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Aktuelle Entwicklungen in den USA – Aktuelle Entwicklungen und Herausforderungen im Bereich ESG

In diesem Beitrag in der CCZ-Reihe „Aktuelle Entwicklungen in den USA" diskutieren Sarah E. Fortt, Betty M. Huber and Paul A. Davies aktuelle Entwicklungen im Bereich ESG in den USA, Europa und weltweit. Zudem geben sie einen Ausblick auf künftige Herausforderungen für Unternehmen, die sich sowohl von regulatorischer Seite als auch von Investorenseite stellen.

Over the last several years, ESG has become increasingly important in various industries and business areas but also for investors and private equity funds alike. How have clients' demands changed over time?

S. Fortt: Client needs have grown increasingly complex and nuanced over the past few years. If we look back 10 or even five years ago, relatively few companies in various industries were asking for basic ESG concepts to be integrated into their policies and practices and for basic ESG disclosures. What we are seeing now is unprecedented – a far more significant number of clients across all industries and of all sizes are increasingly asking for help in executing complex ESG-related strategies, audits and reviews, and risk analysis, as well as for support in considering and addressing ESG-related activism, capital raising and finance considerations, litigation, and engagement.

B. Huber: ESG was not a household word five years ago, but every single public company or pre-IPO company is now focused on ESG. There are two primary drivers for this focus. First, investors are demanding more disclosure, more systems, and more showing of appreciation of ESG issues being embedded in the strategy, operations, mission, culture, and values of companies they invest in. Second, there has been a real ramp-up in scrutiny during the past 24 months as public companies have faced increasing regulation since the Biden Administration came into place.

The idea of long-term investing has always been a part of private equity, and, indeed, one or two investors could ha-

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ve major leverage over a private equity fund. I have encountered 10 different firms in the past two years that emphasized they need not just an aspirational ESG program, but a real ESG program that is embedded into how they fundraise, how they conduct themselves in terms of their diversity, equity, and inclusion, how they are managing climate change risk, and how they are monitoring their different portfolio companies. There is now an identifiably higher level of sophistication in this area, even among middle-market private equity funds.

What are the most significant challenges posed by ESG issues, and how do you tailor your advice to clients to account for such challenges?

B. Huber: One of the most significant challenges is just how broad ESG is. ESG can encompass so many different topics, some of which may or may not be materially significant to a company or an industry. Individual companies need to determine which of these varied topics is most significant so they can prioritize them. Companies run the risk of attempting to cover every single topic, but that is simply not an efficient use of time. Moreover, to complicate matters further, ESG issues evolve over time. Therefore companies will need to keep pace and respond accordingly.

S. Fortt: Another major challenge is that disclosure regarding ESG practices and policies is moving from voluntary to required in different jurisdictions, at different speeds, and to different degrees. These disclosures are being integrated into financial reporting, which means the level of internal controls necessary to create effective ESG disclosures is increasing. In general, companies will need to consider that ESG rules interact with one other and that ESG regulation in one jurisdiction can differ from or even compete with regulation in another jurisdiction. Moreover, ESG regulation that is applicable to one industry or jurisdiction will influence the practices and/or disclosures in another. ESG matters are a patchwork of sometimes conflicting and competing legislation, regulation, enforcement, litigation, and activism.

ESG is moving from investor-company and consumer-business considerations to business-to-business considerations through litigation trends and regulation that would require companies to consider their supply and value chains. In addition, ESG risk analysis is maturing, requiring more complex assessments of the ways in which risks overlap and create new levels of risk.

All of this uncertainty means that in order for companies to avoid being a test case in litigation, they must be consistent and careful with respect to their ESG risk analysis, practices (including with respect to political and lobbying efforts), and disclosures.

On March 21, 2022, the SEC proposed new rules that would require registrants to include climate-related information in registration statements and annual reports,[1] *and similar European provisions such as the European Commission's Corporate Sustainability Reporting Directive and the International Sustainability Standards Board's exposure drafts of the IFRS Sustainability Disclosure Standards, are also poised to soon take effect. Do you expect any further regulatory steps in this direction in the near future in the US or even globally?*

B Huber: The SEC has fulfilled its pledge to issue climate-related disclosure proposals and, notably, the latest SEC regulatory flux agenda includes three other ESG potential proposals. The first would relate to human capital management – a clinical term for workforce – which deals with the attraction, retention, and development of a workforce. The SEC had a finalized rule on human capital management in 2020, but the agency is now revising that rule. I would expect a general, prescriptive metric that companies would need to disclose under that new proposal, which would apply only to diversity, equity, and inclusion of workforce. The metric would include the question, "How do you develop that talent and increase the amount of racially or ethnically diverse people in top management?"

S. Fortt: I think what is most interesting, and potentially risk-rich for companies, is that the SEC's human capital management and diversity-related rules that we expect to come out this year are potentially being promulgated in the context of the diversity-related board rules in California being overturned[2] and the war taking place in various state legislatures around diversity-related matters. We are increasingly in a space where matters around diversity can be politicized and those politics can create new and complex considerations for companies. I think as we move forward, we know that part of our job is going to be helping clients think through compliance matters, but another, arguably bigger part, of our job is going to be helping companies think through the complex array of issues and considerations.

B. Huber: Stakeholders believe that ESG should focus in part on employees being paid a fair wage. Therefore, it will be interesting to see this rule will include more on how employees are being paid and compensated. Another rule would focus on board diversity in terms of diversity and underrepresented communities, and how public company boards disclose that information. This area is under fire at present with a California law requiring the same being held unconstitutional by a California court. Therefore, perhaps the SEC's proposal is being held up as we wait to see what happens in those courts.

S. Fortt: The Nasdaq rule requires companies listed on Nasdaq to disclose by August 2022 statistics on director diversity. In other words, gender, racial/ethnic, and LGBTQ+ status, and, beginning in 2023, to include two diverse directors or explain why they are not included.

B. Huber: The final rule relates to ESG regulation of registered investment advisors. There is an idea that investment advisers need to be sure that how they are investing and

1 Siehe hierzu Latham & Watkins, Client Alert: „SEC Proposes Extensive Climate Change Disclosure Regulations", abrufbar unter: https://www.lw.com/thoughtLeadership/sec-proposes-extensive-climate- change-disclosure-regulations (zuletzt abgerufen am 25.4. 2022).

2 Siehe hierzu Latham & Watkins, Client Alert: „California Board Diversity Law Requiring Directors From "Underrepresented Communities" Is Held Unconstitutional", abrufbar unter https://www.lw.com/thoughtLeadership/california-board-diversity-law-requiring-directors-from-underrepresented-communities-is-held-unconstitutional; „California bender Board Diversity law Is Held „unconstitutional", abrufbar unter https://www.lw.com/thoughtLeadership/California-Gender-Board-Diversity-Law-Is-Held-unconstitutional (zuletzt abgerufen am 24.5.2022).

voting proxies is consistent with what they are seeing in their marketing materials and what their written policies say. In short, are you doing what you say you are doing?

S. Fortt: Companies that are not investment companies or advisers may find that, to the extent investment companies and advisers are required to disclose ESG information about their investee companies in the aggregate, there may be trickle down effects to public companies.

P. Davies: Proposals such as the Corporate Sustainability Reporting Directive (CSRD)[3] and the International Sustainability Standards Board's (ISSB's) standards will not take effect immediately, as we anticipate a reasonable period for consultation and procedural requirements (similar to the SEC proposed new rules). While this may result in material amendments to these proposals before they become mandatory, nonetheless we do expect that these proposed standards will lead to significant changes to the way that subject companies are obliged to disclose ESG matters.

In terms of further developments, we expect that the CSRD will also be impacted by the publication of initial drafts of the European Sustainability Reporting Standards (ESRS)[4] for public comment over the course of 2022. The ESRS are the specific reporting requirements that underpin the CSRD, which are currently in development. As these are finalized, companies will gain a better understanding of what ESG reporting in the EU is likely to look like in practice.

Also, particularly significantly in the EU, the European Commission has issued a proposal for a Corporate Sustainability Due Diligence Directive (CSDDD).[5] This is currently under consideration by the Council and Parliament and switches the focus away from a company to its value chain. In particular, the CSDDD proposal would require in-scope companies to monitor and disclose their efforts in monitoring their supply chains, impose obligations to develop and disclose transition plans aligned with global temperature rises of 1.5 °C, and require directors of in-scope companies to have specific oversight of such obligations. These disclosure requirements will also introduce civil liability responsibilities in relation to in-scope companies' value chains. Such obligations are likely to prove onerous for many companies, especially given the proposal would apply to certain non-EU companies (dependent on their size of operations within the EU).

From a German perspective, ESG has mostly been focused on the E, or environment, aspect. Do you think this will continue or will the S, social, and the G, governance, come more into focus into next few years? And if so, how?

S. Fortt: In the US, board diversity and corporate diversity efforts generally have been the focus on investor engagement, and we expect this to continue. I think we also expect to see the areas of overlap between the "E" and the "S", so for example in the environmental and energy justice spaces.

B. Huber: I think there will be a focus on E, S, and G, equally. I talked about the fair wage for employees earlier in this article, which forms a big part of the social aspect.

S. Fortt: We do expect to see trends regarding human rights considerations in the context of supply chains in other parts of the world to be mirrored in the US, if not through legislation and regulation then through the interest of investors and other capital providers as well as business-to-business expectations. And "human rights" considerations can be as complex as environmental considerations when we consider access to work, regional wage considerations, local laws, and historical and political considerations.

B. Huber: The term "human rights" means different things for different companies. How is your business impacting the communities that you serve? How is your business impacting and affecting the daily life of your employees? These are factors that stakeholders and sophisticated issuer clients are focused on. These issuer clients want to stay ahead of these factors and make sure – either from a reputational risk standpoint or just to do good business – that businesses are focused on the same factors.

In your opinion, what have been the most noteworthy observations and developments in the area of ESG in the last years? And do these also reflect a particular shift in corporate thinking?

S. Fortt: I think the most noteworthy development in ESG in the last few years is the fact that we're having this conversation. We are having this conversation because ESG has become a household term in the past two to three years, and before that, we were often still in the space of defining what "ESG" meant. Now most companies, regardless of size and industry, are at least considering where they should be in their ESG journey. I think this reflects an understanding that the status quo with respect to how we think about the role of the corporation is not value neutral. ESG is about neutralizing the existing assumptions and biases that have historically applied to how we think about what companies should be doing, what they should be valuing, and who they should be engaging with. I think we're going to continually see this question arise as our world becomes increasingly more connected.

B. Huber: The public benefit corporation provides a good case study. The corporation has been in the Delaware statute for some time but did not have an uptake in the public company arena – until one company went public as a public benefit corporation. Now there are several Delaware publicly traded public benefit corporations. These companies are being brave to take on that corporate forum despite a lack of developed case law on how directors can balance the interests of different stakeholders. This reflects a particular shift in corporate thinking because that means it is part of a corporation DNA to focus on all stakeholders and the corporate purposes, which is aligned to a public benefit as opposed to setting up a corporation in the US capitalistic structure with the sole purpose of making money for investors – though this is a laudable cause, it is not the only cause in the public benefit corporation space. There is an identifiable shift in that approach, perhaps

3 Vorschlag für eine Richtlinie des Europäischen Parlaments und des Rates zur Änderung der Richtlinien 2013/34/EU, 2004/109/EG und 2006/43/EG und der Verordnung (EU) Nr. 537/2014 hinsichtlich der Nachhaltigkeitsberichterstattung von Unternehmen vom 21.4. 2021.

4 Siehe dazu https://www.efrag.org/Activities/2105191406363055/Sustainability-reporting-standards-interim-draft# (zuletzt abgerufen am 25.4.2022).

5 Vorschlag für eine Richtlinie des Europäischen Parlaments und des Rates über die Sorgfaltspflichten von Unternehmen im Hinblick auf Nachhaltigkeit und zur Änderung der Richtlinie (EU) 2019/1937 vom 23.2.2022.

from a number of institutional investors. Passive institutional investors – the so-called Big Three – are in it for the long-term, and therefore they demand corporations to be able to articulate their values and their culture. In 2019, one of the Big Three averred that boards of directors should oversee and articulate oversight of corporate culture. This created shock waves as a lot of boards of directors were uncertain about clarifying their corporate culture and expressing it, however three years on many corporations seemingly accept that approach as part of the job.

What trends do you see for 2022 and 2023 in the area of ESG, both in the US and in Europe?

B. Huber: I am a linear thinker and I want to say that this will grow continually, but maybe, maybe not. ESG continues to evolve, and I do not foresee that evolution stalling given that the Biden Administration will be in place for another two years. The train has left the station in Europe, therefore progress in that jurisdiction will continue. And in this global world, it can be a bit of a feedback loop. I like to look at shareholder proposals because that provides an excellent indication of what the ESG community is focused on. Currently, the proposals cover the topics we have discussed: climate change, human capital management, board diversity, civil rights, and human rights.

S. Fortt: Generally, I am looking at the movement of proposed or promised regulations into final forms across jurisdictions. I am also considering regulation and enforcement trends in respect to ESG concepts and terminology, such as net-zero, carbon neutral, and "green" terminology. As previously discussed, the pushback on diversity-related legislation and regulation is also of great interest, as is the ongoing focus on greenwashing, particularly in the financial sector.

In regards to ESG metrics and reporting, the regulation of ESG ratings and the use of those ratings in credit contexts is significant – specifically the business-to-business contracting, including ESG-related performance indicators, and trends toward internal compliance and internal investigation-style audits of ESG matters.[6]

I will continue to monitor trends in climate risk modeling efforts in the technology sector and corporate responses to extreme political positions on ESG matters. Algorithmic risk is another key focus area, including, but not limited to, the context of bias.

B. Huber: A key trend to watch in the US is that the SEC intends to allow universal proxy cards in proxy fights going forward, which will take effect in summer or fall of 2022. This change could make it easier for shareholder activists to get their dissident nominee director elected to the board. How will this impact ESG? If they are ESG activists who want to avail themselves of the universal proxy card, they may be able to get ESG-type directors on board to public companies. Achieving this would likely require a great deal of organization as the activists would require money to develop and launch a proxy campaign and issue a proxy statement. However, there is a possibility that some ESG activists are now organized enough to do so, which would not have been the case five years ago. We are watching very carefully and advising public companies to be prepared to defend their directors in the event that this happens.

P. Davies: In Europe, the continuing development and eventual entering into force of the wide range of proposals related to the EU Green Deal will be an area of key interest, with the possibility of regulation that has broad, economy-wide impacts entering into force over the next 18 months. We also expect that supply chains will continue to be a major area of focus from an ESG perspective, not only with respect to human rights and modern slavery (the topic most frequently associated with ESG issues in supply chains), but also broader considerations of suppliers' ESG performance in areas such as GHG emissions as companies face increasing regulatory and stakeholder pressure to record and reduce their Scope 3 emissions and ensure a sustainable value chain. The CSDDD proposals (see discussions on this proposal earlier in this article) are a material part of this trend.

As ESG issues become more ingrained in the public consciousness and are therefore more likely to become key aspects of companies' marketing strategies, we expect an increased focus on greenwashing claims, not only in the form of regulatory investigations but also through increased private litigation and wider stakeholder pressures. We are already seeing regulators in Europe take interest in this area, with the UK's Competition and Markets Authority issuing a Green Claims Code in late 2021, and the proposed EU Ecodesign and Energy Labelling Working Plan 2022-2024 being published by the Commission in March 2022. Further, as ESG matters become increasingly important to stakeholders' investment considerations, more general ESG litigation is likely to continue to proliferate.

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6 Siehe hierzu auch Latham & Watkins, Client Alert: „EU Issues Call for Evidence on the ESG Ratings Market", abrufbar unter https://www.globalelr.com/2022/04/eu-issues-call-for-evidence-on-the-esg-ratings-market/ (zuletzt abgerufen am 25.4.2022).