PROGRAM MATERIALS
Program #31195
August 11, 2021

The Push for ESG Disclosure Requirements: What Companies and Investors Can Expect

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ESG Disclosure Presentation Outline

- Presentation Title: **The Push for ESG Disclosure Requirements: What Companies and Investors Can Expect**
- Overview
    - Investors and activists focused on environmental, social and governance ("ESG") issues have gathered momentum in their efforts to require public companies and local governments to make more substantial disclosures about how their operations may be affected by ESG-related risks and opportunities. The U.S. Securities and Exchange Commission ("SEC"), among other regulatory agencies, is currently considering what new rules to mandate regarding ESG disclosures that must be made to the investing public. This webinar will offer insights about the ESG disclosure movement, what regulatory changes are most likely to be enacted, and how companies may want to prepare for expected new requirements.
- Environmental
    - How is climate change affecting business? Practical consequences
        - Supply Chain Sustainability
            - How are products made/shipped? What is the company's energy use like? Pollution?
            - Fragile supply chain: for all the benefits technology and innovation provide, our connectivity renders the global supply chain relatively sensitive. The fragility of our consumer economy is straightforward: an earthquake in California causes harm to a tech factory in Silicon Valley, which causes delays in the shipment of critical parts to a company in Europe, which is left unable to operate as planned.
        - Expensive Clean Up
            - Though the challenges posed by climate change are truly global in nature, more local impacts exist as well. Already, some regions are facing rising, untenable financial burdens caused by the fallout from natural disasters and extreme weather events (and the associated interruption to businesses unable to operate during these events). Just in the past few years, we've seen wildfires, hurricanes, tornadoes, tsunamis, and other natural disasters cause unprecedented destruction. Estimates place the sum of the damage caused by extreme weather events in 2018 at more than $150 billion. See https://www.weforum.org/agenda/2019/11/climate-change-risk-business-regional-doing-report/ ; https://www.cnn.com/2019/01/16/business/climate-change-global-risk-wef-davos/index.html
        - Regressive Impacts
            - As these disasters continue to increase in frequency and devastation, climate change's effects are expected to become more regressive; in other words, the greatest impacts will likely be felt by the poorest populations. A recent study from the University of Miami that evaluates

        rising sea levels projects that over the next handful of decades, several thousand federally and/or locally subsidized housing units will be at risk of being flooded and uninhabitable. https://www.miamiherald.com/news/local/environment/article247681520.html?ac_cid=DM339580&ac_bid=-1212172687
    - Since the communities most likely to be harmed will also likely be those with the least means to protect themselves, it is incumbent on business and civic leaders to be transparent as to why and how they are incorporating strategies to handle environmental issues into their practices.
- What legal avenues are available to stakeholders to inform and protect themselves?
  - The Courts: *Juliana* hurdle
    - The plaintiffs in *Juliana v. United States*, 947 F.3d 1159 (9th Cir. 2020) were youths seeking to bring an action rooted in constitutional law against the United States, arguing that the government had violated their fundamental rights to due process, liberty, and property by failing to provide a "climate system capable of sustaining human life." Specifically, the plaintiffs alleged that by allowing and promoting the use of fossil fuels, the United States government had caused them injury entitling them to redress under the Fifth and Ninth Amendments.
    - After initially surviving the government's motion to dismiss, the Ninth Circuit reversed the District Court of Oregon's decision, finding that the plaintiffs lacked a concrete injury giving rise to standing to bring the claims. The court noted it considered such a suit to be beyond the powers of Article III courts to decide given the complex web of policy and legislative decisions it would require it to second guess.
  - Other Avenues for Redress
    - Sometimes left, as in *Juliana*, without a direct path to redress through the courts, interested parties have taken to placing pressure on the businesses that they believe have largely contributed to the global climate crisis. Recently, several large institutional investors made public comments suggesting they would be shifting their focus to investing in companies that took efforts to implement environmental-friendly practices into their businesses and disclosed those efforts.
    - Evidently concerned by such comments and various related lobbying efforts, Jay Clayton, the former Chairman of the Securities and Exchange Commission, spoke out against a push for uniform corporate ESG disclosures in May. See https://www.forbes.com/sites/bhaktimirchandani/2020/05/29/what-to-make-of-the-secs-warnings-on-esg-ratings-and-recommendations-for-esg-disclosures/?sh=fbadb8d31841
      - Clayton warned that mandating these disclosures could place unnecessary strain on businesses while failing to provide

information that would actually be useful to investors and the public.

- New SEC disclosures possibly on the way
  - Notwithstanding former Chairman Clayton's public comments and the range of existing opinions on mandated ESG disclosures, the SEC, in response both to public petitions and its own subcommittees' recommendations, recently announced that it is accepting public input on potential mandated disclosures related to climate change. The SEC's stated objective in seeking public comments is to assist its staff in "eval[uating] our disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change." To facilitate constructive public input, the SEC released a list of 15 questions as to which it would like to receive feedback. Two examples of the questions the SEC is posing are:
    - "How can the [SEC] best regulate, monitor, review, and guide climate change disclosures in order to provide more consistent, comparable, and reliable information for investors while also providing greater clarity to registrants as to what is expected of them? Where and how should such disclosures be provided? Should any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished?"
    - "What are the advantages and disadvantages of establishing different climate change reporting standards for different industries, such as the financial sector, oil and gas, transportation, etc.? How should any such industry-focused standards be developed and implemented?"
  - As context for the SEC's solicitation of public feedback on these issues, SEC Commissioner Allison Herren Lee recently addressed the agency's evolving stance on ESG disclosures. The crux of Commissioner Lee's comments was that the SEC views the existing legal framework as not requiring disclosure of ESG matters but is open to enacting additional requirements to capture these kinds of disclosures as long as those requirements are specific and well-reasoned. The tide thus might be turning towards new disclosure requirements.
  - As the SEC ponders the kinds of information that might aid ESG-minded investors in choosing how to allocate their investment dollars, it's becoming increasingly incumbent on public companies' counsel to review and assess their organizations' policies, practices and initiatives that may soon be the subject of disclosure requirements.
- Recent House Bill https://www.rollcall.com/2021/06/16/house-passes-esg-climate-disclosure-rules-for-public-companies/
  - In June, the US House of Representatives passed legislation that would require public companies to disclose environmental, social, and governance metrics.
  - Narrowly passed 215-214. Stated goal according to Rep. Maxine Waters is to "create clear, consistent disclosure standards for issuers and finally provide investors and our markets with the information they need to make the best investment decisions possible and to hold the companies they're invested in accountable."

        - Bill now heads to the Senate, where it's likely Democrats and Republicans will continue to spar over these issues. Important to continue monitoring.
        - Even if this legislation fails, significant step in getting this kind of bill passed in the House and further evidence of looming changes. Not only has the issue of additional ESG disclosures made its way prominently onto the radar of the SEC, but now is being evaluated and acted on by Congress.
- Social
    - Stances on important issues including social justice
        - According to research from the Edelman Trust Barometer, 54% of employees globally believe that CEOs should speak publicly on controversial political and social issues they care about. Similarly, 53% of consumers agree that every brand has a responsibility to get involved in at least one social issue that does not directly impact its business. https://hbr.org/2020/10/when-should-your-company-speak-up-about-a-social-issue
            - The above article from the Harvard Business Review goes on to list "Three Questions to Guide [Companies' Approaches]"
                - Does the issue align with your company's strategy?
                - Can you meaningfully influence the issue?
                - Will your constituencies agree with speaking out?
            - Four questions companies should ask themselves in evaluating and positioning their response and their answer to the three questions above:
                - What is the company's mission, vision, value set, and strategy?
                - What are the social, political, and environmental threats to these elements of strategy?
                - Where and how can you meaningfully influence the discussion to neutralize these threats? Will your voice uniquely add to the discussion?
                - Which issues do you have constituency alignment on?
    - Business relationships
        - Do partners share stances on important issues?
        - Important to seek out partners that your company has positional alignment with. This leads to positive outcomes in building organizational synergies and momentum, but also to eliminating potential public relation issues and mitigating the need to spend time and resources seeking out new partners. Diligence and careful thought is critical.
    - Charitable contributions
        - Is your organization supporting other organizations/non-profits that are doing the kind of work that aligns with your company's value sets?
        - Is your organization now, or has your organization in the past, supported organizations/causes that are inconsistent with your company's value sets? Important to understand the historical information pertaining to your organization and identify areas to improve.
    - Relationships with and well-being of employees

        - Especially coming out of this unprecedented period of time we have been in, it is going to become more and more important for employers to be transparent about employee work expectations, health insurance options, etc.
        - It is self-evident that any company is only as good as the work of its employees and that employee health/productivity directly relates to a company's success.
        - The provision of additional information along these lines can be useful to companies not just in attracting and assuaging investors, but also in attracting employees.
- Governance
    - Board diversity
        - Despite significant progress, public companies still have a long, long way to go in making their boards truly diverse. There is significant opportunity for businesses to add new perspectives to their leadership teams, and to improve their organizations in doing so. https://www.shrm.org/hr-today/news/all-things-work/pages/boosting-corporate-board-diversity.aspx
            - While 60% of the population is white, more than 80% of board seats for Fortune 500 companies are filled by white people.
            - Black individuals represent 12.5 percent of the population but hold just 4.1 percent of Russell 3000 board seats. In addition, 37 percent of S&P 500 companies had no Black board members in 2019.
            - States, including California have started passing legislation mandating board diversity.
        - Important for representation, diversity of thought, diversity of experience, etc.
    - Shareholder rights
        - Investors want to understand what ability they would have to influence the direction of and get information pertaining to the company or companies they are choosing to invest in.
        - What is the composition of the board? What is the shareholders role in selecting/maintaining/guiding the board?
    - Executive pay
        - Investors and the public want to see a leadership team whose success is tied to the success of the company and of the investors.
        - 14 S&P 500 companies had more than 50% of investors reject executive pay packages in 2021 as of May. The number is likely higher now. Shows investors' evolving view on this issue. https://www.reuters.com/business/investor-opposition-us-ceo-pay-its-highest-ever-report-2021-05-24/
        - More than two thirds of investors want executive pay tied to ESG initiatives, according to the Edelman Trust Barometer Special Report: Institutional Investors. https://www.corporatesecretary.com/articles/esg/32346/more-investors-want-executive-pay-tied-esg
    - Accurate, reliable, transparent accounting
        - "Rigorous accounting is the key to ensuring that capital is allocated in the right way. This is well-established when it comes to private enterprise, but it's true for governments as well. There is plenty of evidence that strict reporting

regulation improves public welfare." Jim Naughton, Assistant Professor of Accounting Information and Management at Northwestern's Kellogg School of Management. https://insight.kellogg.northwestern.edu/article/how-transparent-accounting-leads-to-smarter-decisions

            - "It's like managing a persona or the perfect Facebook profile," Naughton says. "It's unsustainable. It's better for business leaders to accept that investors are sophisticated and to think from their perspective. If you put yourself in the shoes of an investor and ask, 'What would I want to know about this company?' rather than sticking to what's required under regulation, I think that would improve your firm's position in the market."
        - Transparency in finances is key to instilling confidence in investors even now. As these issues continue to become more prominent and given the now imminent prospect of additional mandated disclosures from the SEC, it would behoove corporate counsel and leadership to examine the current state of the financial information provided to investors and the public and to consider opportunities for proactive improvement. In the article above from the Kellogg School, the author notes that studies have shown that transparency in corporate finances has proven to attract additional investors.
    - Lack of conflicts of interest
        - Similarly to the issue of executive pay, investors care about this issue because they want to know that the board/leadership of the company are rowing in the same direction as the investors. In the information age we live in, more and more important for companies to have robust disclosures about their decision-making processes and their decision-makers themselves.
    - Cybersecurity
        - The SEC views cybersecurity as an important issue and one tied to ESG disclosures. Recently made its way onto Chairman's 2021 rulemaking list; action likely soon. https://www.complianceweek.com/regulatory-policy/sec-rulemaking-list-2021-esg-cyber-risk-governance-among-highlights/30477.article
            - https://news.bloomberglaw.com/securities-law/sec-proposals-on-climate-esg-disclosures-planned-for-october
                - This Bloomberg article expands on cybersecurity and other ESG issues being on the SEC's radar. Notes that agenda states the SEC is looking to enhance corporate disclosures on climate risks, human capital management, and the diversity of board members.
- The Disclosures
    - Content and Form
        - Ideally, SEC will provide sufficient guidance for uniformity via a standardized framework from which you can plug in the things that are most applicable to particular businesses.
        - The next element of what is likely to come in terms of disclosures is there's going to be a need for companies to talk both in terms of principles. How are

        they approaching, sustainability and resiliency issues? But also some hard facts and some data that investors can use in deciding how they want to allocate their investment dollars.
        - It's reasonable to assume that what companies are going to need to do is talk about risks and opportunities, related to the physical structures that they have, their headquarters or other physical structures that they have, and how those places might be affected by climate change related issues. They'll also speak about their products, to the extent their products may be affected by these kinds of issues.
        - And, just generally, if you're in an industry or in an area in which your supply chain or your day-to-day operations for one reason or another are likely to be affected or disrupted at some point by some sort of climate event, you're going to need to disclose that and investors want to hear about it. Conversely, it's not just the negative stuff, and investors want to know about the opportunities.
    - Support from Businesses
        - Uber recently said they think there should be ESG disclosures. https://news.bloombergtax.com/daily-tax-report/sec-climate-disclosure-push-brings-corporate-lobbying-flood?context=search&index=0
    - Support from Investors
        - Collier Capital recently did a survey in which somewhat surprisingly they found that more than 75% of limited partners in partnerships were demanding more in terms of disclosures from general partners and other interested parties about what ESG related risks, especially climate related risks, might be for a particular company.
        - 47% of respondents in another survey said that as they look as private equity investors to evaluate what the companies are that they want to be investing in over the next five years, what's going to be a really important driving factor for them is exactly what they can ascertain from the companies about environmental, especially again, climate change related risks.
- Recommendations for In-House Counsel
    - Recognize that these kinds of requirements are coming, and begin taking stock at least generally of how your company is doing, areas of strength and weakness, etc.
    - Create a paper trail that these kinds of issues are being assessed, they are being considered, that board members or board committees or senior managers are focused on these issues and taking action and that compliance officers are looking not just at what might be, what might need to be done to comply with forthcoming SEC requirements, but also just in terms of climate change related issues, generally, and climate change regulations, generally. What can a company be doing to comply now, sooner rather than later, obviously, with what the requirements are, across a whole host of areas, across a whole host of agencies?
    - Staying abreast of what both the SEC and other agencies are doing, what states are doing at the state governmental level to prepare for a world in which more and more needs to be disclosed by management formally in corporate filings of one sort or another. Certainly, the recent House legislation is critical to stay on top of.