**SKY HARBOR** CAPITAL MANAGEMENT

# Staying the Course on Sustainability

## People, Planet, Purpose, Profits & Politics

## Our Purpose

To grow our clients' assets by investing in sustainable high yield companies that have committed to benefit all their stakeholders and society as a whole.

## How We Do It

By compounding current income over time, protecting principal and giving our clients the returns they expect and the information they need.

## Why We Do It

We believe that companies that meet their ethical obligations to employees, customers, suppliers, communities, shareholders, government, the environment, and society as a whole will prosper over the long term, attract lower cost capital, and generate superior returns to their investors.

**Sustainability Outlook 2021**

Elections have consequences

*A closer look at:*

Biden climate policy initiatives

US regulatory outlook

Corporate governance issues

**Sustainability Outlook 2021**

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# I. Introduction

As one of the most event-driven years in recent memory — certainly since our founding in 2011 — comes to a close, we are pleased to provide this Sustainability Outlook for 2021. In preparing this Outlook, we took stock and reflected on the combined impacts of the Covid-19 pandemic; civil unrest from the killing of George Floyd in police custody; the near-death experience of the global economy; and finally, in the waning days of the Trump presidency, the almost daily drama surrounding the peaceful transition of power in the United States. Re-living these events while looking ahead to the new year has made our reflections on the meaning of "sustainability" all the more poignant.

Lost lives, extreme income, racial and gender inequality, excessive cultural and political polarization leading to a near collapse of previously accepted norms, food insecurity affecting millions around the world and at home, and seemingly endless natural disasters brought about by extreme weather and uncontrolled wildfires marked much of 2020. Each one of these is tragic in itself, and taken together these tragedies could have easily been a montage in the opening scenes of a dystopian movie. Yet beneath the surface and above the noise of the 24-hour news cycle, 2020 also marked significant progress in the transition to a sustainable economy. As in every great dystopian drama, collective action among thoughtful, determined, and passionate individuals carves a path to a brighter future.

It is in support of such collective action that we commemorate and celebrate the 20th anniversary of the United Nations Global Compact, which is a voluntary initiative based on CEO commitments to implement universal sustainability principles established on July 26, 2000, and the 5th anniversary of the Paris Agreement, which was adopted by 196 parties in Paris on December 12, 2015.

The anniversaries of the UN Global Compact and the Paris Agreement evoked reflections of our own story in integrating sustainability into our investment processes here at SKY Harbor. We became a signatory to the UN-backed Principles for Responsible Investment ("PRI") in October 2015 as the final details of the Paris Agreement were still being negotiated. In June 2017 we subscribed to the UN Global Compact and committed to support the 17 Sustainable Development Goals ("SDGs"), which lies at the heart of the UN Global Compact's agenda. We went on to join and publicly support a number of collaborative efforts such as the Thirty Percent Coalition, the FAIRR initiative, which addresses ESG issues in protein supply chains, and the Task Force on Climate-related Financial Disclosures. In 2020 we became a member of the SASB Alliance in conjunction with the rollout of our proprietary Value Rubric 3.0, designed to track and evaluate ESG risk factors across the below-investment-grade-rated debt-issuing universe and support our risk-taking in the portfolios that we manage on behalf of our clients and investors. Our efforts are informed by the belief that sustainable companies, particularly in the corporate below-investment-grade space, are better prepared to prosper and attract capital in coming years. Corporate sustainability to us means a company's delivery of long-term value in

financial, environmental, social, governance and ethical terms. In that regard, our updated Value Rubric 3.0 seeks to capture in a quantifiable and deliberative fashion ESG factors to help identify high yield companies that are best positioned to benefit from the transition to a sustainable economy — or not. We were pleased to note a significant increase in one of our metrics in 2020: about 40% in corporate social responsibility reports issued by high yield companies captured in our Value Rubric 3.0.

As of November 30, 2020, we have converted all the sub-fund compartments of SKY Harbor Global Funds, the Luxembourg-based UCITS fund that we serve as investment manager, to socially responsible investment strategies built on ESG integration, negative exclusions, and engagement.[1]

In reviewing the major developments in sustainability in 2020 and thinking about what they portend for 2021, we are mindful of the implications of nearly every aspect of our sustainability prognosis on industry sectors and individual companies in the high yield space.

The theme that elections have consequences seems to us the right starting point. The Biden-Harris administration promises to usher in a sea change in national and foreign policy, and its ambitious climate agenda will surely have important implications for a number of sectors in the high yield space. Utilities, energy, transportation, building & materials, and autos (especially electric vehicles and the corresponding supply chain) are but a few examples that quickly come to mind but there will be others. Regulatory policy motivated and informed by ESG-related disclosure and transparency initiatives will dominate the fund and investment industry followed by renewed scrutiny on corporate governance. Many of the potential regulatory initiatives in 2021 will have important implications for how we and others in our industry do business, particularly with respect to disclosure and reporting. For these reasons, after we survey the shifting landscape of sustainability in 2020, we offer a closer look at President-elect Biden's climate agenda, US regulatory developments and the outlook for corporate governance in the coming year.

The denouement of great dystopian stories typically ends with an inspirational achievement — a breakout moment when collective action brings about a renewed sense of freedom and the promise of a brighter future. While the sustainability story is yet to unfold in 2021, we are hopeful and cautiously optimistic that indeed the new year will bring about meaningful achievements on the path to global sustainability.

We welcome your thoughts, comments, and questions. In closing we take this opportunity to express to our clients, friends, and the communities in which we all belong our wishes for a safe, healthy, and peaceful new year.

December 29, 2020

## II. Executive Overview

### Elections Have Consequences

As this column has noted previously, sustainability can be conceptually thought of in terms of the Five Ps: People, Planet, Purpose, Profit and Politics. The Biden-Harris victory in the recent US presidential election is an important reminder of the critical role that the 5$^{th}$ P, politics, plays in advancing — or impeding — efforts to transition to a sustainable economy. Whether the new administration will face a divided Congress will not be known until the results of the Georgia Senate run-off election on January 5, 2021. It is, nevertheless, a safe bet that regardless of that outcome, the Biden-Harris inauguration on January 20, 2021, promises to usher in a sea change across a wide range of national and foreign policy issues, not the least of which will be environmental, social and governance ("ESG") issues that will have important consequences for US and by implication global financial markets.

### Climate Action a Top Priority

The environment promises to be among the top priorities on the Biden-Harris to-do list of immediate actions. To begin chipping away at its ambitious climate action agenda — to make US electricity production carbon-free by 2035 and have the US achieve zero emissions by 2050 while spending up to $2 trillion in the coming decade — the early months of the new administration may have no other viable options other than to issue a tsunami of executive orders[2] coupled with cabinet-level agency actions to reverse the tide of the Trump administration's generally hostile attitude toward environmental regulation. As reported by the *New York Times*, over the past four years of the Trump administration, more than 100 environmental rules covering clean air, water, wildlife, and toxic chemicals have been dismantled or rolled back.[3] In addition to mitigating Trump's environmental policies, early indications by the Biden-Harris transition team suggests that the incoming administration's agenda will also prioritize a range of ESG-related policy issues including racial, gender and income inequality. Expect social justice issues to loom large in any discussion concerning not only ESG-related issues but also policies relating to the pandemic, the administration of pending vaccines, economic stimulus, and racial and income inequality.

### A Return to Global Engagement

With respect to transitioning to a sustainable economy, the incoming administration's repudiation of Trump-era policies will revive moribund efforts to address lingering gaps in US policy and enforcement — beginning with the US re-entry to the Paris Agreement. The early announcement that former Secretary of State John Kerry will serve as climate envoy for national security is an indication of the high priority the incoming administration places on climate action. Mr. Kerry was one of the leading architects of the Paris Agreement, and he will be the first member of the National Security Council to focus exclusively on climate action. Mr. Kerry's role is emblematic of the incoming administration's desire to end the Trump era of US isolationism and

return to a foreign policy characterized by American leadership and collaboration with long-standing allies.

Moreover, Mr. Biden's choice of Linda Thomas-Greenfield, a veteran American diplomat with vast experience in Africa, to be the US Ambassador to the United Nations, and his promise to restore the UN ambassador position to Cabinet rank[4] sends yet another signal that the new administration aims to reinvigorate cooperation and engagement with global institutions and to re-establish American leadership in international affairs. The president-elect's revival of American support of the United Nations and the many initiatives under the UN umbrella should refresh and bolster support for the UN Global Compact (the "Compact"), the sustainable development goals ("SDGs"), and the UN-backed Principles for Responsible Investment ("PRI"), all of which are conducive to the increasing momentum for socially responsible investment strategies.

The expected return to the Paris Agreement also means the US will once again be an important participant in the annual Conference of the Parties ("COP 26"), the annual UN mechanism by which countries convene and agree on lowering their carbon emissions. This year's COP was originally scheduled for November to be hosted by the UK in Glasgow but due to the pandemic, has been re-scheduled for November 2021.

### Expect Better Coordination Between Federal Agencies on Sustainability

With the appointment of Janet Yellen as Treasury Secretary, better cooperation and collaboration between the Treasury and the Fed, at the very least, can be expected, which contrasts with the current situation where Chair Powell and Secretary Mnuchin offered very different visions facing the US economy in the months ahead.[5] Cooperation of the Secretary of the Treasury is especially important with respect to any attempts by the incoming administration (as suggested by some circles) to declare global warming as a systemically important risk by the Financial Stability Oversight Council ("FSOC"), which was established by the Dodd-Frank Act of 2010 to provide comprehensive monitoring of the stability of the US financial system. Both the Secretary of the Treasury and the Chair of the Fed are voting members along with other agency heads with the Treasury Secretary acting as Chair.

FSOC is charged with identifying risks to the financial stability of the US that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; promoting market discipline by discouraging the expectation of government bailouts of aforementioned entities; and responding to emerging threats to the stability of the US financial system. FSOC's growing relevance to climate action stems from the emerging consensus as expressed in recent remarks by Fed Chair Jerome Powell, that "[t]he public will expect, and has every right to, that we will make sure that the financial system is resilient against all sorts of major risks, including climate change."[6] Largely dormant during the

Trump administration, FSOC may very well emerge as a player in the sustainability conversation in 2021.

Changes in leadership at the US Treasury Department, the SEC, CFTC and DOL promises to bring greater formal recognition of the risk that climate change poses to the US financial markets, and with that recognition, a more accommodating attitude by regulators toward enhanced ESG-related disclosure by corporations and acceptance of the legitimacy of ESG investment strategies — the latter particularly with respect to rolling back a recent Department of Labor rule widely viewed as discouraging ESG investment strategies in the management of US private pension plans governed under the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

### Collective Action by the States Will Continue . . .

While undoubtedly federal action, particularly by the incoming administration, will dominate headlines in the early months of 2021, sustainability initiatives will not be limited to the executive branch and federal agencies. State and local government action undertaken in recent years in the absence of federal action — including litigation against energy companies for a variety of claims — will not suddenly halt with the inauguration of a sustainability-friendly administration. Collective action by state and municipal governments, which have been actively promoting climate action such as targeting GHG emissions, plays an increasingly important role in developing and evolving global solutions to climate change. For instance, on the 5th anniversary of the Paris Agreement, the US Climate Alliance — a bipartisan coalition of 25 US governors committed to achieving the goals of the Paris Accord — released a report on December 10, 2020, proclaiming that its member states have created more than 133,000 new clean energy jobs and are outpacing the rest of the nation.[7] States may follow California's lead in legislating gender and racial diversity in board memberships as well as exercising the state's right to set its own fuel economy and emissions regulations, the latter of which is currently in litigation following the Trump administration's attempt to revoke California's right to set its own auto emissions standards, which were stricter than federal standards.

When the Trump administration announced its intention to revoke California's right to set its own auto emission standards, a number of carmakers backed the Trump administration's effort. Notably, Honda, Volkswagen, BMW, and high yield fallen angel Ford Motor Co. sided with California.[8] Within a few weeks after the US election, GM — which initially backed the Trump effort to support a single, lower national standard — announced that it was withdrawing its support from the Trump litigation.

### . . . As Will Initiatives by the Business and Financial Sectors

GM's announcement is but one of a number of statements and actions by American corporations that suggest increasing support of climate action to mitigate global warming;

among them is the prominent corporate lobbying organization known as the Business Roundtable ("BRT").

On the one-year anniversary of its much-publicized 2019 restatement of corporate purpose — overturning a 22-year policy statement that defined a corporation's principal purpose as maximizing shareholder return — the BRT issued a statement of Principles and Policies Addressing Climate Change (the " Plan").[9] The Plan acknowledges the "scientific consensus that the climate is changing and that human activities are contributing to that change" and further notes that despite having made progress during the past decade in the US toward reducing GHG emissions (primarily by shifting power-generation from coal to natural gas and renewables), "the existing patchwork of federal and state regulations, tax incentives, subsidies and other policies is inefficient and has negatively affected the long-term investment strategies of many US companies by creating regulatory uncertainty." Criticizing the current policy approach as "fragmented" and "insufficient to meet the challenges posed by climate change," the Plan calls for the US to "adopt a more comprehensive, coordinated and market-based approach to reduce emissions."

Among the Plan's Goals for Addressing Climate Change is to "limit global temperature rise this century to well below 2 degrees Celsius above preindustrial levels, *consistent with the Paris Agreement,*"[10] (emphasis added). As reported by one news source, "the move throws the lobbying voice of corporate America behind efforts to combat climate change" and reflects "a stark division between the business community and the Trump administration."[11] The BRT is an influential organization of CEOs from major American corporations. According to its calculations the BRT CEO members lead companies that aggregate more than 15 million employees, $7.5 trillion in revenues, and a combined market capitalization of member companies equivalent to over 27% of the value of the US stock market.[12]

The Biden administration's promise to re-enter the Paris Agreement will find support not only from CEO members of the BRT but also the financial sector including investors, investment funds and money-center banks.

Emblematic of the fund industry generally, the big three fund families — BlackRock, Vanguard and State Street — have all marketed themselves as advocates for ESG constituencies, not only for their designated socially responsible investment funds but also generally for all their fund complexes, although critics have noted that their proxy voting records in support of 2020 shareholder resolutions related to ESG remains mixed.[13] Whether voting records by the large fund families match their public stance on climate action notwithstanding, the momentum to address ESG constituencies has been unmistakable throughout 2020 and promises to carry over well into the new year.

The momentum is especially noteworthy within the US financial community. Not wanting to be left behind in the wake of a Democratic administration committed to climate

action, money-center banks such as JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Morgan Stanley and Goldman Sachs are among firms that have committed hundreds of billions of dollars to investments that they claim will reduce carbon emissions including voluntarily documenting climate-related activities based on the Task Force on Climate-related Financial Disclosures ("TCFD").[14] The incoming administration will be pressured by some constituencies to subject the banks to greater scrutiny and disclosure rules including stress tests aimed at identifying the risks in bank portfolios directly impacted by destructive climate events or a costly transition to a low carbon economy.[15] A number of Republican members of Congress, however, have already publicly warned against such stress testing of bank portfolios. (See *infra* Expect Partisan Pushback Against Climate Action.)

### Corporate Governance: Increasing Board Engagement on ESG

The landscape in ESG is shifting rapidly and sometimes in unexpected ways as witnessed in 2020 when the Covid-19 pandemic, civil unrest following the killing George Floyd, and resulting economic chaos demanded unprecedented responses by the corporate community. Many corporations needed to craft policies to these developments and communicate them publicly in a timely, thoughtful, and transparent manner in protecting their customers, employees, and reputations. Done poorly, as one chief executive officer of a national fitness franchise quickly learned, these responses can lead to immediate loss of business including the CEO's job.[16] In yet another example of how the trend toward stakeholder primacy and ESG has taken hold globally, the decision by mining giant Rio Tinto[17] to destroy an indigenous site to make room for a mining project should serve as a cautionary tale for the notion that simply because one *can* do something does not mean that one *should* do it.

As discussed in more detail below, mandatory listing requirements along with rising litigation, regulatory and compliance risks, all of which implicate what is known as *Caremark* oversight, will ensure that the evolving landscape of ESG transparency and disclosure reporting will be a much-discussed agenda item by all but the most soporific corporate boards in 2021.

### Expect Partisan Pushback Against Climate Action

Despite the incoming administration's desire to hit the ground running on January 20, 2021, the most ambitious parts of President-elect Biden's climate initiatives will take time, partly due to the nature of the huge infrastructure plans in his proposed $2 trillion decade-long budget but also because of staunch resistance by Republican members of Congress, who appear poised to resist even the most modest efforts to combat climate change.

In a letter dated December 9, 2020, (the "Letter"), 47 House Republicans warned Fed Chair Powell and Vice Chair for Supervision Randal Quarles against introducing climate change scenarios into its supervisory stress tests of regulated banks "without due consideration of their methodological shortcomings and challenges, and the potential downstream impacts on regulated banks' commercial clients and the millions of consumers they serve."[18] The Letter

also noted the recent reports that the Fed has applied for membership in the Network for Greening the Financial System ("NGFS"), a network of central banks and supervisors launched in 2017 willing to voluntarily share best practices, contribute to the development of environment and climate risk management in the financial sector and mobilize mainstream finance to support the transition toward a sustainable economy.[19] The Fed is the only major global central bank besides the Reserve Bank of India that is currently not a member of the NGFS.[20]

The Letter urged the Fed to not join the NGFS "without first making public commitments to only accept and implement in the US recommendations that are in the best interest of our domestic financial system, would not disproportionately disadvantage US banks compared to their European competitors and would not have harmful impacts on the customers those banks serve." The reference to harmful impact on bank customers is apparently a reference to the Letter's contention that introducing climate scenario risk tests would accelerate the "de-banking" of "politically unpopular" legally operating businesses in industries such as coal and oil and gas.

Without citing any authorities, studies or reports, the letter also claims that a "number of methodological challenges could negatively impact the effectiveness and reliability of climate change stress testing." The Letter suggests that because of the gap in time between scenario tests and climate effects — the effects of climate change occur over a course of decades while scenario testing typically extends over a period of less than three years — the authors contend that it "would compromise the reliability of the tests."

Of the 47 (all Republican) congressional members who signed the letter 33 were also signatories to the amicus brief in support of the lawsuit brought by the Texas Attorney General and backed by President Trump aimed at invalidating members of the Electoral College in Michigan, Wisconsin, Pennsylvania, and Georgia. The lawsuit was summarily dismissed by the US Supreme Court on December 11, 2020.

These recent actions highlight the importance of the Georgia run-off election on January 5, 2021, the results of which can mean the incoming Biden-Harris will either face smoother sailing during the early days of the new administration with respect to the legislative agenda or serious headwinds in seeking compromise, particularly with respect to policy issues such as climate action and a host of other agenda items that seek to repudiate and rollback Trump administration policies.

Epilogue: at the time of this publication, media reports confirmed that the Fed has officially joined the NGFS.

## ESG Outlook in the EU

In addition to the goal of limiting the global average temperature increase to "well below 2°C above pre-industrial levels" and "increasing the ability to adapt to the adverse

impacts of climate change," the third objective of the Paris Agreement is "making finance flows consistent with a pathway toward low greenhouse gas emissions and climate-resilient development."[21] Perhaps nowhere is the latter objective of directing finance flows taken more seriously than among the signatory member states of the EU. The European Commission, the executive branch of the EU, has expressed its aspiration to achieve net zero GHG emissions by 2050 in a series of policy initiatives commonly referred to as the "European Green Deal."[22] Among the many initiatives to achieve the goal of net zero emissions by 2050, this column will briefly discuss two initiatives in the form of recently promulgated regulations designed to facilitate capital flows toward sustainable investment. Both regulations mandate sustainability disclosure requirements covering a wide range of "financial market participants," a broadly defined term that includes undertakings for collective investment in transferable securities ("UCITS"), credit institutions, alternative investment fund managers ("AIFMs") that manage or market alternative investment funds, insurance undertakings, investment firms, insurance intermediaries, pension funds and others.

### The Sustainable Finance Disclosure Regulation: Effective on March 10, 2021

The first of these is the Sustainable Finance Disclosure Regulation[23] ("SFDR"). The regulation acknowledges that current directives and regulations do provide end investors with more uniform protections that "make it easier for them to benefit from a wide range of financial products, while at the same time providing rules that enable end investors to make informed investment decisions." However, the basis of the promulgation of the SFDR was European regulatory authorities' conclusion that, "disclosures to end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, or on the promotion of environmental or social characteristics, in investment decision-making and in advisory processes, are insufficiently developed because such disclosures are not yet subject to harmonised requirements."[24]

The central theme of the SFDR is the disclosure of specific sustainability-related information to end investors concerning (1) the integration of sustainability risks in the investment process; and (2) consideration of adverse sustainability impact in the investment decision-making processes. It becomes effective on March 10, 2021 and will mandate specific sustainability disclosures by financial market participants regardless of whether the product or the financial advice is a sustainable or ESG strategy.

The SFDR further identifies and provides for additional disclosure and manner of disclosure of specific information for any financial product that "promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics."[25] The definition is conditioned, among other things, that "the companies in which the investments are made follow good governance practices," and the required disclosures be provided to end investors in pre-contractual disclosures that must include information on how those characteristics are met; and if an index has been designated as a

reference benchmark, in which case information must be disclosed on whether and how the index is consistent with the stated sustainability characteristics. Where a financial product has a sustainable investment as its objective and an index has been designated as a reference benchmark, the SFDR sets forth disclosure requirements specific to those products.[26]

While it may not always be clear how or where the distinction lies between an investment strategy that promotes ESG characteristics and one that has a sustainable investment objective, generally it appears the distinction hinges on whether the objective is susceptible to quantitative evaluation, although even here gray areas may require further guidance from the European Securities and Markets Authority ("ESMA") once the regulation goes into effect in March 2021. Compounding the uncertainty is the decision by European Commission to delay the applicability date for the regulatory technical standards ("RTS"), which were scheduled to take effect by the end of 2020 and intended to supplement the principles-based SFDR with specific templates and other requirements. The delay means that the RTS may not be available until 2022 or later but does not affect the SFDR's effective date of March 10, 2021, which means that entities subject to the SFDR can expect that however they comply with the SFDR, it will likely need to be changed once the RTS is finalized.

The SFDR is also noteworthy for codifying the notion that financial market participants have a duty to act in the best interest of end investors; must integrate sustainability in financial analysis, including in their due diligence processes and "should assess on a continuous basis not only all relevant financial risks but also including all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment or advice."[27] This can be interpreted as establishing sustainability integration as a financial market participant's fiduciary duty, a concept in contrast to the position taken by the US Department of Labor in its recent rule, namely that an investment manager's fiduciary duty is solely toward investment returns and any consideration of sustainability must be justified.

### The Taxonomy Regulation

With the proliferation of investment strategies with self-proclaimed sustainable strategies in recent years, the EU authorities became concerned about "greenwashing," which refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met. To address this, the EU promulgated the Taxonomy Regulation in 2020, which establishes an EU-wide classification system to provide a common definition of "the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable."[28] Essentially, the Taxonomy Regulation can be thought of as a truth-in-labeling regulation that sets forth the criteria in which a financial product can legally refer to itself as environmentally "sustainable."

For purposes of establishing the degree to which an investment is environmentally sustainable, the economic activity must "contribute substantially" to one of the following objectives: (a) climate change mitigation; (b) climate change adaptation; (c) the sustainable use and protection of water and marine resources; (d) the transition to a circular economy; (e) pollution prevention and control; (f) the protection and restoration of biodiversity and ecosystems.[29] Moreover, the economic activity must also do no significant harm to any of the other environmental objectives on the list; be carried out in compliance with certain minimum standards set forth in the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights; and comply with technical screening criteria ("TSC") established by the EU Commission.[30]

The Taxonomy Regulation does not alter the requirement of the SFDR that market participants who do not consider the criteria for environmentally sustainable investments should provide a statement explaining why they do not. Non-European asset managers — which now includes the UK — who offer financial products in the EU will be subject to the regulation.

The Taxonomy Regulation provides for a phased implementation with an effective date of January 1, 2022 with respect to climate change mitigation and climate change adaptation objectives, and January 1, 2023 with respect to the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.

Finally, a word on Brexit. According to recent press reports, while the UK seeks to be a global leader in green finance and has indicated its intention to develop a green classification system loosely based on the Taxonomy Regulation, it has not officially embraced the SFDR,[31] creating uncertainty for UK-based asset managers who may indirectly be subject to the EU regulations as non-EU third country parties but may be faced with potentially different or even conflicting green regulations to be issued by the UK.

## III. A Closer Look at Biden Climate Policy Initiatives

Within days of the election being called, the *Washington Post* (the "Post") among other news outlets reported that President-elect Biden's transition team had already begun to address climate action. The ambitious plans reach well beyond the environmental agencies like the Environmental Protection Agency ("EPA") to encompass a wide range of federal agencies including the Department of the Treasury, Department of Agriculture, Department of Energy, Department of the Interior, Department of Justice, Office of Management and Budget ("OMB"), Department of Transportation, Department of State, and the National Oceanic and Atmospheric Administration ("NOAA").[32] The Post reported that President-elect Biden has

discussed climate action with "every European head of state" with whom he has spoken since the election including the leaders of Britain, France, Germany and Ireland.

### The Climate 21 Project

The Post also reported that a team of former Obama administration officials and experts over the last year and a half "have created a 300-page blueprint laying out a holistic approach to the climate while avoiding some of the pitfalls that hampered President Obama, who shared the same goals but was unable to enact all of them." The blueprint entitled the Climate 21 Project has been delivered to the Biden-Harris transition team.

According to its website, the Climate 21 Project (the "Project"), consisting of 13 "memos" addressed to the next President, is the work of more than 150 experts with high-level government experience, including nine former cabinet appointees (presumably from the Obama-Biden administration). The objective is to "deliver actionable advice for a rapid start, of whole-of-government climate response coordinated by the White House and accountable to the President."[33] The Project notes, however, that it "is not offering a policy agenda." Rather it is intended as recommendations to the President-elect to enable him "to hit the ground running and build the capacity of his administration to tackle the climate crisis quickly with the existing tools at hand."[34]

While the Project recommendations do not purport to be an expression of the incoming Biden-Harris administration's official policy agenda, the scope, nature and pedigree of the contributors to the Project and the fact it has been delivered to the transition team suggests its policy suggestions are not simply another incoming item in the suggestion box. It should be taken seriously if for no other reason that it will offer a baseline in which to evaluate, forecast or critique the new administration's actions as they emerge during the first 100 days. The Project memos set forth its recommendations for climate-action across nearly a dozen federal agencies across three timelines: Pre-inauguration, Day 1, and the First 100 Days.

One of the Project's top Pre-Inauguration recommendations is to select "an Assistant to the President for Climate who will serve as the first Director of a newly created White House National Climate Council to organize and drive White House and administration-wide domestic and international climate strategy and actions."[35] A Recommendation for the Department of State on Day 1: in addition to re-joining the Paris Agreement, "appoint a special envoy for climate change," in order to "enable immediate, high-level re-engagement and to signal to the international community, as well as the department [of State] itself, that climate change is again a top-tier US priority."[36] President-elect Biden has already moved on this Day 1 Recommendation with the appointment of former Secretary of State John Kerry — among one of the first intended appointments announced by the transition team pre-inauguration — to a newly created post as special presidential envoy for climate, based on the National Security Council with cabinet standing.

That the ambitious blueprint apparently was started 18 months ago seems to suggest that the authors were hoping for a Democratic election victory although at the time the Project was started it was not known who would be the next president. One can imagine the collective sigh of relief by the more than 150 contributors once it became clear that Joe Biden would become the next president and thereby ensuring that the work would not be wasted in a Trump re-election victory.

### Pre-inauguration Recommendations

The Project's top recommendations pre-inauguration are:

- Select an Assistant to the President for Climate who will serve as the first Director of a newly created While House National Climate Council to organize and drive White House and administration-wide domestic and international climate strategy and actions
- Hold a public event to showcase the president-elect's commitment to climate action and preview Day 1 climate plans
- Draft Day 1 climate Executive Orders and lay the foundation for a Day 1 launch of a cabinet-level task force to develop a Climate Ambition Plan
- Evaluate readiness to lead on climate change as an essential consideration when selecting nominees across the government to support an administration-wide climate mobilization
- Engage with Congressional leaders to identify the most promising strategies to achieve budgetary and legislative climate priorities

### Day 1 Recommendations

Among the Project's other top recommendations for Day 1:

- Issue an Executive Order ("EO") to create the National Climate Council ("NCC") that is co-equal to the Domestic Policy Council and the National Economic Council
- Launch a 90-day, cabinet-level Climate Ambition Plan Task Force that holds the entire administration accountable to meeting the president's stated goals
- Update EO 12898 (Federal Actions to Address Environmental Justice ("EJ") in Minority Populations and Low-Income Populations, issued by President Clinton in 1994) to formalize the Council on Environmental Quality's role in convening EJ leaders and advancing EJ across the federal government
- Mitigate damaging previous climate and environmental decisions, including re-joining the Paris Agreement
- Embed aspects of the climate change agenda in other White House policy councils and functions

## Project Recommendations for the First 100 Days

- Convene cabinet-level and staff-level Climate Task Force meetings and produce the administration's Climate Ambition Plan (90 days)
- Issue additional Executive Orders to reverse damage done during the prior administration and take additional steps forward
- Convene world leaders to lay the groundwork to secure more ambitious global climate pledges

The Project Summary sets forth top recommendations and key programs for the departments at OMB, EPA, Interior, Energy, Agriculture, Transportation, State, Justice, NOAA, and Treasury. The Project also includes a section of recommendations within each department entitled Top Recommendations: Management, Budget, and Structure, which provides further recommendations aimed to facilitate the operational and administrative aspects in executing the recommended policy proposals.

The Project's recommendations for the EPA call for immediate actions to set priorities and target resources at the EPA, writing: "It will be especially urgent because EPA has experienced a prolonged, systematic assault to disable effective capacities, demoralize its highly expert and dedicated staff, undercut its own legal authorities, and betray the EPA's core mission to protect human health and the environment."[37] The Project foresees the EPA as having a major impact on GHG emissions in the transportation, energy and industrial sectors as well as through international engagement.

High yield issuer Tesla and other EV manufacturers and their suppliers should be heartened to see that the Project envisions the Department of Transportation — to be led by Pete Buttigieg — to play an important role in reducing emissions "through vehicle efficiency standards, investments in electric vehicle charging infrastructure, and other low-carbon transportation options."[38]

## Yellin' for a Carbon Tax

The Project also envisages that the "Secretary of the Treasury will play a central role in shaping the administration's economic recovery program and the Secretary likely will be the President's chief voice on these matters."[39] The Department of the Treasury under Janet Yellen will play a starring role in the Biden-Harris administration if the Project recommendations are indeed embraced.

The notion of a carbon tax does not feature prominently in the Climate 21 Project if at all. Moreover, AXIOS reported before the election that, according to people close to Mr. Biden's campaign, candidate Joe Biden was "unlikely to pursue a carbon tax if he [won] in November."[40] Well, we all know by now that Joe Biden won in November. What we don't know is whether President-elect Joe Biden still feels the same way as candidate Biden about a carbon tax. We do

know, however, that one of president-elect Biden's most prominent choices for the incoming cabinet is very much in favor of a carbon tax — namely incoming Treasury Secretary Janet Yellen.

Janet Yellen is a founding member of a group called the Climate Leadership Council,[41] ("CLC") whose individual founding members also include, among other prominent names, former Fed Chair Ben Bernanke, former Secretary of Energy under President Obama Steven Chu, former NJ Governor Christine Todd Whitman, founder of the Word Economic Forum (which sponsors the annual Davos conference) Klaus Schwab, the late physicist Stephen Hawking, and Ray Dalio, founder and CEO of the investment firm Bridgewater. The list of the CLC's corporate founding members is a who's who of prominent corporations, banks, and energy companies.

The CLC's "Carbon Dividends Plan," last updated September 2019, rests on four pillars:

- A $40 per ton carbon tax
- Carbon dividends for all Americans
- Significant regulatory simplification
- Border carbon adjustment

Because "economists agree that an escalating carbon fee offers the most cost-effective climate policy solution, sending a powerful price signal to steer businesses and consumers toward a low-carbon future," the self-proclaimed bipartisan plan's first pillar calls for an economy-wide tax on $CO_2$ emissions starting at $40 a ton (in 2017 dollars) and increasing every year at 5% above inflation. The CLC claims that, if enacted in 2021, the plan "will cut US $CO_2$ emissions in half by 2035 (as compared to 2005) and far exceed the US commitment" under the Paris Agreement.

The CLC plan proposes to return all net proceeds from the carbon tax "to the American people on an equal and quarterly basis," and estimates that during the first year of the plan a "family of four will receive approximately $2,000."

The third pillar calls for streamlining regulations that the CLC contends will no longer be needed, because the carbon tax "offers a more cost-effective solution," which will replace regulations. The CLC believes that "all current and future federal stationary source carbon regulations, for example, would be displaced or preempted" if the plan is enacted.

The final pillar proposes a mechanism to level the playing field with respect to exports to and imports from countries without comparable carbon pricing systems. Carbon-intensive exports to such countries will generate a rebate to American exporters while carbon-intensive imports from such countries will incur the carbon tax. The thought here is the belief that a "well-designed system of border carbon adjustments will enhance the competitiveness of

American-based firms that are more energy-efficient than their foreign competitors, while preventing carbon leakage and free-riding by other nations."

Among the original co-authors of the CLC's Carbon Dividends Plan is James A. Baker III (Secretary of State under President George H.W. Bush and Treasury Secretary under President Reagan), George P. Shultz (Secretary of State under President Reagan and Treasury Secretary under President Nixon), Henry M. Paulson, Jr. (Treasury Secretary under President George W. Bush), Martin Feldstein (Chairman of the President's Council of Economic Advisers under President Reagan) and N. Gregory Mankiw (Chair of the President's Council of Economic Advisers under President George W. Bush).

Whether a plan authored by virtually entirely Republican, free-market-oriented individuals would be accepted by the incoming administration and members of the Democratic Party remains to be seen. On the other hand, except for the most ardent of President Trump's acolytes, moderate Republicans and Democrats alike view global warming as a common foe. Nevertheless, the CLC's Carbon Dividends Plan now has a credible and powerful voice in the incoming administration in Janet Yellen. Before the election and her recently announced appointment as incoming Treasury Secretary, Ms. Yellen was reported to have said that if Joe Biden is elected president, the combination of social injustices exposed by the pandemic, the Black Lives Matter protests, and wildfires in California could boost support for a carbon tax, with proceeds shared by American households.[42] Democrats of all stripes may be persuaded to at least lend an ear to the proposal. She has expressed her own belief that there "really is a new kind of recognition that you've got a society where capitalism is beginning to run amok and needs to be readjusted in order to make sure that what we're doing is sustainable and the benefits of growth are widely shared in ways they haven't been."[43] With sentiments such as these from an influencer of the likes of Janet Yellin in support of a carbon tax, one cannot rule out the possibility that the CLC's Carbon Dividends Plan in some form or another may very well be given serious consideration after the Biden-Harris team takes office on January 20.

# IV. A Closer Look at US Regulatory Outlook

Climate 21 Project does not issue specific policy recommendations concerning the Securities and Exchange Commission ("SEC") or the Commodity Futures Trading Commission ("CFTC"), but their absence from the Plan belies the critically important role these two agencies play — especially the SEC — with respect to ESG transparency and disclosure by public companies and their investors. Both agencies through their respective subcommittees issued recommendations in 2020 in recognition of the risk that climate change poses to the financial markets and the need for reliable, consistent, and comparable data and methodologies.

## A More Receptive SEC Toward ESG Transparency and Disclosure

As a reminder, both the SEC and the CFTC are governed by five commissioners, one of whom is appointed by the president as chair and at least two of whom must be from the party

that is out of power. The current chairs of the SEC and CFTC (Jay Clayton and Heath Tarbert, respectively) have announced their resignations, although because of the staggered nature of the commissioners, the CFTC will continue to have a 3-2 Republican majority until at least 2022 absent any unplanned resignations by one of the three Republican commissioners. On the other hand, the SEC will see a shift to Democratic control as soon as President-elect Biden nominates a successor to Jay Clayton.

With regard to the issue of ESG transparency and disclosure, by far the greater role will fall on the SEC. *The Wall Street Journal* recently noted that the "CFTC isn't expected to play as central a role as it did the last time a Democrat entered the White House,"[44] which appears plausible given that the issues concerning ESG transparency largely falls into the domain disclosures under the SEC's rules and regulations.

In addition to the tone at the top from President-elect Biden towards climate change and social justice issues, and from speeches and other reported comments from the SEC's two current Democrat-appointed Commissioners,[45] the impending appointment of a Democrat Chair at the SEC could generally be expected to auger well for enhanced climate, human capital and other ESG risk disclosures in 2021. For example, SEC Commissioners Lee and Crenshaw, expressing their personal views, believe that the SEC's current preference with principles-based disclosure requirements, while helpful, has resulted in "non-standardized, inconsistent, and incomparable disclosures," when coupled with voluntary disclosure. [46] The sentiment expressed by these two Commissioners leaves little doubt how they would vote in future rulemakings coming before the SEC on the topic of ESG transparency and disclosure.

### Investors Believe ESG Information to be Important and Material

The urge to incorporate specific ESG disclosure as material information desired and needed by investors is also supported by recent studies and recommendation coming from the government itself, one of which comes directly from a report by a subcommittee of the SEC.

The SEC Investor Advisory Committee Relating to ESG Disclosure[47] (an SEC subcommittee) asserted that after nearly 50 years of periodically considering "whether ESG disclosures are material and should be incorporated into its integrated disclosure regime for SEC registered issuers," the time has come for the SEC to address the issue in order to a) provide investors with the material, comparable and consistent information they need to make investment decisions, b) provide issuers with a framework to disclose material, decision-useful, comparable and consistent information relevant to the Issuers' businesses, rather than having investors largely rely on third-party ESG data providers, which "may not always be reliable, consistent, or necessarily material," c) level the playing field among all US Issuers regardless of market cap size or resources, d) ensure the continued flow of capital to US Issuers, and e) take control of ESG disclosure for the US capital markets before other jurisdictions impose disclosure regimes on US Issuers and investors alike.

In referencing the possible imposition on US Issuers by other jurisdictions, undoubtedly the subcommittee authors had in mind the ever-growing regulatory playbook promulgated by the EU's security regulator, the European Securities and Markets Authority ("ESMA"), as it implements the European Green Deal. The European Green Deal seeks to transform the 27-member bloc to a low-carbon economy by, among other things, promulgating a regulatory framework that includes extensive financial disclosure of ESG investment strategies, such as the regulatory initiatives set forth in more detail later in this report. Many of the recent and pending ESG financial disclosure rules will directly or indirectly impact US investors and issuers to the extent US investment managers or US corporations seek to manage or raise capital from the EU and elsewhere.

The SEC subcommittee report found that "investors consider ESG information as material to their investment and voting decisions, regardless of whether their investment mandates include an 'ESG-specific' strategy." The subcommittee further concluded that ESG information is "material to investors regardless of an Issuer's business line, model or geography, and is different for every Issuer." The subcommittee makes the case that the need for "material, comparable, consistent information" on which investors can base investment decisions is all the more pressing as evidenced by the number of investors who incorporate ESG information into their investment analysis and decision-making processes.

As discussed in an earlier SKY Harbor Sustainability column in October 2020, the Climate-Related Market Risk Subcommittee of the CFTC has likewise issued a progressive and forward-looking report that echoes, and in many ways goes further in scope and detail than, the SEC's subcommittee report.[48]

The 196-page report by the CFTC's subcommittee makes a detailed case that climate change poses a major risk to the stability of the US financial system and its ability to sustain the American economy. Similar to the SEC subcommittee report, the CFTC report notes the lack of standard, consistent and comparable data. As a reminder, among the key recommendations of the CFTC report is for the US to establish a price on carbon. Echoing the reasoning of the CLC, the CFTC subcommittee wrote that, "without an effective price on carbon, financial markets lack the most efficient incentive mechanism to price climate risks."[49] The CFTC report also recommended that FSOC — in which the CFTC is a voting member — as part of FSOC's mandate to monitor emerging risks to financial stability, should incorporate climate-related financial risks into its existing oversight function, including FSOC's annual report and other reports to Congress, which provides support for this report's prediction that FSOC may emerge as a player in the sustainability dialogue in 2021.

The general findings of the subcommittees of the SEC and CFTC have been corroborated by the US Government Accountability Office (the "GAO"), which serves as an independent nonpartisan agency that works for Congress. Often called the "congressional watchdog," the GAO's mission, among other things, is to provide Congress and the federal agencies with

objective, reliable information with the aim of helping the government to work in a cost-effective and efficient manner.[50]

The GAO recently reported to Congress (the "GAO ESG Disclosure Report") that, "Investors are increasingly asking public companies to disclose information on environmental, social, and governance (ESG) factors to help them understand risks to the company's financial performance or other issues, such as the impact of the company's business on communities."[51] The GAO found that, "[i]nstitutional investors with whom [the GAO] spoke generally agreed that ESG issues can have substantial effect on a company's long-term financial performance."[52] Foreshadowing the likelihood of continuing demands for greater corporate disclosure, the GAO ESG Disclosure Report also concluded that, "some investors and market observers have continued to express dissatisfaction with the quality and consistency of public companies' ESG disclosures." The quality and availability of ESG data is especially true of the high yield corporate universe, a problem exacerbated by the significant proportion of high yield private company issuers not subject to periodic SEC filings.

The SEC, however, has not been entirely unresponsive to investor demands for greater transparency as evidenced by the recent change in the rule regarding human capital.

### SEC Responds to Some Investor Demands for Human Capital Disclosure

The SEC often begins the rulemaking process with an exploratory "Concept Release," which provides background and solicits public comment. In 2016 the SEC issued a Concept Release revisiting the business and disclosure requirements in Regulation S-K and requested public comment on whether the Regulation is providing the information that investors need and whether any of the rules have become outdated or unnecessary. In response, a group of institutional investors under the banner of the Human Capital Management Coalition petitioned the SEC to adopt new rules, or amend existing rules, to require registrants to disclose information about their human capital management policies, practices, and performance. The rulemaking petition generated a substantial number of comments in support of increased disclosure of human capital management policies and specific human capital metrics.[53]

The investor-led efforts culminated in the final adoption of the rule modernizing Regulation S-K, which among other things, now requires on Form S-K, Item 101 (c), "to the extent such disclosure is material to an understanding of the registrant's business taken as a whole, a description of a registrant's human capital resources, including any human capital measures or objectives that the registrant focuses on in managing the business." In making the final rule, the SEC stated that it believes "that, in many cases, human capital disclosure is important for investors," and as a material resource for many companies it is "in varying ways, an important driver of performance."[54] The successful petition by institutional investors in the Human Capital Management Coalition in bringing about meaningful change in SEC disclosure

regulations is a testament to the influence that investors can have in continuing to press the SEC and other regulators to compel companies to create and disclose the kind of material, comparable, consistent information as recommended by the SEC's Investor Advisory Committee Relating to ESG Disclosure.

Notably, the SEC chose not to define "human capital," in the update to Rule S-K despite recommendations to do by some commenters, explaining that "this term may evolve over time and may be defined by different companies in ways that are industry specific." [55]The decision to not shoehorn a definition of human capital may be a manifestation of the SEC's preference to avoid a one-size-fits all disclosure rule, particularly with respect to any fact deemed "material," whether it be human capital resources or other sustainability factor.

## Materiality Matters in Matters of Disclosure

Clamoring for coordinated regulatory responses to sustainability transparency and disclosure often boils down to the question of what standardized ESG reporting frameworks, if any, should be mandated for public companies in lieu of the current principles-based voluntary framework. Progress in this regard may hinge on the meaning of "materiality," which is a key element in the US federal securities laws. Its interpretation by the courts is hugely important to the corporate community concerned over litigation risk. Defining materiality may be the one impediment to a consensus on standardized and mandatory ESG disclosure by public companies.

Given the prospect of a Democratic majority at the SEC and the sentiment expressed by the current Democratic Commissioners, the prospect of significant progress in establishing standardized, reliable, consistent and comparable ESG information — backed by data — should reasonably be expected in 2021. While such an expectation may be supported by bounded rationality, a closer look at some of the complexities of the federal securities laws suggests otherwise. The path to standardized, reliable, consistent, and comparable ESG data may take much longer than one would expect because of the complexities — and uncertainties — of the US federal securities laws and how they are administered by the courts, particularly with respect to the legal meaning of "materiality."

At the heart of the US securities regulatory regime is the notion of disclosure rather than merit review. In 1933, Congress considered three different models of securities regulation that were then used by states in their blue sky laws:[56]

- The merit model, in which regulators review a proposed securities offering and judge whether the offering's provisions were "unfair, unjust, inequitable or oppressive," and whether it offered in the regulator's view "a fair return."
- The fraud model, which prohibits fraud in the sale of securities, with civil and criminal penalties imposed for committing fraud.

- The disclosure model, which allows issuers to sell very risky or even unsound securities, so long as they gave buyers enough information to make an informed investment decision.

In adopting the US federal securities laws nearly 90 years ago, Congress opted for a mix of the fraud and disclosure models. The disclosure model in turn relies on disclosing material information on which investors can base their decision whether or not to invest in a particular stock, bond or an interest in a citrus grove.[57] The notion of whether ESG and especially climate-related information is material to investor decision-making is a core issue of whether the SEC can or will issue further standardized ESG disclosure obligations on public companies, and if so, what the limits of those obligations will look like.

The US federal securities laws, primarily (but by no means exclusively) the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act, and the Investment Company Act of 1940, and the rules and regulations promulgated thereunder, require companies and entities subject to these statutes to provide certain information to investors and the public, and as mentioned, will impose civil and criminal penalties for misleading investors. In some cases, the law provides for private rights of action, meaning companies can be sued by private investors (whether by individuals or legal entities) "if they purchased or sold a security in reliance on a misrepresentation or omission — that was *material* and made with the intent to deceive and caused an economic loss — and the SEC has enforcement powers for violations of securities law obligations." (emphasis added).[58] Given the risk of civil and criminal liability for getting it wrong, the key question for anyone responsible for public company disclosure is at what point does sustainability information cross the materiality threshold for purposes of the US federal securities laws?

## What Is Material?

It may be surprising to advocates of ESG transparency and disclosure that the federal securities laws do not define "materiality" despite the frequency and seemingly ubiquitous use of the word sprinkled throughout the statutes, rules and regulations.[59] The SEC, however, defines the term based on a landmark 1976 Supreme Court case *TSC Industries v. Northway*, which found that omitted information is material when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[60] Every serious investor has probably come across this definition in one form or another. The key questions in this formulation are what or who is the "reasonable investor," what circumstances constitute a "substantial likelihood" and what is the meaning of the "total mix" of information? A decade after the *TSC Industries* case, the Supreme Court affirmed it and clarified this definition by noting "materiality depends on the significance the reasonable investor would place on the withheld or mispresented information."[61] One would not be alone in concluding that the court-defined materiality standard might be difficult to apply *ex ante* when deciding what and the

extent to which certain sustainability information and data should be publicly disclosed in the face of potential civil and criminal sanctions under the aforementioned materiality standard.

As one writer describes it, the SEC's definition of materiality "simply restates the [Supreme] Court's standard without providing additional insight into its interpretation, thus the 'inattention of Congress, the SEC, and the FASB [the Financial Accounting Standards Board] has left elaboration of materiality to the judiciary."[62] In short, because determining in a contested case whether information is material requires a case-specific review of the unique facts and circumstances, there is no bright-line rule to apply.[63] The result of all this is unsurprisingly, a high degree of uncertainty for companies faced with increasing pressure to release sustainability information backed by data.

### What Is a Reasonable Investor?

Compounding the uncertainty is the question of what is a reasonable investor with respect to ESG information? As generations of law students have been taught, what is "reasonable" is whatever the jury thinks it is.[64]

Based on recent studies, some of which have been cited here, investors' persistent demand for sustainability information and their professed claims that this information is important and even material to their decision-making may mean the courts will begin to view ESG information as financially material to the reasonable investor. But that determination may not be as straight-forward as some advocates of greater sustainability disclosure may believe. The GAO July 2020 report to Congress found that, "some institutional investors, companies, and market observers noted that it was too early to prescribe standards for ESG disclosures, because there is not consensus among companies, investors, and market observers on which ESG issues should be disclosed," adding that, the "marketplace should be given time to resolve these issues, according to these market participants and observers."[65]

### No Quick Fix to Standardized, Reliable, Consistent and Comparable ESG Data

Despite the excitement and expectation that the incoming administration will likely see significant progress in creating reliable, standardized, consistent and comparable ESG-related information backed by data, the prospect that companies will agree and comply without some form of certainty concerning liability appears unlikely. This is also borne out by the GAO ESG Disclosure Report, which found that most companies in their study "noted that legal and regulatory requirements were their primary consideration when determining which ESG factors to disclose."[66] As noted, the topic is enormously complex and fraught with significant uncertainty concerning legal liability, which explains the general reluctance by public companies to disclose subjectively defined ESG information. As a result any progress by the SEC to issue standardized sustainable disclosure in the near future is unlikely, leaving it for now to the courts to set the first guardrails for how to consider climate-related information, increasing the importance of how courts' understanding of the definition of materiality could apply to

climate-related information.[67] Because cases take time to wind their way through an independent judiciary, this may be one area of sustainability not immediately susceptible to being shaped by the incoming administration.

While the foregoing concerns may impede progress in climate-related reporting by US companies, global efforts to encourage ESG transparency and disclosure standards, especially with respect to climate-related data, will continue unabated in 2021 particularly in Europe, although other countries will also see increasing agitation for more and better disclosure. For example, Reuters reported last month that Canada's eight largest pension funds joined the global effort to improve corporate sustainability reporting by urging their investment partners to report ESG data in a standardized way by using SASB and TCFD disclosure frameworks.[68]

## V. Sustainability Reporting: A Fecundity of Frameworks

### How Many Is Too Many?

One of the fastest-growing cottage industries during the past few years has to be sustainability frameworks: an alphabet soup of contributors colors the sustainability disclosure landscape. For instance, the SEC Advisory subcommittee report referenced above cites a study that found, as of 2016, there were more than 125 ESG data providers. Among the many contenders, a handful have been emerging as possible standard-bearers in this field.

The GAO ESG Disclosure Report identified the following half dozen leading ESG Standard-setting organizations in its report, the oldest being the Global Reporting Initiative ("GRI"), which is an international nonprofit organization that was established in 1997. The GAO, citing the GRI, notes that 82 percent of the world's 250 largest companies report on ESG topics using GRI standards.[69] The United Nations Global Compact, established in 2000, encourages participating companies to incorporate the Compact's 10 principles on human rights, labor, the environment, and anti-corruption. In a trend of increasing frequency, frameworks have been merging, partnering, or collaborating. In 2017 for example, the Compact partnered with GRI to produce a guide that uses GRI standards to guide companies in disclosing their compliance with the 10 principles.

More climate-change focused frameworks include CDP Global (previously known as the Carbon Disclosure Project), which was established in 2000. The CDP scores organizations on environmental risks related to climate change, water security and deforestation. The GAO reported that the CDP scores companies as well as public entities, including cities, states, and regions, via questionnaire. Also focused on climate is the Task Force on Climate-related Financial Disclosures ("TCFD"), which was established by the Financial Stability Board in 2015 to make recommendations for improving principles and practices for voluntary climate change disclosure. The TCFD released its climate-related disclosure framework in 2017 and has seen increasing acceptance by companies and investors alike.

The International Integrated Reporting Council ("IIRC") is yet another international nonprofit set up in 2010. The IIRC encourages companies to integrate their financial and sustainability disclosures using an IIRC process although according to the GAO, the IIRC does not provide standards for ESG disclosures.

The GAO report also cited the Sustainability Accounting Standards Board ("SASB"), a nonprofit organization established in 2011 that has developed a voluntary reporting framework comprising industry-specific sustainability accounting standards for 77 industries with the primary focus on identifying within those industries ESG information that may have a materially financial impact on an industry or company. It is not always clear, however, whether SASB's definition of "material" is necessarily equivalent or applies in the same way as interpreted by the *TSC v. Northway's* version of materiality as discussed above.

### More Consolidation Ahead for ESG Reporting Frameworks

At the end of November 2020, the IIRC and SASB announced their plan to merge into a single organization to be named the Value Reporting Foundation with the proclaimed goal of working toward a comprehensive reporting framework demanded by investors and companies. According to its announcement, the merger will not result in disbanding the SASB, which will continue its mission of setting standards designed primarily for providers of capital and focus on ESG information that is financially material and relevant to enterprise value creation.

The merger of IIRC and SASB may be the culmination of the Statement of Intent to Work Together Towards Comprehensive Corporate Reporting, released in September 2020, which is essentially a pledge by the CDP, GRI, SASB, IIRC and the Climate Disclosure Standards Board ("CDSB").

With so many frameworks vying for attention in recent years, further consolidation in the months ahead appears likely. It may be apparent that the various reporting frameworks themselves recognize the danger of framework fatigue and the possible confusion generated by the plethora of multiple and overlapping reporting frameworks all purportedly in pursuit of similar goals. Increasing support such as the recent call by the Canadian pension funds mentioned above, however, appears to favor the SASB and TCFD as the frameworks of choice. BlackRock CEO Larry Fink, who has been instrumental in moving the topic of climate action to center stage among the corporate community, has also stated his support for companies to disclose information in accordance with the SASB and TCFD frameworks.[70] Regardless of the degree of further consolidation, it seems that the SASB and TCFD will survive in one form or another for the foreseeable future.

# VI. Corporate Governance and the Board

## Directors: No Time to be Bored with ESG

The National Association of Corporate Directors ("NACD") issued a report in September 2020, concluding that, "[b]oards are not strongly concerned about the impact of climate change on their businesses in the short term" and finding that only 13% of directors ranked climate change among their top-five risks.[71]

The proclaimed focus on climate change and social justice issues by the incoming Biden-Harris administration coupled with pressure from the progressive wing of the Democratic Party suggests that public corporations will be under increasing scrutiny for the next four years. Boards of directors will be well advised to monitor their companies' exposure to ESG issues that may have in the past been viewed as a fringe topic or limited solely to the domain of a small group of thematic investors. Hardly a day goes by without an article or a thought leadership piece being published on some aspect of ESG risks and opportunities. Sharing the focus this year with the pandemic, civil unrest and the economic fallout, it is difficult to deny that ESG has also become a mainstream and a main street concern encompassing both values-driven investors (motivated primarily by moral values) and value-driven investors (motivated primarily by investment returns).

Historians may look back at the decade of the 2020s as the coming of age of sustainability and stakeholder primacy. A Venn diagram of where values and value investors share the same space may render unexpected common ground. Directors of public companies would be well advised to learn from the experience of Rio Tinto, the world's second largest listed mining company by market value. The Australian company's ADR shares trade on the NYSE (ticker RIO). The Company's CEO and two other senior executives (one with responsibility for indigenous affairs) resigned under pressure from shareholders over the company's decision to destroy a 46,000-year-old Aboriginal site in Western Australia earlier in 2020 in order to expand an iron ore mine. As reported by the *Wall Street Journal*, "Rio Tinto's troubles show how environmental and cultural issues have taken center stage in an industry that is fighting to change investors' perceptions that mining is problematic."[72] When coupled with lessons from the pandemic (i.e., safety of employees, customers, suppliers, and the communities in which they serve), the experience of Rio Tinto should be a wake-up call for directors of public companies to be sensitive to the expanding constituencies comprising a company's stakeholders.

While Rio Tinto may seem far afield for a director of a US public company, closer to home, directors of Delaware-incorporated public companies may need to be reminded of their duty of oversight under the 1996 landmark Delaware case by the Delaware Chancery Court in *In re Caremark Int'l Inc. Deriv. Litig.*[73]

## ESG and Caremark Liability

Generally, under Delaware corporate law (the state of choice for a vast proportion of American corporations for purposes of incorporation), Directors are shielded from personal liability while making decisions that they believe in good faith are for the benefit of the corporation even if in hindsight the decision appears to have been viewed as poor judgment resulting in some form of harm or loss to the corporation. The provision is part of a corporation's certificate of incorporation and operates to eliminate or limit "the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director."[74] The protection, however, is not without its limits and will not shield a director from personal liability for, among other things, "any breach of the director's duty of loyalty to the corporation or its stockholders; for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."[75] This is where the *Caremark* case comes in.

The *Caremark* case was an attempt to hold directors personally liable for a failure of oversight. The opinion ultimately held the directors not liable but in rendering that judgment, Delaware Chancellor William Allen clarified that directors must be reasonably informed by "assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope to reach informed judgments concerning both the corporation's compliance with law and its business performance."[76] Chancellor Allen opined that the failure to assure in good faith that adequate information and reporting systems exist under some circumstances "may, in theory at least, render a director liable for losses caused by non-compliance with adequate legal standards."[77]

The *Caremark* case and its progeny stand for the proposition that directors must exercise their oversight responsibilities to ensure that reasonably adequate information and compliance systems are in place or risk breaching the duty of loyalty, which will expose directors to personal liability irrespective of any exculpation clause in the corporation's charter.

Over the years, the *Caremark* case has had enormous influence in encouraging focused attention on corporate compliance programs and is the basis of perennial training sessions by leading corporate counsel designed to educate and remind directors of their fiduciary duties of oversight. While *Caremark* claims are notoriously difficult to win and rarely result in legal liability being imposed on director defendants, recent *Caremark* decisions by Delaware courts suggesting otherwise have brought renewed attention to directors' oversight duties [78] and the potential for personal liability.

Pressured by constituents for increasing degrees of voluntary ESG disclosures coupled with the prospect of mandatory disclosures imposed by regulation — if not in the US then certainly in other jurisdictions such as the EU — directors may soon find themselves with greater litigation and compliance risk implicating their duty of oversight under *Caremark*.

As one leading Wall Street law firm noted, with the "growing momentum toward the development of common framework for ESG disclosure, companies should evaluate the potential litigation and regulatory risks of proposed metrics and how they would adapt to a regime in which such metrics became a widely accepted standard."[79] Accordingly, directors would be well advised to pay attention to ESG developments even if they do not believe many ESG factors are relevant or financially material to their company's products, services or processes. The recently proposed mandatory reporting of board diversity by Nasdaq is an example of how the trend toward greater ESG transparency and disclosure can have significant impact common to all listed public companies.

### Nasdaq's "Comply or Explain" Diversity Disclosure Rule

Following the lead set by California in legally mandating both gender and racial diversity on the boards of public corporations headquartered in that state, on December 4, 2020 Nasdaq filed with the SEC[80] a proposed series of rule changes including a new Rule 5605 (f)- Diverse Board Representation that would require Nasdaq-listed companies, subject to certain exceptions, "(A) to have at least one director who self-identifies as a female, and (B) to have at least one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or as LBGTQ+, or (C) to explain why the company does not have at least two directors on its board who self-identify in the categories listed above." The filing also proposes to adopt a new Rule 5606 requiring Nasdaq-listed companies, subject to certain exceptions, to provide statistical information in a proposed uniform format related to a director's self-identified gender, race, and self-identification as LGBTQ+. The two proposed rules if approved by the SEC will be promulgated in the 5600 series in the Nasdaq Rulebook under the heading of Corporate Governance Requirements for Nasdaq-listed companies.

The proposed rule harkens to the EU's recent regulations, which subject companies in scope with EU regulations to either comply with disclosures regarding integrating ESG factors in the investment process and to describe the "principal adverse impacts" of their activities on the environment or in the absence of compliance to explain why the subject entities are not compliant. The Nasdaq rule changes also include an update to the rule pertaining to Foreign Private Issuers (Rule 5615) subjecting these issuers to the proposed new rules. The current rules permit a Foreign Private Issuer to follow home country practices in lieu of the requirements set forth in the Rule 5600 series, subject to several exclusions. Nasdaq's proposal revises current rules, so that Foreign Private Issuers must satisfy the proposed Diversity disclosure rules and may not fall back on home country practices in lieu of the proposed requirements. However, the comply or explain provisions permit Foreign Private Issuers that elect to follow an alternative diversity objective in accordance with home country practices, or are located in jurisdictions that restrict the collection of personal data, may satisfy the requirements of the proposed new rules by explaining their reasons for doing so instead of meeting the diversity objectives of the proposed rules.[81]

The Nasdaq filing explains that the purpose of the proposed rule is to encourage diversity in the boardroom because "[t]he benefits to stakeholders of increased diversity are becoming more apparent and include an increased variety of fresh perspectives, improved decision making and oversight, and strengthened internal controls." In providing a basis for the proposed rule change, Nasdaq cites extensive third-party studies in addition to its own research (including in-person interviews) that found a positive correlation exists between improved corporate governance and board diversity, particularly with respect to board membership of women. The studies show that improved corporate governance often translated to positive financial outcomes (including fewer cases of fraud, financial manipulation, or restatements of audited results). Nasdaq believes that the recent focus on board diversity from a number of stakeholders including investors and governance organizations "demonstrates that investor confidence is enhanced when boardrooms are comprised of more than one demographic group," noting that current disclosure of board diversity is either inconsistent or not provided on a sufficiently widespread basis. Because Nasdaq concludes that investors are unable to readily compare board statistics across companies, it is proposing the new Rule 5606 cited above, which will mandate Nasdaq-listed companies to provide diversity statistical information in a standardized Board Diversity Matrix. An example of the template is included in the Federal Register release.

The proposal provides a transition period up to two years after the SEC approves the rule change to comply or explain. The SEC has 45 days from the date the proposal is published in the Federal Register to approve, reject, or extend the approval period. The 45-day period ends on January 25, 2021, at which time it is highly likely that President-elect Biden will have nominated a new Chair to replace Chair Jay Clayton, who announced his resignation on December 23. In the meantime, the SEC has invited public comment on the proposed rule changes.

Nasdaq is a member of Sustainable Stock Exchanges Initiative ("SSE"), a United Nations Partnership Program organized by UNCTAD, the UN Global Compact, UNEP FI, and the PRI. SSE's mission statement is "to provide a global platform for exploring how exchanges, in collaboration with investors, companies (issuers), regulators, policymakers and relevant international organizations, can enhance performance on ESG (environmental, social and corporate governance) issues and encourage sustainable investment, including the financing of the UN Sustainable Development Goals."[82] SSE's members include 98 exchanges around the world including most major European and Asian stock exchanges. Both Nasdaq and NYSE are among the 98 exchange members. Should the SEC approve Nasdaq's proposed rule change, the NYSE, which is about twice as large as Nasdaq in market capitalization, may be compelled to consider following suit.

### Investment Company Institute Joins Chorus for Enhanced ESG Disclosure

Within days of Nasdaq's announcement of its proposed corporate governance rule changes, the governing board of the Investment Company Institute ("ICI") unanimously approved a statement encouraging US public companies to provide enhanced reporting on ESG factors and to do so within the TCFD and SASB reporting frameworks.[83]

The ICI is an influential association representing regulated funds including US-registered mutual funds, ETFs, closed-end funds, and unit investment trusts and similar funds offered worldwide. According to ICI's website, ICI members manage total assets of $25.8 trillion in the US, serving more than 100 million US shareholders, as well as $8.3 trillion in assets in other jurisdictions.

## Endnotes

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[1] SKY Harbor Global Funds is a Luxembourg mutual fund (not open to US investors) established in accordance with the Undertakings in Collective Investment in Transferable Securities ("UCITS") and regulated by the *Commission de Surveillance du Secteur Financier* ("CSSF"). See www.skyharborglobalfunds.com for additional information.

[2] An executive order is a signed, written, and published directive from the President of the United States that manages operations of the federal government, and like regulations issued by federal agencies, executive orders have the force of law. Executive orders are not, however, legislation and do not require Congressional approval; nor can Congress simply overturn them. Congress can, however, pass legislation that might make it difficult or impossible to carry out an executive order such as removing necessary funding. Only a sitting US President can overturn an existing executive order by issuing another executive order to that effect. See *What Is an Executive Order?* Available at: https://www.americanbar.org/groups/public_education/publications/teaching-legal-docs/what-is-an-executive-order-/.

[3] Nadja Popovich, Livia Albeck-Ripka and Kendra Pierre-Louis, *The Trump Administration Is Reversing More Than 100 Environmental Rules. Here's the Full List.*, New York Times online, updated November 10, 2020, available at: https://www.nytimes.com/interactive/2020/climate/trump-environment-rollbacks-list.html.

[4] Rick Gladstone, *Feeling Spurned by Trump, U.N. Sees Redemption in Biden and Team*, N.Y. Times online, December 3, 2020, available at: https://www.nytimes.com/2020/12/03/world/americas/feeling-spurned-by-trump-un-sees-redemption-in-biden-and-team.html (also reporting that the president-elect will reverse Mr. Trump's widely criticized decision to withdraw from the World Health Organization, the U.N.'s public health arm.)

[5] See *Powell and Mnuchin split on risks to the economy in Senate testimony*, December 1, 2020 updated December 14, 2020, (reporting recent testimony before the Senate Banking Committee, reveal that cooperation between the two economic policy makers has shown signs of cracking since the start of the current pandemic). Available at: https://www.nytimes.com/live/2020/12/01/business/us-economy-coronavirus#powell-and-mnuchin-split-on-risks-to-the-economy-in-senate-testimony.

[6] Ann Saphir, *Fed moves closer to joining global peers in climate-change fight*, November 13, 2020, Reuters online (reporting Fed Chair Powell's remarks on recognizing climate change as a risk to the US financial system; Fed's intent to join the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and has been attending NGFS meetings; and the fact the Fed is the only major global central bank besides the Reserve Bank of India that is not a member of the NGFS). Available at: https://www.reuters.com/article/us-climate-change-fed/fed-moves-closer-to-joining-global-peers-in-climate-change-fight-idUSKBN27T2RB.

[7] See *U.S. Climate Alliance States Outpace Nation in Clean Energy Job Creation While Pushing to Achieve Goals of Paris Agreement*, Press Release dated December 10, 2020 available at: http://www.usclimatealliance.org/publications/2020/12/10/us-climate-alliance-states-outpace-nation-in-clean-energy-job-creation-while-pushing-to-achieve-goals-of-paris-agreement.

[8] Carol Davenport and Hiroko Tabuchi, *White House Pressed Car Makers to Join Its Fight Over California Emissions Rules*, NY Times Online, October 30, 2019, available at: https://www.nytimes.com/2019/10/30/climate/general-motors-toyota-emissions-white-house.html.

[9] Business Roundtable, *Addressing Climate Change Principles and Policies*, September 2020, available at: https://s3.amazonaws.com/brt.org/Business-RoundtableAddressingClimateChangeReport.September2020.pdf.

[10] Id. at 1.

[11] Zack Coleman, *Business Roundtable endorses market-based climate policy,"* Politico, September 15,2020, available at: https://www.politico.com/news/2020/09/15/business-roundtable-endorse-market-based-climate-policy-415804.

[12] Id.

[13] Caleb N. Griffen, *Environmental and Social Voting at the Big Three*, The Colombia Law School Blue Sky Blog, June 16, 2020 (questioning whether statements of support for Environmental and Social initiatives translate into meaningful changes in voting outcomes or are largely self-promotional puffery?), available at: https://clsbluesky.law.columbia.edu/2020/06/16/environmental-and-social-voting-at-the-big-three/. See also, Jackie Cook, Tom Lauricella, *How Big Fund Families Voted on Climate Change: 2020 Edition*, September 28, 2020, Morningstar Commentary (finding that Vanguard, State Street, and Fidelity increased support for shareholder resolutions aimed at tackling climate change, while BlackRock voted "no" more than 80% of the time), available at: https://www.morningstar.com/articles/1002749/how-big-fund-families-voted-on-climate-change-2020-edition.

[14] Zachary Warmbrodt, *Wall Street braces for climate change scrutiny under Biden: A Biden win would expose banks to intense scrutiny.*, November 20, 2020, Politico (reporting that banks are accelerating efforts to get ahead of the climate change issue and make clear to President-elect Biden's team that they want a place at the table when decisions are made). Available at: https://www.politico.com/news/2020/11/09/wall-street-braces-for-climate-change-scrutiny-under-biden-435539.

[15] Id.

[16] Katherine Rosman, *CrossFit Gym C.E.O. Greg Glassman Steps Down in Chaos*, published June 9, 2020 and updated June 24, 2020, online New York Times (reporting that Greg Glassman, who started a fitness movement that's grown for decades, spun CrossFit into a disaster in just days after posting a tweet that made light of both the coronavirus pandemic and the killing of George Floyd in police custody), available at: CrossFit Gyms Founder Resigns Amid Black Lives Matter Furor - The New York Times (nytimes.com).

[17] Infra note 54.

[18] See Zachary Warmbrodt, *Republicans warn Powell about Fed plans for climate* regulation, December 10, 2020, www.Politico.com. Available at https://www.politico.com/news/2020/12/10/republicans-federal-reserve-climate-regulation-444194, with a link to the letter at: https://www.politico.com/f/?id=00000176-4cfb-d52c-ad7e-dcff3d220000.

[19] See https://www.ngfs.net/en.

[20] Supra note 5.

[21] See Article 2 clause 1 of the Paris Agreement.

[22] See, *What is the Green Deal?*, Politico, October 2020 (explaining the basics of the European Green Deal, "one of the most consequential legislative efforts in the history of the European Union"), available at: What is the Green Deal? – POLITICO.

[23] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, available at: EUR-Lex - 32019R2088 - EN - EUR-Lex (europa.eu).

[24] Id. at Recital (5).

[25] Id. at Article 8.

[26] Id. at Article 9.

[27] Id. at Recital (12).

[28] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, amending Regulation (EU) 2019/2088, available at: EUR-Lex - 32020R0852 - EN - EUR-Lex (europa.eu).

[29] Id. at Articles 3 and 9.

[30] Id. at Article 3.

[31] Siobhan Riding, *Big Investors Push UK to go further on green finance,* Financial Times, November 15, 2020, available at: https://www.ft.com/content/cff58c77-ed90-49ff-bd1f-94b69d00d054.

[32] Juliet Eilperin and Annie Linskey, *How Biden aims to amp up the government's fight against climate change*, The Washington Post, November 11, 2020, available at: Joe Biden is poised to embed climate action throughout the federal government - The Washington Post.

[33] See Climate 21 Project, available at: The Climate21 Project.

[34] Id.

[35] *Summary Report Transition Recommendations for Climate Governance and Action*, November 2020, available at Summary - Climate 21.

[36] Id. at 20.

[37] Id. at 10.

[38] Id. at 18.

[39] Id at 26.

[40] Amy Harder, *Joe Biden unlikely to push carbon tax as part of climate change plan*, AXIOS, August 20, 2020, available at: Exclusive: Joe Biden unlikely to push carbon tax as part of climate change plan - Axios.

[41] See Climate Leadership Council (clcouncil.org).

[42] Matthew Green, *U.S. could adopt carbon tax under a Biden presidency, ex-Fed Chair Yellen says,* Reuters, October 8. 2020, available at: U.S. could adopt carbon tax under a Biden presidency, ex-Fed Chair Yellen says | Reuters.

[43] Id. (quoted during an interview with Reuters).

Paul Kiernan, *CFTC Chairman Heath Tarbert to Resign, Remain at the Derivatives Regulator,* December 10, 2020, online Wall Street Journal (subs. req'd), available at: CFTC Chairman Heath Tarbert to Resign, Remain at the Derivatives Regulator - WSJ.

[45] See *Joint Statement by Commissioners Lee and Crenshaw on Amendments to Regulation S-K*, November 21, 2020, Harvard Law School Forum on Corporate Governance (criticizing that the recent rule change while a step in the right direction, nevertheless, "fails completely to address climate risk, similar to other recent modernization rulemakings that have failed to deal adequately with this and other critical factors that impact an issuer's long-term sustainability, such as human capital management," and calling for the SEC to establish an internal task force and ESG Advisory Committee "to address climate, human capital and other ESG risks in a comprehensive fashion with new rulemaking specific to these topics"), available at: Joint Statement by Commissioners Lee and Crenshaw on Amendments to Regulation S-K (harvard.edu).

[46] Id.

[47] See *Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (As of May 14, 2020),* available at: Managing Climate Risk in the U.S. Financial System (cftc.gov).

[48] See CFTC's subcommittee report entitled *Managing Climate Risk in the US Financial System*, September 9, 2020, available through link at: CFTC's Climate-Related Market Risk Subcommittee Releases Report | CFTC.

[49] Id. at 4 (section of the CFTC report entitled "The Centrality of Carbon Pricing" and citing British economist Lord Nicholas Stern who called climate change "the greatest and widest-ranging market failure the world has ever seen.").

[50] See U.S. GAO - About GAO - Overview.

[51] See GAO 20-530, *Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, published July 2, 2020 and released on July 6, 2020. Available at: https://www.gao.gov/products/GAO-20-530. Hereinafter the "GAO ESG Disclosure Report."

[52] Id. at 9 (notes that "institutional investors include public and private entities that pool funds on behalf of others and invest the funds in securities and other investment assets. We interviewed 14 institutional investors: four large private-sector asset management firms (each with more than $1 trillion in worldwide assets under management), three private-sector mid-sized asset management firms (each with from $500 billion to $1 trillion in worldwide assets under management), three large public pension funds (each with more than $100 billion in total assets), and four mid-sized public pension funds (each with from $40 billion to $100 billion in total assets). Other types of institutional investors include private or nonprofit organizations such as labor organizations, foundations, and faith-based investors)."

[53] See SEC Release Nos. 33-10825; 34-89670; File No. S7-11-19, *Modernization of Regulation S-K Items 101, 103, and 105*, Federal Register Vol. 85, No. 196, October 8, 2020, at 63726, 63737.

[54] Id. at 63739.

[55] Id.

[56] Prof. Stephen Bainbridge, *Federal merit review of securities offerings? No thanks!,* April 22, 2012, ProfessorBainbridge.com blog available at: https://www.professorbainbridge.com/professorbainbridgecom/2012/04/federal-merit-review-of-securities-offerings-no-thanks.html?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+professorbainbridge%2FsheN+%28ProfessorBainbridge.com+%C2%AE%29.

[57] See SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (a landmark US Supreme Court case that defines "security" broadly as a contract, transaction or scheme whereby a person (i) invests money (ii) in a common enterprise and (iii) is led to expect profits (iv) solely from the efforts of the promoter or a third party in a case arising from the promotion of small lots of fruit trees where the offeror also offered a " management" contract by which an affiliate of the issuer would pick and market the fruit with the profit inuring to the investor). See §1:50 Treatise of the Law of Securities Regulation, Seventh Edition, Thomas Lee Hazen.

[58] See Hana V. Vizcarra, *Climate-Related Disclosure and Litigation Risk in the Oil & Gas Industry: Will State Attorneys General Investigations Impede the Drive for More Expansive Disclosures?*, 43 Vermont Law Review 733, June 26, 2019, at 747, available at: Climate-Related Disclosure and Litigation Risk in the Oil & Gas Industry: Will State Attorneys General Investigations Impede the Drive for More Expansive Disclosures? by Hana Vizcarra :: SSRN.

[59] Id. at 750.

[60] Id. citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

[61] Id. at 750-51 citing *Basic, Inc. v. Levinson*, 485 U.S. 224, 249 (1988).

[62] Id. at 751 citing Kurt S. Schulzke & Gerlinde Berger-Walliser, *Toward a Unified Theory of Materiality in Securities Law,* 56 COLUM. J. TRANSNAT' LL. 6, 16 (2017).

[63] Supra note 44 at 751.

[64] See also supra note 43 at 752 citing FN 107, *United States v. Sayre,* 434 Fed. App'x 622, 624 (9th Cir. 2011) (reasoning "the term 'reasonable investor' is a concept within a jury's ordinary experience and understanding,' that does not need to be defined).

[65] Supra note 36 at 44.

[66] Id. at 17.

[67] Hana V. Vizcarra, *The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures*, Environmental Law Reporter, at 50 ELR 10106-101007, February 2020, (writing that, "how a court applies the current definition of materiality to new types of information will determine how effectively climate-related information is integrated into mainstream investing," and "to properly account for climate change risk and opportunity in the market as a whole and not have it relegated solely to the concerns of impact investors, we must understand when and how it is financially material under the current legal construct"), available at: The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures | Environmental Law Reporter (elr.info).

[68] Mayla Keidan, *Canada pension funds with combined $1.2 trillion under management ask companies to standardize ESG reporting,* Reuters, November 25, 2020, available at: Canada pension funds with combined $1.2 trillion under management ask companies to standardize ESG reporting | Reuters.

[69] See supra note 36, Table 2 at p.6.

[70] Attracta Mooney and Billy Nauman, *Larry Fink rules on the best global standards for climate risk reporting; (*reporting that BlackRock backs two sustainability accounting standards in warning to companies — SASB and TCFD*)*, Financial Times, January 20, 2020, available at: https://www.ft.com/content/fc51227b-9d64-4e5a-b1e2-f6c07f4caa58. (subs. req'd).

[71] See *Climate Change Is an Enterprise Risk Multiplier*, September 15, 2020, available at: NACD BoardTalk | Climate Change Is an Enterprise Risk Multiplier (nacdonline.org). See also, Mark Olsen, *Corporate Boards Get Wake-up Call on Climate Change*, September 15, 2020, Securities Mosaic Blogwatch, available at: https://www.lexissecuritiesmosaic.com/net/Blogwatch/Blogwatch.aspx?ID=37213.

[72] David Winning, *Rio Tinto CEO to Step Down Amid Fallout Over Destruction of Ancient Rock Shelters*, Wall Street Journal Online, September 10, 2020 (reporting that investors had pushed for senior leaders to be held accountable for destruction of caves at Australia's Juukan Gorge in May), available at: Rio Tinto CEO to Step Down Amid Fallout Over Destruction of Ancient Rock Shelters - WSJ. (subs. req'd).

[73] 698 A.2d 959 (Del. Ch. 1996).

[74] Delaware General Corporate Code Section 102(b)(7).

[75] Id.

[76] Supra note 58 at 970.

[77] Id.

[78] See Leo E. Strine, Jr., Kirby M. Smith, and Reilly S. Steel, *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy,* Harvard Law School Discussion Paper No. 1037, July 2020, at 13 (citing recent *Caremark* decisions denying defendants' motion to dismiss that have resulted in renewed attention to directors' oversight obligations and proposing integrating ESG or EESG — the extra "e" for employees — and compliance functions for more effective promotion and measurement of EESG goals and legal compliance), available at: Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy by Leo Strine, Kirby Smith, Reilly Steel :: SSRN.

[79] Wachtell, Lipton, Rosen & Katz Memo, *ESG Disclosures and Litigation Risk*¸ February 19, 2020, available at: ESG Disclosures and Litigation Risk (wlrk.com).

[80] See SEC release No. 34-90574; File No. SR-Nasdaq-2020-081, *Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity*, published in the Federal Register Vol. 85, No. 239 at 80472 on Friday, December 11, 2020.

[81] Id. at 80489.

[82] See About | Sustainable Stock Exchanges (sseinitiative.org).

[83] See https://www.ici.org/pressroom/news/20_news_esg.

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