefore violated the Administrative Procedure Act. The U.S. Chamber of Commerce, the Business Roundtable and the Tennessee Chamber of Commerce & Industry also challenged the 2022 amendments in a case pending before the U.S. Court of Appeals for the Sixth Circuit. Unless the Sixth Circuit reaches a different conclusion, companies and investors should expect the notice-and-awareness requirements to be reinstated, which we expect will impact proxy advisory firm practices and proxy season engagement in the future, including on environmental and social shareholder proposals (which once again represented the majority of proposals submitted this proxy season). The Fifth Circuit's reasoning could also have implications for future agency rulemakings. In particular, the panel emphasized that when an agency reverses a prior policy based on factual findings that contradict those underlying its prior policy, the agency must provide a more detailed explanation. *See* our memo on the decision here. Our 12th annual proxy season review, which analyzes shareholder proposals for the 2024 proxy season, will be published in the coming weeks.

Exxon lawsuit against shareholder proponents is dismissed by federal judge. On June 17, a federal district court in Texas dismissed Exxon's lawsuit with respect to a shareholder proposal on setting GHG emissions reduction targets, which was submitted by Arjuna Capital and Follow This last December. As discussed in our May 2024 newsletter, the court dismissed Exxon's claims against Follow This on May 22. After Arjuna filed a letter on May 27 with the court promising to refrain from submitting future proposals related to GHG emissions or climate change, the court found that Exxon's claims against Arjuna were moot, and dismissed Exxon's lawsuit without prejudice.

Litigation Updates

United States

Eleventh Circuit holds diversity grant program focused exclusively on Black women-owned businesses is substantially likely to violate federal anti-discrimination law. On June 3, in a 2-1 ruling, a three-judge panel of the U.S. Court of Appeals for the Eleventh Circuit granted a preliminary injunction to prevent the Fearless Fund, a venture capital firm, from administering a privately funded contest to award $20,000 grants to small businesses owned by Black women (the "Contest"). The court held that the contest was substantially likely to violate 42 U.S.C. § 1981, which prohibits discrimination on the basis of race when making or enforcing contracts, and that "although the First Amendment protects the defendants' rights to promote beliefs about race, it does not give the defendants the right to exclude persons from a contractual regime based on race." The court held that the American Alliance for Equal

Rights, an organization led by the lawyer that challenged college affirmative action programs in *Students for Fair Admissions* v. *Harvard*, had standing to sue on behalf of three anonymous business owners, who were "able and ready" to enter the contest should it be open to non-Black applicants. On the merits, the court rejected Fearless Fund's argument that the Contest "seek[s] to address the 'manifest racial imbalance' in access to capital for black women-owned businesses," holding that the Contest is not a proper remedial program because it presents an "absolute bar" for non-Black applications.

Energy Transition Updates

Global

CDP releases 2023 Climate Transition Plan Disclosure. In June, CDP released its 2023 State of Play Climate Transition Plan Disclosure, a report summarizing trends across climate transition disclosures of over 23,000 organizations in 129 countries. The analysis revealed a 44% year-over-year increase in organizations with 1.5°C-aligned climate transition plans. According to the report, although nearly 40% of companies that reported having a climate transition plan are already disclosing against most of the key indicators of credible climate transition plans identified by CDP, only 2% are currently disclosing to all 21 indicators. Noting the various challenges for organizations in developing climate transition plans (including financial planning, Scope 3 accounting, governance and policy engagement), CDP encouraged companies—particularly the 36% of respondents that indicated an intent to develop a plan over the next two years—to proactively assess and identify their barriers and seek solutions.

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