Vinson&Elkins

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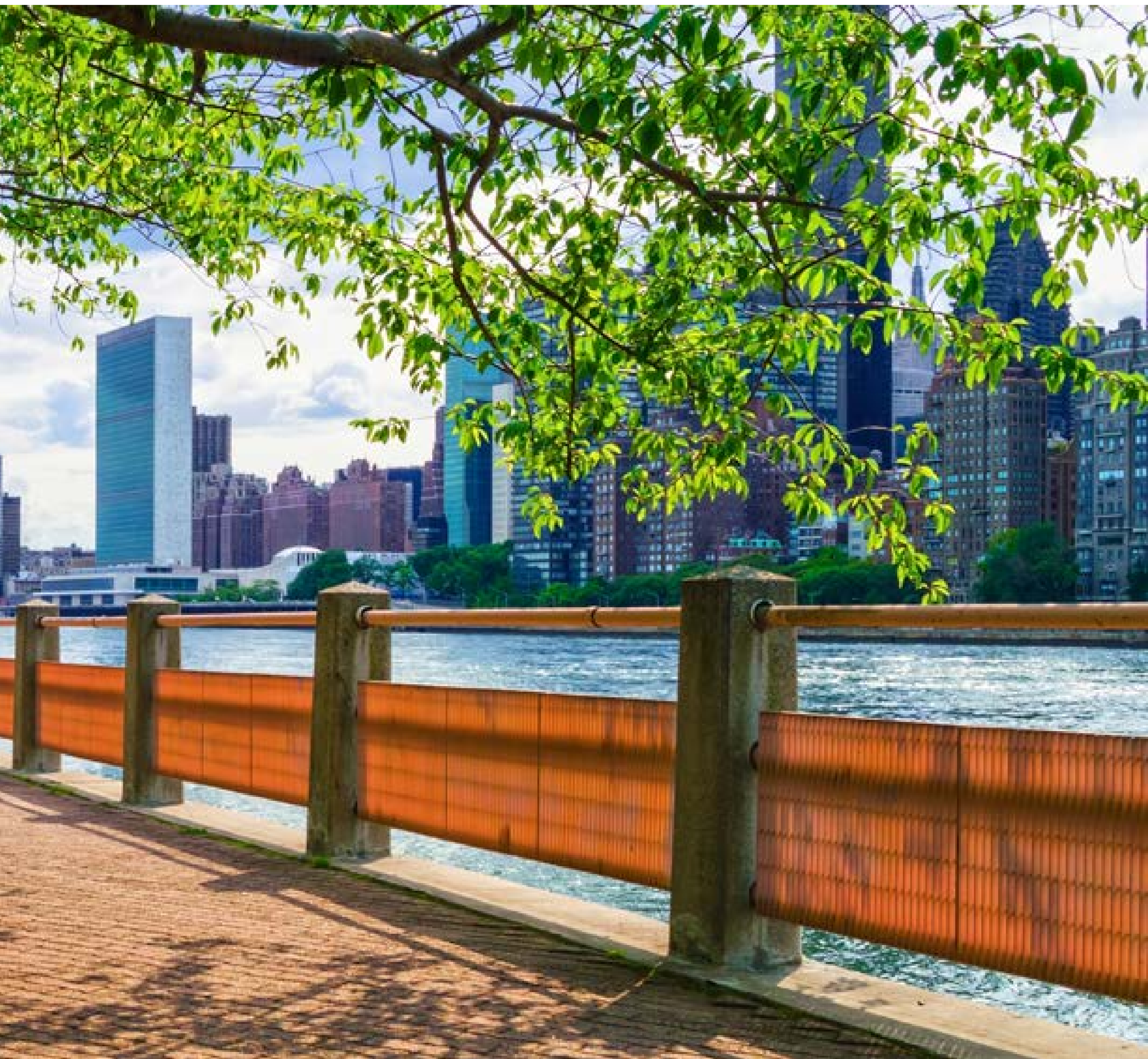
V&E Quarterly
Securities & ESG Updates



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Letter from the Editors

Welcome to Vinson & Elkins' Securities and ESG Updates. Our aim is to provide insights into notable developments in securities reporting and the environmental, social and governance space over the quarter and, where applicable, offer calls to action for contacting V&E.

Taking in the events of the second quarter of 2023, it is evident that the focus of lawmakers, regulators, investors and companies on ESG-related matters remains high: the Biden administration and the Environmental Protection Agency are pushing ahead with an ambitious environmental justice agenda (*see* pages 31-32); states are proposing ESG-related legislation (*see* pages 23; 31-32); the Securities and Exchange Commission ("SEC") has signaled that it may finalize its climate change disclosure rule as soon as October 2023 (despite blowing through its April 2023 estimation) (*see* pages 12-17); the volume of 2023 shareholder proposals remains high compared to 2022 with climate-related proposals continuing to be the most prevalent type of proposal (*see* page 4) even as we are seeing voting support decrease year-over-year; companies are increasingly tying ESG metrics to executive compensation and making disclosure regarding employee voice (*see* pages 25; 39-40); and biodiversity-related concerns are gaining traction with several constituencies (*see* page 27-28).

That being said, with continued focus on ESG-related matters comes heightened skepticism and scrutiny toward companies' ESG-related initiatives and disclosure. In addition to growing ESG-related enforcement actions and litigation, companies seeking to promote their green credentials — even via nontraditional marketing materials like sustainability reports — are becoming increasingly subject to potential claims of "greenwashing," which are only likely to intensify over time (*see* page 34-38). A particular matter of focus is carbon offsets, which the Federal Trade Commission has specifically sought public comment on in updating its "Green Guides," and companies that rely on or otherwise utilize carbon offsets as part of their energy transition strategy have recently been targeted by private plaintiffs. For example, in late May, a class action lawsuit was brought against Delta Airlines for alleged "false and misleading" claims related to its carbon-neutral status because of the company's reliance on offsets.

This sustained focus on ESG-related matters by investors, companies, and other entities has also led to a swell of anti-ESG backlash, which has taken form in a notable rise in anti-ESG shareholder proposals submitted during the 2023 proxy season (*see* page 4) and a continuing effort by mostly Republican-led state governments to institute anti-ESG legislation (*see* pages 21-22). This force of opposition to ESG-related matters has, in addition to other factors (*e.g.*, the SEC's more lenient approach to allowing shareholder proposals in recent years, as detailed below), also potentially contributed to the decline in support for ESG-related shareholder proposals during the 2023 proxy season compared to 2022, as it has caused investors to moderate their messaging (and at times, votes) around ESG commitments (*see* page 5).

Given these developments, companies must stay abreast of the ever-shifting laws, regulations, litigation and enforcement actions, investor policy, and other trends in the ESG space. This is certainly a tall order, given the dynamism in this space, and V&E is here to help.

Proxy Season 2023 What We're Seeing

2023 Shareholder Proposal Trends

Volume of 2023 shareholder proposals are up slightly compared to 2022 and remain high relative to prior periods.[1]

With proxy season in full swing, as of May 24, the volume of shareholder proposals in proxy statements filed with Russell 3000 companies has been consistent with figures from 2022 (803 through May 24 in 2023 vs. 801 proposals in the first half of 2022). Shareholder proponents are targeting S&P 500 companies in greater numbers, with 85% of shareholder proposals being filed with S&P 500 companies in 2023, compared to 79% in the first half of 2022. This trend is likely due in part to the SEC's more lenient approach to shareholder proposals in recent years: in 2021, the SEC issued Staff Legal Bulletin No. 14L, which rescinded Staff Legal Bulletin Nos. 14I, 14J and 14K, and provided new guidance that affected several arguments for proposal exclusion, generally making it more difficult for companies to exclude shareholder proposals using several arguments under Rule 14a-8 of the Securities Exchange Act of 1934 ("Exchange Act"). For more information on the SEC's approach to no-action letters, see "No-Action Letter Trends" below. Note that the SEC has also proposed rules to amend Rule 14a-8 of the Exchange Act to revise three additional bases for excluding shareholder proposals; should such amendments be adopted as proposed, they would also likely limit such bases for exclusion and lead to more shareholder proposals making it onto companies' ballots. For more information regarding the SEC's forecasted timing for finalizing the proposed rules, please see "Regulatory Agenda: SEC Releases Spring 2023 Regulatory Agenda" below.

Support for ESG-related shareholder proposals has declined since 2022[2]

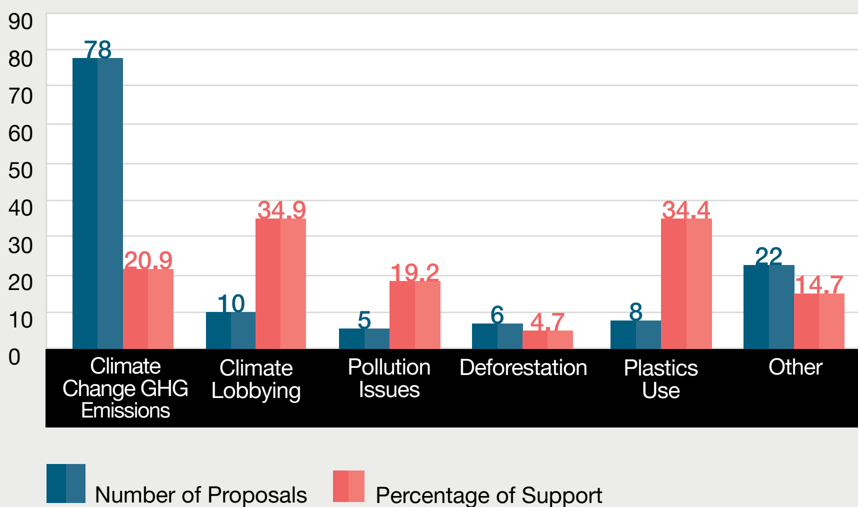
While the absolute number of shareholder proposals is up slightly year-over-year, a survey of shareholder proposals reaching a vote at Russell 3000 companies found that support for ESG-related shareholder proposals has actually fallen since 2022, continuing the downward trend in median support for such proposals. As of May 24, 2023, the average support for environmental proposals is 21%, down from 34% in 2022; 18% for social proposals, down from 22% in 2022; and 30% for corporate governance proposals, down from 37% in 2022. This includes a drop in support for climate-related proposals, where average support fell from 35% in 2022 to 22% as of May 24, 2023.

While this phenomenon appears to be somewhat muddled (proposals slightly up, support down), it can likely be attributed to a number of factors. One such factor is that institutional investors are increasingly feeling that many proposals are too prescriptive or lack a clear investment thesis — *i.e.*, while such proposals may make a strong argument on moral, ethical, or other grounds, they do not link the proposed change to improving the company's business strategy (near- or longer-term) or support the fiduciary duties and oversight of its directors and officers. Additionally, factors include more proposals not being excluded by the recently more permissive SEC and proponents likely feeling emboldened with high-profile shareholder proposal success in recent years. The net result is a moderate softening of institutional vote support, while those same investors continue to assert publicly that they remain as committed as ever to ESG topics. We can expect that, for at least the next couple of years, ESG related proposals will remain elevated, but support will likely plateau or perhaps decline slightly, especially with vociferous anti-ESG constituents causing investors to moderate their messaging (and at times, votes) around ESG commitments. Additional details of voting results thus far are as follows:

Climate change is so far the most prevalent type of environmental or social proposal (99 proposals as of June 28, 2023)[3]

The most common climate change related proposals in 2023 (78 proposals as of June 28) are requests to report on or adopt greenhouse gas ("GHG") targets in line with the Paris Agreement goal of limiting global warming to 1.5° Celsius (in many cases such proposals included Scope 3 emissions targets[4]) and to detail plans for achieving GHG reduction targets. Such proposals averaged 21% shareholder support. Other common types of climate change-related proposals included those seeking adoption of a time-bound phase out of financing for new oil and gas developments; those calling for disclosure regarding climate lobbying (both direct and through trade organizations); those regarding company assets in relation to climate change (*e.g.*, requests to issue recalculated emissions baselines excluding GHG emissions from divested assets); those looking for companies to report on measurement of methane emissions; and those relating to environmental justice (*e.g.*, file reports on the impact of climate strategies on a company's stakeholders). As of June 28, 2023, there have been no say-on-climate proposals put forward voluntarily by management. There were at least 47 other environmental proposals filed as of early June, with a large share of such proposals relating to the use and production of plastics and deforestation. Shareholder support among all environmental proposals in 2023 hovered at approximately 21%.

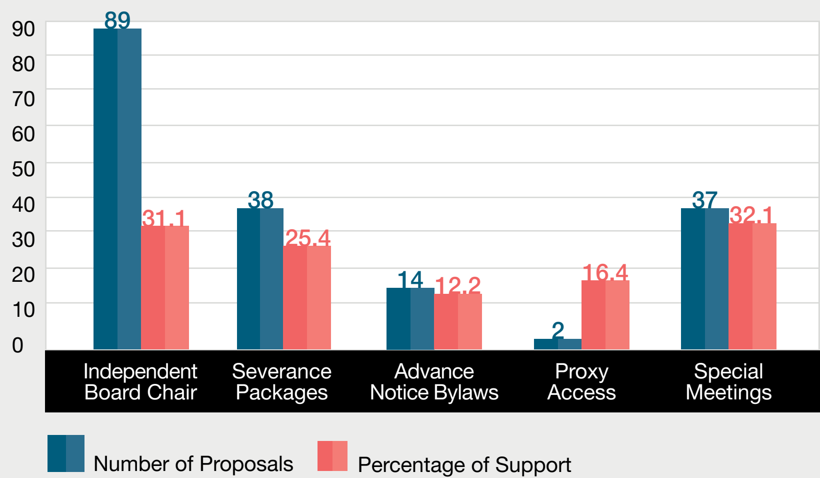
Environmental Proposals (2023)



Focus of governance- and compensation-related proposals seems to be shifting from special meetings and proxy access to independent board chairs, severance pay, and universal proxy-related advance notice bylaws.[5]

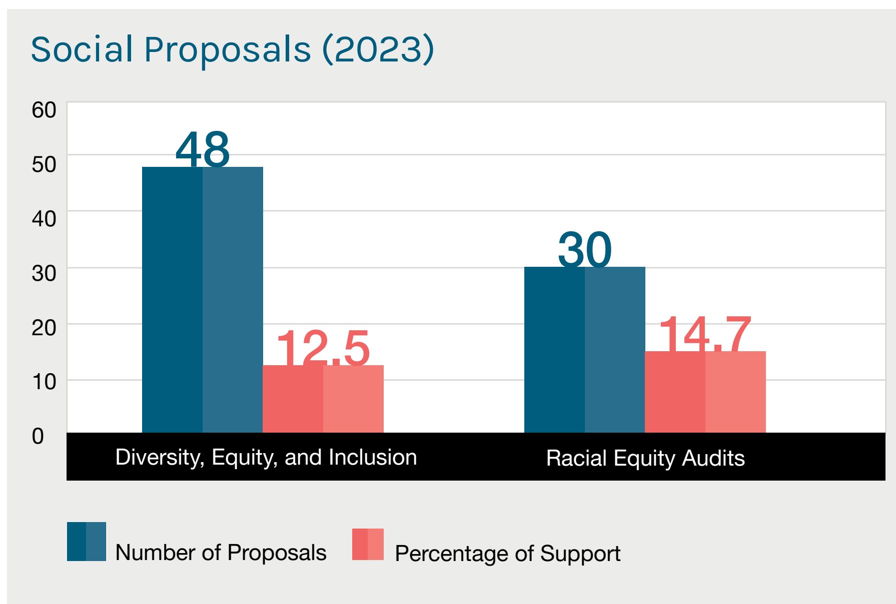
While certain governance topics such as shareholders' rights to call special meetings and providing shareholders with proxy access were also highly represented in 2022 proposals, other governance and compensation topics are emerging as new leading governance and compensation proposals in 2023, such as calling for independent board chairs (87 as of June 28 averaging 30% shareholder support), providing shareholders with the right to approve senior management's severance packages (44 as of June 28 averaging 24% shareholder support), and providing shareholders with the right to approve certain advance notice bylaw amendments (19 as of June 28 averaging 12% shareholder support). Many companies have also submitted management proposals in 2023 requesting shareholder approval of amendments to companies' articles of incorporation to exculpate officers in accordance with 2022 amendments to the Delaware General Corporate Law (for more information on such proposals, see "Officer Exculpation Proposals" below). While special meeting rights have represented a high volume of governance proposals filed in 2023 (41 as of June 28 averaging 32% shareholder support), the prominence of such proposals has significantly decreased since 2022. Some things, however, have not changed: John Chevedden, Kenneth Steiner, James McRitchie, and Myra Young are still the most active proponents of governance and compensation proposals, representing more than two-thirds of the proposal submissions in this space as of June 28, 2023.

Governance Proposals (2023)



Diversity, equity and inclusion ("DEI") is so far the most prevalent type of social proposal. [6]

Such proposals include requests for reports on the effectiveness of DEI efforts and metrics and additional data (48 as of June 28) and requests for racial equity and civil rights audits (30 as of June 28). DEI proposals in 2023 have also included requests for reports on median and adjusted gender/racial pay gaps and proposals relating to board diversity. Other popular social proposals in 2023 have included those relating to lobbying and political spending (including those seeking companies to address disparities between their stated policies and political advocacy), human rights, health and safety, and abortion and reproductive health and rights.



Anti-ESG proposals are on the rise, but support remains low. [7]

The rise of anti-ESG political sentiment over the past year has been reflected by a corresponding increase in the number of anti-ESG proposals. The number of anti-ESG proposals filed this year has already passed the previous record set in 2022, with over 96 proposals filed as of June 28, 2023. The main categories of such proposals are civil rights audits, "debanking" (*e.g.*, asking banks, insurers, and payment processors to explain policies on account suspensions or the extent they prioritize non-financial factors in deciding to establish, reject, or discontinue client relationships) aimed primarily at financial institutions that have reduced their investments in fossil fuels, censorship (*e.g.*, proposals regarding policies for taking down content or content-producing entities at the request of U.S. government entities), and human rights (*e.g.*, proposals asking companies whether their business activities in China align with their human rights' policies). It should also be noted that many of these proposals are being excluded from proxy statements and, when they have reached the ballot, they have received minimal support (6% at Russell 3000 companies for the year as of May 24, 2023, down from 9% in 2022). This trend of elevated proposal numbers, but low support, seems to indicate that, while anti-ESG proponents may be getting significant media attention, major institutional investors have been relatively dismissive in supporting their proposals.

No-Action Letter Trends

- The Staff was asked to respond to far fewer no-action requests in 2023 than in 2022, dropping from 241 to 184 (a roughly 25% decrease).[8] Correspondingly, 635 shareholder proposals have been included in companies' proxy statements this year, compared to 573 last year (a roughly 22% increase).[9]
- The Staff granted more no-action requests in 2023 than in 2022, increasing from 35% to 46% of requests after success rates plummeted from a success rate of 71% in 2021.[10]
- The number of no-action letters seeking to exclude proposals for procedural reasons (*e.g.*, ownership requirements, providing the company with dates and times for meetings to discuss the proposal, etc.) has increased in 2023, rising from 42 requests in 2022 to 53 in 2023.[11]
- Similar to prior years, the most frequent argument that companies made for no-action relief was pursuant to the "ordinary business" exclusion under Rule 14a-8(i)(7) of the Exchange Act.[12] Exclusions under such argument were up as a percentage of all exclusions in 2023, rising from 29% in 2022 to 35% in 2023.[13] Some have observed[14] that the Staff at the SEC are more likely to allow the exclusion of anti-ESG proposals under the ordinary business argument.
- We can surmise that the decrease in no-action requests from corporate issuers was in part due to the fact that the current SEC has been less receptive to excluding shareholder proposals in recent years (see above "Support for ESG-related shareholder proposals has declined since 2022"), which has likely caused many issuers to be less optimistic about their chances of success in submitting no-action relief.
- The percentage of proposals withdrawn this proxy season have been in line with last proxy season.[15]
- The National Center for Public Policy Research ("NCPPR") petitioned an appellate court to review the SEC's decision to provide no-action relief to The Kroger Co. ("Kroger") under the ordinary business exception for an anti-ESG proposal requesting that the company issue a public report detailing the potential risks associated with omitting "viewpoint" and "ideology" from its written equal employment opportunity policy. Though it is unclear whether the court took action on this matter, the proposal was ultimately included in Kroger's proxy statement. This could lead to other proponents seeking similar legal action in the future when companies are granted no-action relief from the SEC.

Universal Proxy Card

In late August 2022, the SEC's rules providing for universal proxy cards became effective for any shareholder meeting featuring a director election. As a refresher, the rules require companies and activist shareholders to use a "universal proxy card" that lists the names of all duly-nominated director candidates for election and enables shareholders to mix and match candidates from the separate slates of the company and activist shareholders. Many predicted that the new rules, would lead to an increase in proxy fights. Accordingly, in response to the new rules, nearly 40% of companies reviewed their bylaws and at least 23% amended their bylaws.[16] Note that such amendments have garnered some negative attention from shareholders: shareholder proposals requesting that companies provide shareholders with the right to approve certain advance notice bylaw amendments are on the rise (see "2023 Shareholder Proposal Trends" above) and in a lawsuit a hedge fund shareholder sued a company seeking to invalidate bylaws amendments that required greater disclosure about nominating shareholders and their nominees (the company has since rescinded the bylaws).

The era of the universal proxy card is still young, but some observations can be made[17] based on the first few months of the rules' effectiveness. First, few activists have attempted to use the universal proxy card rules so far — there have only been a handful of universal proxy card contests to date. Further, although the universal proxy card could theoretically reduce proxy contest costs by allowing activists to make "nominal" solicitations and spend only the absolute minimum effort and cost needed to nominate one or more candidates (*i.e.*, relying on "notice and access" delivery of proxy materials to satisfy Rule 14a-19's 67% solicitation requirement and on the company to deliver physical proxy cards including the activist's nominee(s)), proxy fights do not seem to have become any less expensive, as activists have not pursued such "nominal" solicitations in large numbers. Further, the few proxy contests that have used the universal proxy card rule have not resulted in significantly different outcomes from those using traditional proxy rules. That being said, there is data that suggests activist shareholders are gaining more board seats than they would have previously, as the ratio of activist seats proposed and won (either by votes or settlements) this proxy season is much higher than in 2022 (66% won in 2023 vs. 47% in 2022).[18] While it is too early to come to a definitive conclusion on the effect the universal proxy rules have had on director elections and proxy contest settlements, commentators are predicting that campaign settlements will continue to rise due to the universal proxy rules. Finally, the universal proxy card represents a marked shift in how activists can undertake proxy contests and may still lead to greater shifts in the activism space, including increasing the importance of good disclosure around individual director skills, qualifications and attributes and giving more leverage to activists in settlement negotiations.

Officer Exculpation Proposals

In light of the 2022 amendments to the Delaware General Corporation Law, many companies have included management proposals in their proxy statements providing for officer exculpation amendments to their certificates of incorporation (more than 260 during this proxy season so far). As previously noted, Glass Lewis has been generally recommending against these proposals in 2023 while Institutional Shareholder Services ("ISS") has generally been recommending for them. That being said, we have seen ISS apply a more nuanced approach for controlled companies. In at least one instance, ISS recommended against the proposal due to its belief that unaffiliated shareholders should have the right to hold directors and officers accountable through litigation where the largest shareholders at the company held director designation rights.

Despite any proxy advisor opposition, however, the vast majority (~85%) of officer exculpation proposals have passed, with supermajority approval often being the culprit behind any failed proposals.

Please contact V&E to discuss the 2023 proxy season and its implications.

SEC (and Delaware) Watch

Regulatory Agenda: SEC Releases Spring 2023 Regulatory Agenda

On June 14, 2023, the SEC released its highly anticipated Spring 2023 Regulatory Agenda, which provides estimated time frames for planned rulemaking. While these dates are aspirational and do not represent strict deadlines (your editors have heard from current and former SEC staffers that the SEC can only use April and October as potential target months for its regulatory agenda), if the SEC were to make good on some of these commitments, it could be a busy spooky season for public companies.

Highlights regarding *final* rulemaking include:

- Climate Change Disclosure — October 2023
- Cybersecurity Risk Governance — October 2023
- Rule 14a-8 Amendments — October 2023
- Special Purpose Acquisition Companies — October 2023
- Modernization of Beneficial Ownership Reporting — October 2023

Highlights regarding *proposed* rulemaking include:

- Human Capital Management Disclosure — October 2023
- Corporate Board Diversity — April 2024
- Disclosure of Payments by Resource Extraction Issuers — April 2024

Final Rule: Share Repurchase Disclosure Modernization

On May 3, 2023, the SEC adopted final rules to modernize share repurchase disclosure that will go into effect for the first periodic report that covers the first full fiscal quarter beginning on or after October 1, 2023 (which means that for calendar-year companies the first report will be on the Form 10-K filed in early 2024 for fiscal year 2023). The new rules apply to almost all reporting companies, require disclosure that must be tagged using *inline XBRL*, and require quarterly disclosure of:

- A new exhibit with daily repurchase data — A new exhibit (Exhibit 26) will disclose daily quantitative repurchase data instead of the current requirement to disclose aggregated monthly repurchase data
- Director and officer trading disclosure — A checkbox in the new exhibit will indicate whether certain directors and officers traded in company securities during the four business days before or after key public announcements about share repurchase plans or programs
- Enhanced narrative disclosure — Companies must include additional narrative disclosure about their objective, rationale, and other matters relating to their repurchase programs and practices — including policies about whether officers and directors may trade during a program (Item 703 of Reg. S-K)
- Company Rule 10b-5 plan disclosure — Companies must disclose their adoption and termination of Rule 10b5-1 plans (Item 408(d) of Reg. S-K)

In preparing for compliance, companies should take several items into consideration:

- Companies should ensure that they have disclosure controls and procedures in place to track both company and director and officer share repurchase information that will be required for compliance with the Final Rules. The banks and brokers involved in executing such trades will likely need to provide relevant information.
- Companies should determine the identities of their affiliated purchasers and consider adopting policies and procedures to assist the company in keeping track of them and their purchases.
- Companies should consider whether they wish to make changes to their Rule 10b5-1 Plans and practices in light of the new disclosure rules.
- Companies may wish to consider whether their internal procedures regarding the approval of repurchase plans or programs should be augmented in light of the new disclosure rules.
- Companies may want to revisit their policies and procedures to determine the extent to which insider trading policies and procedures or other internal policies should be revised to change the timing of trading of company securities by insiders in light of the new disclosure requirements. This could mean delaying the start of the open window period following earnings announcements, when share repurchase plans or programs are often announced, and enhancing pre-clearance procedures to monitor trading more closely during the period before and after significant announcements regarding repurchase plans or programs.
- If companies do not already have in place policies and procedures relating to company share repurchase plans or programs or the trading in company securities by officers and directors during a repurchase plan or program, companies may wish to consider adopting such policies and procedures.

On May 12, 2023, the U.S. Chamber of Commerce sued the SEC to block the new rules, arguing that they will hurt public companies and investors. The Chamber is asserting that the rules risk publicizing important managerial decisions and compel speech in violation of the First Amendment.

The new rules and the corresponding commissioner statements signal that the SEC is looking upon stock repurchases with suspicion. The change in disclosure requirements might in fact signal that the SEC will begin pursuing enforcement actions relating to adherence to the Rule 10b-18 safe harbor. Note that the new rules will help the SEC better monitor whether companies are staying within the Rule 10b-18 safe harbor, as Rule 10b-18 requires companies (and their affiliated purchasers) to limit aggregate repurchases to a certain volume in a single day, and the previous rules only required disclosure of the aggregate monthly volume of such share repurchases.

Companies, therefore, should be on notice of the impact the new rules might have on SEC enforcement and ensure that adequate internal processes are in place to accurately identify affiliated purchases, and disclose their daily share repurchases and the number of shares intended to qualify for the Rule 10b-18 safe harbor.

C&DIs: SEC Issues C&DIs Regarding Rule 10b5-1 Trading Plans

On May 25, 2023, the SEC issued three new Compliance and Disclosure Interpretations ("C&DIs") regarding the SEC's recent amendments to Rule 10b5-1 and related disclosure requirements. C&DIs 120.26 and 120.27 pertain to the timing for compliance with the new rules, and C&DI 120.28 provides greater clarity regarding one of the exceptions to Rule 10b5-1(c)(1)(ii)(D), which allows a person (other than the issuer) to maintain two separate Rule 10b5-1 plans at the same time as long as trading pursuant to the later-commencing plan is not authorized to begin until after all trades under the earlier-commencing plan are completed or have expired without execution. Pursuant to C&DI 120.28, if a person (other than the issuer) terminates the earlier-commencing plan, the later-commencing plan will be subject to an "effective cooling-off period," which begins on the termination date of the earlier-commencing plan and lasts for the time period specified in Rule 10b5-1(c)(1)(ii)(B); however, if the earlier-commencing plan ends by its terms without action by such person, then the cooling-off period for the later-commencing plan is not reset and trading may therefore begin as soon as the plan's original cooling-off period is satisfied (which could be as soon as immediately after the earlier-commencing plan is completed).

Companies should ensure that they are prepared to timely comply with the new disclosure rules regarding Rule 10b5-1 trading plans.

Clawback Updates:

- Notice: SEC Extends Review Period Regarding NYSE and Nasdaq Clawback Listing Standards
- NYSE and Nasdaq Amend Effective Date of Clawback Listing Standards

As a reminder, on February 22, 2023, the NYSE and Nasdaq filed with the SEC proposed listing standards related to Rule 10D-1 under the Exchange Act, which is frequently referred to as the "clawback rule" as it requires public companies to adopt policies to recover erroneously awarded incentive-based compensation based on material errors in the companies' financial reporting. The clawback rule was originally mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The listing standards proposed by the NYSE and Nasdaq generally conform to Rule 10D-1, except with additional details on delisting procedures for public companies that fail to comply with the clawback rule.

On March 13, 2023, the listing standards proposed by the NYSE and Nasdaq were published in the Federal Register and were scheduled to be implemented within 45 days (or up to 90 days if designated by the SEC) of such publication date, subject to SEC approval. On April 24, 2023, the SEC announced that it would utilize the longer 90-day period. As a result, the SEC was expected to take action on the proposed listing standards no later than June 11, 2023. However, in an unexpected twist, on June 5, 2023, the NYSE filed Amendment No. 1 to its proposed listing standards and, on June 6, 2023, Nasdaq filed Amendment No. 1 to its proposed listing standards, each of which extends the effective date of the applicable listing standards to October 2, 2023. On June 9, 2023, the SEC approved both amendments.

Once the SEC approves the proposed listing standards, public companies will have to adopt compliant clawback policies within 60 days from such approval date. Hence, setting aside the recent amendments adopted by the NYSE and Nasdaq, if the SEC would have approved on June 11, 2023, the original listing standards proposed by the NYSE and Nasdaq, public companies would have been required to adopt clawback policies no later than August 10, 2023. ***However, because the SEC has approved the recent amendments adopted by the NYSE and Nasdaq, public companies will now be required to adopt clawback policies no later than December 1, 2023***. As a general matter, Rule 10D-1 requires that the stock exchange listing standards be finalized no later than November 28, 2023.

Companies should begin to develop new or evaluate existing clawback policies in light of the proposed listing standards. Companies should also review existing compensation arrangements to ensure that new or updated clawback policies may be properly implemented. Finally, companies should plan for the potential need to convene board or committee meetings over the summer to approve new or update existing clawback policies.

Proposed Amendments: Delaware Senate Adopts DGCL Amendments Bill

The Council of the Corporation Law Section of the Delaware State Bar Association released its 2023 proposed amendments to the Delaware General Corporation Law ("DGCL"), which were adopted by the Delaware Senate on May 16, 2023. The bill provides for amendments to various sections of the DGCL intended to, among other things, clarify issues relating to the issuance of stock, rights, and options; simplify procedures in connection with the ratification of some certain deceptive corporate acts; and make certain changes to procedures for amending a corporation's certificate of incorporation.

If adopted as written in the bill, Section 242 of the DGCL, which governs corporate procedures for amending a corporation's certificate of incorporation, would be revised to add new subsection (d)(1), which would eliminate the need for a shareholder vote for charter amendments effecting certain specified forward stock splits and corresponding increases in the authorized number of shares. Further, the bill adds new Section 242(d)(2), which under certain circumstances would reduce the required shareholder vote to approve charter amendments to increase or decrease the number of authorized shares or effect a reverse stock split.

If adopted by the Delaware House of Representatives and signed into law by the Delaware governor, the changes would become effective August 1, 2023.

SEC Settles Charges Against Stanley Black & Decker and Former Executive Over Compensation Disclosure Failures

On June 20, 2023, the SEC announced settled charges against Stanley Black & Decker ("SBD"), a publicly traded tools company, for failing to disclose at least $1.3 million in perquisites it provided to certain executives and one director, including former executive Jeffery Ansell. Without agreeing or denying the SEC's findings, both SBD and Ansell agreed to cease and desist violating the applicable provisions of the Exchange Act to settle the SEC's enforcement actions. SBD avoided a fine, while Ansell consented to pay a $75,000 civil penalty.

In light of the SEC's enforcement actions, if executive or director compensation disclosure failures are suspected, companies should consider the actions endorsed by the SEC in the SBD charges described below, including a prompt internal investigation, voluntary self-reporting to the SEC, proactive cooperation, and timely remediation.

SEC vs. SBD

The SEC's order against SBD alleged that the company did not properly apply the SEC's compensation disclosure rules in its system of identifying, tracking, and calculating perquisites. Between 2017 and 2020, SBD failed to disclose in its definitive proxy statements at least $1.3 million worth of perquisites and personal benefits paid to, or on behalf of, four of its named executive officers and one director. Such expenses predominantly related to corporate aircraft use, for which SBD listed $0.00 in compensation attributable to its executives. However, because SBD self-reported the failures, cooperated with the SEC's investigation, and implemented corrective measures, the SEC did not impose a civil penalty against the company.[19]

Gurbir S. Grewal, the Director of the SEC's Division of Enforcement, spoke on SBD's cooperation and the SEC's resulting settlement with the company: "Today's action not only reaffirms the Commission's commitment to enforcing executive compensation disclosure rules, but also to incentivizing self-reporting and cooperation when entities and individuals discover violations of the federal securities laws. In the end, proactive compliance enhances public trust in our markets and benefits all participants, especially the investing public."

SEC vs. Ansell

Between 2017 and 2020, when Ansell was still a senior executive at SBD, he received undisclosed perquisite and personal benefits from SBD totaling at least $647,000, including $280,000 in personal expenses charged to SBD, which resulted in SBD's books, records, and accounts inaccurately and unfairly reflecting its disposition of assets. The SEC's order against Ansell alleged that the former executive caused SBD to incorrectly record payments for the benefit of Ansell as business expenses and not compensation, based at least partially on Ansell submitting expense reimbursement requests and approving certain payments to vendors, and Ansell's failure to correct SBD's omission of his perquisite compensation on draft proxy disclosure statements that he was given prior to SBD filing such documents with the SEC. To settle the charges brought by the SEC, Ansell agreed to pay a $75,000 civil penalty.

Please contact V&E to discuss these developments and their implications.

Anti-ESG (and Pro-ESG) at the State Level

Texas Legislature Puts Insurance Companies at the Center of ESG Controversy

The anti-ESG movement shows no signs of slowing down as several of the states in the now 19-member anti-ESG state coalition, in addition to several other Republican-led states, passed a slate of new anti-ESG legislation in 2023.[20] Many such laws attempt to mirror the approach taken by 2020 rules issued by the Trump administration (which were subsequently replaced by counteracting rules of the Biden administration) that required ERISA fiduciaries to make investment decisions based solely on pecuniary factors.[21]

The 88th Texas Legislature, however, is adding a new dimension to the movement. With a trio of new bills, the Texas Legislature is shifting the focus of anti-ESG ire from financial institutions to insurance companies and pension funds. Insurance companies, which are primarily regulated at the state level, have become increasingly concerned with the impact that certain ESG-related factors may have on their underwriting risks, particularly with regard to the potential effects of climate change.[22] For example, many insurance companies believe that climate change may influence investment and underwriting risks by increasing the frequency and severity of natural disasters, among other issues.[23] Conversely, anti-ESG proponents in state legislatures argue that, similar to financial institutions, insurers should be prohibited from considering ESG principles. Texas Representative Tom Oliverson, who sponsored two of the anti-ESG bills described below, claimed that consideration of ESG principles might "destabilize the entirety of the insurance industry by injecting a bunch of non-actuarially sound principles."[24]

Texas Senate Bill ("TX SB") 833, which was signed into law by Texas Governor Greg Abbott on June 18, 2023, and becomes effective September 1, 2023, restricts insurance companies from using ESG principles to charge different rates to businesses or risks in the same class for essentially the same hazard. This means that insurance companies doing business in Texas are now barred from considering ESG-related factors in evaluating financial risks for investments or factoring ESG-related risks into their investment decisions. However, the bill contains a carve-out for the use of ESG models, scores, factors or standards in charging different rates, but only if those criteria are based on sound actuarial principles or financial solvency considerations reasonably related to the expected loss and expense experience for the different types of risks made available by the insurer.

TX SB 1060, which passed the Texas State Senate on April 18, 2023, but whose future remains uncertain now that the Texas regular legislative session has ended, would prohibit insurers from both including in their proxy statements or implementing what they deem to be "political shareholder proposals." The bill defines "political shareholder proposals" as shareholder proposals that (1) prohibit or limit an insurer's ability to insure risks related to the fossil fuel industry, (2) require an insurer to reduce or track GHG emissions (including the insured entities, as would be implicated by Scope 3 emissions), or (3) prohibit or limit an insurer's ability to insure an entity for the purpose of achieving environmental, social or political ends, though the bill does not define "environmental, social, or political ends." The proposed legislation does not address how it would apply vis-à-vis Rule 14a-8 of the Exchange Act, which requires public companies to include in their proxy statements shareholder proposals under certain circumstances. Note that this legislation closely mirrors anti-ESG approaches that state-level anti-ESG proponents have taken toward financial institutions by effectively prohibiting insurance companies from selectively doing or withholding business with certain industries if they want to operate within the state.

TX SB 1446, which passed the Texas State Senate on April 20, 2023, but also failed to pass the Texas House of Representatives during the regular legislative session, would require Texas state public retirement systems, including the Employee Retirement System of Texas and the Teacher Retirement System of Texas, to make investments solely on the basis of pecuniary interests. Although the bill does not mention ESG by name, it expressly mandates that state public retirement systems must not use the systems' assets to further any social, political, or ideological interests. Furthermore, TX SB 1446 would prohibit state public retirement systems from engaging in contracts with investment managers and proxy advisors unless those contracts expressly require the manager or advisor to solely consider financial factors (and implicitly exclude ESG-related principles) when investing assets and advising voting, respectively. Similarly, any state public retirement system seeking to grant proxy voting authority to a proxy advisor would require the advisor to vote shares based solely on financial factors, and to maximize financial return while controlling the associated levels of risk. TX SB 1446's financial factors definition closely tracks the pecuniary factor standard employed by Florida's House Bill 3 and similar legislation inspired by the Trump administration's ERISA rules.

Although Governor Abbott called a special session of the state legislature on May 30, it is yet to be seen whether either of the remaining bills will be taken up again or join the growing number of anti-ESG bills that have failed to become law.[25]

Companies should remain attentive to ongoing legislative developments in this area to ensure that requisite action is taken to be compliant if and when it becomes necessary. Please contact V&E if you have any questions regarding the implications of any new legislation.

State-Level Pro-ESG Legislation Focuses on Divestment and Disclosure

While anti-ESG legislation has recently been in the spotlight, several Democratic-led states have doubled down on ESG-related legislation in recent months. In particular, the California State Senate has passed and the California State Assembly is now considering a trio of bills comprising California's "Climate Accountability Package,"[26] which is aimed at divesting the state's pension funds from fossil fuel companies, establishing state-level disclosures and reporting on GHG emissions and climate-related financial risks. It is unclear when the California State Assembly will reach a decision on these bills, but we will continue monitoring these developments.

The Fossil Fuel Divestment Act (SB 252)

- Much like the current trend in anti-ESG bills, this legislation focuses on leveraging state pension funds and financial institutions to advance pro-ESG-related goals. The Fossil Fuel Divestment Act would prohibit the boards of the California Public Employee's Retirement System and the California State Teacher's Retirement System from making new investments or renewing existing investments of public employee retirement funds in fossil fuel companies.

The Climate Corporate Data Accountability Act (SB 253)

- With the SEC's proposed climate-related disclosure rules still in limbo (as noted in the "SEC (and Delaware) Watch" section above, they will likely not be finalized until at least this fall), California has been working on its own set of climate-disclosure laws. The Climate Corporate Data Accountability Act piggybacks off of last year's Climate Corporate Accountability Act which proposed the creation of a statewide GHG reporting and verification system and passed the California State Senate but failed to gain traction in the California State Assembly. If passed, beginning in 2026, the Climate Corporate Data Accountability Act would require entities engaged in business in California with total annual revenues greater than $1 billion to make public disclosures of their GHG emissions, including Scope 1, Scope 2, and Scope 3 emissions.[27] Unlike the SEC's proposed climate-related disclosure rules, California has no carve-outs for Scope 3 emissions, and entities would be required to report their Scope 3 emissions even if not material and the entity has not disclosed any GHG emission targets or goals. The legislation would also require reporting entities to independently verify their Scope 1, Scope 2 and Scope 3 emissions through a third-party auditor.

The Climate-Related Financial Risk Act (SB 261)

- The Climate-Related Financial Risk Act would require covered entities with total annual revenues greater than $500 million to prepare annual reports disclosing the entity's climate-related financial risk by following the recommended framework and disclosures contained in the Task Force on Climate-Related Financial Disclosures ("TCFD"). Companies would be required to submit such reports to the California State Air Resources Board, make the reports publicly available on their websites, and issue a statement to the California Secretary of State affirming that the report discloses climate-related financial risks in accordance with the requirements of the legislation. The legislation would also require entities to disclose the measures they adopt to reduce and adapt to the climate-related financial risks they identify.

Companies should take note that, while the SEC's proposed climate-related disclosure rules, if finalized, would only apply to public registrants, California's proposed legislation would have a broader reach that would encompass any private company with the requisite total annual revenues doing business in California. Furthermore, companies with total annual revenues between $500 million and $1 billion would still be subject to the Climate-Related Financial Risk Act, even if not required to comply with the Climate Corporate Data Accountability Act.

Please contact V&E to discuss these developments and their implications.

COSO Internal Controls Over Sustainability Reporting

Companies are under increasing pressure to report sustainability-related information about their businesses. These demands come from multiple directions: institutional investors seeking disclosure on certain sustainability-related topics, shareholders making sustainability-related proposals at record numbers, and regulators proposing and adopting new rules requiring companies to disclose sustainability-related information, such as the SEC's proposed rules regarding climate disclosure, California's Climate Accountability Package (discussed above), the European Union's Corporate Sustainability Reporting Directive ("CSRD"), and the International Sustainability Standards Board's ("ISSB") Sustainability Disclosure Standards (which the UK government has signaled that it will adopt as part of its sustainability reporting requirements).

As companies seek to provide ESG and sustainability-related disclosure in their reporting, it is important that they develop and maintain systems and controls to safeguard the quality and accuracy of such information. Without such systems and controls in place, companies may face risks relating to their ESG and sustainability reporting, such as regulatory enforcement actions and greenwashing claims. Though public companies are required to have financial disclosure controls and procedures in place, the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") has found that many companies have yet to begin their journey on developing internal controls over sustainability and ESG reporting. Ad hoc controls around key sustainability metrics and internal assurance procedures have been largely unsuccessful in creating effective, replicable, and (to the extent appropriate or required) assurable sustainability reporting controls.

With that backdrop, on March 30, 2023, COSO released new guidance for implementing effective internal controls over sustainability reporting (the "ICSR"). COSO's ICSR builds on its widely adopted financial control framework, the internal control integrated framework for financial reporting ("ICFR"), by applying its effective internal control principles to sustainability reporting issues. The ICFR, and by extension the ICSR, focus on internal assurance and data integrity, and can be applied to companies regardless of size and complexity. COSO's ICSR can help companies develop and improve their sustainability disclosure controls and procedures by leveraging their existing financial disclosure controls and procedures and adapting them for sustainable business information. This can provide companies with pathways for implementing trustworthy and confident sustainable business information that can be utilized internally for decision making and externally for public disclosures.

Please see our recent Insight on the COSO ICSR for more information and contact V&E to discuss these developments and their implications.

ESG Metrics In Compensation

Companies are increasingly tying ESG metrics to executive compensation. Approximately 70% of the S&P 500 companies adopted some level of ESG metrics in their incentive plans in 2022. The practice is even more prevalent from a global perspective, with 77% of major companies across North America and Europe including ESG metrics in either annual or long-term incentive plans in 2022, up from 68% in 2021. Additionally, at the end of 2022, ISS found that 35% of S&P 500 companies used at least one specific environmental and social ("E&S") metric in their incentive pay programs, up from 20% as of June 30, 2021. This practice is even more common for large energy companies in the United States, with 81% of the S&P 500 companies in the 1010 GICS industry group (energy) disclosing the use of at least one specific E&S metric in their short-term incentive program in 2022. Furthermore, of more than 200 corporate directors of public companies surveyed in February 2023, 30% identified designing incentives tied to ESG metrics as a long-term priority, and 21% identified designing incentives tied to ESG metrics as a short-term priority.

Why are so many companies choosing to incorporate ESG metrics in their executive compensation? Some companies are reacting to investor expectations — while certain institutional investors such as BlackRock and Vanguard state that they are agnostic to whether companies link ESG to executive compensation, some investors, including AllianceBernstein, Legal and General, Allianz, Amundi, and UBS, maintain policies encouraging companies to adopt certain ESG-related incentive metrics. Other companies are seeking to signal to their investors and other stakeholders that they are prioritizing certain ESG matters. Finally, some companies may be linking ESG metrics to executive compensation to improve their chances of achieving ESG commitments that the companies have made.

In light of this growing trend, companies should take several matters into consideration in determining whether to link ESG metrics to executive compensation and or enhance ESG-linked compensation practices over time. First, consistent with BlackRock's and Vanguard's guidelines and approaches, companies should ensure that there are clear links between the ESG performance metrics used and the company's strategy. Leading investors remain wary that certain ESG metrics might not be strategic or appropriately calibrated to incentivize the right corporate outcomes and can be used as a way to grant additional compensation that is otherwise unwarranted.

Where companies choose to incorporate ESG metrics into annual or long-term compensation plans, investors typically prefer to see metrics that are strategic to the business' key objectives and publicly stated goals. Companies should also strive to apply the same rigor and disclosure for ESG metrics that they do for traditional financial metrics. With that said, certain ESG achievements or progress may be more difficult to identify and quantify than relatively straightforward financial targets, which results in added complexity when developing and administering ESG compensation metrics. If companies are seeking to tie ESG metrics to compensation in a meaningful way, many investors believe that they should assign clear weight to ESG-related metrics (for example, 10% to 20% of target incentive opportunities for either short-term or long-term incentive plans may be viewed as an appropriate weighting) and identify consequences for failing to meet such targets. Companies should recognize that there may be hard-to-predict factors or developments that arise that are beyond management's control and therefore build into plans appropriate flexibility for necessary adjustments, while being mindful of the stakeholder optics for any discretionary adjustments.

Please contact V&E to discuss these matters.

Update On Board Diversity

In 2018 and 2020, California passed legislation requiring public companies headquartered in California to have a minimum number of women directors (SB 826) and directors from underrepresented communities (AB 979) on their boards, with violations under each law entailing six-figure fines. Both laws have since been challenged in state court, with the lower courts ruling against the state in both cases and enjoining the state from implementing and enforcing the laws while both cases are on appeal. Plaintiffs also filed cases against the statutes in federal court, and on May 16, 2023, the U.S. District Court for the Eastern District of California granted summary judgment to the plaintiff, Alliance for Fair Board Recruitment, in their challenge against the underrepresented community diversity law, determining that the legislation is unconstitutional. This decision could have implications for other board diversity requirements, including the ongoing state court litigation regarding the California laws. This case could also be relevant for Alliance's pending challenge to the SEC's approval of the Nasdaq's board diversity rule in the Fifth Circuit. As a reminder, Nasdaq Rule 5605(f) requires most Nasdaq-listed companies to have, or explain why they do not have, at least two "diverse" board members, including "(i) at least one Diverse director who self-identifies as Female; and (ii) at least one Diverse director who self-identifies as an Underrepresented Minority or LGBTQ+."

It has been reported that the Nasdaq board diversity rule prompted rapid adoption of inclusive LGBTQ+ policies by Nasdaq-listed companies (a 1,556% increase between 2022 and 2023), leading to half of all Nasdaq-listed companies adopting such a policy as of March 2023. The report also finds that there have been large increases in adoption of policies inclusive of gender (+206%), race (+318%), ethnicity (+284%), national origin (+579%), and age (+215%). Nevertheless, self-identified LGBTQ+ people remain the most underrepresented group on U.S. public company boards, representing less than 1% of the seats on S&P 500 companies in 2022. Self-identification poses a challenge to accurately capturing LGBTQ+ representation data in public disclosures, with companies almost certainly undercounting total representation, but the gulf between policy and reality is clearly sizable.

Please contact V&E to discuss these developments and their implications.

Biodiversity

Climate may still be at the top of stakeholders minds when it comes to the "E" in ESG reporting, but momentum may be building around biodiversity. Although several organizations offer slightly differing definitions of "biodiversity," at a broad and general level it "refers to the variety of life on Earth at all its levels, from genes to ecosystems, and can encompass the evolutionary, ecological, and cultural processes that sustain life."[28] Biodiversity plays a role in our world and the health of the ecosystems in which we, and all organisms, live. In fact, many consider biodiversity to be an important factor in tackling the challenges presented by climate change. But biodiversity is in decline with climate change being one of the main drivers of biodiversity loss and ecosystem degradation. Addressing these twin crises together is, therefore, necessary to avoid the "chicken or egg" problem.

Focus on biodiversity is gaining traction with corporate stakeholders — governments, regulators, investors, NGOs and other constituencies — turning their attention toward this issue. In December 2022, 188 countries entered into the Kunming-Montreal Global Diversity Framework ("GBF") to conserve 30% of the world's land and 30% of the world's oceans by 2030 (the "30 x 30" pledge). The "high seas" treaty, an international treaty comprised of United Nations members, quickly followed in March 2023, which intends to protect and promote the sustainable use of marine biodiversity in areas beyond national jurisdiction. Following these developments, new disclosure and target-setting frameworks emerged in late Q1 and through Q2 of 2023. Despite the increasing prominence of biodiversity, a recently released report indicates that many of the world's largest asset managers are voting against shareholder proposals intended to protect this valuable resource. The factors underpinning these voting results are complex, but, as described above (see above "Proxy Season 2023 – What We're Seeing"), many of these proposals are viewed by institutional investors as overly prescriptive, even if these stockholders are aligned in principle with the intent of preserving biodiversity.

Taskforce for Nature-related Financial Disclosures

The Taskforce on Nature-related Financial Disclosures ("TNFD")[29] released its fourth and final beta framework at the end of March 2023. Final recommendations are expected in September 2023. Largely following the four pillars of the TCFD[30] — governance, strategy, risk management and metrics — the framework adds specific nature and biodiversity considerations to the recommended disclosures. The TCFD has been the subject of renewed focus since the integration of the framework by the SEC into its proposed rule on climate-related disclosures, released in March 2022, and due to be finalized this year. Although the TNFD may not gain traction in quite the same way, the final framework will offer a means by which companies can assess nature-related risks and opportunities upon their business, strategy, and finances and report this information to their various stakeholders. Notably, the TNFD considerably aligns with the TCFD, with certain modifications integrated to adapt the framework to a nature context. For example, rather than "scopes" of greenhouse gases, companies can report metrics and targets with respect to their "direct," "upstream," "downstream" and "financed" operations.

The public comment period on the framework closed on June 1, 2023. The final recommendations, based on the feedback and pilot testing, are due to be released in September of this year. Significantly, the TNFD is designed to inform the relevant standards of both the ISSB and the Global Reporting Initiative ("GRI").[31]

Companies with biodiversity-related sustainability goals or aspirations should consider assessing any existing disclosures against the draft TNFD framework, particularly if they also claim to report in accordance with the GRI and/or ISSB given the eventual linkage between standards.

Science Based Targets for Nature

In May 2023, the Science Based Targets Network ("SBTN")[32] released the [first science-based targets] for nature. Built upon the Science Based Targets initiative which provides for climate-target setting, the SBTN's science-based targets for nature offers a framework by which companies can voluntarily report their effects on nature as part of their corporate environmental reporting. The framework aligns with both the Paris Agreement and the GBF.

The SBTN's first release covers freshwater and land objectives as well as partial biodiversity coverage. The five-step framework — (1) Assess; (2) Interpret & Prioritize; (3) Measure, Set & Disclose; (4) Act; and (5) Track — will be piloted by a group of 17 companies that will submit data to the SBTN by the end of the year to inform the development of its target validation process as well as an initial version of land targets. Ocean targets are expected to be available next year. The SBTN's science-based targets for nature are designed to meet the requirements of existing disclosure frameworks including the TCFD, GRI, and the forthcoming TNFD.[33]

Mixed Support for Biodiversity Proposals from Asset Managers to Date

According to the World Economic Forum, half of the world's gross domestic product (estimated at $44 trillion as of January 2020) is moderately or highly dependent on nature.[34] Despite this, Planet Tracker found that more than one-half of investment managers voted against proxy biodiversity proposals. Analyzing 38 biodiversity proposals (deforestation, genetic materials, and other biodiversity issues) from 2010 through 2022, Planet Tracker found that, of the 26,500 votes cast, 38% were in favor while 54% were not. Most of the proposals sought corporate reporting on a biodiversity-related issue. Four of the proposals asked management to adopt a biodiversity policy, while six asked for the adoption of deforestation goals (or something similar). The top four reasons provided for voting against such proposals were that they were overly prescriptive, the corporation already reported such issues, the corporation already had a policy in place, or there were insufficient shareholder benefits.

Interestingly, the report found that the sustainability funds of three of the world's biggest global asset managers voted against biodiversity proposals. Although biodiversity is receiving increasing interest, it appears that biodiversity proposals remained scarce at annual shareholder meetings this past reporting year.

Please contact V&E to discuss the implications of these developments.

European Frameworks Regarding Climate Disclosure

It appears there is no stopping the European Union ("EU") from moving full steam ahead with respect to climate-related disclosures (as well as antitrust guidelines for ESG competitor agreements). The CSRD took effect on January 5, 2023, creating additional ESG and sustainability reporting requirements for a number of companies, including certain U.S.-based companies with European operations.[35] More recently, at the beginning of June 2023, the European Parliament voted on new rules that will require companies to identify and address the impact of their activities and value chains on human rights and the environment and, importantly, implement climate transition plans. Although these developments impact only a handful of U.S. companies presently, many look toward EU trends as a precursor of potential similar, future domestic actions.

CSRD

The CSRD requires companies to provide a wide range of disclosures with the aim of providing consistent, comparable, and reliable information for various stakeholders — financial firms, investors, and the public. Building upon the Non-Financial Reporting Directive introduced in 2014, the CSRD expands the number of companies subject to the reporting requirements (approximately 37,300 additional companies, to include non-EU parent companies) and broadens the scope of such reporting, to include both retrospective and forward-looking disclosures. Companies subject to the CSRD now need to incorporate both qualitative and quantitative assessments in their reporting and obtain assurance (limited assurance by October 1, 2026, and reasonable assurance by October 1, 2028) to ensure both reliability and accuracy.

Additional disclosures in the CSRD are largely aligned with the recommendations of the TCFD, which also mirror the forthcoming SEC's proposed rules on climate-related disclosures. Notably, the CSRD increases reporting around due diligence requirements with companies needing to evaluate the actual and potential adverse impacts of their activities throughout the value chain. Companies will also be required to identify actions they are taking to prevent, mitigate, and remediate such impacts. Such reporting aligns with the UN Guiding Principles on Business and Human Rights and the Organization for Economic Cooperation and Development's Due Diligence Guide for Responsible Business Conduct.

Companies will not be subject to the CSRD's reporting requirements until at least 2024, with phase-in relief provided by the European Commission's most recent draft proposal for all companies for certain disclosures (*e.g.*, one year before they must provide disclosures on anticipated financial effects related to non-climate environmental issues) and smaller companies with under 750 employees (*e.g.*, one year before they must provide Scope 3 GHG emissions reporting). However, given the significant impact the CSRD will have upon ESG reporting, companies should begin preparations well in advance.[36]

New EU Rules Implementing Climate Transition Plans

On June 1, 2023, the European Parliament voted 366-225 in favor of new rules which will require companies (including those in financial services) to (a) identify and address the impact of their activities on both human rights and the environment, and (b) adopt and implement climate transition plans. The new rules apply to EU companies based on employees and revenue. Importantly, non-EU companies earning revenue in the EU above the applicable thresholds would also be subject to the new rules.

The new rules are part of the European Parliament's negotiating position on the European Commission's proposed Corporate Sustainability Due Diligence Directive ("CSDDD"). In December 2022, the EU Commission adopted its position on the CSDDD which would require companies to integrate more stringent due diligence into its policies. Companies would also need to identify the actual or potential adverse human rights and environmental impacts of its operations, subsidiaries and value chain, end or minimize actual impacts, and prevent or mitigate potential impacts. An important change adopted in the European Parliament's position on the initial proposed CSDDD is the addition of requiring companies subject to the new rules to implement climate transition plans aligned with the Paris Agreement, inclusive of Scope 1, 2 and 3 GHG emissions. Companies with more than 1,000 employees would also be required to tie performance on the targets of the climate transition plan to directors' variable compensation. Finally, companies would need to perform due diligence on climate impacts. The integration of climate transition plans in the new rules is considered by some as the piece missing from the CSRD.

Following this official position on the CSDDD from the European Parliament, negotiations can begin. The CSDDD will be the subject of trilogue discussions among the European Parliament, European Council, and the European Commission over the coming weeks.

Although the CSDDD is not in effect, U.S. companies potentially subject to the new rules should begin efforts to address the requirements now. This will also aid compliance with the SEC's proposed rule on climate-related disclosures, if finalized as currently proposed, which would require registrants that have adopted a transition plan to describe the plan, "including the relevant metrics and targets used to identify and manage physical and transition risks."[37]

Please contact V&E to discuss the implications of these developments.

Environmental Justice

In the first week of his administration, President Biden signed Executive Order No. 14008 — Tackling the Climate Crisis at Home and Abroad — which launched an ambitious Environmental Justice ("EJ") agenda. Since then, the Biden administration has issued several more Executive Orders, continuing to promote a "whole-of-government" approach to advancing EJ. Several states, most recently (and notably) New Jersey, have undertaken several actions to address the communities subjected to disproportionate environmental harms and risks. However, EJ is fast proving a contentious issue for some, with arguments stating the government's focus has gone too far while others state it has not gone far enough.

The U.S. Environmental Protection Agency ("EPA") defines EJ as "the fair treatment and meaningful involvement of all people regardless of race, color, national origin, or income, with respect to the development, implementation, and enforcement of environmental laws, regulations, and policies."[38] More specifically, the EPA is concerned with the protection of historically "overburdened communities" — "[m]inority, low-income, tribal, or indigenous populations or geographic locations in the United States that potentially experience disproportionate environmental harms and risks."[39]

Recent Federal Actions

In April 2023, President Biden signed Executive Order No. 12898, Revitalizing Our Nation's Commitment to Environmental Justice for All. The Executive Order directs each federal agency to prioritize the achievement of EJ as part of its core mission through the implementation of a number of practices. These include, for example, identifying and analyzing certain disproportionate and adverse environmental and human health effects, risks, and hazards of federal activities. Additionally, the Executive Order established an Office of Environmental Justice within the Council of Environmental Quality to be led by an appointed Federal Chief Environmental Justice Officer, whose role will be to advance EJ initiatives (for example, to identify collaboration and coordination opportunities with local, state, territorial, and tribal governments).[40]

A month later, at the end of May 2023, the EPA released the ECHO Clean Air Tracking Tool ("ECATT"). ECHO — the EPA's Enforcement and Compliance History Online website — allows users to search for facilities to assess compliance with environmental regulations, such as the Clean Air Act and Clean Water Act, and examine enforcement data (*i.e.*, the violation and outcome). The addition of the ECATT allows users to analyze air quality, locate areas of high air pollution concentrations, and evaluate the emissions of stationary source facilities in those areas. The ECATT integrates data from multiple sources, including EJ data. A user can search the Air Monitoring Station search feature of ECATT to identify areas that have a higher potential for health impacts, including elevated cancer risk, and compare those areas to nearby emission concentrations, thereby locating potential risk "hotspots." ECATT also has an Emissions Screener search feature which provides data on regulated stationary sources. The addition of ECATT to ECHO is one more in a number of legal tools available to identify EJ impacts.

Certain Recent State Actions

New Jersey has been a forerunner in addressing EJ issues. In April 2023, the New Jersey Department of Environmental Protection finalized its EJ rules, which implement the state's 2020 Environmental Justice Law (the "EJ Law"). The EJ rules require certain facilities to prepare an EJ impact statement if they seek to obtain certain permits (for a new facility, the expansion of an existing facility, or the renewal of an existing permit) in overburdened communities, as defined by the EJ Law. The EJ impact statement is required to assess the potential environmental and public health stressors that the facility has either caused or to which it has contributed. Moreover, such facilities are also required to hold a public hearing, thereby allowing the opportunity for public participation in the permitting process. The New Jersey Department of Environmental Protection will review the EJ impact statement to determine approval of the application, as proposed. Importantly, the Department could deny an application altogether upon a finding that approval would cause higher adverse cumulative environmental or public health stressors in overburdened communities (as compared to other communities). The Department is also provided the option to apply permit conditions. [41]

Not all states are supportive of efforts to address EJ issues. In Louisiana, following EPA's announcement that it was launching a civil rights investigation of two Louisiana state agencies in connection with permitting certain industrial facilities, Louisiana Attorney General ("AG") Jeff Landry filed suit in the U.S. District Court for the Western District of Louisiana, alleging that the EPA overstepped its bounds in violation of the U.S. Constitution and its authority under the Civil Rights Act of 1964 by attempting to implement (and enforce) EJ policies. Louisiana's suit asserted that the EPA had "lost sight of the agency's actual environmental mission" by declaring that compliance with environmental law was not enough and that states must also satisfy the EPA's "increasingly warped vision" of EJ and equity. As a result, the complaint asserted, activities that would be lawful under environmental law are threatened by the agency's focus on "racial demographics." The complaint followed the EPA's challenge to two permits granted by the Louisiana Department of Environmental Quality in January 2020, pursuant to the Clean Air Act. The EPA's challenge of the permits, per the complaint, was not based on the substance of the permits but rather to "undefined parts of the process used to issue those permits" which the EPA sought additional information on, claiming authority to do so under Title VI. Unfortunately, this suit is not going to provide any insight into EPA's EJ-authority under the Civil Rights Act of 1964. On June 27, 2023, EPA announced that it had closed its civil rights investigation into the two Louisiana state agencies, claiming that the investigation was no longer necessary in light of agreements reached at the two plants and additional air emission control rules that EPA recently finalized.

Despite EPA's decision to close its civil rights investigation, focus on addressing EJ in permitting decisions in Louisiana is not going away any time soon. Environmental groups have voiced their concern regarding the state's proposed permitting program for carbon capture and storage sites on EJ grounds. In April 2023, the EPA proposed to grant Louisiana's application for primacy to issue Class VI permits pursuant to the Safe Drinking Water Act's ("SDWA") Underground Injection Control Program for long-term carbon capture and sequestration ("CCS").[42] EPA's proposed approval is based upon its determination that the state's application meets all requirements for approval under the SDWA and addresses all EJ elements set forth in a December 9, 2022 letter the EPA sent to state governors regarding the importance of CCS while also mitigating impacts on vulnerable communities. However, EJ advocates claim Louisiana's permitting plan does not actually address EJ concerns at all, providing pledges that lack substance and concrete action. It is likely that these concerns will form the basis of public comments due by July 3, 2023, on EPA's proposed approval of Louisiana's Class VI permitting program.

Whether mandated by law or not, EJ issues require careful and early consideration for any potential construction project. In addition to potential legal risks, there is significant reputational risk for companies given the social and environmental harm dynamics at play in EJ issues. New projects in heavily industrialized areas should expect increasing scrutiny on EJ grounds.

Proactive assessment and quantification of impacts can help mitigate these risks. Data is readily available from various EJ-focused tools, such as EJSCREEN, and companies are advised to integrate such information into their analyses.

Please contact V&E to discuss the implications of these developments.

High Profile Exits from Net-Zero Insurance Alliance

Nearly half of the insurance companies that comprised the Net-Zero Insurance Alliance ("NZIA") have withdrawn their membership from the organization over the last few months. Since February 2023, Munich Re, Swiss Re, Hannover Re, and Allianz have departed the NZIA, shrinking membership to just 17 (down from 30). Increasing ESG antitrust concerns in the United States are cited as one central rationale for such exits. Mounting political turmoil stemming from climate policy (see "Anti-ESG (and Pro-ESG) at the State Level" above), also in the United States, is likely to be a contributing factor, too.

In discontinuing Munich Re's membership, Joachim Wenning, CEO of Munich Re, noted that the insurer would continue to pursue its decarbonization goals, "without exposing [itself] to material antitrust risks."[43] Similarly, Hannover Re stated that, although it would be leaving the NZIA "after careful consideration," the insurer would continue its commitment to the Paris Agreement and climate neutrality by 2050.[44]

The NZIA, a member-led group of insurance companies which launched in 2021, is a voluntary initiative, convened by the United Nations Environment Programme ("UNEP"). As such, members can freely join or withdraw at any time and for any reason.[45] The group is committed to decarbonizing their underwriting portfolios through science-based intermediate targets and periodic reporting, along with engagement and advocacy efforts in the transition to net-zero GHG emissions by 2050, in accordance with the Paris Agreement.[46] In 2022, the NZIA collaborated on the development of the first global standard to measure and disclose emissions attributable to insurance underwriting portfolios — Version 1.0 of the Target-Setting Protocol was released on January 17, 2023.[47]

The insurance industry plays an ever-increasing role in the path to net-zero emissions given that insurers can influence business decisions by selectively refusing to finance carbon-intensive industries and projects.[48] Although insurers have traditionally been concerned with the risk of impact of climate change and natural disasters on their underwriting portfolios, many insurers have also begun to see their role in the shaping of decarbonization initiatives. Around 62% of insurance companies already maintain coal exclusion policies, like Munich Re, Swiss Re, Hannover Re, and Allianz, and more recently some insurance companies have expanded their policies to cease coverage of new oil and gas projects.[49]

In a statement released on May 24, 2023, the UNEP recognized the impact of U.S. policy on the NZIA and the influence this appears to have had upon recent departures.[50] However, the UNEP emphasized the need for collaborative action to reach net zero GHG emissions and has pledged to continue working with the insurance industry to achieve that goal.

Please contact V&E to discuss the implications of these developments.

Greenwashing

Companies seeking to promote their bona fide green credentials are becoming increasingly subject to scrutiny and potential claims of "greenwashing" — false or misleading statements about the environmental impacts or sustainability of a particular practice or activity.[51] These claims are no longer limited to typical consumer-oriented marketing materials (like TV ads and claims on packaging), but are now seeping into corporate ESG goals, aspirations, and progress and cover non-traditional marketing means, such as corporate sustainability reports.

The Green Guides Update

Such scrutiny looks to likely intensify. In December 2022, the Federal Trade Commission ("FTC") announced it was seeking public comment on potential updates and changes to the Green Guides. The Green Guides offer federal guidance to companies making statements regarding environmental benefits or related matters to avoid making misleading claims. The FTC sought public comment regarding general issues (*e.g.*, the continuing need for the Green Guides, industry compliance, accounting for the implications of international laws/regulations/standards, etc.) and specific claims; notably, carbon offsets and the use of term "sustainable" and similar phrases. With respect to the former, the FTC asked the public whether its existing guidance as to carbon offsets needed updating with respect to climate change — *i.e.*, the relationship between the use of offsets and consumer perception on climate change mitigation, with many companies using carbon offsets to help achieve climate change-related targets and goals, such as "net zero by 2050." In its last update more than a decade ago (in 2012, the current version of the Green Guides), the FTC determined that it lacked a basis to provide specific guidance as to how consumers could interpret sustainability claims. The FTC may need to revisit this determination and, if so, determine what guidance the agency should provide.

The public comment period closed on April 24, 2023. The FTC is expected to release an updated version of the Green Guides sometime this year.

Please contact V&E for more information about the impending Green Guides updates and emerging greenwashing risks. Our ESG and antitrust attorneys are here to help companies navigate how to appropriately communicate their sustainability performance and goals in light of this dynamic landscape.

Delta Lawsuit

In May 2023, a class action lawsuit was filed alleging Delta Airlines ("Delta") "grossly misrepresent[ed] the total environmental impacts of its business operations in its advertisements, corporate announcements, and promotional materials and thereby attain[ed] undeserved market share and extract[ed] higher prices from consumers." The complaint alleges that since March 2020, Delta has "repeatedly touted itself as 'the world's first carbon-neutral airline'" through various means, such as advertisements, LinkedIn posts, podcasts, press releases, and even in-flight napkins. To make its claims of being "carbon-neutral," Delta has made use of the voluntary carbon offset market, investing in carbon offsets to offset its CO2 emissions, such that Delta was "not responsible for releasing additional carbon into the atmosphere during this time." Plaintiffs point to Delta's reliance on the voluntary carbon offset market to allege that its claims are false, appearing to premise their suit on market credibility allegations by skeptics, including certain journalists. These media exposés have called into question the accuracy of the carbon accounting practices, speculative emissions reduction forecasts, the permanence of carbon reductions and the additionality of such projects.

Many companies' carbon abatement plans and net zero goals involve the planned use of carbon offsets. If your company leverages — or plans to leverage — these types of offsets, V&E is here to assist and discuss any risks, mitigation plans and similar considerations.

Calls for Plastics Recycling Symbol to be Ditched

In response to the FTC's request for public comment on its update to the Green Guides, the EPA, alongside thousands of environmentalists and individuals, submitted comments regarding "recyclable" claims, recommending the agency replace the familiar chasing arrows triangle symbol with a solid triangle outline. The EPA advised that the chasing arrows triangle symbol, combined with a resin identification code (a number from 1 through 7 which appears in the middle of the arrows), is deceptive and misleading to consumers, even if placed in an inconspicuous location. More specifically, the EPA explained, consumers generally misunderstand the chasing arrows symbol — which was originally intended to simply identify the resin type — to mean a given package or product is universally recyclable. However, not all resins are — many plastics with higher resin codes (especially 3 through 7) are not financially viable to recycle and do not have end markets nor widespread infrastructure to process them. Plastics with resin codes 3 through 7 include films, foam packaging, and trash bags, all of which generally cannot be recycled at most mechanical recycling facilities, according to the EPA. The plastics industry, however, is not uniformly on board with the EPA's assertion, pointing to new technologies such as chemical recycling (the transformation of plastics into their chemical components for future use), or conversion to energy. The EPA recently clarified that it does not consider the transformation of plastic into energy (*i.e.*, burned in a waste-to-energy facility) to be a recycling activity.[52]

The EPA's commentary in its letter to the FTC is likely to be strongly considered by the latter agency, so we can expect that any details regarding the potential elimination or phase-out of the chasing arrows design will coincide with the final Green Guides publication, which is anticipated later this year.

EU Progress Reports on Greenwashing

Greenwashing is not just a U.S. concern. Early in June 2023, the European Supervisory Authorities ("ESAs") published their Progress Reports on Greenwashing in the financial sector, which set forth the ESAs' high-level understanding of greenwashing and "provides market participants and regulators with a shared reference point in dealing with this phenomenon."[53] The ESAs (the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority) have each drafted a report providing their input on greenwashing as it relates to their respective sectors. The reports provide advice for the sectors within their respective remit, including:

- Defining greenwashing
- Identifying examples of the most relevant types of greenwashing
- Understanding the risks that greenwashing poses
- Identifying supervisory practices of greenwashing
- Identifying the gaps, inconsistencies, and problems within the current legislative framework

The reports assert a "clear increase" in the level of greenwashing within the EU's financial system, finding that all core parts of a product's or entity's sustainability profile are susceptible to deceptive and misleading claims. The ESAs will publish their final greenwashing reports in May 2024, which could include possible changes to the current EU regulatory framework.

Net Zero Commitments Subject to Greenwashing Scrutiny

Over the last few years, stakeholders have been increasingly pressuring companies to take aggressive action with respect to climate change. Many companies have, in response, committed to "net zero" goals — for example, "net zero by 2050." Such commitments are often found in sustainability reports or on company websites, as well as within "non-traditional" means, such as podcasts, posts, and advertising paraphernalia (think in-flight napkins). Net zero, or similar, goals are not considered mere "puffery"; rather, they are subject to increasing regulatory scrutiny and potential legal challenges if such aspirations are not grounded in plausible plans (even if not fully fleshed out) demonstrating efforts and actions over specified timelines. Without this foundation, companies open themselves up to the possibility of greenwashing claims.

We can expect that, with the coming revisions to the Green Guides, which are likely to spell out in more granular detail the dos and don'ts of net zero and other carbon abatement claims, as well as the early indications from the FTC and the plaintiff's bar (as well as the National Advertising Division of the Better Business Bureau adjudicating regular green claims disputes between industry participants), this area will continue to garner scrutiny and increasing activity. The competing pressures on corporate issuers from shareholders and other stakeholders to set and develop plans around net zero will begin colliding into regulatory and litigation risk regarding the potentially misleading overstatement of these environmental activities.

This risk can be financial, but especially for consumer facing companies, reputational, so companies should carefully tread in these waters and be well-advised by counsel as they set goals and communicate progress.

Please contact V&E to discuss the implications of these developments.

Increased Focus On Employee Voice

New guidance from State Street Global Advisors ("SSGA") links Board oversight of employee voice with effective human capital management.

SSGA Publishes Guidance on Board Oversight of Employee Voice

In March 2023, SSGA, together with Russell Reynolds Associates, and the Ford Foundation, published an Insight, "The Board's Oversight of Employee Voice," with a stated goal of providing guidance to Boards that will help them oversee human capital management through quantitative and qualitative feedback from employees regarding their perspectives, interests and needs, otherwise known as "employee voice." The Insight is based on interviews with public board members in the U.S. and UK.

Boards May Lack Depth of Knowledge on Employee Voice

The Insight suggests that, while boards increasingly recognize the importance of employees as stakeholders, many directors still lack a depth of visibility into the employee experience. Although the majority of directors say they frequently review data on employee turnover (75%) and engagement (69%), fewer (59%) say they have "a strong understanding of the day-to-day experience of the employee base," and only 40% have direct exposure to front-line and junior employees.

Further, 42% of the board directors surveyed reported that they would benefit from increased exposure to human resources functions. The information collected in the study demonstrates how boards need to "push beyond surveys and quantitative data to understand employees' experiences." Boards should deepen their understanding of the employee experience.

Employee Voice Linked to Retention

According to the Insight, directors recognize that oversight of employee voice is linked to improved corporate culture and employee retention. The Insight sets forth a three-stage maturity model for board capture and use of employee voice. Given fluctuations in the labor market, effective oversight of human capital management strategy may be integral in driving long-term value and analyzing increasing investment risks and opportunities relating to human capital management.

What do companies need to do?

SSGA's focus on employee voice is not new. "Corporate culture," and its alignment with long-term strategy, has been a priority for SSGA in recent years. A 2019 proxy letter from its then-CEO stated, "we have found that boards sometimes fail to adequately ensure that the current corporate culture aligns with corporate strategy."

Resultingly, it is important to consider how well your company captures employee voice and how public disclosures can — or should — reflect the results, and efforts made to capture the results, of employee voice mechanisms. The Insight probes a potential opportunity for improvement in human capital management strategy, through better and more extensive employee voice capturing mechanisms. As V&E previously reported, the ways in which an organization captures employee voice are likely relevant to employee relations as a whole.

Please contact V&E to discuss the implications of these developments.

Political Engagement Disclosure

As the 2024 presidential election cycle approaches, data suggests that boards of publicly traded companies are actively engaged in oversight of company political spending and how it aligns with company values and long-term strategy. Likely a result of recent contentious election cycles and investor focus on ESG matters (as well as certain state and local hostility to ESG), companies and boards should take stock of policies and practices concerning political spending.

Increase in Board Oversight of Political Spending

Historic data suggests that more public companies will implement policies regarding political spending, and oversee expenditures. The Center for Political Accountability ("CPA") and the Wharton School annually produce the CPA-Zicklin Index tracking measures of public company electoral spending and transparency.

In the wake of the January 6, 2021 attack on the capital, as the contentious 2022 midterm election cycle approached, data showed that in 2021 general board policies regarding oversight of political spending among the S&P 500 increased by 13.9%, with the result of almost 60% of S&P 500 companies having such policies. Moreover, board committee review of direct political contributions and expenditures increased by 12.3% to 255 companies. Trends among the S&P 500 also included a 14.6% increase (to 228 companies) of board committee review of payments to trade associations and other tax-exempt groups.

This trend continued among the S&P 500 in 2022 and the aforementioned measures (general board oversight; board committee review of direct political contributions; and board committee review of payments to trade associations and other tax-exempt groups) continued to gain in popularity. In 2022, the CPA-Zicklin Index also studied the Russell 1000 outside of the S&P 500, but found that adoption of these measures varied widely.

Public Disclosures of Political Spending Were High in 2021

According to the same above-mentioned data from the CPA and the Wharton School, in 2022, nearly 78% of the S&P 500 companies evaluated as part of the CPA-Zicklin Index fully or partially disclosed their political spending. This is an increase from 75% in 2021.

Shareholder and Investor Focus on Political Spending and Value Congruency

Consistent with recent proxy seasons, shareholder proposals targeting political spending have been notable this year. Albeit, such proposals (for example with Coca-Cola and JP Morgan Chase) were not successful and are non-binding. However, failure to effectively respond to shareholder proposals that receive strong support can result in reputational damage. Consulting data regarding the 2023 annual general meeting season shows numerous proposals on political contributions and lobbying, even if these proposals have not generally been passed. According to the Proxy Preview report, "corporate political influence resolutions are now split in three roughly equal buckets: lobbying, election spending and values congruency (between company policies and the viewpoints of recipients)."

BlackRock's February 2022 statement on corporate political activities also sheds some light on to what extent disclosing political contributions impacts institutional investors: corporate political activity can "create material risks for companies, including certain reputational risks as well as other risks that can arise from the complex legal, regulatory, and compliance considerations associated with corporate direct or indirect [] political spending and lobbying activities."

Companies Should Review Oversight and Policies Regarding Political Spending and Disclosure

As the 2024 election grows closer, companies should undertake a review of policies concerning political spending, governance documents concerning oversight of political spending, and actual political spending. To get ahead of feedback from shareholders, companies may consider the extent to which corporate donations to Political Action Committees, trade groups, and other third-party political organizations should be disclosed, and the proper means for their disclosure.

Please contact V&E to discuss the implications of these developments.

Prior results do not guarantee a similar outcome.

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[20] States that have passed anti-ESG legislation in 2023 include Florida (HB 3), Arkansas (HB 1845), Idaho (HB 190), Indiana (HB 1008), Kansas (HB 2100), Kentucky (HB 236), Montana (HB 356), North Dakota (HB 1429), Utah (HB 449), and West Virginia (HB 2862).

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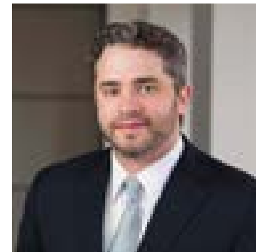

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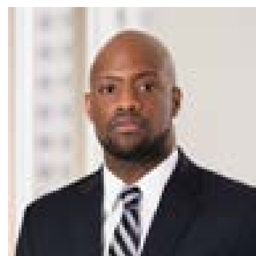

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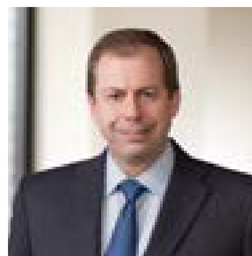

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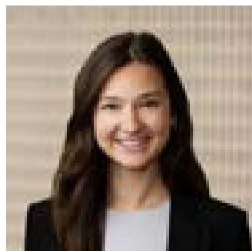

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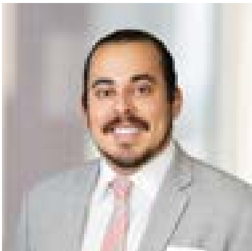

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