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Connecting Climate Change and the Law

Cadwalader Climate

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In this week's edition, we look at a Brazilian enforcement action relating to illegal deforestation in the Amazon. We also discuss ESMA's opinion on the functioning of the Sustainable Finance Framework, as well as proposed amendments to California's climate disclosure laws.

Brazilian Rancher Ordered to Pay USD 50 Million for Amazon Destruction

In a landmark ruling handed down on July 18, 2024, a Brazilian court ordered a prominent rancher to pay USD 50 million in damages for environmental destruction in the Amazon rainforest. The decision marks one of the most significant penalties imposed for illegal deforestation in the region, underscoring the growing pressure, both domestic and international, to protect the world's largest tropical rainforest.

The rancher, Dirceu Kruger, was found guilty of orchestrating extensive illegal logging and land clearing activities, eliminating thousands of hectares of rainforest. The case highlighted that such large-scale deforestation led to a significant loss of biodiversity and also contributed to increased carbon emissions, exacerbating global climate change.

Kruger was investigated over the course of several years, with environmental groups and government agencies collaborating to gather evidence of the environmental damage. The case was brought by the Attorney General's office on behalf of the Brazilian Institute of Environment and Renewable Natural Resources (Ibama). Satellite imagery and on-the-ground inspections revealed the transformation of once-dense forest into barren land, primarily to expand cattle ranching operations.

The court's decision to impose the substantial fine reflects the severity of the damage and the general consensus around the need to establish effective deterrence to prevent similar actions in the future. Illegal deforestation of this kind is a key problem in the Amazon region and Brazil's environmental protection agencies have long struggled to effectively police such a huge geographic area. The Attorney General told the court that damage to the Amazon rainforest emits approximately 161 tons of carbon per hectare. The court estimated the damage in monetary terms at USD 60 a ton, based on the social cost of carbon (SCC) calculated by the U.S. Environmental Protection Agency and the Organization for Economic Cooperation and Development (OECD). The USD 50 million will be directed towards reforestation efforts and the restoration of the affected areas, aiming to revive the local ecosystem and support the livelihoods of indigenous communities and wildlife dependent on the forest. The ruling underscores the message to landowners and businesses that illegal environmental degradation will not be tolerated and will result in severe financial consequences. The decision may also indicate an increasing trend for greater enforcement of environmental laws in Brazil and inspire similar actions against other perpetrators of deforestation.

The Amazon remains a net carbon sink, playing a crucial role in regulating the planet's climate by absorbing vast amounts of carbon dioxide. However, in recent years, it is reportedly on the edge of becoming a net source. The judgment has been delivered at a time when global environmental organizations and foreign governments are urging Brazil and institutional investors to take stronger action against deforestation. For example, in June 2024, Exit Amazon Oil and Gas (EAOG) **published a report** claiming that the policies of a small group of the largest financial institutions in the world fail to address the impact their continued financing of oil and gas extraction in the Amazon is having on people and nature.

While the court's decision in favor of Ibama is considered significant, much work remains to ensure the long-term protection of the Amazon rainforest including effective implementation of the ruling, ongoing monitoring of deforestation activities, and sustained support for conservation initiatives. Many activists and indigenous leaders across the Amazon Region face significant challenges as they oppose illegal logging and land grabbing. In July 2024, the Constitutional Court in Colombia **ruled in favor** of six indigenous tribes who had challenged the validity of an agreement establishing carbon credit projects in the Amazon's Pira Parana territory. The agreement required indigenous communities to

preserve 7,100 square kilometers but the tribes argued that false representatives had signed the agreement on their behalf and had violated their rights to territorial autonomy and self-government.

As we discussed previously, Brazil had the third highest number of climate litigation cases filed in 2023 after the U.S. and UK. Ibama vs Kruger is cited by the Grantham Institute, whose research was discussed in that edition, as demonstrative of a growing trend in cases concerning civil liability for environmental and climate-related damage associated with deforestation. Over the last year, the spotlight has been trained on deforestation in a number of different contexts. For example, in June 2024, police in Brazil launched **"Operation Greenwashing"** with the aim of dismantling a criminal organization suspected of selling approximately R$180 million in carbon credits where the underlying projects involved the illegal invasion of areas across Brazil. In December 2022, the European Commission published the **Deforestation Regulation**, which will require companies to show that the products they are selling within the territory do not come from illegally deforested areas. In order to sell their products in the EU, companies will have to show their geographic origin, which in practice means providing the relevant GPS coordinates to prove the area has not been deforested. On May 13, 2024, **the U.S. Department of Agriculture announced** that, in partnership with 17 States, it will conserve nearly 168,000 acres of "economically and ecologically significant" forestlands.

ESMA Publishes Opinion on the Functioning of the Sustainable Finance Framework

On July 24, 2024, the European Securities and Markets Authority (ESMA) published an opinion on improving the Sustainable Finance Framework to better support investors in sustainable investment decisions. The framework aims to align with **the EU's goals of climate neutrality** by 2050 and a 55% reduction in greenhouse gas emissions by 2030. This opinion builds on ESMA's earlier reports on greenwashing and aligns with broader policy aims to create a transparent and cohesive approach for the sustainable investment value chain (SIVC) (issuers, ESG rating providers, benchmark administrators, asset managers, financial advisors, and retail and institutional investors). Key points of the opinion include:

1. Investor-Focused Approach:
    - The framework must facilitate the investor journey by providing clear, consistent information about sustainable investment products.
    - Retail investors, who may lack the expertise of professional investors, should receive adequate support and clear guidance.
2. Holistic Vision:
    - ESMA envisions a framework that is interconnected and considers the dependencies between various regulatory texts.
    - The goal is to ensure the SIVC operates effectively, fostering trust in sustainable investments through high-quality disclosures and market conduct.
3. EU Taxonomy:
    - ESMA recommends that the EU Taxonomy should become the sole reference for assessing sustainability, replacing the current definitions under the Sustainable Finance Disclosure Regulation (SFDR).
    - The taxonomy should be expanded to include social sustainability aspects and cover all economic activities that can substantially contribute to environmental goals.
4. Transition Support:
    - The framework should include detailed disclosures on revenue and capital expenditure (CapEx) related to harmful activities that are transitioning or being decommissioned.
    - A clear legal definition of transition investments is needed to support the creation of transition-related financial products.
5. International Interoperability:
    - ESMA stresses the importance of ensuring that the EU framework is compatible with international standards to maintain the competitiveness of EU capital markets.
6. Simplification and Consumer Testing:
    - The framework should be simplified to reduce complexity.

    - Consumer testing, informed by behavioral science, is crucial before implementing new legal proposals to ensure they meet retail investors' needs.
7. Recommendations for Enhancing the Framework:
    - Complete the EU Taxonomy with comprehensive environmental and social criteria.
    - Phase out the SFDR's definition of sustainable investments in favor of the EU Taxonomy.
    - Develop high-quality standards for transition bonds and sustainability-linked bonds.
    - Align transition-related disclosure requirements across EU legislation to ensure consistency and credibility.

These enhancements are aimed at further strengthening the existing safeguards against greenwashing, a key priority under the European Green Deal. As we have covered in a previous edition, in June 4, 2024, the European supervisory authorities (ESAs) published their **final reports on greenwashing in the financial sector**. ESMA, the European Banking Authority (EBA), and the European Insurance and Occupational Pensions Authority (EIOPA) each called for "enhanced supervision and improved market practice on sustainability-related claims." On May 14, 2024, ESMA also published **final guidelines for funds using ESG or sustainable terms in their names**. More broadly in the EU, the European Council adopted the Green Claims Directive in June this year. The directive requires companies to substantiate their green claims and regulate the use of environmental labels, requiring them to be reliable, transparent, independently verified and regularly reviewed. In April 2024, **the European Commission announced action** it had taken against 20 airlines under Articles 5 (prohibition of unfair commercial practices), 6 (misleading actions) and 7 (misleading omissions) of the Unfair Commercial Practices Directive (UCPD) which affords consumer protection against greenwashing. As we discussed previously, in addition to the UCPD and the Green Claims Directive, EU consumers benefit from several other protections against misleading environmental claims under the Directive on empowering consumers for the green transition, which explicitly bans claims, based on the offsetting of greenhouse gas emissions, that a product has a neutral, reduced or positive impact on the environment in terms of greenhouse gas emissions.

Amendments Proposed to California's Climate Disclosure Laws

On June 28, 2024, California's Governor, Gavin Newsom released proposed amendments to climate emissions disclosure and climate-related financial risk reporting laws, Senate Bills 253 and 261, as well as Assembly Bill 1305, enacted in 2023. These bills, designed to heighten corporate accountability on environmental impacts, could see compliance timelines extended and reporting requirements adjusted.

Senate Bill 253: Emissions Reporting

S.B. 253 mandates that large companies report their greenhouse gas emissions. The proposed amendments focus on:

- Compliance Deadlines: Extending the deadlines by two years to allow companies more time to adapt to the new reporting requirements.
- Scope of Emissions: Revising the scope of emissions that need to be reported, particularly those from indirect sources.
- Consolidated Reporting: Permitting entities to rely on consolidated reporting at parent company level, eliminating the need to prepare a separate report.

Senate Bill 261: Climate-Related Financial Risk Disclosure

S.B. 261 requires companies to disclose climate-related financial risks. The amendments under consideration include:

- Phased Implementation: Introducing a phased approach to compliance, giving companies a staggered timeline based on size and sector.
- Disclosure Criteria: Clarifying the criteria for what constitutes a significant climate-related risk and how it should be reported.

Assembly Bill 1305: Voluntary Carbon Offsets and Emissions Reductions

A.B. 1305 addresses the transparency of companies' claims regarding emissions reductions and activities involving voluntary carbon offsets. The proposed changes to this bill include:

- Effective Date: Initial disclosures will now be required by January 1, 2025 and the requirements will only apply to activities addressed by the law that occur after that date.
- Renewable Energy Certificates (RECs): Carving out certain kinds of RECs from disclosure requirements applicable to carbon offsets.

The amendments that aim to clarify reporting requirements and extend deadlines will have been welcome news for many companies impacted by these bills as they provide more time and clearer guidelines for compliance. However, an extension in reporting deadlines will ultimately be perceived as delays in long-awaited reporting. In addition, the increased costs and administrative burdens associated with enhanced verification and standardized reporting requirements will undoubtedly cause some concern.

The proposed amendments have garnered varying degrees of legislative support. While changes to A.B. 1305 appear to have broad backing, the fate of S.B. 253 and S.B. 261 remains uncertain. Key legislators have expressed opposition to some of the amendments, indicating that further negotiation will be necessary to reach a consensus. The deadline for passing any legislation for 2024, including these amendments, is the end of August.