

ESG Monthly Newsletter

February 2023

This memorandum highlights key recent developments in environmental, social and governance matters of relevance to public and private 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

- ISSB standards expected to be finalized in Q2 2023.** The International Sustainability Standards Board (“ISSB”) announced that it has finalized the substantive decisions on the content of its sustainability- and climate-related disclosure standards, and expects to issue the final standards at the end of Q2 2023, with an effective date of January 1, 2024, consistent with the EU’s timeline for adopting the first set of European Sustainability Reporting Standards (“ESRS”) pursuant to the Corporate Sustainability Reporting Directive.
- Global expectations on financial institutions’ climate-related efforts continue to evolve.** The Net-Zero Insurance Alliance (“NZIA”) launched a Target-Setting Protocol (the “Protocol”) that will require NZIA members to begin to set science-based decarbonization targets for their insurance and underwriting portfolios. In the U.S., the Federal Reserve Board continues to clarify its expectations on climate scenario analysis through detailed instructions provided to the six largest U.S. banks participating in its pilot climate scenario analysis exercise.
- EU takes further steps to bolster green industrial activity and a renewable hydrogen market.** The European Commission published a set of policy proposals entitled the Green Deal Industrial Plan that are designed to improve the European Union’s low-carbon industrial capacity, focused on simplifying regulatory requirements, easing access to sufficient funding, enhancing skills and opening supply chains. The European Commission also adopted two new Delegated Acts clarifying the criteria certain fuels must meet in order to be classified as “renewable,” including hydrogen/ammonia, which would apply to both imported and EU-produced fuels.
- First few U.S. universal proxy contests highlight importance of proxy advisor recommendations.** Following the SEC’s adoption of the universal proxy rules, Land & Buildings Investment Management, LLC (“L&B”) secured one of two board seats sought in a universal proxy contest against Apartment Investment and Management Co. (“AIMCO”), replacing the longest-tenured incumbent director who was up for reelection after ISS recommended against the incumbent who lost and in favor of the L&B nominee who won. Meanwhile, Capital Returns Management, LLC (“CRM”), which sought two board seats at Argo Group International Holdings (“Argo”), ultimately withdrew after both Glass Lewis and ISS recommended in favor of Argo’s nominees and against CRM’s nominees.

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**Legislative/
Regulatory
Updates****1. Global**

ISSB expects to finalize reporting standards at the end of Q2 2023. On February 16, the ISSB board confirmed that its Exposure Draft IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (“S1”) and Exposure Draft IFRS S2 *Climate-related Disclosures* (“S2”) would undergo a drafting and formal “balloting” process ahead of expected issuance at the end of Q2 2023. At the same meeting, ISSB voted in favor of fixing an effective date of January 1, 2024 for S1 and S2. ISSB also voted to reference the European Sustainability Reporting Standards (“ESRS”) within an appendix to S1, consistent with ISSB’s announcement with the European Commission and the European Financial Reporting Advisory Group last December that they are working together to maximize interoperability of their standards and aligning on key climate disclosures. Given that the substantive decisions on the content of the ISSB standards are now finalized, this joint work will now focus on detailed terminology within the standards. The first batch of ESRS are also due to be adopted by the European Commission by the end of Q2 2023.

TNFD continues to advance draft disclosure framework. On February 1, the World Business Council for Sustainable Development (“WBCSD”) launched a consultation process for ASEAN-headquartered businesses to review the current beta version of the Nature-Related Risk and Opportunity Management and Disclosure Framework proposed by the Task Force on Nature-related Financial Disclosures (“TNFD”). TNFD released the current beta version of the proposed framework last November, including recommendations regarding disclosures on how companies “locate the source of inputs used to create value” that may generate nature-related consequences, the relationship between metrics and targets for nature (as outlined in the TNFD framework) and climate (as outlined in the Task Force on Climate-related Financial Disclosures framework), as well as guidance for financial institutions, the first of several sector-specific guidance documents set to be published. The final version of the framework is expected to be released in September 2023.

2. United States

NYSE and Nasdaq propose clawback listing standards. On February 22, 2023, the New York Stock Exchange and the Nasdaq Stock Market filed their respective proposed listing standards implementing the SEC’s new mandatory clawback rules pursuant to Section 954 of the Dodd-Frank Act. The SEC’s final rule requires the exchanges’ standards to become effective no later than one year after publication of the final rule (i.e., no later than November 28, 2023). Each listed issuer will then be required to adopt a clawback policy within 60 days after its exchange’s listing standard has become effective. Assuming that each exchange’s listing standard becomes effective on November 28, 2023, then the deadline to comply will be January 27, 2024 (regardless of whether the contracts under which incentive-based compensation is to be awarded were entered into prior to, on or after such date).

FTC issues a proposed rule that would bar most non-compete agreements with workers. On January 5, the Federal Trade Commission (“FTC”) proposed its “Rules Concerning Unfair Methods of Competition”. If adopted, the proposed rules would prohibit most non-compete clauses in employment agreements and agreements with independent contractors. According to the FTC, more than 30 million worker non-compete agreements currently in place would be rendered illegal by the proposed rulemaking. The comment

period on the proposed rules expires on March 20. See S&C's [memo](#) for additional information on the proposed rules.

California legislature proposes climate-related bills. On January 30, members of the California Senate introduced three bills pertaining to climate-related financial risk. [Senate Bill \("SB"\) 261](#) would require covered entities (i.e., U.S. entities, other than insurance companies, with total annual revenues in excess of \$500 million and that "[do] business in California") to disclose a climate-related financial risk report on or before December 31, 2024, and annually thereafter. [SB 252](#) would prohibit the boards of the Public Employees' Retirement System ("CalPERS") and the State Teachers' Retirement System ("CalSTRS") from making new (or renewing existing) investments in fossil fuel companies, and would generally require CalPERS and CalSTRS to liquidate such investments by July 1, 2030. [SB 253](#) would require the California Air Resources Board ("CARB") to develop and adopt regulations requiring U.S. entities with total annual revenues in excess of \$1 billion and "that do business in California" to annually disclose and verify their Scope 1, 2, and 3 greenhouse gas emissions from the prior calendar year. Under SB 253, CARB would have until January 1, 2025 to adopt the regulations, and disclosure and verification would begin in 2026. The California Senate is currently soliciting feedback on all three bills.

3. [United Kingdom](#)

ASA publishes guidance on misleading environmental claims in advertising. On February 10, the UK's advertising regulator, the Advertising Standards Authority ("ASA"), published new [guidance](#) intending to help marketers and advertising agencies interpret the rules of the UK Code of Broadcast Advertising ("BCAP Code") and UK Code of non-Broadcast Advertising and Direct & Promotional Marketing ("CAP Code") that concern environment-related advertising issues. Among other things, the ASA's guidance addresses the making of "carbon neutral," "net zero" or similar claims. It advises against making unqualified claims, and advises that accurate information should be given about whether a claim is based on actively reducing or offsetting carbon emissions. Where a claim is based on offsetting, information should be provided about the offsetting scheme being used.

FRC updates ESG Statement of Intent. On January 30, the UK Financial Reporting Council ("FRC"), which has responsibilities in accounting and corporate reporting and governance matters, published an [update](#) to its 2021 Statement of Intent on ESG Challenges. The update summarizes actions taken by the FRC since the publication of its initial Statement of Intent to contribute to the evolution of reporting, assurance and governance of ESG matters. It also sets out areas of ongoing challenges with respect to ESG reporting, the FRC's actions to address these challenges and the FRC's planned activities in each area. Such activities include a comprehensive update to the FRC's Guidance on the Strategic Report to capture changes in narrative reporting requirements, and revising the UK Corporate Governance Code in a way that recognizes the growing importance of ESG reporting.

UK Government creates new Department for Energy Security and Net Zero. On February 7, the Prime Minister's Office [announced](#) the creation of a new Department for Energy Security and Net Zero. The new department will take on certain responsibilities previously allocated to the Department for Business, Energy and Industrial Strategy, which has been broken up into four new departments. These responsibilities comprise delivering security of energy supply, ensuring properly functioning energy markets, encouraging greater energy efficiency, and seizing the opportunities of net zero to lead the world in

new green industries. The new department also intends to secure the passing of the [Energy Bill](#) to support the emerging carbon capture, utilization and storage and hydrogen sectors; to update the governance of the energy system; and to reduce the time taken to consent offshore wind.

UK Government publishes Net Zero Review. On January 13, the UK Government published an independent [review](#) of its strategy to reach net zero greenhouse gas emissions by 2050. Commissioned by former Prime Minister Liz Truss and continued by the current Prime Minister, Rishi Sunak, the 340-page report made 129 recommendations to achieve net zero.

4. [European Union](#)

EU adopts two new Delegated Acts governing renewable fuels, including green hydrogen. On February 13, the European Commission [adopted](#) two Delegated Acts (the “First Delegated Act” and “Second Delegated Act”) that address the criteria for classification as “renewable” fuels (applicable to, among others, hydrogen and ammonia) and the methodology for calculating greenhouse gas emissions savings associated with such fuels, respectively. The First Delegated Act will in many instances require renewable fuel producers to demonstrate “additionality” in their use of renewable electricity as well as temporal and geographic correlation between the electricity generation and fuel production. The Second Delegated Act outlines the calculation of total greenhouse gas emissions. Fuels must demonstrate over 70% greenhouse emissions savings over the fossil fuel comparator to qualify as renewable. Both Delegated Acts will be submitted to the European Parliament and Council for approval, which will have a maximum of four months (including extensions) to accept or object to the Delegated Acts.

EU publishes an Industrial Plan to support the European Green Deal. On February 1, the President of the European Commission [presented](#) the EU’s Green Deal Industrial Plan (the “Industrial Plan”) to support the EU’s green transition ambitions and net zero targets for 2050. The Industrial Plan is based on four pillars: (1) a predictable and simplified regulatory environment, (2) faster access to sufficient funding, (3) enhancing skills and (4) open trade for resilient supply chains. With respect to the first pillar, the European Commission will put forward three proposals this spring, including a Net-Zero Industry Act to streamline the permitting process for approving green industrial projects, a Critical Raw Materials Act to diversify the EU’s sourcing of rare earth materials, and reforms to the electricity market. With respect to the second pillar, the European Commission plans to relax current state aid rules restricting public investment in the renewable energy and green technology sectors and increase the availability of EU-level funding for low-carbon projects. With respect to the third pillar, the European Commission intends to continue to work alongside Member States and the higher education sector in monitoring the supply and demand of skills and jobs in green sectors. With respect to the fourth pillar, the European Commission has plans to develop clean tech/net zero industrial partnerships and an export credits strategy to promote the adoption of net zero technologies globally.

Litigation/ Enforcement Developments

1. [United States](#)

Republican AGs sue DOL over ESG investing rule. On January 26, 25 Republican state attorneys general sued the U.S. Department of Labor (“DOL”) in the Northern District of Texas seeking to enjoin DOL’s recently finalized rule governing how retirement plan managers may consider ESG factors in their investment decisions. The suit alleges that DOL’s “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder

Rights” rule violates the Employment Retirement Income Security Act of 1974 (“ERISA”), which requires that plan fiduciaries act solely to promote the financial interests of plan participants and their beneficiaries. Citing *West Virginia v. EPA*, the complaint also states that the rule fails under the Major Questions Doctrine on the grounds that regulating trillions of dollars in ERISA plans for nonfinancial purposes presents an extraordinary case requiring an express grant of authority from Congress not present in ERISA. Additionally, the complaint states that the rule is arbitrary and capricious under the Administrative Procedure Act. See S&C’s [memo](#) for more information on the DOL rule.

Delaware court rules that corporate officers have *Caremark* duties. On January 26, the Delaware Court of Chancery explicitly held for the first time that officers owe a “duty of oversight” analogous to that owed by directors. In *In re McDonald’s Corp. Stockholder Derivative Litigation*, plaintiffs alleged that McDonald’s former head of human resources, David Fairhurst, had personally “committed multiple acts of sexual harassment” and “that under Fairhurst’s watch, the human resources department ignored complaints about the conduct of co-workers and executives.” The court held that these allegations were sufficient to plead knowing misconduct. The court further held that “[w]hen a corporate officer himself engages in acts of sexual harassment, it is reasonable to infer that the officer consciously ignored red flags about similar behavior by others.” See S&C’s [memo](#) for additional information on the litigation. In addition, on January 9, the SEC [settled](#) charges it brought against McDonald’s former CEO (for making false and misleading statements about the circumstances leading to his termination) and McDonald’s (for failing to disclose that the company exercised discretion in terminating the CEO without cause).

Masimo amends advance notice bylaws. On February 6, as the Delaware Chancery Court was nearing a decision on Politan Capital Management’s (“Politan”) lawsuit against Masimo Corporation (“Masimo”) in connection with Masimo’s advance notice bylaws, Masimo amended its bylaws to remove provisions that had been criticized as “draconian.” In particular, Masimo’s advance notice bylaws included provisions that would require a shareholder making a director nomination to disclose the identity of their financial backers, like limited partners. Politan has said it was “glad” to see the bylaw amendments, although the lawsuit is continuing on other grounds. Companies that have recently adopted amendments to (or that are considering amending) their advance notice bylaws should examine the recent Masimo amendments in evaluating their own bylaw amendments.

2. [United Kingdom](#)

ClientEarth launches judicial review against FCA oil & gas IPO approval. On February 13, ClientEarth, an environmental law non-governmental organization, [announced](#) that it has asked the UK High Court for permission to apply for judicial review of the decision, taken by the UK Financial Conduct Authority (FCA), to approve the IPO prospectus for Ithaca Energy plc, a UK oil and gas company. ClientEarth alleges that the FCA acted unlawfully by approving the prospectus because the prospectus failed adequately to explain how the risks climate change presents to the oil and gas industry affect Ithaca’s business specifically, or how significant these risks are for Ithaca. ClientEarth also alleges that, by failing to provide investors with a meaningful indication of how Ithaca’s business and finances might be affected by a full or partial achievement of the Paris Agreement goal to limit temperature increases to 1.5°C above pre-industrial levels, the prospectus failed to meet the requirement to disclose the necessary information for investors to make an informed assessment of the company’s financial position. This is the first time ClientEarth has sought judicial review of a decision taken by the FCA.

ClientEarth launches derivative action against Shell plc's board of directors. On February 9, ClientEarth [announced](#) that it had filed a derivative action in the UK High Court against Shell plc's board of directors. ClientEarth alleges that Shell's directors have breached duties owed to Shell under the UK Companies Act 2006 by failing to adopt an energy transition strategy that aligns with the Paris Agreement. The filing of the claim follows a pre-action letter sent by ClientEarth to Shell on March 15, 2022. See our May 2022 [newsletter](#) for further information on the pre-action letter.

UK court dismisses appeal against LNG export finance decision. On January 13, the UK Court of Appeal [dismissed](#) an appeal by Friends of the Earth ("FoE") against the High Court's refusal to grant an application for judicial review of the UK Government's decision to approve a £1.15 billion investment by UK Export Finance, the UK Government's export credit agency, in a liquefied natural gas project in Mozambique. FoE claimed that there was no rational basis on which the Government could conclude that its decision was compatible with the Paris Agreement, but the Court of Appeal held that it would not derive hard-edged obligations from the interpretation of an international treaty that had not been incorporated into domestic law. Instead, the Court of Appeal found that the UK Government had adopted a "tenable" view as to whether funding the Project was aligned with its obligations under the Paris Agreement. FoE also argued that the Government breached its duty of enquiry by failing to obtain a quantification of the project's Scope 3 emissions, but the Court of Appeal found that the UK Government should be allowed a substantial margin of appreciation in taking the funding decision and that it did not err in taking the decision without quantifying Scope 3 emissions. FoE stated it is considering whether to appeal to the UK Supreme Court.

Financial Institutions Developments

1. [Global](#)

Insurers and United Nations Launch Target-Setting Protocol to Accelerate Transition to Net-Zero Economy. At the World Economic Forum's Annual Meeting on January 17, the United Nations-convened Net-Zero Insurance Alliance ("NZIA") [launched](#) the first Target-Setting Protocol (the "Protocol"). The Protocol will require NZIA members to begin to set science-based decarbonization targets for their respective insurance and underwriting portfolios to support the net-zero transition. The Protocol outlines two target types within the emissions reduction category, two target types within the engagement category, and one target type for the re/insuring the transition category. Existing NZIA members must set and disclose at least one of the five target types by July 31, 2023 and at least one target type in each category by July 31, 2024. New NZIA members that join after January 2023 will have six months to set their first target and one year after that to set a target type in each of the three target categories. The NZIA also recently announced that it will continue to collaborate with the Science Based Targets initiative to develop its approach to target-setting for insurance and reinsurance underwriting portfolios.

2. [United States](#)

Fed moves forward with pilot climate scenario analysis. On January 17, the Board of Governors of the Federal Reserve System [released](#) instructions for its pilot climate scenario analysis. The six banks in the pilot (Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Wells Fargo) were instructed to focus on two modules: (1) physical risk and (2) transitional risk. The participating banks must submit completed data templates and supporting information in response to the Fed's scenario analysis questions by July 31. Though the Fed does not plan to release firm-specific information, it will release results from this pilot exercise on an aggregated level. The pilot

exercise does not have capital consequences or supervisory implications for the participants. See S&C's [memo](#) for more information on the Fed's instructions regarding the pilot exercise.

3. [European Union](#)

ECB releases climate-related statistical indicators. On January 24, the European Central Bank (ECB) [released](#) a set of climate-related statistical indicators, including: (1) experimental indicators on sustainable finance, (2) analytical indicators on carbon emissions and (3) analytical indicators on physical risks. The ECB has noted that its main goal of developing these indicators is to improve the data and methodologies used for measuring climate-related risks and to facilitate the green transition. However, the ECB has also noted that the indicators are a work in progress and should be used with caution. Financial institutions should consider whether it is appropriate to incorporate these indicators into their existing models and continue to monitor as new ways of measuring climate-related risks emerge.

Republican Working Group to focus on ESG shareholder proposals. On February 3, the Chairman of the House Financial Services Committee, Patrick McHenry, [announced](#) the formation of a Republican Working Group led by Oversight and Investigations Subcommittee Chairman Bill Huizenga. The working group will focus on combatting "the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals" by: (1) "[r]ein[ing] in the SEC's regulatory overreach," (2) [r]einforc[ing] the materiality standard as a pillar of our disclosure regime and (3) "hold[ing] to account market participants who misuse the proxy process or their outsized influence to impose ideological preferences in ways that circumvent democratic lawmaking." The working group also intends to coordinate Republicans' response on ESG through member education and policy development.

ISS and Glass Lewis defend ESG-related policies. On January 17, Republican attorneys general from 21 U.S. states sent a [letter](#) to proxy advisory firms ISS and Glass Lewis, stating that the firms' voting guidelines on issues such as climate change and boardroom diversity may violate statutory and contractual duties. According to the letter, ISS and Glass Lewis policies that promote goals such as net zero emissions, for example, elevate non-financial considerations over the financial interests of their clients. Both ISS and Glass Lewis responded to the letter on January 31. ISS [stated](#) that although investors' increased focus on ESG considerations may give a false impression that ISS has altered its operating approach, ISS's fiduciary and contractual responsibilities remain the foundation of ISS's business. Similarly, Glass Lewis [noted](#) that it evaluates all environmental and social issues through the lens of long-term shareholder value.

Institutional investors update voting policies for 2023. On January 26, Vanguard [released](#) its Proxy Voting Policy for U.S. Companies for 2023. Among other updates, the 2023 policy, which became effective on February 1, clarifies that when considering compensation, Vanguard will not look for nonfinancial metrics (such as ESG metrics) to be a standard component in all compensation plans. BlackRock's [2023 Investment Stewardship Global Principles](#) became effective on January 1, encourages companies to produce sustainability-related disclosures sufficiently in advance of their annual meeting so that the disclosures can be considered in relevant vote decisions. In addition, BlackRock's policy also encourages companies to disclose how they consider their reliance on and use of natural capital, as well as risk oversight and relevant metric and targets in respect of natural capital that may be integrated into a company's strategy,

indicating that the emerging TNFD recommendations may help companies report on natural capital.

First universal proxy contests demonstrate importance of director tenure and proxy advisor recommendations. In December 2022, L&B secured one of two board seats sought in a contest against AIMCO fought on universal proxy cards, replacing the longest-tenured incumbent director who was up for reelection. ISS seems to have applied its guidance surrounding the universal proxy rule, which indicates that ISS would recommend replacing a “long-tenured, over boarded director who seems disengaged” with “a nominee who brings clearly-relevant skills to the board, or perhaps enhances diversity,” by recommending against the incumbent who lost and in favor of the L&B nominee who won (Glass Lewis recommended a vote for both AIMCO nominees). Proxy advisor recommendations may have also influenced the decision-making of activist investor CRM, which sought two board seats at Argo. CRM withdrew after both Glass Lewis and ISS recommended in favor of Argo’s nominees and against CRM’s nominees. See our [memo](#) for more information on the universal proxy rules.

Sustainable Finance Updates

LMA/LSTA/APLMA updates ESG loan principles. On February 23, the Loan Market Association (“LMA”), Loan Syndications & Trading Association (“LSTA”) and Asia Pacific Loan Market Association (“APLMA”) [published](#) updated Green Loan Principles, Social Loan Principles and Sustainability-Linked Loan Principles (together, the “2023 Principles”) with accompanying guidance regarding use and implementation. The 2023 Principles retain the same basic principles of the prior versions, with modest updates to reflect current market practices. The updated 2023 Principles apply to transactions completed after March 9, 2023.

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