SULLIVAN & CROMWELL LLP

ESG Monthly Newsletter

March 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

- **Conflict over ESG investing continues at the U.S. federal and state level.** In Washington, both chambers of Congress passed a resolution that would have overturned a new Department of Labor rule that permits retirement fund fiduciaries to consider ESG factors in their investment decision-making. Although President Biden vetoed the resolution and kept the DOL rule intact, similar efforts to limit financial market participants' consideration of ESG factors continue across many U.S. states.

- **New European Union actions focus on boosting low carbon industries.** The European Commission has proposed two new laws aimed at supporting the development of clean energy industries and decarbonization technologies within the EU. The two proposed acts — the Net-Zero Industry Act and the Critical Raw Minerals Act — would offer expedited permitting to support domestic development of clean technology manufacturing and critical mineral extraction, processing and recycling. The Commission has also released additional proposals for the new European Hydrogen Bank, which will take a multipronged approach to increasing investment in renewable hydrogen.

- **IPCC warns of need for near-term action to limit climate change.** In a report released mid-March, the Intergovernmental Panel on Climate Change reported that global warming will likely reach 1.5°C in the near term as the climate will continue to heat up between now and 2040 mainly due to increased cumulative CO_2 emissions. Although climate financing has increased, the IPCC noted that achieving current climate goals would require a "many-fold" increase in financing for both adaptation and mitigation, and that, currently, climate finance flows fall short of the levels needed to meet climate goals across all sectors and regions.

In this Issue

Legislative and Regulatory Updates

1. *United States*

President Joe Biden vetoes Congressional resolution limiting retirement fund managers from considering ESG factors. In February, a Republican-led resolution under the Congressional Review Act passed both chambers of Congress, seeking to nullify the U.S. Department of Labor's ("DOL") 2022 rule, which deleted the prohibition on retirement plan fiduciaries from considering "non-pecuniary" factors when making investment decisions. On March 20, President Biden vetoed the resolution, keeping intact the DOL rule, which specifies that a fiduciary's duty of prudence may require evaluation of climate and other ESG factors.

State-level "anti-ESG" pushback continues. On March 16, 19 governors signed on to an open letter pledging to "work together and leverage our state pension funds to force change in how major asset managers invest the money of hardworking Americans, ensuring corporations are focused on maximizing shareholder value, rather than the proliferation of woke ideology". According to the pledge, the governors plan to lead state-level efforts that may include eliminating consideration of ESG factors by state and local governments when issuing bonds and prohibiting state fund managers from considering ESG factors when investing taxpayer money. Several of the governors are from states that have already enacted or proposed legislation designed to address similar topics.

DOE launches series of reports on commercial development of clean energy technologies. On March 21, the U.S. Department of Energy ("DOE") launched a series of reports aimed at linking public and private sectors to accelerate growth of clean energy technologies. The Pathways to Commercial Liftoff Reports focus on how and when certain technologies, including clean hydrogen, advanced nuclear, and long duration energy storage, can reach full-scale commercial adoption. The first reports conclude that reaching the U.S.'s decarbonization targets will require increasing investments in hydrogen, nuclear, and long duration energy storage from approximately $40 billion to $300 billion by 2030, with continued acceleration in investments through 2050.

2. *European Union*

European Commission proposes new Net-Zero Industry Act. On March 16, the Commission proposed a new regulation, the Net-Zero Industry Act, that aims to scale up the EU's ability to manufacture the strategic net-zero technologies, including wind turbines, heat pumps, solar panels, renewable hydrogen, and CO_2 storage, needed to reach the EU's climate and energy targets. The proposed regulation aims to attract investment and improve conditions for setting up net-zero projects in the EU, including by shortening permitting timelines and streamlining procedures for strategic projects. The proposed regulation also outlines new targets for CO_2 storage and support for workforce training. The proposed regulation will next be reviewed by the European Parliament and the Council of the European Union.

European Commission proposes to boost access to battery metals needed for renewable energy. Also on March 16, the Commission proposed the Critical Raw Materials Act to establish a framework for ensuring the EU's access to a secure and sustainable supply of critical raw materials, such as rare earth metals and lithium, needed for the renewable energy, digital, defense, space and health sectors. Please see the firm's recent S&C Energy Transition Insights for additional details about the Commission's proposal.

European Commission announces details of proposed new European Hydrogen Bank. The Commission has announced details of its plans to promote hydrogen production through creation of a European Hydrogen Bank ("EHB"), which is targeted to be operational by the end of this year. The new EHB aims at increasing investment in hydrogen so the EU can reach its goals of producing domestically 10 million tonnes of renewable hydrogen by 2030 and importing a further 10 million tonnes. The EHB is intended to reduce the cost gap between renewable hydrogen and fossil fuels for early projects. Among other measures, the EHB aims to de-risk renewable hydrogen production by creating an auction platform for renewable hydrogen production that will provide producers with a fixed price payment per kilogram of hydrogen produced for a maximum of 10 years of operation. The auction design is still being developed, with a first pilot auction expected in autumn 2023. The EHB will also implement financing measures to support imports of renewable hydrogen production. Please see the firm's recent S&C Energy Transition Insights for key considerations for exporters of renewable hydrogen to the EU.

European Commission proposes new directive to protect consumers from greenwashing. The Commission has proposed a new Directive on Green Claims that would require that covered companies abide by minimum norms on how they substantiate and communicate certain claims related to environmental impacts of goods, services or an organization, and that will regulate the use of environmental labels. Environmental claims (such as "packaging made of 30% recycled plastic" or "ocean friendly product") will need to be substantiated, and such substantiation must be independently verified ex-ante. The proposed directive will next be reviewed by the European Parliament and the Council of the European Union. In parallel, the Commission has also proposed a new directive on common rules promoting the repair of goods to reduce waste and promote the circular economy.

3. *United Kingdom*

UK Parliamentary committee expresses concern over regulator's anti-greenwashing proposals. On March 9, the Treasury Sub-Committee on Financial Service Regulation raised concerns about proposals consulted on by the Financial Conduct Authority ("FCA") to introduce new disclosure requirements and a labelling regime for sustainable investment products. The Sub-Committee has warned that the cost-benefit analysis on the proposals undertaken by the FCA focused on the administrative burdens of firms complying with the proposed regulatory framework and did not factor in costs to the consumer, which the Sub-Committee expects to be "substantial." It has therefore requested that the FCA provide a new cost-benefit analysis, among other requests. On March 29, the FCA announced that the new rules are intended to enter into force in Q3 2023, rather than from June 30 as initially intended.

UK Government boosts funding for critical mineral supply chain. On February 27, the UK government announced £15 million of government funding for research aimed at improving the supply of critical materials to the UK. The new program will support research into recycling of rare earth elements and aims to unlock further private investment in projects to develop resilient supply chains. The UK's investment aligns with a more expansive proposal by the EU (discussed above) to improve access to raw materials needed for clean technology manufacturing.

UK Government classifies nuclear power as environmentally sustainable. When delivering the UK's Budget on March 15, UK Chancellor Jeremy Hunt announced that, subject to public consultation, nuclear energy would be included in the UK's forthcoming Green Taxonomy, a system that will be used to classify certain economic activities as "green." The decision, which the Chancellor said would encourage private investment, reflects similar measures by the European Union to recognize nuclear and gas activities as "green." The Chancellor also announced that the UK Government will launch the Great British Nuclear ("GBN") project, which had previously been discussed in April 2022 as part of the British Energy Security Strategy. GBN aims to address constraints in the nuclear market and support new nuclear builds as the UK Government works towards net zero emissions.

UK Competition and Markets Authority publishes draft guidance on environmental sustainability agreements. On February 28, the UK's Competition and Markets Authority ("CMA") published its draft guidance on the application of Chapter I of the Competition Act 1998 to environmental sustainability agreements. With its new guidance, the CMA intends to make it easier for companies to jointly pursue environmental and sustainability initiatives. The CMA's draft guidance provides detail on cross-industry cooperation that would fall outside the Chapter I prohibition altogether, and cooperation that can benefit from certain exemptions from otherwise applicable competition measures, provided that the sustainability objectives pursued by such cooperation are sufficient to offset any potential harm to competition. The guidance also contains a new exemption specifically for "climate change agreements" that contribute towards the UK's binding climate change targets under domestic or international law. Exceptionally, such agreements will not need to demonstrate that they provide a fair share to a particular group of consumers to be permissible under UK competition law where it can be shown that they provide benefits to society more broadly. The guidance highlights the CMA's willingness to provide informal, individual guidance on sustainability cooperation and protection from fines where parties to an agreement engage with the CMA early on. The CMA is hosting a number of webinars and roundtable events and is soliciting stakeholder feedback on the draft guidance by April 11.

Litigation and Enforcement Developments

1. *United States*

Recent U.S. Securities and Exchange Commission enforcement actions signal focus on disclosure controls. In recent enforcement actions, the Securities and Exchange Commission ("SEC") has charged companies with failures to maintain disclosure controls, even in cases where the SEC did not charge the company with an underlying reporting violation. In other recent enforcement actions where the SEC has charged the company with an underlying reporting violation (e.g., failure to disclose related-party transactions or materially misleading non-GAAP disclosures), the SEC has also emphasized its claims that the company failed to maintain adequate disclosure controls. In light of these developments, companies should review and, as appropriate, refresh their disclosure controls and related trainings in consultation with legal advisors, including to prepare for compliance with new requirements to disclose sustainability-related information.

U.S. Department of Justice further scrutinizes overlapping directors. Last October, the Department of Justice ("DOJ") announced that directors had resigned from the boards of five companies in response to DOJ concerns that their roles violated Section 8, noting that this would be "the first in a broader review of potentially unlawful interlocking directorates." On March 9, the DOJ announced that the Division of Antitrust's recent efforts had prevented or unwound a total of at least 13 potential director interlocks from 10 boards. In addition, Jonathan Kanter, the head of the DOJ's antitrust division, said during a recent speech that the department has 17 active investigations into potential director interlocks.

2. *Australia*

Australian regulators focus on greenwashing. Australian regulators recently announced new investigations and proceedings related to "greenwashing." The Australian Competition and Consumer Commission ("ACCC") has announced investigations across the packaging, consumer goods, food manufacturing and medical devices sectors for alleged misleading environmental claims. ACCC's 2022-23 compliance and enforcement priorities include consumer and fair-trading issues in relation to environmental and sustainability claims, and these investigations follow ACCC's "internet sweep" last year, which focused on environmental and sustainability marketing claims. In addition, the Australian Securities and Investments Commission ("ASIC") has launched civil proceedings into a superannuation fund that it alleges has made misleading statements about the sustainable nature and characteristics of some of its superannuation investment options. The case is ASIC's first court proceeding related to alleged greenwashing. Like the ACCC, ASIC has also made action against greenwashing one of its enforcement priorities for 2023.

Financial Institutions Developments

1. *United States*

U.S. DFC proposes revisions to environmental and social policy and procedures. The U.S. International Development Finance Corporation ("DFC"), which offers investment and risk insurance to private investments outside the U.S., has announced a planned update to its Environmental and Social Policy and Procedures ("ESPP"). Among other changes, the revised ESPP would expand requirements that supported projects quantify and report direct and significant indirect greenhouse gas emissions related to projects. The revised ESPP is open for public review and comment, with comments due by April 28. Please see the firm's recent S&C Energy Transition Insights for more details on the proposed revisions.

2. *European Union*

European Union set to conduct one-off scenario analysis exercise focused on EU financial system as a whole. The EU has begun preparations for a one-off scenario analysis exercise that should assess the resilience of the EU financial sector as a whole, including financial institutions and insurers, in line with the EU's climate goals. On March 8, the European Commission outlined its goals for the exercise in a letter sent to the heads of the EU's insurance, banking and securities market regulators. The letter noted that the exercise should review how early climate-related shocks could generate significant stress for the financial system in the period up to 2030 as well as review how the financial system can support green investments under stress. The results are expected to inform subsequent supervisory or monitoring programs of the European Supervisory Authorities and European Central Bank where the exercise identifies specific vulnerabilities in the financial system such as concentration or contagion risks.

3. *United Kingdom*

Bank of England releases report on climate risk and regulatory capital framework. A new report from the Bank of England set out updates on the Bank's work and research on climate change and the regulatory capital frameworks for banks and insurers. Among several key findings, the Bank noted that difficulties in estimating climate risk and challenges in capturing risks in the existing capital frameworks means there remains uncertainty about whether banks and insurers are sufficiently capitalized for future climate-related losses. The Bank also noted that, as a short-term priority, it was focused on ensuring firms make progress to improve their identification, measurement, and management of climate risks, and would continue further developing its capabilities to test the resilience of the financial system to climate risks.

4. *Canada*

OSFI issues new guideline on climate risk management. On March 7, the Office of the Superintendent of Financial Institutions ("OSFI"), an independent body responsible for the supervision of federally regulated financial institutions in Canada, released final guidelines outlining its expectations for how regulated financial institutions manage climate-related risks. The new Guideline B-15 sets forth OSFI's expectations on governance and risk management (including internal controls and climate scenario analysis) and climate-related financial disclosures. Aspects of Guideline B-15 will become applicable to domestic systemically important banks and certain Canadian insurance groups as early as fiscal year-end 2024 and to all other federally regulated financial institutions at fiscal year-end 2025, with limited application to foreign bank branches.

Shareholder Engagement, Governance and Proxy Advisory Updates

1. *United States*

ISS releases new Global Board-Aligned Voting Policy to counter ESG-focused policies. On March 16, proxy advisor Institutional Shareholder Services Inc. ("ISS") released a new Global Board-Aligned Voting Policy. The policy will focus on creation and preservation of economic value when considering corporate governance, executive compensation and corporate structure-related proposals, and will generally recommend in favor of management on environmental or social proposals except in instances where greater disclosure would directly enhance or protect shareholder value. The new policy will be available to investors alongside ISS's other thematic policies, including its faith-based and socially responsible investors policy. The policy is similar to Glass Lewis's Governance-Focused Policy, which Glass Lewis describes as a policy for customers who want to promote effective governance mechanisms on boards while avoiding taking strong positions on several emerging environmental and social issues.

2. *United Kingdom*

FTSE Women Leaders Review finds companies met voluntary gender diversity targets early. On February 28, the FTSE Women Leaders Review published an update report on the gender diversity of UK-listed companies. The Review notes that the voluntary target, introduced last year, to achieve 40% representation of women on FTSE 350 boards by the end of 2025 has been met three years early, as representation reached 40.2% in January 2023, up from 37.6% a year prior. FTSE 350 companies are also on track to meet a target of 40% women representation in leadership teams by the end of 2025. For the first time, the scope of the Review extended to 50 large private companies. Although women's representation in private companies' leadership teams is very similar to that in FTSE 350 companies, standing at 34.3%, the proportion of women at board level is lower, at 31.8%. The Review identifies a number of areas for further progress, including increasing the number of women in CEO and finance director roles.

Parker Review Committee reports latest findings and sets new, voluntary diversity targets. On March 13, the Parker Review Committee published an update report on the ethnic diversity of UK-listed companies. The Committee, at the invitation of the UK Government, independently reports on and sets voluntary targets as to the ethnic diversity of UK boards. The report found that 96 of the FTSE 100 companies have met the Committee's target of having at least one director from a minority ethnic background, an increase of seven companies compared to last year. For the first time, the Committee has also made recommendations for diversity in FTSE 350 senior management teams and in 50 large private companies. It has requested that, by December 2023, each FTSE 350 company set an appropriate target for the percentage of its senior management team who identify as being from an ethnic minority and aim to meet the target by December 2027. FTSE 350 companies are expected to set out their chosen target in the annual reports they publish in 2024 report on progress annually.

Sustainable Finance Updates

EU legislators reach deal on European Green Bond Standard. At the end of February, European legislators announced they had reached a provisional agreement on creation of a voluntary EU green bond standard. The announcement of the agreement by the EU indicated that the designation of "European green bond" would be available for bonds whose use of proceeds would need to be invested, with certain exceptions, in activities aligned with the EU Taxonomy Regulation's definition of environmentally sustainable activities. The provisional agreement will next be adopted by the European Parliament and Council of the European Union and would start applying 12 months after its entry into force.

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