Legal Side of ESG: Top Three Issues to Watch in 2022

The SEC's proposed rules and ESG-related litigation risk are among the key ESG themes impacting the regulatory and legal space of the energy sector this year.

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Governments, regulators, non-governmental organizations, the private sector and other important stakeholders worldwide continued to emphasize ESG issues in 2021. The energy sector was no exception to this trend as companies and investors were confronted with a host of ESG issues including the transition to a net-zero economy, evolving emissions reporting requirements and a growing focus on supply chains. Given the societal importance that is now placed on ESG issues, Latham & Watkins LLP expect this growth trend to continue throughout 2022.

There are three ESG-related developments and trends that will likely impact the world of energy in 2022.

1. Supply chains: tracking new legal proposals

Governments and regulators are increasingly looking to require large (typically multinational) companies to take further steps to manage their value chain. The European Commission is expected to formally propose a mandatory supply chain due diligence law in early 2022.

In the U.S., on Dec. 23 2021, President Biden signed into law the Uyghur Forced Labor Prevention Act (UFLPA) in response to purported human rights abuses against Uyghurs and other ethnic minorities in the Xinjiang Uyghur Autonomous Region (XUAR).

The UFLPA represents a significant expansion of existing U.S. restrictions on items imported from, or with links to, the XUAR. The previous restrictions were limited to specific categories of items and items produced by specific suppliers. However, the UFLPA goes further by imposing a rebuttable presumption against imports from, or linked to, the XUAR. This effectively prohibits the import into the U.S. of such products unless the importer can clearly demonstrate that the item was produced free from forced labor or human rights abuses.

Meanwhile, Germany will continue to implement its Supply Chain Act, which will initially require German

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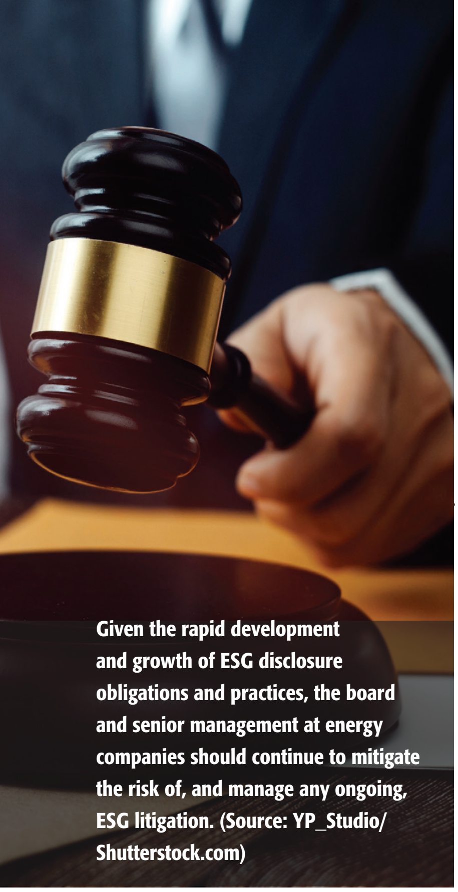


Given the rapid development and growth of ESG disclosure obligations and practices, the board and senior management at energy companies should continue to mitigate the risk of, and manage any ongoing, ESG litigation. (Source: YP_Studio/ Shutterstock.com)

pursued under the French Duty of Vigilance Act against companies that did not perform adequate diligence on their supply chains.

This regulatory shift, while placing an increased compliance burden on companies operating worldwide, is also encouraging them to consider technological solutions to perform diligence on their supply chains.

2. ESG litigation

Given the rapid development and growth of ESG disclosure obligations and practices as well as the societal focus on ESG, the board and senior management at energy companies should continue to mitigate the risk of, and manage any ongoing, ESG litigation. Latham & Watkins expects more litigation covering a broad and growing range of ESG factors.

Supply chain issues are likely to play a growing role in ESG litigation that is not related to climate change in 2022. Furthermore, greenwashing claims (from regulators, shareholders and other stakeholders) may increase as green marketing and ESG commitments become more important to consumers and investors. Climate change litigation will continue to develop in scope, as public and private entities face increased scrutiny for their role in financing high-emitting companies and/or infrastructure projects, and whether such financing aligns with their publicly stated commitments.

In addition, given the notable successes of 2021 in relation to the climate-related proxy battles, Latham & Watkins expects to see more such campaigns in 2022, with activist investors seeking to impact the ESG-related policies of high-emitting companies through shareholder action.

3. SEC: when and what to expect

The U.S. Securities and Exchange Commission (SEC) has recently placed greater emphasis on ESG and climate change issues, a trend which continued in 2021. By March 2021, the SEC had hired its first senior policy adviser for climate and ESG, created a Climate and ESG Task Force within the Division of Enforcement (the Task Force), directed the Division of Corporation Finance to enhance its focus on climate change disclosures, and requested public comments on such disclosures.

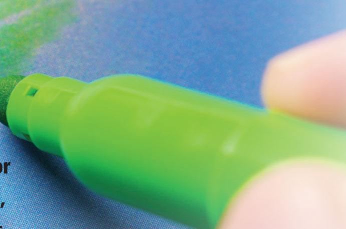
SEC Chair Gary Gensler requested that such a climate risk disclosure rule be mandated by the end of 2021. Gensler also indicated that the new rule may "learn from and be inspired by" the recommendations of the Task Force on Climate-related Financial Disclosures, although some commentators believe a proposed new rule will likely be bespoke and not use an existing framework.

The SEC has not yet released any such rule, and observers anticipate developments in early 2022. If released, such a rule could face considerable scrutiny. Notably, the public consultation saw multiple responses suggesting that climate disclosure rules will be challenged in court for being outside the SEC's statutory authority. The progress of the proposed rule and any related litigation will be closely monitored throughout 2022.

Still, the SEC will continue its work in ESG-related enforcement actions (which would not require any specific new rulemaking). In September 2021, a sample comment letter was produced on the SEC website requesting information on various ESG issues and demonstrating the type of queries that issuers could receive in relation to ESG matters. The Wall Street Journal further reported that the SEC had sent tailored comment letters to "dozens" of companies relating to their climate change disclosures.

> "While net-zero emission pledges are an important step forward, they underscore the loud, repeated and sustained calls for decision-useful metrics, That is a core purpose of the SEC's disclosure obligations."
>
> **–Caroline Crenshaw,** SEC

One possible SEC focus point is combatting perceived greenwashing. Commissioner Caroline Crenshaw, on Dec. 14 2021, noted that an increasing number of companies are making public climate pledges or committing to a net-zero strategy, while providing limited or no information on how those pledges will be achieved. ■



Greenwashing is a marketing ploy in which an organization or company spends more time and money on public relations and marketing itself as more ecological and environmentally friendly than on actually minimizing its environmental impact, which deceives the public that its products, goals and policies are safe for the environment. Examples include environmental imageries or use of the color green, misleading labels, hidden trade-offs, irrelevant claims and/or misleading targets. (Source: Ivan Marc/Shutterstock.com)