ESG Monthly Newsletter

February 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

SEC to vote on final climate-related disclosure rules.

The US Securities and Exchange Commission (SEC) has announced that on March 6 it will vote on whether to adopt rules that would require registrants to provide certain climate-related information in their registration statements and annual reports. The announcement of the SEC vote comes amidst pending US Supreme Court review of the power of federal agencies and legal challenges to state-level ESG legislation in the US.

EU due diligence directive suffers major setback.

In a vote on February 28, the European Council failed to approve the Corporate Sustainability Due Diligence Directive (CSDDD). Leading up to the failed vote, the European Council's vote on the CSDDD had been repeatedly postponed following reports that support for the final draft of the directive eroded after Germany indicated that it would abstain from the vote, which effectively counts as a vote against the proposal. Other large EU Member States (France and Italy) followed suit. In addition, the European Parliament and European Council provisionally agreed to delay the adoption of corporate sustainability reporting standards for specific sectors and non-EU companies until 2026.

S&C releases resources highlighting considerations for 2024.

To support our clients in preparing for ESG-related developments in 2024, S&C has published the following resources:

- Energy Transition Year in Review and Look Ahead, reviewing key recent developments for energy transition projects in the US and across the world, as well as expectations for 2024.
- Year in Review – Labor and Employment, highlighting significant issues reviewed by S&C's Labor and Employment Group over the last year, including the Supreme Court's 2023 *Harvard* decision.
- S&C Critical Insights – ESG Considerations for Financial Institutions, a podcast providing practical takeaways for financial institutions as they navigate ESG trends—such as the growing divergence in ESG requirements and expectations at the international, federal and state level—in 2024.
- Investment Management Newsletter – Q4 2023, summarizing key legal and regulatory developments relevant to the investment management industry, including ESG-related developments such as the SEC's fund "names" rule and California's new diversity reporting requirements for venture capital companies.

Legislative and Regulatory Updates

United States

SEC to vote on final climate-related disclosure rules. On February 28, the SEC released a Sunshine Act Notice indicating that on March 6 the SEC will vote on whether to adopt rules that would require registrants to provide certain climate-related information in their registration statements and annual reports. The SEC released its proposed rules in March 2022 (*see our memo for more information*). When the final rules are released, S&C will host a webinar and update our ESG practice website with additional materials on the final rules, as well as key takeaways for how companies can navigate these requirements.

Fifth Circuit to reconsider challenges to Nasdaq board diversity rules. On February 20, the US Court of Appeals for the Fifth Circuit granted a petition for an *en banc* hearing to reconsider a challenge of Nasdaq's board diversity rules. On October 18, 2023, a three-judge panel of the Fifth Circuit had upheld Nasdaq's board diversity rules, which would (1) require listed companies to have at least one director who self-identifies as female and at least one director who self-identifies as an underrepresented minority, or explain the lack of such directors (*see our memo for more information*), and (2) have Nasdaq provide certain listed companies with one year of complimentary access to a board recruiting service that would provide a network of board-ready diverse candidates for companies to identify and evaluate. After the SEC approved the rules in August 2021, the Alliance for Fair Board Recruitment and the National Center for Public Policy Research (NCPPR) sued Nasdaq and the SEC. The court has tentatively scheduled oral arguments for the week of May 13. *See our previous newsletter for more information on the October 2023 decision.*

Supreme Court hears cases on *Chevron* deference. On January 14, the US Supreme Court heard oral arguments in *Loper Bright Enterprises* v. *Raimondo* and *Relentless Inc.* v. *U.S. Department of Commerce*, a pair of cases that challenge the principle of administrative deference established by the 1983 case *Chevron U.S.A. Inc.* v. *National Resources Defense Council*. In *Chevron*, the Supreme Court held that courts should defer to an agency's interpretation of a federal statute that is ambiguous or silent, so long as such interpretation is reasonable. *See our webinar for more information on the potential implications of these cases.*

California legislature may consider potential clarifications to Voluntary Carbon Market Disclosures Act (AB 1305). On February 12, California Assembly Member Jesse Gabriel, the author of AB 1305, introduced a placeholder bill (AB 2331) expressing an intent to "enact future legislation that would clarify the provisions of [AB 1305]." As further discussed in our memo, California enacted AB 1305 on October 7, 2023, which imposes website disclosure requirements on both (1) business entities that market or sell voluntary carbon offsets within California and (2) entities operating in California that make, among other claims, claims regarding the achievement of net zero emissions or "carbon neutrality," including entities that purchase or use voluntary carbon offsets. One aspect of AB 1305 on which market participants have sought clarification is the date on which the first set of disclosures must be posted to a company's website, which is not specified in the text of AB 1305. Previous efforts to provide clarification on this point includes a letter from Assembly Member Gabriel printed in the January 3, 2024 edition of California's Assembly Daily Journal, which does not have the force of law, stating

his intent that "the first annual disclosure be posted by January 1, 2025." At the time of this newsletter, the placeholder bill does not include any details on what clarifications would be included. Instead, it represents an initial step in preserving the California legislature's ability to take formal legislative action to clarify the disclosures required under AB 1305, including potentially the timing for the initial disclosures under AB 1305.

US Chamber of Commerce sues California over climate disclosure laws. On January 30, the US Chamber of Commerce, together with the American Farm Bureau Federation, California Chamber of Commerce, Central Valley Business Federation, Los Angeles County Business Federation and Western Growers Association, filed a lawsuit against California in the US District Court for the Central District of California challenging two climate disclosure bills that were signed into law on October 7, 2023. One of the laws, SB 253, would require US companies with total annual revenues in excess of $1 billion that do business in California to publicly disclose all Scope 1, 2 and 3 GHG emissions on an annual basis. The other law, SB 261, would require US companies (other than insurance companies) with total annual revenues in excess of $500 million that do business in California to, on a biennial basis, publicly disclose climate-related financial risk in accordance with the framework of the Task Force on Climate-Related Financial Disclosures (*see our memo for more information on both laws*). The complaint alleges that these laws violate (1) the First Amendment, (2) the Supremacy Clause, and (3) limits on extraterritorial regulation under the US Constitution. The outcome of this lawsuit may impact similar laws pending adoption in states such as New York and Illinois, and could potentially affect state-level "pro-ESG" and "anti-ESG" lawmaking activities more broadly. In its press release announcing the lawsuit, the US Chamber of Commerce expressed concern that recent developments at the state level may "usher[] in an era of duplicative and conflicting state-imposed requirements," "leaving businesses and other investors caught in the middle of a political scrap between states."

United Kingdom

Financial Reporting Council (FRC) publishes UK Corporate Governance Code 2024 and consolidates existing guidance. On January 22, the FRC published the 2024 edition of the UK Corporate Governance Code (the "Code"). This was followed on January 29 by publication of new, non-mandatory Corporate Governance Code Guidance, which consolidates and updates the FRC's existing guidance on applying the Code. The Code currently applies to all companies, whether incorporated in the UK or elsewhere, with a premium listing on the London Stock Exchange. When the Financial Conduct Authority's proposed reforms of the UK listing regime for equity shares come into effect later this year, the Code will apply to all companies listed in the single "commercial companies" listing category that will be introduced to remove the distinction between a premium and a standard listing. The Code is divided into sections covering five areas: (1) board leadership and company purpose, (2) division of responsibilities, (3) composition, succession and evaluation, (4) audit, risk and internal control, and (5) remuneration, and sets out within those sections 18 general governance principles that companies should apply and a further 41 detailed provisions against which companies must "comply or explain." Amendments to the Code include, among other changes, those

intended to promote diversity, inclusion and equal opportunity. *See our memo for a summary of the updates to the UK Corporate Governance Code.*

European Union

European Council fails to approve Corporate Sustainability Due Diligence Directive (CSDDD). In a vote of the European Council on February 28, CSDDD did not achieve the requisite votes for approval. Throughout February, the European Council's vote on the CSDDD had been repeatedly postponed, following reports that support for the final draft of the directive eroded after Germany indicated that it would abstain from the vote. German political leaders continue to voice concern that the EU's recent regulation of sustainability matters is creating an excessive burden on small- and medium-size businesses. Following the failed vote, the current Belgian Presidency of the Council released a statement, stating, "We 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 European Parliament and European Council previously announced their provisional agreement on the text of the CSDDD in December 2023 (*see our previous newsletter for more information*). Unless a final vote on the CSDDD passes before late spring, legislative processes, including on the CSDDD, will end due to June 2024 European elections. The European Commission would have to launch a new initiative that would have to overcome EU Member States' concerns and scrutiny from a potentially more ESG-critical, newly constituted European Parliament.

European Parliament and Council agree on two-year delay to publication of sector-specific non-EU sustainability reporting standards. On February 8, the European Parliament and the European Council reached a provisional agreement to extend the deadline for the adoption of certain European Sustainability Reporting Standards (ESRS) under the Corporate Sustainability Reporting Directive (CSRD) from June 30, 2024 to June 30, 2026. Specifically, this relates to (1) sector-specific ESRS and (2) standards that specify reporting obligations for certain large non-EU companies operating in the EU. The intention of the delay is to allow companies to focus on implementing the initial set of general sector-agnostic ESRS, which was adopted by the European Commission in July 2023.

European Parliament and European Council adopt anti-greenwashing law targeting misleading product sustainability claims. Following an affirmative vote of the European Parliament in January, on February 20, the European Council adopted a directive adding to the EU list of banned commercial practices the unsubstantiated use of generic sustainability- and durability-related labels, such as "environmentally friendly," "natural," "biodegradable," "climate neutral," "eco," or advertising that a product can be used for a specific period of time or is repairable when it is not. The ban would include claims that a product has a neutral, reduced or positive impact on the environment based on emissions-offsetting schemes. In addition, the law would only allow the use of sustainability labels based on official certification schemes or established by public authorities. The European Commission proposed the law in March 2022 and the European Parliament and the European Council reached a provisional agreement in September 2023. The directive is expected to enter into force in late March. Thereafter, EU Member

States will have 24 months to incorporate the update into their national law and the changes shall apply 30 months after the directive became effective.

Shareholder Engagement and Proxy Advisory Updates

Global

Multiple large financial institutions withdraw or scale back participation in Climate Action 100+. Throughout February, multiple large financial institutions withdrew from or scaled back their participation in the Climate Action 100+ (CA100+). On February 26, CA100+ announced that JP Morgan Asset Management, State Street Global Advisors (SSGA) and PIMCO have decided to withdraw from the initiative, while BlackRock had transferred its participation to BlackRock International. As an explanation for these developments, both BlackRock and SSGA cited concerns with the enhanced requirements of Phase 2 of CA100+, which would require signatories to make "an overarching commitment to use client assets to pursue emissions reductions in investee companies through stewardship engagement." On the same day of the CA100+'s announcement, the US House of Representatives' Committee on Oversight Accountability sent a letter to the General Counsel of the Board of Governors of the Federal Reserve requesting additional information to aid its ongoing review of integration of ESG policies across the US economy, citing concerns with financial institutions' participations in CA100+ and other ESG-focused alliances.

United States

BlackRock and Vanguard release 2024 updates to Investment Stewardship principles and guidelines. On January 18, BlackRock released updates to its Investment Stewardship priorities, principles, proxy voting guidelines and approach to engagement in specific areas, including human capital management, corporate human rights risks, climate-related risk and low-carbon transition and natural capital. BlackRock's 2024 principles note that robust disclosure on material sustainability-related risks and opportunities enable investors to evaluate a company's strategy and business practices, citing the sustainability reporting standards developed by the International Sustainability Standards Board (ISSB) as a useful guide for companies when preparing their disclosures. In addition, BlackRock referenced nature-related capital as increasingly impacting some companies' ability to generate long-term financial returns, noting that it will look for these companies to disclose how they oversee such nature-related risk. Similarly, Vanguard's 2024 proxy voting policy for US portfolio companies, which is effective February 2024, states that Vanguard may support a shareholder proposal that addresses a shortcoming in a portfolio company's sustainability disclosures relative to a widely accepted investor-oriented framework (specifically noting the ISSB's standards).

Exxon sues shareholder proponents. On January 21, Exxon filed a lawsuit in the Northern District of Texas seeking declaratory judgment with respect to a shareholder proposal submitted by Arjuna Capital and Follow This in December 2023. The proposal, submitted under Rule 14a-8, requested that the company set medium-term GHG emissions reduction targets for Scope 1, 2 and 3 emissions. Instead of asking the SEC to grant no-action relief for excluding the proposal from its proxy statement as is typical, Exxon asked a court to grant declaratory judgment that the company may exclude the proposal because it: (1) addresses "substantially the same subject matter" as proposals voted twice in the previous three years where the most recent vote was below 15% and (2) deals with "ordinary business" operations. Companies have been much less likely to receive no-action relief from the SEC on either of these bases, after the SEC updated its no-action guidance in 2021 and proposed rule changes in 2022 that would heighten certain standards for excluding shareholder proposals (*see our proxy season review for more information*). On February 1, Arjuna Capital and Follow This withdrew their proposal. Although Exxon withdrew its motion to expedite summary judgment, it has not withdrawn the lawsuit, citing the continued existence of "important issues for the court to resolve."

"Post-universal proxy" advance notice bylaws continue to be challenged. In a recent decision, *Kellner* v. *AIM Immunotech*, the Delaware Court of Chancery invalidated certain advance notice bylaw provisions, including, among other language, (1) the bylaw's overbroad definition of "Stockholder Associated Persons" and (2) overbroad disclosure requirements on arrangements, agreements or understandings relating to nominations. Despite striking down these provisions, the court found that the stockholder nomination notice was nevertheless deficient under a previous, reasonable version of the provisions. More recently, while the *Kellner* decision is on appeal, plaintiffs' firms have sent demand letters and filed lawsuits targeting a number of companies (including Halliburton) challenging recently adopted advance notice provisions based on the reasoning in *Kellner*.

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