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FOLEY & LARDNER LLP

ESG in 2022: Here to Stay or Going Away?

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What is ESG?

ENVIRONMENTAL

Conservation & protection of the natural environment

Examples:
- Product and facility air emissions and air quality
- Climate change
- Energy use and conservation
- Natural resources and land use
- Hazardous materials use

SOCIAL

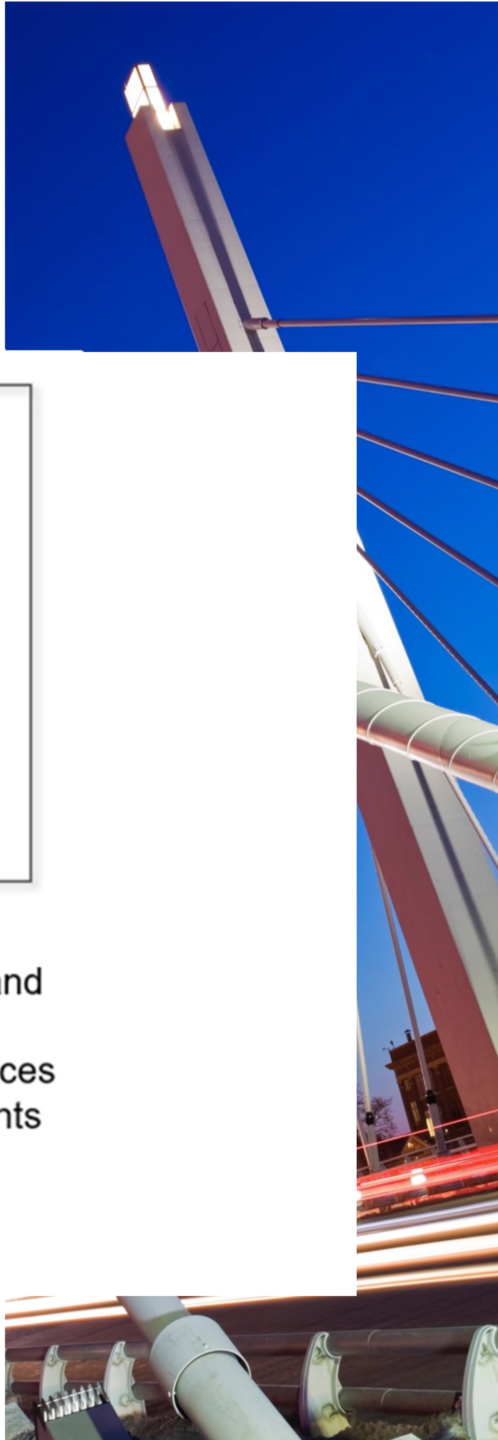
Relationships with employees, suppliers, clients & communities

Examples:
- Equal employment/Diversity
- Health care, education, and social justice
- Labor standards and employee relations
- Production quality and safety
- Local community impact

GOVERNANCE

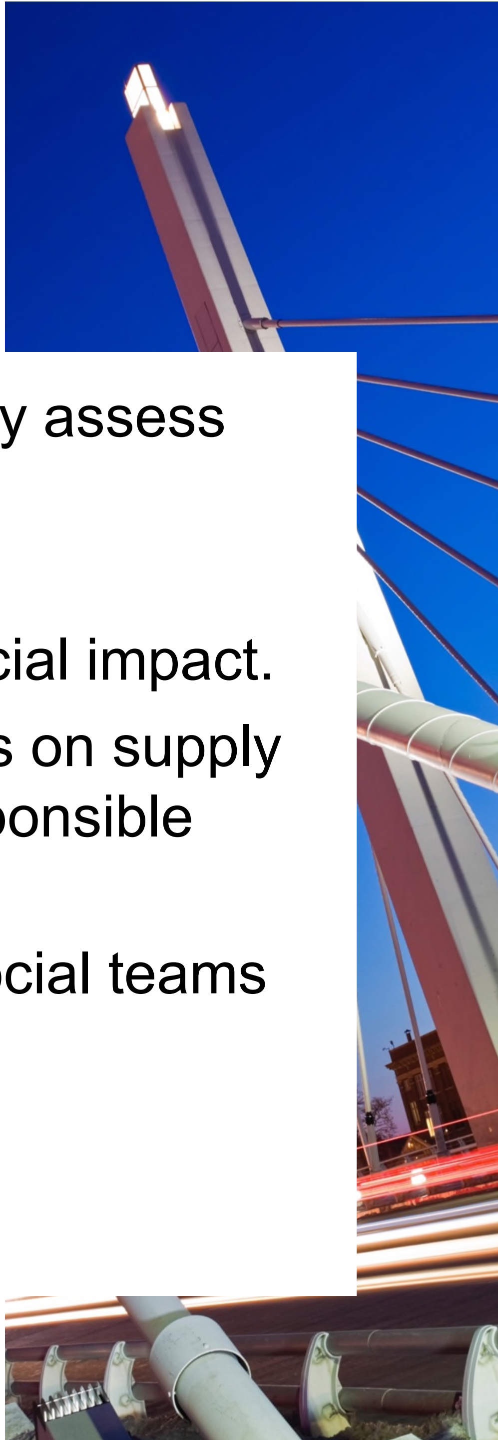
Standards for company leadership, risk controls & shareholder rights

Examples:
- Board independence and diversity
- Ethical business practices
- Shareholder voting rights
- Board oversight of risk

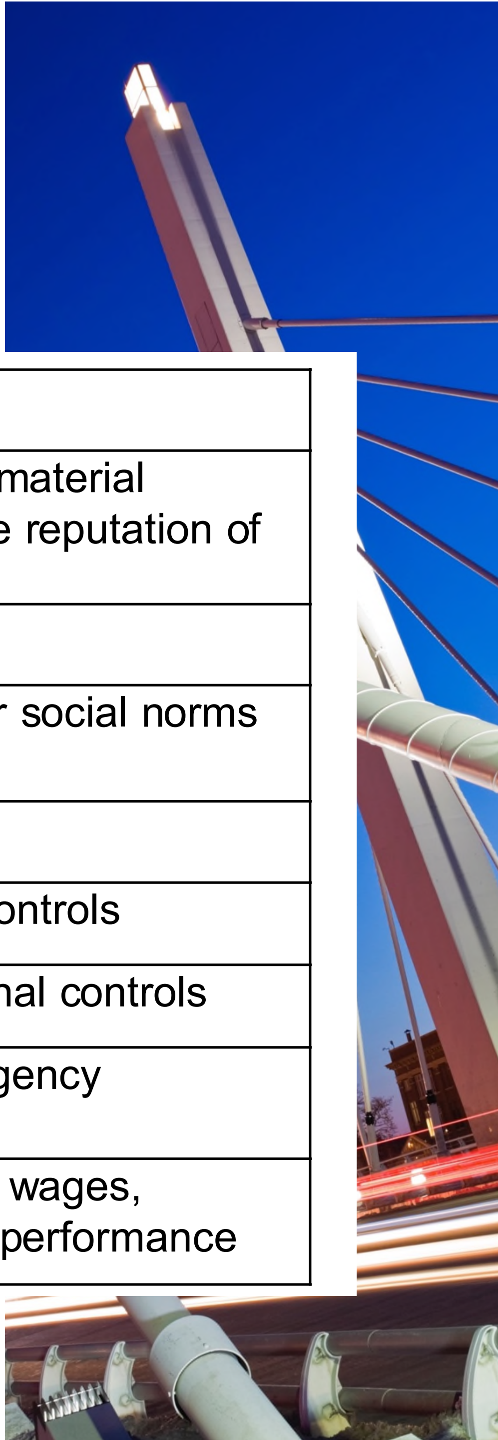


What is ESG?

- Factors against which investors, consumers, and corporations holistically assess performance, value, and investment in company.
- Assessment of corporate responsibility considering social factors.
- Stated goals and objectives to create a favorable environmental and social impact.
- Has become critical consideration for corporate operations, driving focus on supply chain management, regulatory and compliance issues, and socially responsible policies.
- Requires coordination between legal, risk, safety, environmental, and social teams to develop ESG framework:
  - Legal and regulatory
  - Social accountability
  - Corporate responsibility to employees, investors, and consumers



Who is Interested?



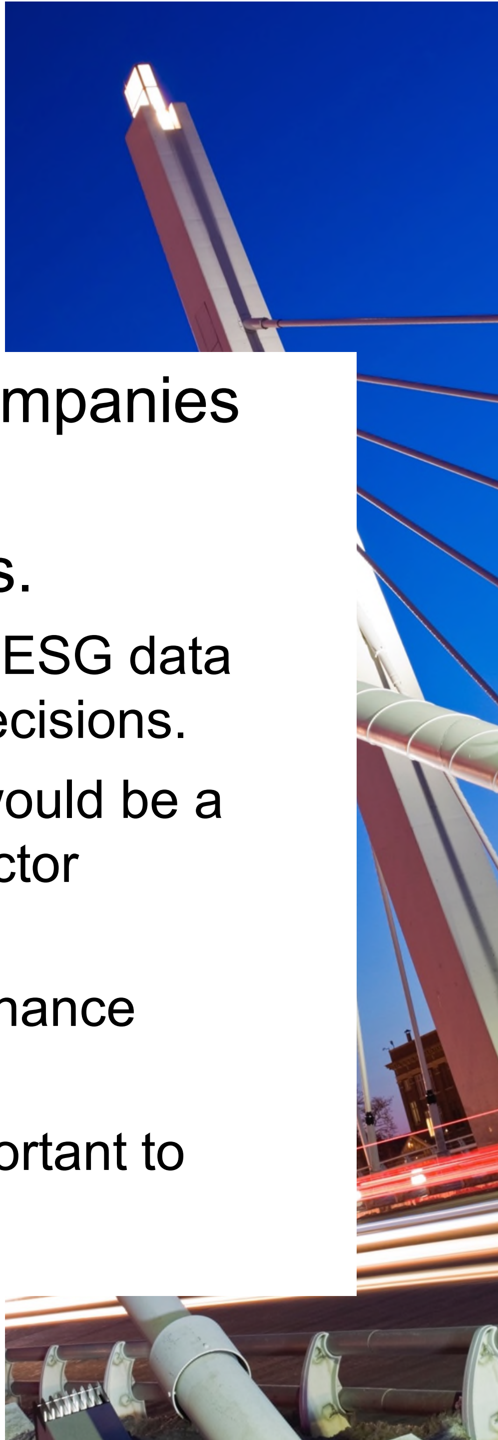
Stakeholders	**Examples of Potential Areas of Concern**
Customers	Product safety, treatment of employees, environmental impact, raw material sourcing, and social/environmental impact; anything that impacts the reputation of the company
Traditional Shareholders	Material information that could impact share price
Modern and Activist Shareholders	Material information; evidence of behavior that violates the ethical or social norms of the shareholder
Investors	Anything that could impact profits or share price
Suppliers	Environmental impact, manufacturing and labor practices; internal controls
Governments	Compliance in all areas, environmental impact, labor relations, internal controls
Communities	Environmental impact, local employment and training, wages, emergency response, diversity
Employees	Anything that could jeopardize company/job viability, labor relations, wages, diversity, parity, work-life balance, good governance; environmental performance

Macro Trends in ESG

- The 2022 proxy season was characterized by increased scrutiny towards ESG matters.
- There was an overall increase in the number of ESG proposals submitted in the 2022 proxy season and an increasing number of ESG topics addressed, including climate plans submitted by management.
- Blackrock noted that climate-related shareholder proposals during the 2022 proxy season were more prescriptive or constraining on companies and may not be able to promote long-term shareholder value.

Macro Trends in ESG (cont.)

- The SEC and FTC are concerned about “greenwashing” (when companies and funds overstate their ESG credentials).
- Advisory firms are continuing to expand their data gathering efforts.
  - Glass Lewis recently announced the launch of “ESG Data Feed,” a source of ESG data that can be used to inform proxy voting, engagement and other investment decisions.
  - Although investors indicated that ESG oversight, particularly of climate risk, would be a more important factor in how they evaluate and vote on directors, overall director support remained fairly stable from 2021 to 2022.
  - However, opposition to certain board roles such as the nominating and governance chair and the compensation committee chair has increased in recent years.
  - Directors’ attention to ESG matters like climate risk could be increasingly important to avoid votes against these directors.

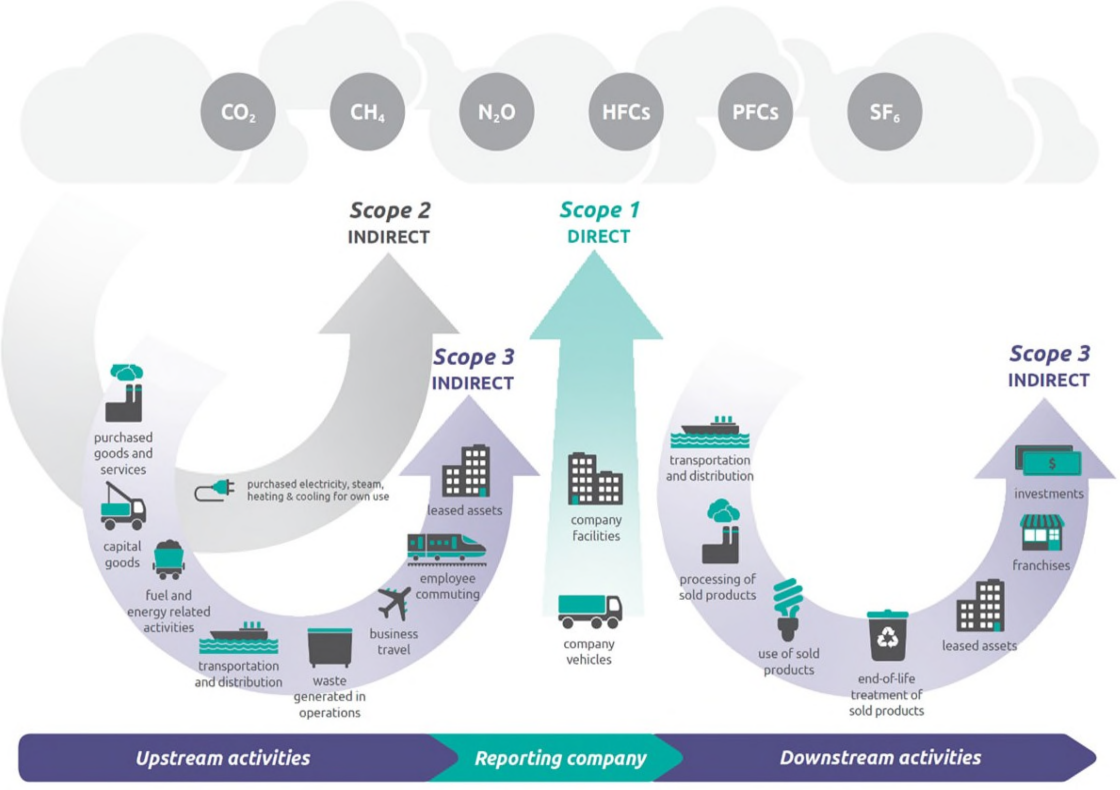


Macro Trends in ESG (cont.)

- In response to investor requests to more explicitly define how ESG matters are included in the work of the board and its committees, more companies:
  - Increased their oversight of ESG at the nominating and governance level;
  - Integrated relevant ESG matters aligned with key committees into the committee charters; and
  - Cited ESG or sustainability as director qualifications (nearly 2/3 of Fortune 100 companies).
- BUT, anti-ESG backlash lead by state attorneys' general.
- Possible Congressional investigation of "climate cartels" in 2023?

Adoption by Jurisdiction (EU/UK/U.S.)

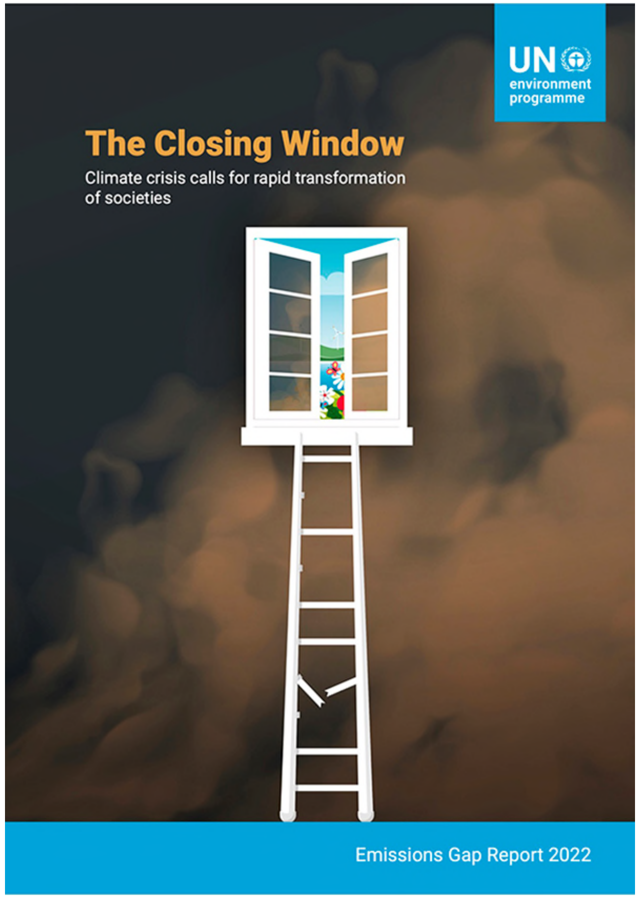
- EU:
  - Three regulations currently in effect: sustainable finance disclosure, climate benchmarks, and taxonomy regulations applicable to finance and investment entities.
  - Additional regulation pending adoption: corporate sustainability reporting directive (mandatory ESG reporting with external auditing and more detailed reporting requirements).
- UK: Climate-Related Financial Disclosure Regulations (2022).
- U.S.: March 2022 “issuer rule” will require public companies to provide certain climate-related data (Scope 1, Scope 2, potentially Scope 3).

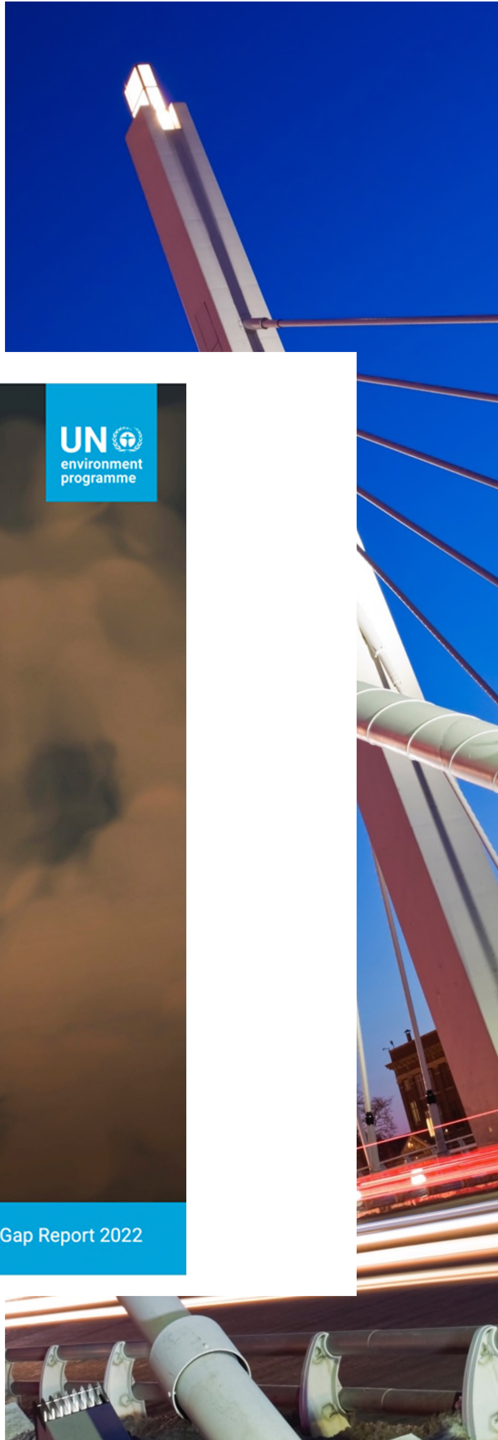


Source: [WRI/WBCSD Corporate Value Chain (Scope 3) Accounting and Reporting Standard (PDF)](), page 5.

GHG Emissions Trends

- Fossil fuel demand increasing:
  - 0.8% increase in oil and gas use in 2022.
  - China, India projected to consume 5.6 billion tons coal in 2023 (2022 U.S. consumption: 600 million tons).
- UNEP: emissions must drop 30% by 2030 to limit warming to 2C (Emissions Gap Report 2022, Oct. 27, 2022).
  - Current policies point to a 2.8C temperature increase by the end of the century.
  - Global emissions projected to increase 16% by 2030 vs. 2010 baseline.





Environmental Elements of ESG Programs

- Climate Change Emissions Targets:
  - Seven GHGs identified in Appendix A to the Kyoto Protocol (CO_2, CH_4, N_2O, HFCs, PFCs, NF_3, SF_6)
  - Emissions reported as Scopes 1, 2, and 3:
    - Scope 1: direct emissions from operations
    - Scope 2: emissions from power purchases/consumed
    - Scope 3: indirect emissions from upstream/downstream production and usage
- Water usage/intensity.
- Waste production (reduction targets).

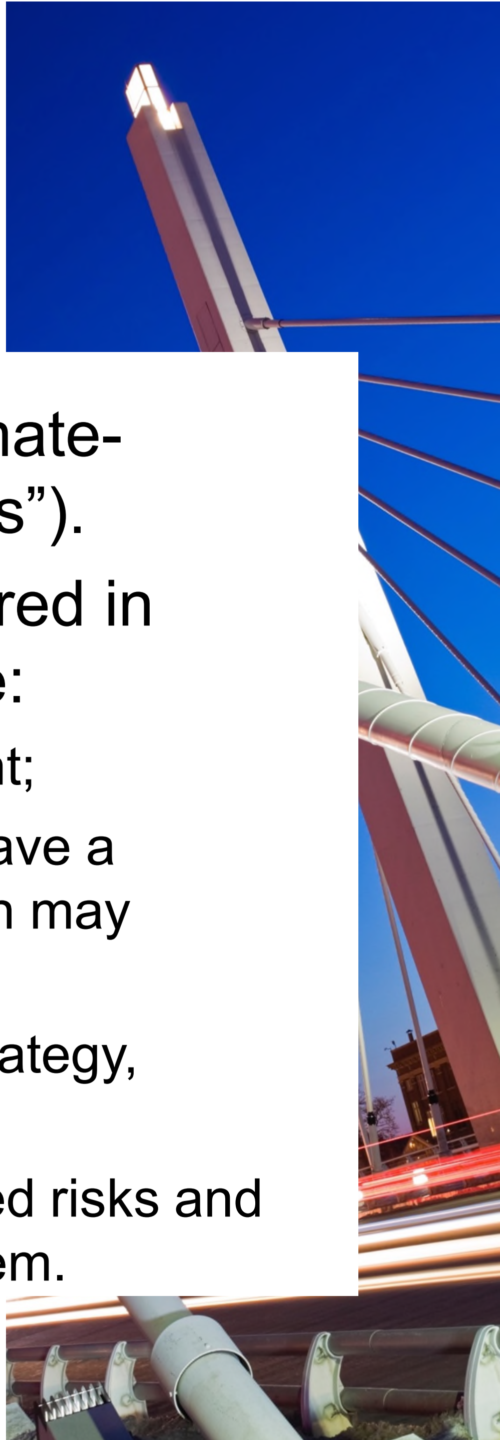
Social Elements of ESG Programs

- Human rights for employees, subcontractors, and suppliers.
- Prohibition of discrimination in the workplace.
- Ensuring compliance with health and safety in the workplace.
- FCPA compliance and prohibition on unlawful influence.

Governance Elements

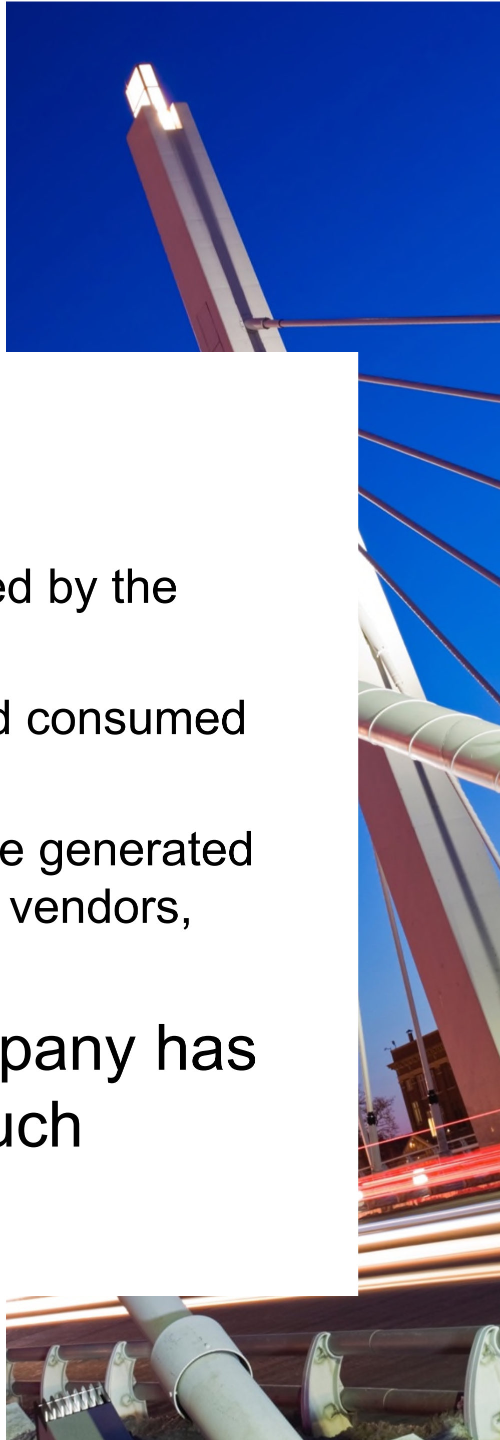
- Governance model:
  - Internal controls
  - Disclosure and transparency
- Role of the Board
- Committee overseeing ESG (audit, risk, Nom & Gov):
  - Processes and frequency by which board/committee are informed of climate and social issues
  - Risk management
  - Strategy/metrics and goals

SEC Proposed Rule on Climate Change Disclosures



- The SEC released comprehensive proposed rules mandating climate-related risk disclosures for public companies (the “Proposed Rules”).
- If enacted, there will be new climate-related risk disclosures required in public company annual reports. Some notable disclosures include:
  - Oversight and governance of climate-related risks by board and management;
  - How any climate-related risks identified by company have had/are likely to have a material impact on the business and consolidated financial statements, which may manifest over the short, medium or long term;
  - How any climate-related risks have affected/are likely to affect company’s strategy, business model and outlook; and
  - Company’s processes for identifying, assessing and managing climate-related risks and whether the processes are integrated into company’s risk management system.

Summary of Climate Change Proposed Rules (cont.)

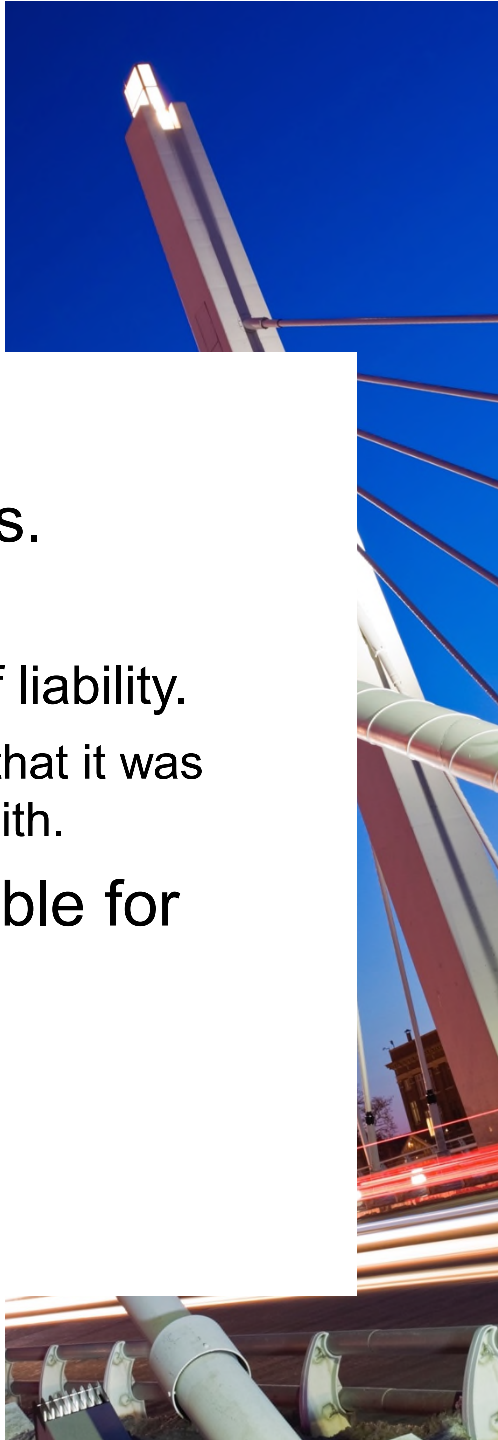


- Seven GHGs, aggregated and disaggregated.
- Scopes:
  - **Scope 1**: Direct greenhouse gas emissions that occur from sources owned or controlled by the company.
  - **Scope 2**: Emissions primarily resulting from the generation of electricity purchased and consumed by the company.
  - **Scope 3**: Indirect emissions that are a consequence of the company's activities, but are generated from sources that are neither owned nor controlled by the company, such as suppliers, vendors, and customers.
- **Scope 3** emissions need only be disclosed if material or if the company has set a greenhouse gas emissions reduction target which includes such emissions.

Summary of Climate Change Proposed Rules (cont.)

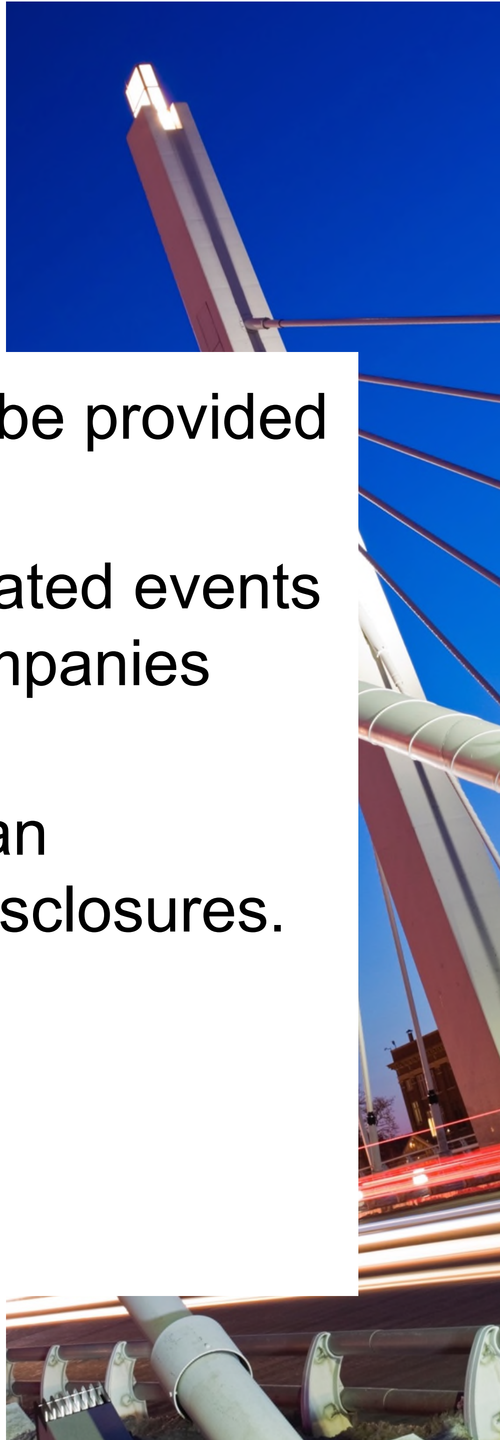
Liability for Non-Compliance

- Companies must file, rather than furnish, climate-related disclosures.
  - Disclosures are subject to potential liability.
  - Scope 3 emissions disclosures would enjoy a safe harbor from certain forms of liability.
    - A Scope 3 emissions disclosure will not be a fraudulent statement unless it is shown that it was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.
- Existing safe harbor for forward-looking statements would be available for forward-looking climate-related disclosures.

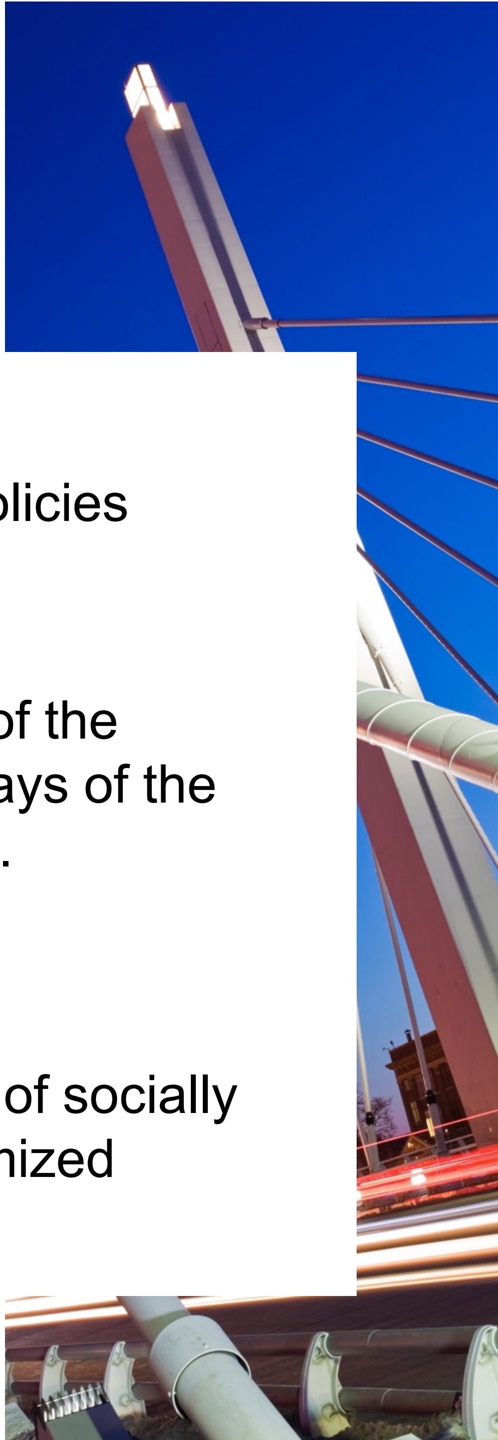


Effects and Implications

- Mandated financial statement metrics and related disclosures must be provided in a note to audited financial statements.
- If the absolute value of negative and positive impacts for climate-related events and transition activities exceeds 1 percent of a related line item, companies must separately disclose all such impacts.
- Companies would be required to include an attestation report from an independent services provider covering Scope 1 and 2 emissions disclosures.
- Recommendations:
  - Conducting scenario analysis.
  - Develop transition plans.
  - Analyze and verify any publicly set climate-related targets or goals.

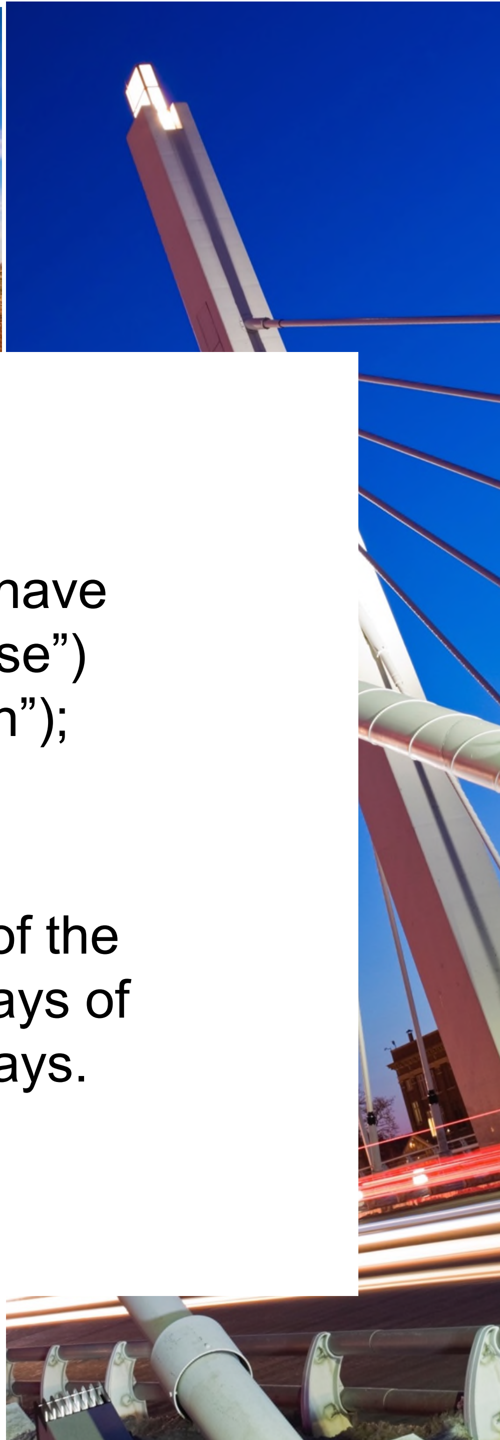


“Anti” ESG State Laws



- Boycott approach:
  - **Texas:** Bans municipalities from doing business with banks that have ESG policies against fossil fuels and firearms.
    - Passed June 2022
  - **Oklahoma:** State governmental entities must rid themselves of at least 50% of the assets of financial institutions that boycott the fossil fuel industry within 180 days of the financial company’s receiving notice, and 100% of the assets within 360 days.
    - Passed May 2022
- “Social Investment” approach:
  - **North Dakota:** Limits investment in “social investment,” or “the consideration of socially responsible criteria…for the purpose of obtaining an effect other than a maximized return to the state.”
    - Passed March 2021

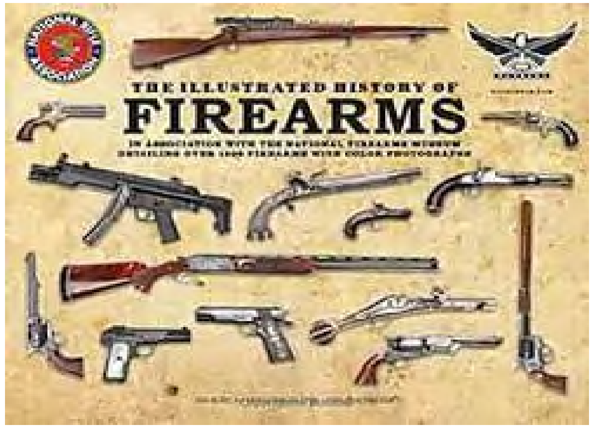
“Anti” ESG State Laws / Position Statements

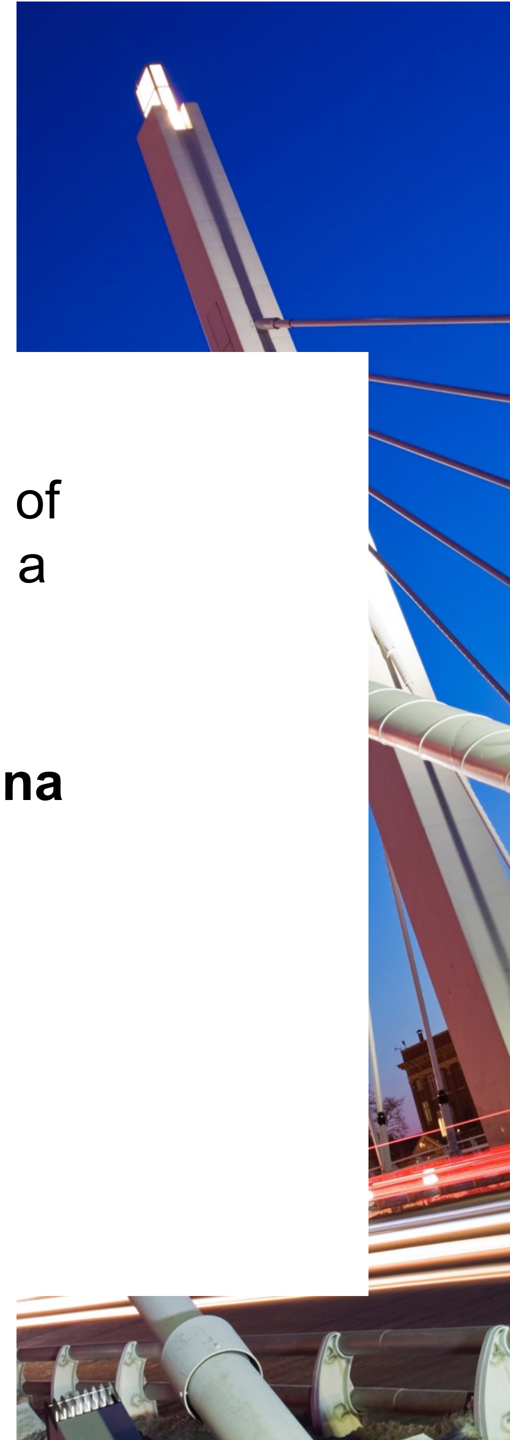


- Generally based upon anti-Israeli boycott laws.
- Boycott approach:
  - **Texas:** Bans Texas government entities from doing business with banks that have ESG policies that “boycott” fossil fuels (unless have “ordinary business purpose”) or firearms (“solely on its status as a firearm entity or firearm trade association”); comptroller creates list; in 2023, statutes likely to be tightened.
    - Passed May 2021 (SB 13 Fossil Fuels), June 2021 (SB 19 Firearms)
  - **Oklahoma:** State governmental entities must rid themselves of at least 50% of the assets of financial institutions that boycott the fossil fuel industry within 180 days of the financial company’s receiving notice and 100% of the assets within 360 days.
    - Passed May 2022
  - Others: **Wyoming** (7/21), **West Virginia** (3/22), **Kentucky** (4/22).

“Anti” ESG State Laws/Position Statements

- “Social Investment” approach:
  - **North Dakota:** Limits investment in “social investment,” or “the consideration of socially responsible criteria…for the purpose of obtaining an effect other than a maximized return to the state.”
    - Passed March 2021
  - Others: **Idaho** (7/22), **Arizona** (8/22), **Florida** (8/22), **Indiana** (9/22), **Louisiana** (10/22), **Missouri** (10/22).





Other State ESG Actions

- August 2022: Texas State Senate State Affairs Committee opens investigation into potential breaches of fiduciary duty to state pensions for failing to invest in fossil fuels, resulting in lower returns on investments.
- Sept. 2022: 19 R State Attorneys General ***publically*** issue Consumer Protection Civil Investigative Demands.
  - To six major banks seeking documents relating to the banks' involvement with the United Nations' (UN) Net-Zero Banking Alliance (NZBA): Bank of America, Citigroup, Goldman Sachs, JP Morgan Chase, Morgan Stanley, and Wells Fargo.
  - Led by Missouri (Nov. 2022 AG Schmitt elected to U.S. Senate), Texas, Arizona, Kentucky (AG Cameron protégé of Mitch McConnell; has announced 2023 run for Governor).

Other Anti-ESG Movements

- Letter from five Senators to 50 law firms cites to ESG “anti-competition” concerns.
- Absence of corporate leaders from COP27.
- “Anti-ESG” funds.

Greenwashing

- With regulators, investors and proxy advisors focused on ESG issues, "greenwashing" is top of mind and must be avoided.
- What is greenwashing?
  - The act of misleading consumers regarding the environmental practices of a company or the environmental benefits of a product or service.
  - Generally refers to environmental issues.
- Who does it?
  - Companies
  - Organizations
  - People

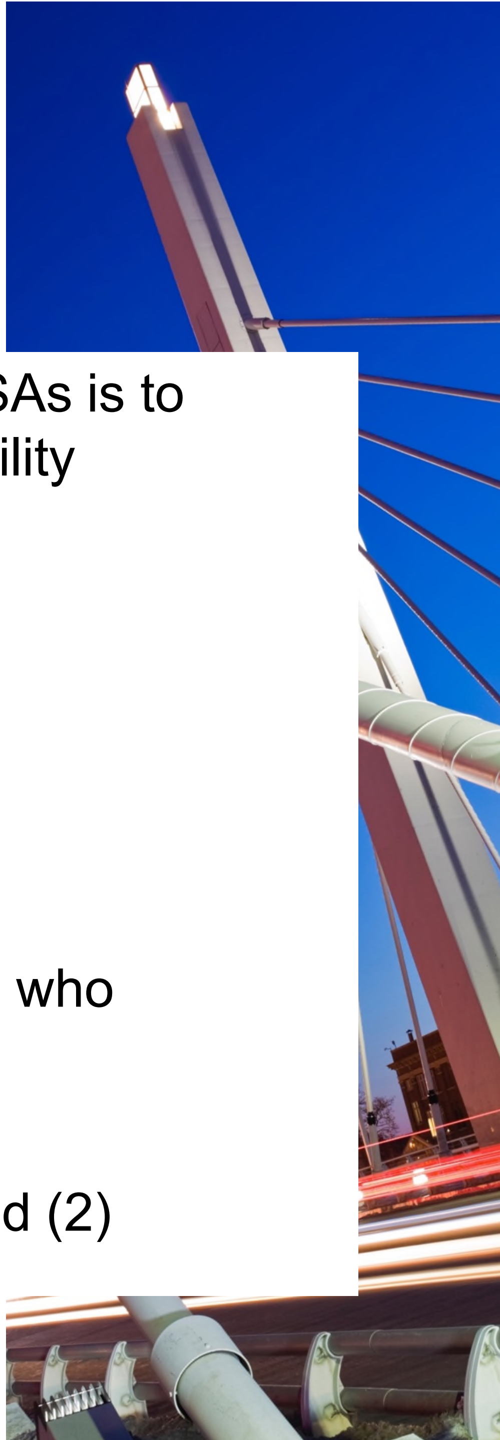
Greenwashing (cont.)

- Where is it found?
  - Advertisements, packaging, products, websites, emails, speeches, and videos.
  - Kids toys, baby products, cosmetics, and cleaning products.
- Impact of greenwashing:
  - Redirects well-intentioned purchase power.
  - Confuses and misleads the consumer.
  - Makes consumers skeptical of all “green” products.
  - Genuinely sustainable companies suffer.

Greenwashing: Potential Exposure

- Shareholder and Derivative Claims:
  - More than a dozen suits filed alleging failure to follow through with diversity commitments made in proxy statements.
- Government and Regulatory Enforcement:
  - *SEC v. BNY Mellon* (May 23, 2022, $1.5 million).
  - *SEC v. Chatfield PCS Ltd* (Mar. 30, 2022, $5.1 million).
- Consumer Protection Claims:
  - *Ehlers v. Ben & Jerry's Homemade, Inc.* (D. Vt. 2020) ("happy cows" and "caring dairy" misleading).
  - *Earth Island Institute v. Coca-Cola* (D.D.C. 2021) (statements regarding recycling one bottle for every one sold, along with other sustainability claims were false and deceptive).

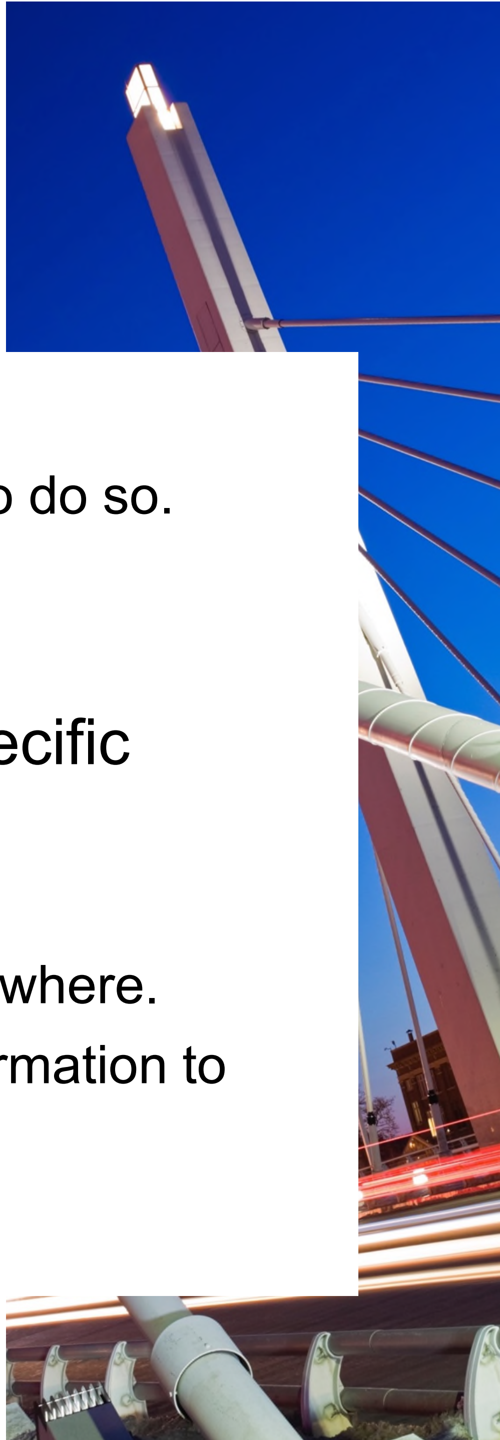
Integrating Sustainability into Contracts



- One approach to adopting requirements for suppliers with existing contracts/MSAs is to adopt a sustainability exhibit, or sustainability T&Cs (e.g., Salesforce Sustainability Exhibit).
- Requires commitment to 1.5 C target made to Science Based Targets Initiative.
- Adoption of plan for to adopt plan “aligned with 1.5 C target.”
- Requires provision of Products or Services on a Carbon Neutral basis:
  - Purchase and retire carbon offsets to achieve.
  - Submit annual Carbon Neutrality Attestation.
- Suitable for contracts with large, sophisticated entities, such as power suppliers who already track GHG emissions under 40 CFR Part 98.
- Limited feasibility for smaller suppliers, based on sales/headcount.
- Potential options are to include Tiers in exhibits based on (1) size of supplier and (2) annual value of purchases.

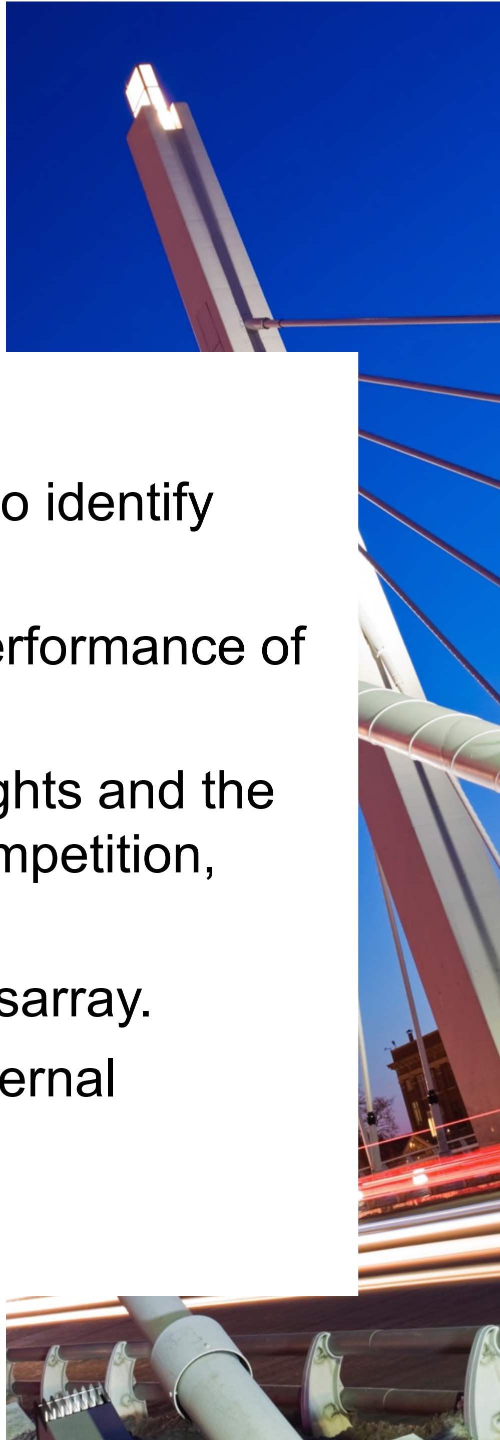
Auditing Supplier Compliance

- Provide for remote and onsite audits:
  - Require suppliers to provide documents in electronic form if possible/willing to do so.
  - Not all suppliers will have sophistication/capacity to do so.
  - Reserve right for site visits and documentation reviews.
- Review provisions with Regulatory/Audit groups to identify any specific needs:
  - Inclusion of auditing provisions in subcontractor requirements.
  - Remediation options for noncompliance with ESG targets (if not covered elsewhere.
  - Dispute resolution mechanism: X days for supplier to review and provide information to supplement audit report.



ESG Best Practices

- Verify the accuracy of ESG statements.
- Perform and oversee audits of ESG disclosures is necessary.
- Build the right frameworks, policies, procedures, controls, and evidence needed to identify compliance concerns.
- Manage enforcement threats on the reputation, financial health, and operation performance of a company.
- Be aware of enforcement risks that stem from voluntarily principles like human rights and the environment as well as from traditional areas, like anti-bribery and corruption, competition, and taxation.
- Communicate with regulators as needed to minimize conflict, inconsistency, or disarray.
- Prioritize the time and resources needed to support ESG goals and regularize internal engagement of ESG goals.
- Proactively engage with C-Suite/Board on ESG goals.
- Communicate strategic importance of ESG goals with legal team.



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