Session Number | CLE 106
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Title | Can Your ESG Or Sustainability Report Get You Into Hot Water?
Date | Friday, November 4, 2022
Time | 9:00 am - 10:15 am

**Topic:** Energy, Environment, and Sustainability

**Title:** Can Your ESG / Sustainability Report Get You Into Hot Water?

**Description:** In 2022, investors and consumers are demanding transparency from companies on environmental, social and governance (ESG) issues, particularly in light of increased public engagement on issues like climate change, racial justice and societal transformations prompted by COVID’S NOTES-19. Companies have responded with a wide variety of ESG and sustainability reports. Some companies have gone further and made advertising claims associated with their ESG efforts. Until recently, however, there have been no mandatory standards for ESG reporting and companies have been free to develop their own metrics. With SEC’s recent proposal for climate disclosure guidelines coupled with the Federal Trade Commission’s Green Guides focused on preventing greenwashing and the corpus of decisions by the National Advertising Division regarding truth in advertising, the rules of the road are starting to come into focus and companies need to understand how the risk profile is changing. Join a panel of experts to learn more about how the SEC, FTC and NAD approaches to ESG issues are impacting both public and privately held companies. Co-sponsored by the Energy, Environmental & Sustainability and the Government Enforcement Committees.

**Moderator:**
- Lily N. Chinn, Partner, Baker Botts

**Panelists:**
- OlaWalé Y. Oriola, Counsel, Faegre Drinker (Former Senior Counsel, U.S. Securities & Exchange Commission Division of Investment Management)
- Zheng Wang, Counsel, BBB National Advertising Division
- Ling-Ling Nie 聶蕙玲, Deputy GC, Chief Compliance & ESG Officer, Aura
- Kim Yapchai, SVP & Chief ESG Officer, Tenneco Inc.
Can Your ESG Or Sustainability Report Get You Into Hot Water?

Session 106
Nov. 4, 2022
Speakers

• **OlaWalé Y. Oriola**, Counsel, Faegre Drinker (Former Senior Counsel, U.S. Securities & Exchange Commission Division of Investment Management)

• **Zheng Wang**, Counsel, BBB National Advertising Division

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• **Kim Yapchai**, SVP & Chief ESG Officer, Tenneco Inc.

Moderator

• **Lily N. Chinn**, Partner, Baker Botts
Road Map

• Current ESG Disclosure Trends
  • Although 90 percent of S&P 500 companies voluntarily disclose some form of ESG data, analysis by the SEC reveals that only one-third of public companies mention climate change in their filings.

• Changing Federal/State (& International) Regulatory Landscape
• Revising Expectations of Corporate Governance
• How to Develop or Evolve Your Company’s ESG Program
• How to Mitigate Risk in this Dynamic Environment
What is ESG?

**Environmental**
- Environmental Stewardship
- Environmental Impact of Product Portfolio
- Energy Conservation and Usage; Recycling
- Natural Resources
- Water Use and Sourcing
- Carbon Footprint, GHG Emissions
- Climate Change

**Social**
- Community Engagement
- Health and Safety
- Responsible Investment
- Human Capital Management
- Data Privacy
- Employee Rights
- Diversity, Equity & Inclusion
- Equitable Business Practices
- Philanthropy

**Governance**
- Board Composition
- Leadership Structure
- Committee Structure and Responsibilities
- Business Ethics
- Compensation
- Succession Planning
- Public Policy / Government Relations Practices
- Cybersecurity
Example of Sustainability Reporting

In its 2017 Sustainability Report issued on April 17, 2018, and made available to investors through its website and referenced in its SEC filings, including Form 10-K filed on May 30, 2018, Vale continued its false narrative of safety. Vale falsely stated:

- “At the end of the year, the area ended another cycle of external dams auditing, in which 100% of the audited structures were certified to be in stable condition, physically and hydraulically.”

- “In 2017, external audits were carried out on 107 structures in the Ferrous area, located in Brazil. All of them had their physical and hydraulic stability certified, and were issued Statements of Stability Condition (DCE, acronym in Portuguese) by the responsible auditors.”

- “Vale maintains the management of its dams in permanent alignment and updating with the good and strictest international practices, standards of which exceed the legal requirements. In this sense, it bears emphasizing that the Brazilian dam safety legislation is quite stringent, also based on good international practices and very judicious, both in terms of safety management requirements and emergency management.”

- “In addition to applying best practices pertaining to dam safety management, Vale submits its structures to audits conducted by specialized external consultants, and rigorously complies strictly with applicable legislation.”

- “Another highlight this year was implementing the International Panel of Experts on the Ferrous area, composed of international and national technicians who work in risk management, geotechnics and water resources. The panel's purpose is to evaluate governance, processes, studies, projects and technical analyses of geotechnics and hydrology.”
U.S. Regulatory Landscape

(in addition to international regulation)
Other Key ESG Stakeholders

<table>
<thead>
<tr>
<th>Credit Rating Agencies</th>
<th>Investment Community</th>
<th>Other Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>• All of the major rating agencies incorporate ESG factors into credit ratings; ESG factors impact credit risk and investment performance</td>
<td>• Many institutional investors are signatories to the PRI and integrate ESG factors into their overall investment framework</td>
<td>• Groups setting standards, evaluating risk, conducting research and scoring ESG</td>
</tr>
<tr>
<td>• Signed on to UN Principles of Responsible Investing (PRI) Statement on ESG in Credit Risk and Ratings:</td>
<td>• Deloitte projects that ESG-mandated assets will comprise half of all managed assets in the U.S. by 2025</td>
<td>• Other stakeholders, including employees, independent contractors/distributors, suppliers and customers</td>
</tr>
<tr>
<td>• Commitment to incorporate ESG into credit ratings and analysis in a systematic and transparent manner, including:</td>
<td></td>
<td>• Plaintiffs’ lawyers</td>
</tr>
<tr>
<td>• evaluating the extent to which ESG factors are credit-relevant for different issuers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• publishing their views on the ways in which ESG factors are considered in credit ratings</td>
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Proposed Rule:
SEC Climate-Related Disclosure
Background / Purpose of the SEC’s Proposed Rule

BACKGROUND: On March 21, 2022, the United States Securities and Exchange Commission (“SEC”) released 500+ pages of a new set of proposed rules for mandated climate-related disclosures for all public company filers and registrants with the SEC (the “Proposed Rules”).

GENERAL REQUIREMENT: The Proposed Rules would require registrants with the SEC to disclose in their public filings climate-related risks that are reasonably likely to have a material impact on their business or consolidated financial statements over the short, medium and long term.

KEY TERMS: Material, Reasonably Likely & Climate-related risks

PURPOSE: To provide consistent, comparable, and reliable information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments and evaluating whether to make and/or keep an investment.
Key Features of the Proposed Rule

• **Governance, Oversight and Internal Controls** of climate-related risks by the Board of Directors and Management Team

• **Company’s processes** for identifying, assessing, managing and disclosing **climate-related risks** and Impact of climate-related events

• **Disclosure of company’s climate-related targets or goals**, if applicable
  – Targets and Goals Set: (net-zero, emissions reductions targets, etc.), Use of Carbon Offsets or Renewable Energy Certificates (“RECs”), Transition Planning and Status of progress toward targets and goals

• **Financial Statement Disclosures**: metrics, estimates, expenditures and assumptions

• **GHG Emissions Reporting**
  – Scope 1 (Direct / Owned / Controlled)
  – Scope 2 (Indirect)
  – Scope 3 (Upstream and Downstream; Value / Supply Chain)
  – Independent Third-Party Attestation Requirements
Key Terms in Proposed Rule

**MATERIAL**

- Information is material if there is a **substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote.**

**REASONABLY LIKELY**

**CLIMATE-RELATED RISKS**

- “Actual or potential negative effects of both physical risks and transition risks.”
  - **Physical:** acute and chronic risks/events, such as hurricanes or effects from climate change, weather patterns, higher temperatures or rising sea levels.
  - **Transitional:** involve regulatory, technological and market changes to address the mitigation of climate risks, higher costs due to changes in law or policy or reduced demand for carbon-intensive products.
## Current vs. Proposed SEC Disclosure Regime

<table>
<thead>
<tr>
<th>Current Principles-Based Disclosures</th>
<th>Proposed Mandated Disclosures</th>
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</thead>
<tbody>
<tr>
<td>• Limited by the registrant’s view of “materiality”</td>
<td>• Required for ALL registrants</td>
</tr>
<tr>
<td>• Allows flexibility and deference based on the company making such disclosures</td>
<td>• Lacks flexibility with few exceptions for relevance or materiality</td>
</tr>
<tr>
<td>• Not a one-size fits all regime: a company determines what information is material / important for investors</td>
<td>• All companies must disclose all information applicable to them required under the new rules</td>
</tr>
<tr>
<td>• A Company’s Board and management team can provide disclosures appropriately tailored to their facts and circumstances</td>
<td>• Little to no deference to the company or its board and management teams</td>
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GHG Emissions Reporting
GHG Emissions Reporting – Scope 1 and Scope 2

- **Large Accelerated Filers** must disclose metrics (absolute and intensity; excluding the impact of offsets) for most recent year and other financial years included in 10-K
- Describe methodology, significant inputs and assumptions

- **Scope 1** direct GHG emissions from operations that are owned or controlled by a registrant.
- **Scope 2** indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a registrant.

Proposed Rules require disclosure *(regardless of materiality)* of the emissions *(i)* on a disaggregated basis (by each constituent GHG gas) and in the aggregate; *(ii)* in absolute terms, excluding any use of purchased or generated offsets; and *(iii)* by GHG intensity - a gross basis and relative to intensity (per $ of revenue and per unit of production)
By second year of applicability of disclosure rules, requirement for **Accelerated Filers** or **Large Accelerated Filers** (Foreign or Domestic) to include an attestation report covering, at a minimum:
- disclosure of its Scope 1 and Scope 2 emissions; and
- provide certain related details, disclosures and qualifications of the independent service provider.

- Attestation Service Provider Qualifications and Independence
- Minimum Standard Attestation Report Requirements and Levels of Assurance
GHG Emissions Reporting – Scope 3

- **Materiality Exception**
  - Required to be disclosed if *material* (qualitatively or quantitively) OR if *company has set a target or goal* for reducing Scope 3 emissions.
  - If disclosed, must identify the categories of upstream and downstream activities included and describe data sources (e.g., emissions reported by parties in the registrant’s value chain, whether or not those reports have been verified).
  - Disclosed separately from Scope 1 and 2 emissions, but in the same manner — in absolute terms (disaggregated and aggregated) and by GHG intensity.

- **Safe Harbor**
  - **Issue:** Disclosure of Scope 3 emissions may pose difficulties compared to Scopes 1 and 2 emissions, and it may be difficult to obtain activity data from suppliers and other third parties in a registrant’s value chain, or to verify the accuracy of that information. It may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data.
  - **Proposed Accommodations:**
    - A limited *safe harbor* for Scope 3 emissions disclosure from certain forms of liability under the Federal securities laws, in that a disclosure will be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.
    - An *exemption* for smaller reporting companies (“SRCs”) from the Scope 3 emissions disclosure provision.
    - A *delayed phase-in compliance date* for Scope 3 emissions disclosures (see Phase-In Timing on next slide.)
## Phase-in Periods for Compliance and Accommodation

<table>
<thead>
<tr>
<th>All proposed disclosures, including Scopes 1 and 2 GHG emissions metrics and associated intensity metric (but excluding Scope 3)</th>
<th>Large Accelerated Filer</th>
<th>Accelerated Filer</th>
<th>Non-accelerated Filer</th>
<th>Smaller Reporting Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal year 2023 (filed in 2024)</td>
<td>Fiscal year 2024 (filed in 2025)</td>
<td>Fiscal year 2025 (filed in 2026)</td>
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<thead>
<tr>
<th>Attestation report — limited assurance (Scopes 1 and 2)</th>
<th>Large Accelerated Filer</th>
<th>Accelerated Filer</th>
<th>Non-accelerated Filer</th>
<th>Smaller Reporting Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal year 2024 (filed in 2025)</td>
<td>Fiscal year 2025 (filed in 2026)</td>
<td>N/A</td>
<td>N/A</td>
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</table>

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<thead>
<tr>
<th>Attestation report — reasonable assurance (Scopes 1 and 2)</th>
<th>Large Accelerated Filer</th>
<th>Accelerated Filer</th>
<th>Non-accelerated Filer</th>
<th>Smaller Reporting Company</th>
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</thead>
<tbody>
<tr>
<td>Fiscal year 2026 (filed in 2027)</td>
<td>Fiscal year 2027 (filed in 2028)</td>
<td>N/A</td>
<td>N/A</td>
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</table>

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<thead>
<tr>
<th>Scope 3 GHG emissions metric and associated intensity metric (attestation report not required)</th>
<th>Large Accelerated Filer</th>
<th>Accelerated Filer</th>
<th>Non-accelerated Filer</th>
<th>Smaller Reporting Company</th>
</tr>
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<tbody>
<tr>
<td>Fiscal year 2024 (filed in 2025)</td>
<td>Fiscal year 2025 (filed in 2026)</td>
<td>Exempted</td>
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</table>
• **Example:** Reducing GHG emissions, energy usage, water usage, conservation or ecosystem restoration or achieving net-zero.

• If a registrant has set climate-related targets or goals, the proposed rules would require it to disclose them, including, as applicable, a description of:
  – The scope of activities and emissions included in the target;
  – The unit of measurement, including whether the target is absolute or intensity based;
  – The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;
  – The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
  – Any interim targets set by the registrant; and
  – How the registrant intends to meet its climate-related targets or goals.

• Optional voluntary disclosures related to sustainability or climate-related opportunities
ESG Litigation Risk
Trends in ESG Litigation

- Government ESG Litigation
- Informal ESG Disputes
- Investment Adviser and Fund ESG Litigation
- Advertising / Greenwashing Claims
Trends in ESG Litigation

ESG-Related litigation that concerns company’s operations

ESG related litigation against board directors alleging breach of duty of care or duty of loyalty under state law

ESG-Related litigation associated with corporate reporting and disclosure

• Actions involving the misrepresentation of companies' environmental commitments (that a company's environmental and sustainability actions don't match its public statements)
• Actions involving human capital management (breach of fiduciary duties by publicly touting inclusion)
• **FTC Act**
  - Prohibits “unfair or deceptive acts or practices”
  - “deceptive” = statement – or omits information – *likely to mislead* consumers acting *reasonably under the circumstances* and is “material” or important to a consumer’s decision to buy or use the product

• **FTC Green Guides**
  - Clarifies standards for specific claims (e.g., biodegradable, compostable)
  - Does not directly address “sustainable” but advises to *avoid general environmental benefit claims*
BBB’s National Advertising Division

- 51-year-old independent self-regulatory body
- Largest body of advertising decisions in the US
- Reviews advertising based on challenges from businesses, consumers, trade groups, non-profits regarding truth and accuracy
- Reviews advertising based on own monitoring initiative
- Decisions in 3-6 Months (20 Business Days for SWIFT)
- Referral to Gov’t Agency
NAD’s Process

- Considers claims from the perspective of a reasonable consumer
- Advertiser has burden of providing reasonable basis for claims
  - What’s the message?
  - What’s the substantiation?
  - Is there a good fit?
- Challenger can rebut
- NAD case law
  - FTC precedent
  - NAD precedent
  - Agency laws, guidelines, precedent
  - State law + AG actions
## ESG As Advertising

### What is advertising?

See NAD Procedures §1.1(A)

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<tbody>
<tr>
<td>Commercial</td>
<td>Yes</td>
</tr>
<tr>
<td>Statements on website</td>
<td>Yes</td>
</tr>
<tr>
<td>Press release</td>
<td>Yes</td>
</tr>
<tr>
<td>Social media</td>
<td>Yes</td>
</tr>
<tr>
<td>Annual report</td>
<td>Probably</td>
</tr>
<tr>
<td>Other SEC filings</td>
<td>Maybe?</td>
</tr>
</tbody>
</table>
Types of ESG Claims

- Aspirational Claims
- General Claims
- Specific Claims
- Certification Claims
Aspirational ESG Claim Example
Aspirational Claims

- Aspirational claims require substantiation
  - Must be achievable
  - Must have a plan
  - Must be implementing plan
- Aspirational claims can also convey non-aspirational messages
  - All messages, intended or not, must be substantiated
General ESG Claim Example

We don’t believe anyone should have to sacrifice comfort for a sustainable toilet paper. That’s why Quilted Northern Ultra Soft & Strong® combines the quality you love with the added benefit of keeping the environment in mind. We looked at our product lifecycle and discovered two HUGE ways that we make a difference without you feeling it: innovative manufacturing and promoting healthy forests.

Georgia-Pacific Consumer Products LP (Quilted Northern Ultra Soft & Strong Bathroom Tissue), Report #7018, NAD/CARU Case Reports (September 2021)
General Claims

- “Made Sustainably” too broad
  - Consumers could understand claim to mean product had little or no negative impact on environment
  - But qualifying the general claim with specific information about sustainability efforts may be okay
- General sustainability claims discouraged
  - Capable of conveying multiple messages
  - All messages must be substantiated
Certification Claims

- Certification identifies source
- Certification requirements readily accessible
- General “humane” claims qualified by certification
- Evidence of compliance with certification standard
- Other evidence of humane processes

Butterball, LLC (BUTTERBALL Turkey Products), Report #6930, NAD/CARU Case Reports (August 2021)
Certification Claims

• **FTC Green Guides**
  • Designed to help marketers avoid making environmental claims that mislead consumers.
    • Marketers should qualify general claims with specific environmental benefits.
    • Qualifications for any claim should be clear, prominent, and specific (e.g., Green, social sustainability and equity claims)
  • Certifications likely convey general environmental message
    • Must convey the basis for the certification
  • Still need to substantiate all claims regardless of certification
  • Must meet endorsement requirements (e.g. independent, etc.)
FTC Petition Requesting Enforcement Regarding General ESG Claims

- Chevron Petition/Complaint filed by Earthworks, Global Witness and Greenpeace raises claims about misleading climate and racial justice commitments.
  - [15 min podcast](https://www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/green-guides) by Baker Botts partner former acting chairman and commissioner of the FTC Maureen Ohlhausen
- FTC Acting Commissioner has signaled that she is committed to using enforcement to combat racial inequity.
QUESTIONS?