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Tackle ESG Internal Communication and External Disclosure Before They Tackle You

September 2021

Presenters



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Read all about it! How ESG hit the headlines last summer

APR 29, 2021



World Business Markets Breakingviews Technology Investigation

APR 18, 2021
10:37 AM EDT

Sustainable Business

Citi adds ESG scores to data platform for climate-conscious investors

Analysis

ESG Agenda May Lead The SEC Down Long, Litigious Path

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CFO JOURNAL

Companies Could Face Pressure to Disclose More ESG Data

EHS&S ENERGY MANAGEMENT COMPLIANCE & GOV PLANTS & BUILDINGS SUPPLY CHAIN C

Ready or Not, the Pandemic Informed ESG Trends for 2021, Including Stronger Board Management

CFO JOURNAL

Providing Timely ESG Information Is Becoming More Crucial for CFOs

Analysts and investors rely on data when evaluating a company's outlook, creditworthiness

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Companies Brace Themselves for New ESG Regulations Under Biden

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Video description **Transcript**

ESG Investing

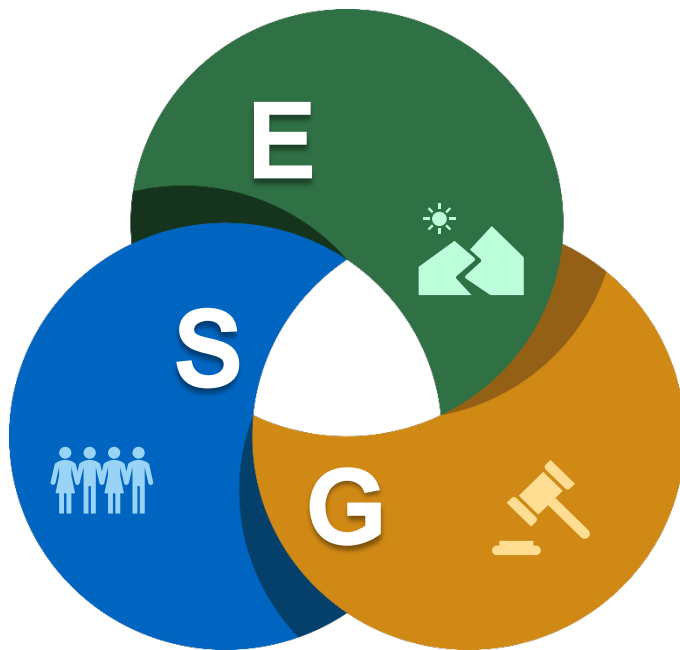
What does ESG-friendly really mean?

Environmental, social, and governance-focused indices advanced 40 per cent in 2019-20. But what counts as ESG is far from straightforward, says FT data journalist Brooke Fox

Bloomberg Equality

Equality

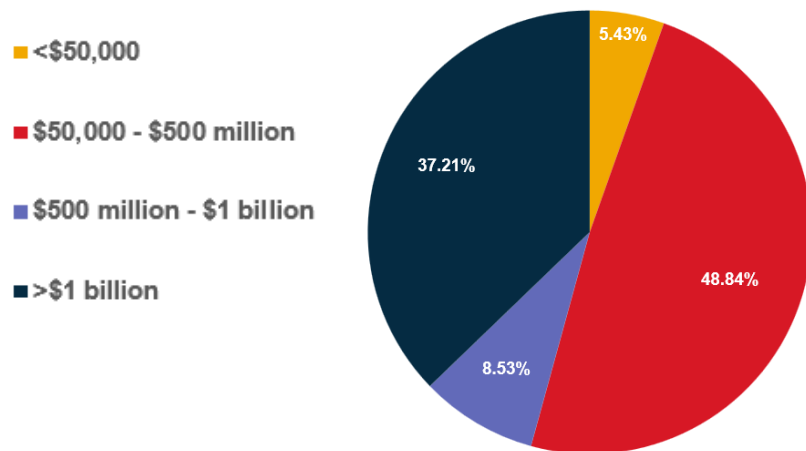
Alphabet to Introduce Executive Bonuses Partly Tied to ESG Goals



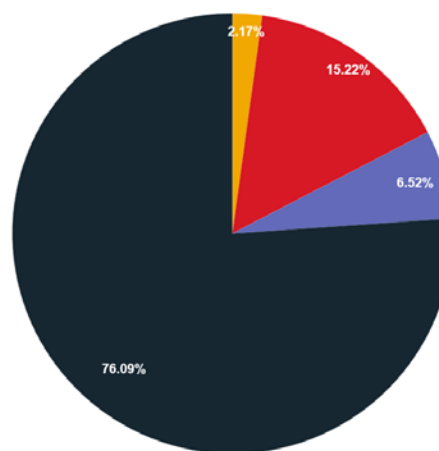
ESG – Thompson Hine Survey (August 2021)

The size of our company [annual revenue] is (select one) (134 survey respondents):

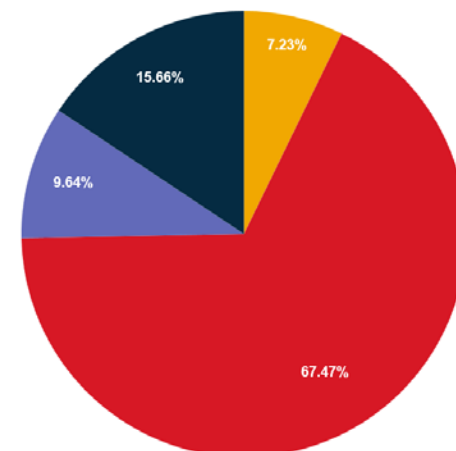
Aggregate



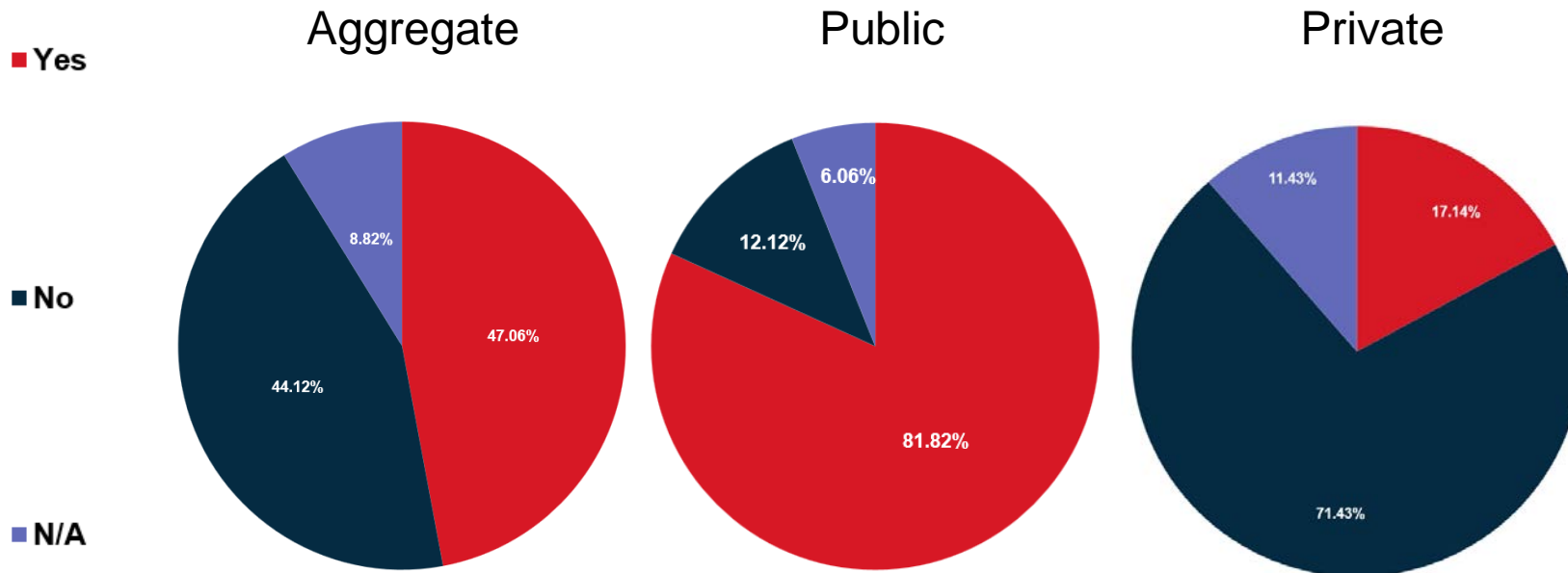
Public



Private

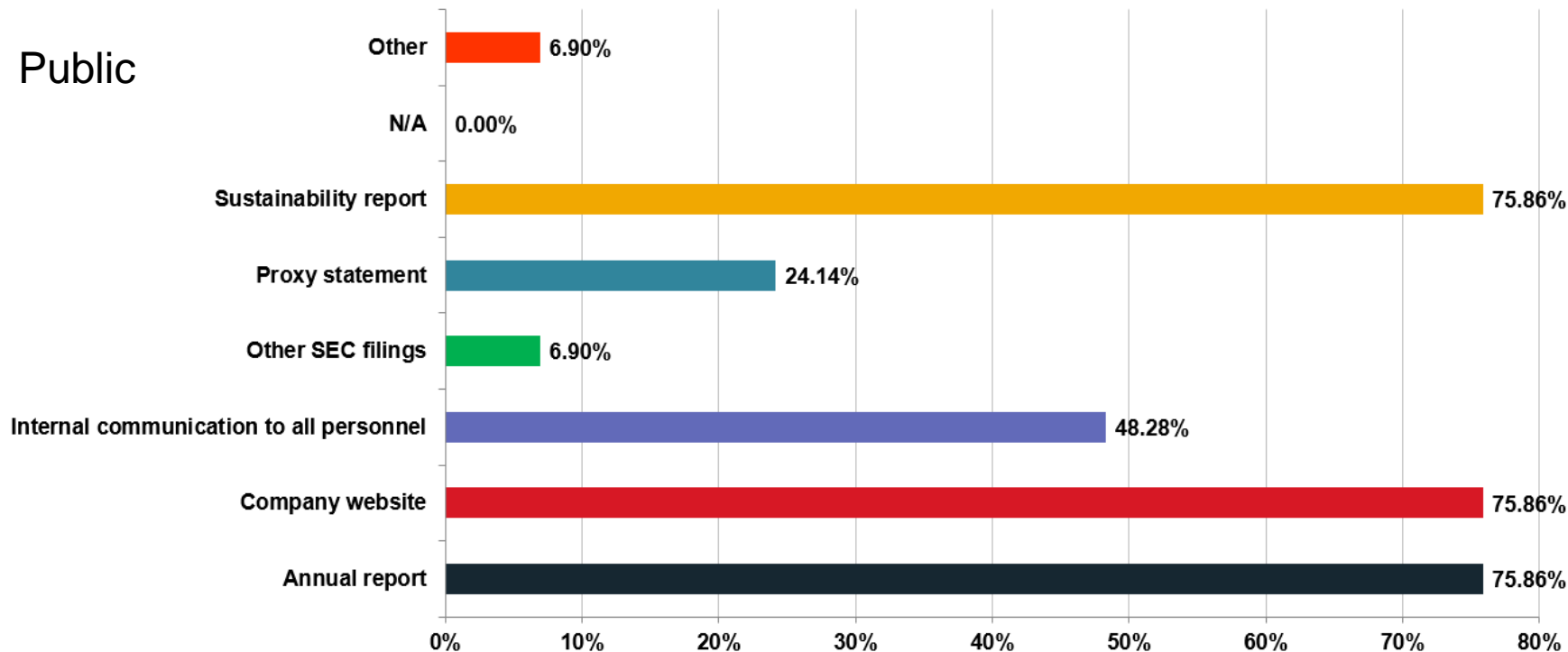


Is your company publicly providing any ESG standards or disclosures?



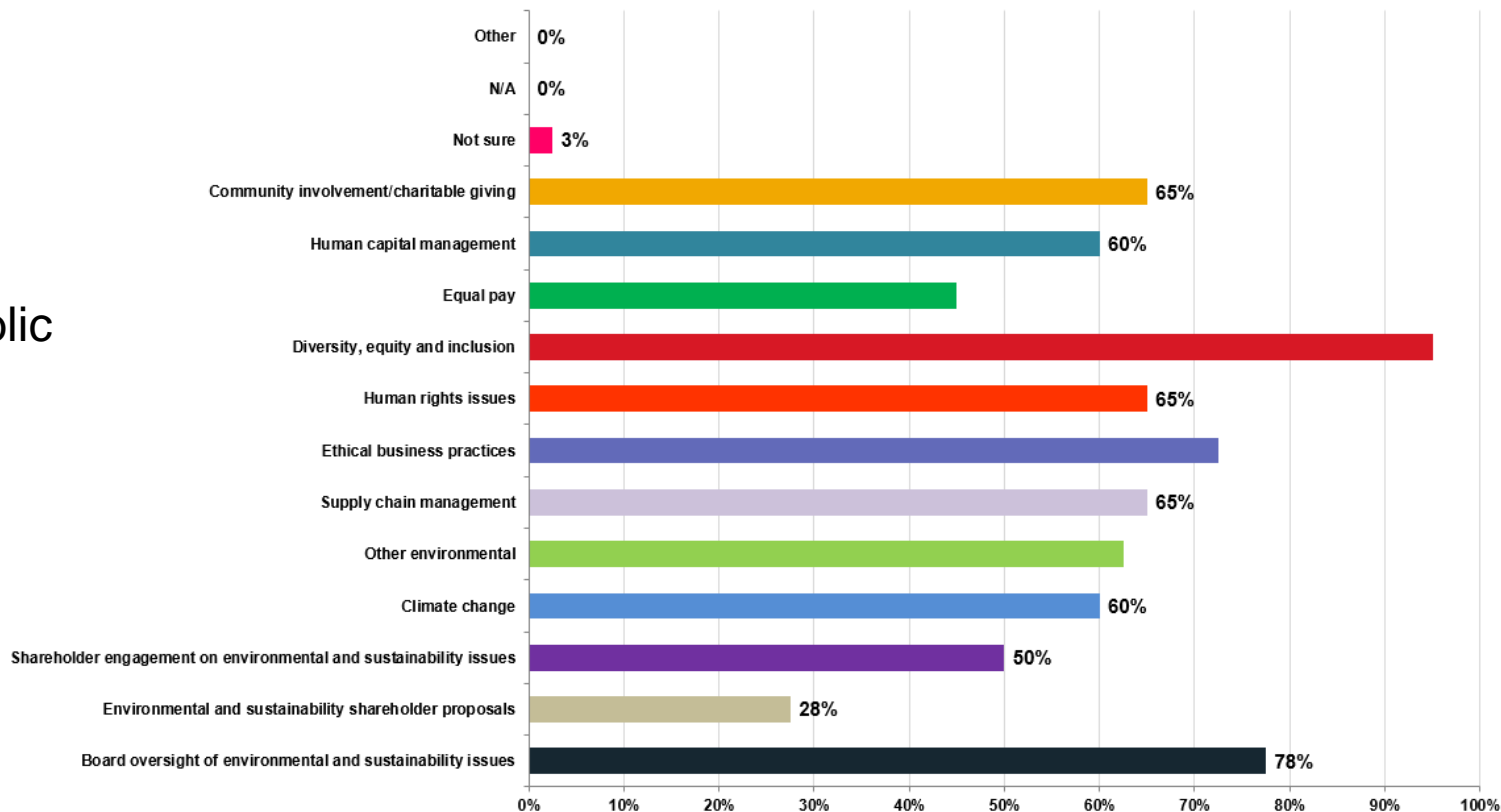
Where is your company providing ESG standards or disclosures? Check all that apply.

Public

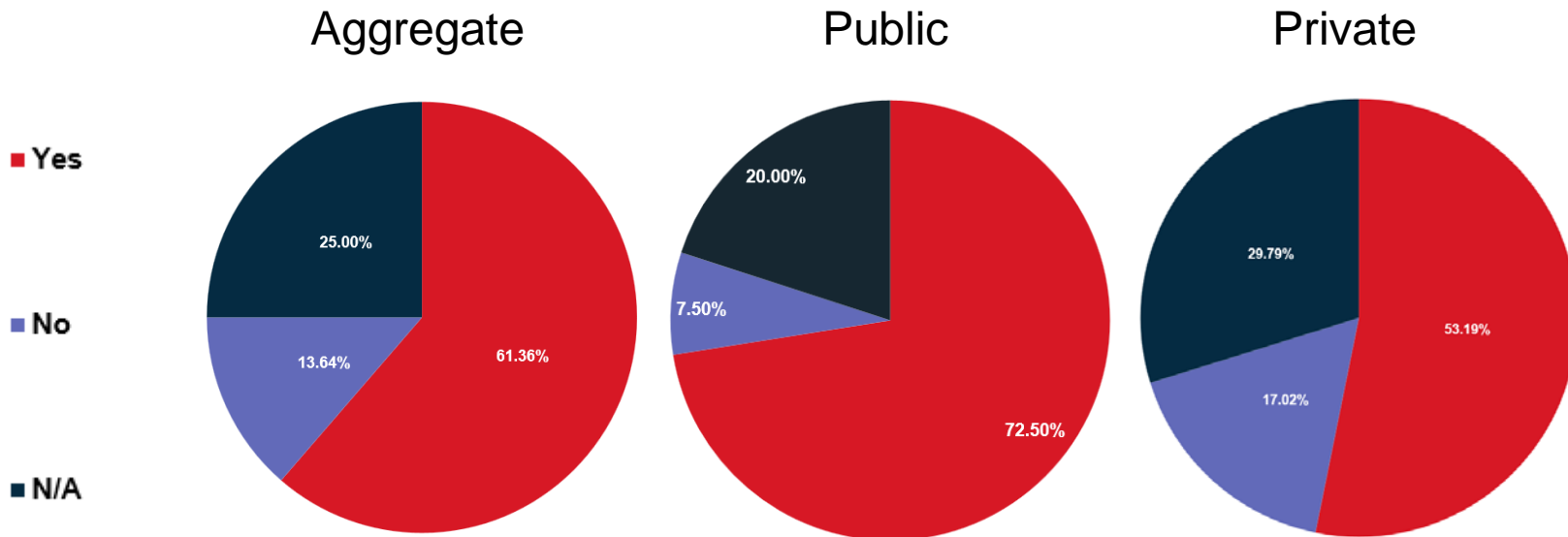


Which categories of ESG disclosures is your company currently providing or planning to provide in the future? Check all that apply.

Public

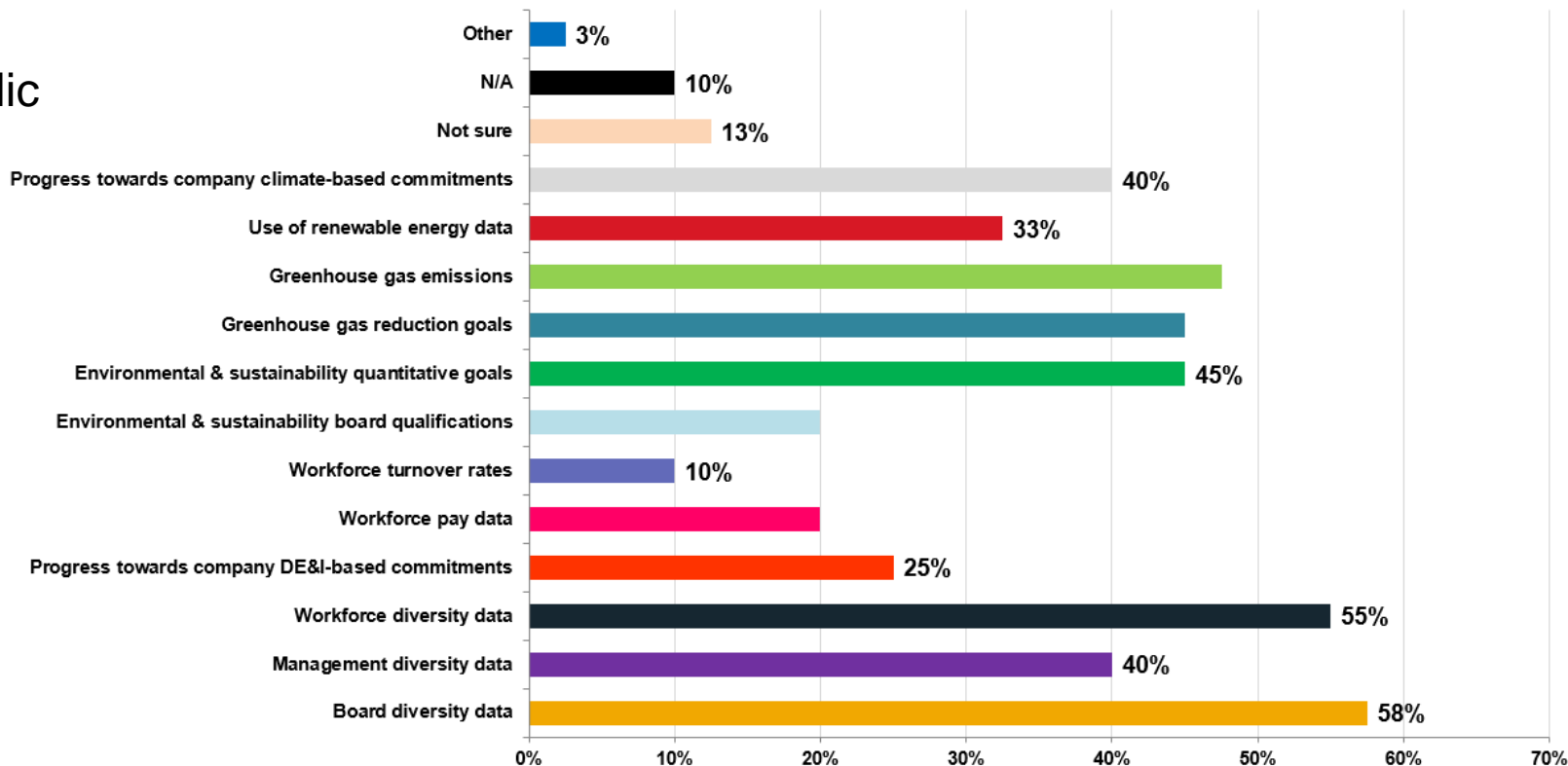


Are you disclosing, or planning to disclose, any quantitative metrics in your ESG disclosures?



Which quantitative metrics are you disclosing or planning to disclose? Check all that apply.

Public



ESG Tools, Metrics & Goals

Transparency



Confirmed Impact



ESG Disclosure Drivers

ESG Disclosure Drivers

- Investors (votes against directors, activism activities, etc.)
- Employees
- Regulators (e.g., California board diversity laws, Nasdaq's board diversity rule, SEC's expected ESG regulations, etc.)
- Rating Agencies
- Other Constituencies

Sample Pending U.S. ESG Regulations

■ Pending U.S. Legislation Related to Climate Change

- ▶ *The Corporate Governance Improvement and Investor Protection Act / ESG Disclosure Simplification Act of 2021, H.R. 1187.* (Passed by the House on 6/16/21.)
 - The bill would require public companies to disclose ESG metrics (to be defined by the SEC) and their connection to the company's long-term business strategy on an annual basis.
 - In addition to climate change disclosures, the bill includes specific disclosures relating to political spending and taxation, executive pay, workforce composition, supply chain, etc.
- ▶ *The Climate Risk Disclosure Act of 2021, H.R. 2570 & S. 1217.* (H.R. 2570 reported out of the committee.)
 - The bill would require the SEC to adopt rules requiring public companies to disclose certain climate-related information on an annual basis, including physical and financial risks that they would face under different climate-change scenarios, strategies and corporate governance processes in place to manage those risks, and analysis of the social cost associated with GHG emissions.
- ▶ *The CLEAN Future Act, H.R. 1512.* (At the committee level.)
 - The bill would require the SEC to adopt rules requiring public companies to disclose information about the company's direct and indirect GHG emissions, fossil fuel-related assets, and climate-related risk disclosures, among others.
- ▶ *California Climate Corporate Accountability Act, SB-260.* (Amended at the California Senate level in 4/2021.)
 - The bill would impose climate disclosure requirements (scope 1, 2 and 3 GHG emissions) on large companies doing business in California.
- ▶ On 5/20/2021, *President Biden issued an Executive Order on Climate-Related Financial Risk* that called on the federal government to mitigate climate change risks and directed the Secretary of the Treasury to work with the Financial Stability Oversight Council to review climate-related disclosures.

■ U.S. Securities and Exchange Commission's ESG Agenda

- ▶ On 3/4/2021, the SEC announced the formation of a *Climate and ESG Task Force in the Division of Enforcement*. On 3/15/2021, the SEC sought public input on disclosures related to climate change.
- ▶ SEC comment letters regarding climate disclosures in September 2021 (based on the SEC's 2010 climate disclosure guidance) (The SEC's form letter is available here: [SEC.gov | Sample Letter to Companies Regarding Climate Change Disclosures\[1\]](#))
- ▶ The SEC's (*non-binding*) agenda for 10/2021 includes proposed rule-making relating to climate change disclosures and enhanced disclosures regarding board diversity, cybersecurity risk governance, and human capital management disclosure.
- ▶ Newly developed standards or adoption of existing framework such as TCFD? Scope 3 in SEC rules? (SEC Chair Gensler's remarks)

Sample Pending EU ESG Directives

- **Asset Manager Regulations**
- **EU Proposal for Corporate Sustainability Reporting Directive**
 - ▶ On 4/21/2021, the European Commission adopted a proposal for a *Corporate Sustainability Reporting Directive (CSRD)*, which would amend existing EU ESG regulations and extend their scope.
 - ▶ The proposal would extend the scope of the existing EU ESG requirements to include all large companies, whether they are EU-listed or not. For companies reporting on ESG matters for the first time, the disclosures would be extensive, covering the environmental, social and governance matters.
 - ▶ The proposal also places a much stronger focus on disclosing the company's impacts on external stakeholders (other than investors) and the environment, independently from the financial materiality for the company. Among other things, it would require disclosure of the company's plans to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.
 - ▶ The CSRD is linked to the European Green Deal and the Taxonomy Regulation, which sets common EU-wide criteria for inclusion in annual management reports. The CSRD provides for ESG standards to be developed by a new European standard setter and would further introduce mandatory limited assurance over the ESG reporting.

Materiality

- Test: what “a reasonable investor would consider important to an investment decision”
 - ▶ As ESG considerations influence investors, ESG disclosures become more important to at least some investors
- Quantitative *and* qualitative considerations
 - ▶ SEC enforcement increasing under existing statutes and rules
 - ▶ “Dynamic materiality”
 - ▶ Possibility of new regulations

SEC Enforcement Underway

- Fiat Chrysler Automobiles N.V.
 - ▶ Cease-and-Desist Order and \$9.5M civil penalty imposed (September 2020)
 - ▶ Arose from disclosures about internal investigation of, and compliance with, applicable emissions regulations for its diesel vehicles following VW “Dieselgate scandal”
 - ▶ Certain “Leaks”; Regulation FD; Review Prior Disclosures (FLS; “full” disclosure; corrective disclosure)
- Deutsche Bank AG asset management arm, DWS Group, under investigation by DOJ, SEC
 - ▶ Former head of sustainability said it overstated its sustainable investing efforts, painting rosier picture to investors
 - ▶ DWS has @ \$1 trillion in assets under management
 - ▶ At issue is whether it overstated how much it used sustainable investing criteria to manage assets
 - ▶ Followed WSJ report that statements on its sustainable investing efforts were inaccurate
 - ▶ Similar reviews and investigations expected of other investment managers (per Commissioner statements)

SEC Enforcement Underway

■ Activision Blizzard

- ▶ Confirmed SEC investigation into its “disclosures regarding employment matters and related issues”
- ▶ Probe into whether it properly disclosed allegations of workplace harassment and gender pay issues
- ▶ Subpoenas issued to company and several current and former employees
- ▶ Followed suit by California alleging company paid women less, provided fewer opportunities for advancement, and ignored complaints of sexual harassment, discrimination and retaliation
- ▶ EEOC also investigating harassment allegations

Regulatory and Legislative Initiatives

- SEC creation of Climate and ESG Task Force in Enforcement Division (March 2021)
 - ▶ Designed to “proactively identify ESG-related misconduct” (not based on new standards?)
 - ▶ Use “sophisticated data analysis to mine and assess information across registrants”
 - ▶ Division of Examinations recent announcement of “Enhanced Focus on Climate-Related Risks” for 2021 exams of registrants
 - ▶ Likely to develop additional guidelines on disclosures through pronouncements and “regulation by enforcement”
- House passed Corporate Governance Improvement and Investor Protection Act
 - ▶ Would require comprehensive ESG disclosures on climate change mitigation, workforce demographics, statistics on workplace harassment, diversity among officers and directors, cyber security, etc.
 - ▶ Unlikely to pass Senate but may pressure SEC on rule-writing

Climate Change & ESG Litigation



U.S. “First Wave” (2005 to 2015)

Largely consisted of unsuccessful public nuisance and tort claims which failed on causation grounds

Recent “Second Wave”

Broadly challenges private entities with claims founded on human rights, nuisance, fraud and misleading conduct and failures to adhere to planning controls and environmental laws

- Claims seeking to influence corporate behavior relating to climate change continues to increase
- Most common defendants = fossil fuel corporations and associated entities
- Most Court decisions focus on procedural/jurisdictional issues

Climate Change & ESG Litigation: What to Watch



Govt. Claims for ESG Exaggerations

*Commonwealth of Mass.
V. Exxon*

Royal Dutch Shell PLC

(May 26, 2021)
Dutch Court ordered Shell
to cut global GHG
Emissions by 45%

Investor Litigation or Other Actions

Growing Areas for Disputes

Breach of Contract Actions
False environmental claims
(i.e., greenwashing)
ESG Related claims

Shareholder and Derivative Litigation

■ Private Plaintiffs are Beginning to Stir

- ▶ Derivative suits against public companies alleging failure to fulfill diversity pledges have been largely dismissed
 - Opko Health Inc.
 - Facebook
 - Oracle
 - The Gap Inc.
 - Monster Beverage Corp.
- ▶ Code of conduct and *Caremark* cases may provide a roadmap for shareholder plaintiffs
- ▶ Specificity of representations will be important determinants of viability of claims
- ▶ Disclaimers tailored to ESG issues may be of use

SEC Focus on Cybersecurity Under New Chairman

■ Cybersecurity Disclosures

- Still a dedicated Cyber Unit within Enforcement Division (started in 2017)
- Focus on both vulnerabilities and on attack incidents (before = risk; after = material)
- ▶ *E.g.*, First American Financial settlement (June 2021)
 - Inadequate disclosure of known security risks—policies, procedures and controls were inadequate to ensure senior management is aware of vulnerabilities
- ▶ *E.g.*, Pearson settlement (August 2021)
 - Referred to data security incident as hypothetical risk when one had occurred
 - Did not accurately describe extent of breach in media statements
- ▶ SolarWinds cyberattack industry sweep
 - Request for voluntary disclosure of effect and of other cyber incidents

ESG Governance

Board Oversight of ESG

- “ESG” encompasses a broad set of continually evolving issues, ranging from human capital and compensation issues, to climate change, deforestation, and water and waste management, to supply chain management.
- There is no consensus on the key topics and issues encompassed within each of the “E,” “S,” or “G” categories.
- Materiality of ESG issues may vary significantly depending upon company circumstances, including industry, size, geographic scope, business operations, and business model, as well as investor and other stakeholder preferences and priorities, which are evolving rapidly.
- There is no “one-size-fits-all” approach to board oversight of ESG.

Board Oversight of ESG – Why Important?

- Directors have fiduciary duties to implement oversight structures and, in certain cases, may have a duty to follow up on “red flags”
- *Caremark*-type claims are likely in the ESG area
- Messaging to investors and other stakeholders / Significance of ESG issues to the company
- Governance Structure in Place; Disclosure Controls in Place; “Good” Data for Disclosure

Alternative Approaches to Board Oversight of ESG

- Full Board
- Existing Board Committee (e.g., governance & nominating committee)
- Standalone ESG Committee
- Multiple Existing Board Committees for Oversight of Discrete ESG Matters
- Combination of Approaches Above (common)
- Considerations: raising profile of ESG issues internally and externally/messaging of importance of ESG; board size; time on the agenda to focus on ESG issues; integration of committee work; directors' expertise

Internal ESG Governance

- Board and C-Suite “Buy-In”
- Reporting up to the Board / Board Committees
 - ▶ Frequency, content, etc.
 - ▶ Different for different ESG issues
- Allocation of ESG Responsibilities Within the Organization
 - ▶ Who “owns” responsibility for various ESG issues?
 - ▶ Right team in place to drive ESG strategy – cross-functional (sustainability, legal, compliance, finance, investor and public relations, risk, technology, safety, CEO, business lines, etc.); senior management; role of chief sustainability officer; role of chief compliance officer; etc.
 - ▶ Established internal reporting lines (different for different ESG issues?) and delegation of authority
- Corporate Formalities – charters, minutes, etc.
- Board Education / Expertise (organic / management presentations, special training, etc.)
- Disclosure Controls

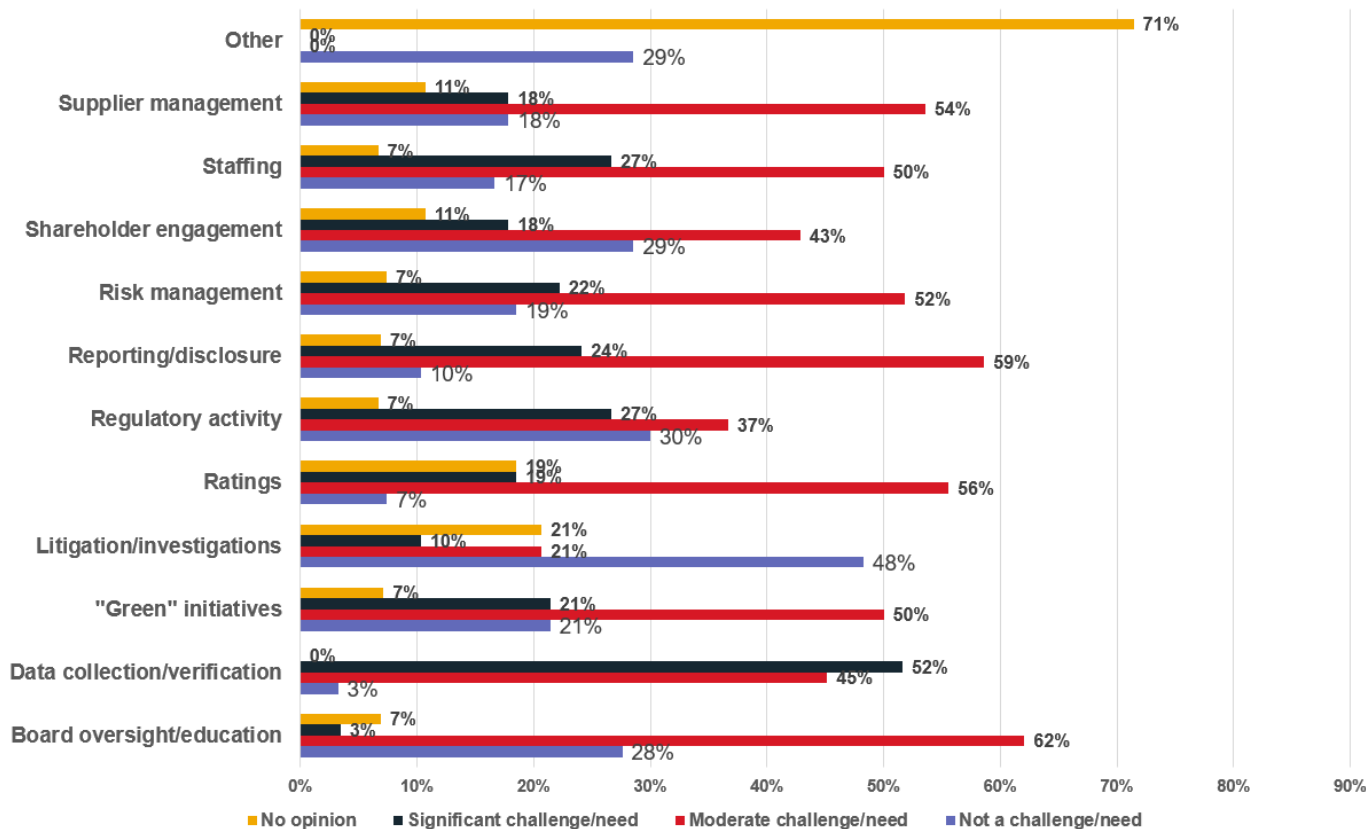
ESG Disclosure Considerations

Disclosure Considerations

- No “one-size-fits-all” approach to ESG strategy, program or disclosure
- C-Suite and Board of Directors “buy-in”; internal governance structure
- Company-specific drivers
 - ▶ What are you hearing from your investors? (BlackRock, State Street, etc.)
 - ▶ What are you hearing from customers and business partners?
 - ▶ What documents are you signing? (incorporated contractual terms and conditions, supplier codes of conduct, agreements/commitments, etc.)
 - ▶ What are your peer companies doing in the ESG area?
- Effectively communicate ESG strategy (e.g., annually, clearly, accurately & consistently)
- “Good” data / integrate ESG into ERM and compliance programs / risk assessments

What are your most significant, ESG challenges/needs in the next year? Please rate each challenge.

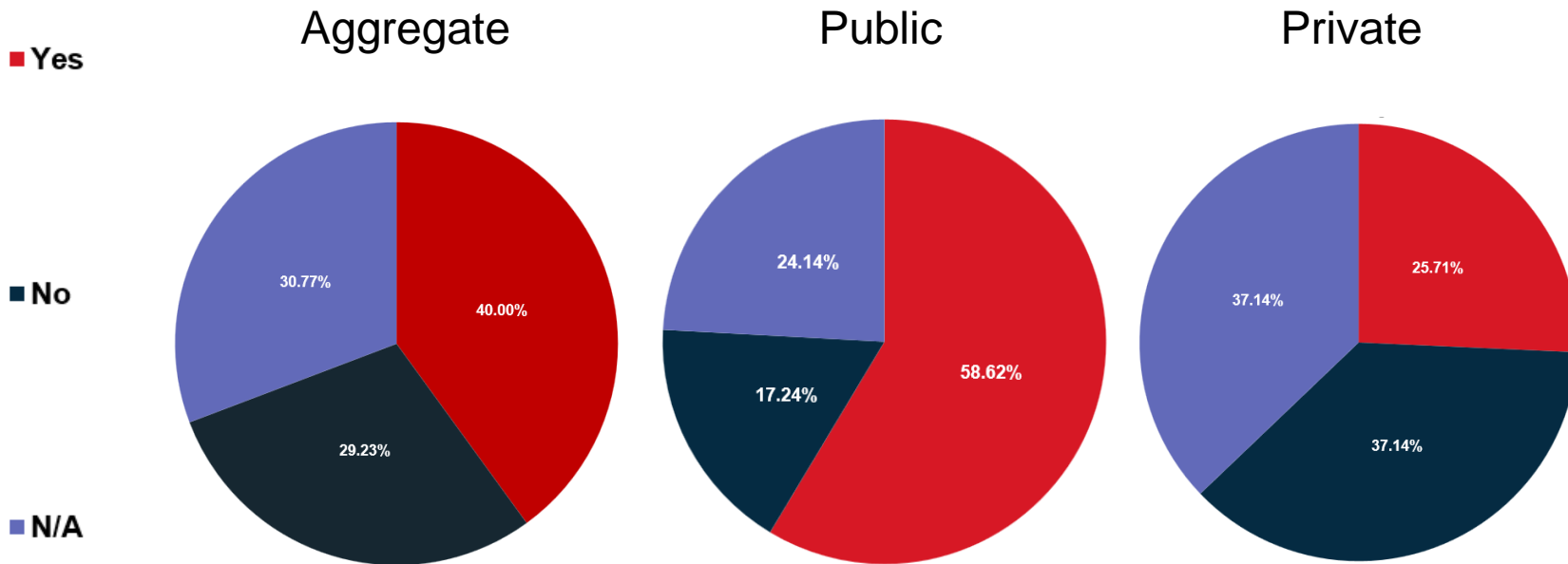
Public



Data Collection & Verification

- No “good” disclosure without “good” data
- Identifying where data “resides”; assigning data collection responsibilities; centralizing process (multiple Excel spreadsheets / challenging)
- Designing and implementing controls and procedures so that data can be tracked and measured, is reliable and verifiable, and can be tracked and repeatedly measured year over year to show progress against established goals
- Evaluating resources (sufficient internal capacity or outside consultants needed?)
- ESG is an evolving area and third-party assurance of ESG data may become a norm down the road (growing)

Is your company using or planning to use third-party assurance services for any of your ESG data?



ESG Disclosure Tips

1. Distinguish between factual and aspirational statements
2. Clarify that commitments are not guarantees
3. Use cautionary language and thoughtful, tailored disclaimers
4. Explain data and underlying assumptions (e.g., scope – which facilities covered? global? recent acquisitions? Which emissions? timeline? baseline? how calculated? which methodology used? internal verification process? third-party assurance level?)
5. Explain “materiality” definition / choose wording (“material” v. “priority”; disclaimers, as needed)
6. Balance disclosure (current circumstances; areas for improvement; pending inquiries/investigations/issues; “leader,” “best” - accurate?)

ESG Disclosure Tips

7. Avoid graphics and images that could convey misleading impression
8. Establish controls and procedures; quality of data (not audited financial data, but . . .)
9. Ensure consistency among forums (*i.e.*, press releases, website, sustainability reports, SEC filings)
10. Watch out for emails, texts and internal communications (consistency in messaging; discoverable)

Large-scale ESG litigation matters go to the heart of a company's business purpose, reputation, corporate values, approach to risk management, and relationships with investors, suppliers, customers, employees and other stakeholders

SEC Investigations

SEC Investigations

■ Most start as informal inquiries

- ▶ Letter requesting voluntary production of documents
- ▶ Can also include request for interview(s)
- ▶ Initiated by staff without approval of Commissioners
- ▶ Can come from anywhere (news story, whistleblower, competitor, industry sweep, data mining, etc.)

■ Subpoenas

- ▶ Requires formal order from Commissioners
- ▶ Enforceable in court
- ▶ Usually indicates investigation has been ongoing or that informal inquiries have not resulted in adequate cooperation

Top Ten Tips for Responding to SEC Investigations

1. Get experienced advice
 - Don't "go it alone"—treat it seriously to avoid missteps even if you think you have done nothing wrong
2. Contact the SEC staff promptly
 - Reach out to staff person on inquiry letter or subpoena
 - Don't wait until close to deadline for response
3. Negotiate scope and timing of response
 - Best way to learn about nature of investigation is to narrow scope of broadly-written requests
 - Propose extension of timetable for response and document agreement

Top Ten Tips for Responding to SEC Investigations

4. Build a cooperative relationship with SEC staff
 - Gain trust by being cooperative, responsive and keeping commitments
5. Who oversees the investigation?
 - General counsel? Board? Audit or Special Committee?
 - Appoint an in-house point person
 - Familiar with, and senior in, the company, but no involvement in reviewed conduct
6. Preserve and gather relevant documents quickly
 - Identify relevant custodians, send out hold notice, suspend destruction policies
7. Learn facts quickly
 - Review documents, conduct interviews; investigate before producing documents and making any representations to SEC Staff Consider disclosure obligations throughout the process

Top Ten Tips for Responding to SEC Investigations

8. Public company disclosure obligations
 - Timing and content
9. Who needs to be notified? (Auditors? Insurance carriers? Board?)
 - Limit information within the company on a need-to-know basis
10. Presentations to SEC staff
 - Ideally in person, to address issues of concern and answer questions
 - Make sure you are fully ready with all facts

Questions?

