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Kansas Public Employees Retirement System Warns of Adverse Consequences From “Anti-ESG” Bills

March 24, 2023

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Earlier this month, the Kansas Public Employees Retirement System (KPERS) urged legislators to reject key aspects of “anti-ESG” bills introduced in the **Kansas Senate** and **House of Representatives**. Both bills are designed, in part, to restrict the ability of investment managers engaged by KPERS to consider ESG factors in investment decisions, either directly or indirectly. The **Senate bill (SB 224)**, which the state's Attorney General, Kris Kobach, **promoted** as the “strongest anti-ESG bill in the country,” operates by prohibiting KPERS from investing in or through financial entities “engaged in ideological boycotts,” a term defined to include “any commercial action that is intended to penalize, inflict economic harm on, limit commercial relations with or change or limit the activities of a company” based on ideological or political considerations, including the company’s failure to satisfy certain environmental criteria. The **House bill (HB 2436)** operates by requiring all investment decisions on behalf of KPERS to be made “solely in the financial interest” of beneficiaries, while defining “financial interest” to exclude any consideration of certain policy objectives, such as eliminating, reducing, offsetting, or disclosing greenhouse gas emissions.

KPERS objected to the bills as both unnecessary and costly. The bills are unnecessary, according to KPERS, because (1) as fiduciaries, members of the KPERS Board and its investment managers are already duty-bound to make “[a]ll investment decisions . . . for the sole purpose of providing promised benefits”—an obligation that the proposed bills could disrupt; and (2) an existing Kansas law, in operation since 1992, already prohibits investments “if the sole or primary investment objective is for economic development or social purposes or objectives.” More critically, under either of the bills, all or nearly all of the current KPERS investment managers would be disqualified because they offer ESG products, resulting in a complete divestment and restructuring of the KPERS fund. Such a restructuring would lead to “asset losses of approximately $1.14 billion due to the early sale of assets from illiquid investments” and would reduce future returns by an estimated 0.85%, resulting in a $3.6 billion reduction in fund earnings over the next 10 years. This underfunding would in turn cost state and local employers billions of dollars in the form of higher mandated contributions. Finally, by restricting the ability of KPERS to delegate its proxy voting rights unless it is not “economically practicable,” and the investment manager commits in writing to “act solely on pecuniary factors” (a term not defined in the bills), the bills would require KPERS “to research and evaluate each of the nearly 100,000 proxy votes based solely on financial factors,” meaning that “an entire

team of investment professionals would have to be hired to manage proxy voting." That, in turn, would “create an unnecessary layer of bureaucracy that will make KPERS less competitive with private market and real estate investments.”

To help mitigate the impact of the bills, KPERS proposed several amendments. First, KPERS recommended narrowing the restrictions placed on investment managers to apply only to assets managed on behalf of KPERS. This would allow KPERS to continue its relationships with current investment managers as long as they commit to managing state assets according to the requirements of the bills. Second, KPERS recommended exempting alternative or real estate investments, “which rarely have proxy votes due to the nature of the investment,” from restrictions related to proxy voting, and clarifying that KPERS could continue to delegate its proxy voting authority to third parties who commit to exercising that authority according to the requirements of the bills. Third, with respect to the Senate bill, KPERS recommended that the divestment requirement “be limited to direct holdings and exclude private markets and real estate to mitigate extraordinary divestment costs from these illiquid investments.” Finally, with respect to the House bill, KPERS recommended a provision that would require the state to defend and indemnify the KPERS Board and staff from any liability arising from compliance with the requirements of the bill—a protection already included in the Senate bill.

Taking the Temperature: KPERS’ response to the two Kansas bills highlights a tension in the efforts on the part of some Republican politicians to eliminate ESG considerations from investment decisions. Proponents of “anti-ESG” legislation often claim to be motivated by a desire to protect investors from the “much lower return on investment” they claim to be associated with ESG funds. Yet organizations whose purpose it is to protect the financial interests of their constituents often oppose such legislation. KPERS opposed the bills in part because the investment restrictions would result in large upfront costs and lower long-term returns for beneficiaries—concerns that are consistent with those of the Indiana Chamber of Commerce, which recently opposed an “anti-ESG” bill it described as “anti-free market,” and which Indiana’s Legislative Services Agency estimated would reduce returns for state pensioners by $7 billion over the next 10 years. Indeed, the Senate bill effectively concedes the possibility that the restrictions could lead to large investment losses by providing an exception to the divestment requirement if “clear and convincing evidence shows that . . . the system has suffered or will suffer a greater than 25% loss” in the value of assets under management, and by protecting KPERS and its employees from lawsuits arising from breaches of fiduciary duties resulting from compliance with the bill. The House Committee on Financial Institutions and Pensions effectively conceded the same point when it recommended an amended version of the bill that would adopt the KPERS proposal to add an indemnification provision.

The back and forth in Kansas is not unique in the United States. As we have reported, Florida Governor Ron DeSantis has formed a coalition of governors from 19 states that is committed to “push[ing] back against President Biden’s environmental, social, corporate governance (ESG) agenda,” and he has announced support for a Florida bill that, similar to laws adopted in other Republican-led states, would blacklist financial firms deemed to be engaged in anti-fossil fuel boycotts. By contrast, as was expected, on Monday President Biden vetoed Congress’s attempt to overturn a Department of Labor rule that permits, but does not compel, consideration of ESG factors in investing

decisions on the part of retirement plan fiduciaries. And various other states, including some where the legislatures are under Republican majority control, have rejected bills proposing these types of financial firm blacklists. Meanwhile, for the foreseeable future in the U.S., asset managers for public pension firms are left to walk a very fine line between these competing camps.

Indian Securities Regulator Consults on Changes to ESG Disclosure and Ratings Regulation

March 24, 2023

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The Securities and Exchange Board of India (SEBI) launched a **consultation paper** (Consultation Paper) last month seeking public comment on three topics: (1) ESG disclosure; (2) ESG ratings; and (3) ESG investing by mutual funds. The comment period closed on March 6, 2023, with SEBI seeking **additional comments** on the regulatory framework for ESG ratings providers. By way of explaining the need for and goals of the consultation, SEBI stated that "as ESG Investing becomes mainstream, companies have been urged by both investors and regulators to make detailed ESG related disclosures to their stakeholders. The use of ESG ratings and rating products is also growing, as investors increasingly factor ESG parameters in their investment decisions. In this backdrop, securities market regulators have felt a need to streamline these three areas of ESG Disclosures, ESG Ratings and ESG Investing."

First, SEBI outlines heightened disclosure requirements under India's ESG disclosure framework. Introduced in 2021, the **Business Responsibility and Sustainability Report** (BRSR) mandates disclosure from the top 1,000 listed companies by market capitalization against the nine core principles of the **National Guidelines on Responsible Business Conduct**, divided into essential indicators (for mandatory reporting) and leadership indicators (for voluntary reporting). Although the BRSR requires only disclosure starting from FY 2022–23, more than 175 companies voluntarily disclosed pursuant to the framework for FY 2021–22. Recognizing the likelihood of reliance on the BRSR disclosures by investors and ESG ratings providers, the Consultation Paper seeks comments on the assurance of sustainability disclosures and the introduction of limited, gradually expanding disclosures at the supply-chain level. To that end, SEBI proposes a BRSR Core framework to "achieve the twin objectives of improving credibility and limiting the cost of compliance." This framework, outlined in greater detail at Annexure 1 to the Consultation Paper, includes Key Performance Indicators (KPIs) for "E," "S," and "G" attributes and "specifies the methodology to facilitate reporting by [corporations] and verification of the reported data by an assurance provider." The KPIs are outcome-oriented and aimed at India-specific factors, but are also quantifiable and contain intensity ratios to enable comparability across jurisdictions.

Second, the Consultation Paper seeks comments on the regulatory framework for ESG ratings providers currently being developed by SEBI. Recognizing that "emerging markets have a different set of environmental [and] social challenges" when compared to developed

jurisdictions, Annexure 2 to the Consultation Paper lists 15 India-specific ESG parameters for ratings providers to consider when assessing a company's ESG risks, opportunities, and impact. These include whether a company has operations in or around ecologically sensitive areas, creates jobs for and makes available infrastructure accessible to the "differently-abled," and the frequency with which the company engages in related party transactions. Similar to the BRSR Core framework, SEBI proposes a Core ESG rating framework aimed at assured and reliable ESG ratings.

Third, SEBI proposes expanded disclosure for ESG funds "to improve transparency, with a particular focus on mitigation of risks of mis-selling and greenwashing and other related areas." To that end, SEBI recommends enhanced stewardship reporting for ESG funds, including voting disclosures and disclosure of engagements and outcomes for any ESG-specific objectives. SEBI also recommends measures to address greenwashing, such as a requirement that 65% of the mutual fund's AUM be invested in companies reporting per the BRSR and providing assurance through BRSR Core disclosures. Another proposed measure to combat greenwashing is a requirement for third-party assurance that the portfolio is in compliance with its stated ESG strategy and objectives, to be provided on a "comply or explain" basis. Finally, SEBI proposes additional measures to increase transparency, such as standardized classifications for ESG funds, and disclosure of the ESG ratings provider(s) used and ESG ratings/scores given.

Taking The Temperature: Analysts have recognized India's developing ESG reporting framework as being "in line with international norms and regulations." Even the leading international norms and regulations, however, have been criticized for lack of uniformity and transparency, and many jurisdictions are working to improve disclosure and fight greenwashing. If adopted, SEBI's proposals outlined in the Consultation Paper will bring India into closer alignment with jurisdictions, such as the EU, that seek broad-ranging and detailed ESG disclosures and have more well-developed regulatory schemes. The proposed regulation of ESG ratings is also consistent with other jurisdictions' initiatives, such as the UK Financial Conduct Authority's development of a code of conduct for ESG rating providers, aimed at promoting greater transparency regarding the methodologies employed and data considered by ratings providers.

French Court Dismisses "Duty of Vigilance" Case Seeking to Halt Multibillion-Dollar Oil Pipeline Project

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On February 28, a French court dismissed an action filed by six French and Ugandan NGOs aiming to force the suspension of TotalEnergies' multibillion-dollar oil pipeline project in Uganda and Tanzania. The NGOs based their case to suspend the pipeline project on Article L. 225-102-4.-I of the French Commercial Code, the Corporate "Duty of Vigilance Act," which requires companies to establish a "Vigilance Plan" to "identify and prevent risks of severe violations of human rights and fundamental freedoms, health and safety of people and to the environment in their entire sphere of influence." The planned pipeline would run from Uganda to the Tanzanian coast passing through many acres of farmland and the Murchison Falls National Park, a habitat that is dense with animal life. The peak production is estimated at 230,000 barrels per day, which, if realized, would make Uganda the seventh-largest oil producer on the continent.

The case was ruled inadmissible after it was filed under the emergency fast-track procedure, but the NGOs have reserved the right to refile the action as a standard trial suit.

The TotalEnergies pipeline project also has been subject to scrutiny and criticism by the European Parliament. In September 2022, the European Parliament passed a non-binding resolution **urging** EU members and the international community to "exert maximum pressure on the Ugandan and Tanzanian authorities, as well as the project promoters and stakeholders, to protect the environment and to put an end to the extractive activities in protected and sensitive ecosystems." The Ugandan state **responded**, asserting its independence and stating that the European Parliament criticism is an insult to the parliament of a sovereign country.

Taking the Temperature: We have previously commented on other sustainability-related litigation asserting violations of the Duty of Vigilance law, including ClientEarth's plastics-focused litigation against Danone as well as a suit related to emissions financing against a financial institution. There are reportedly at least fifteen cases currently underway that rely on the French Vigilance Law.

More generally, there has been a notable uptick in climate-related litigation and shareholder activism around the world, a trend we expect to continue at least in the near and medium term. To cite just one recent example, in the UK, a derivative action was commenced in the High Court against Shell plc's board of directors accusing the

directors of violating their duties to promote the success of the company under Section 172 and their duty to exercise reasonable care, skill and diligence under Section 174 of the Companies Act by not "properly managing climate risk." Likewise, in the same piece, we observed that, last month, a group of 30 investors, representing over $1.5 trillion of assets under management, wrote to the CEOs and board chairs of five major European banks "urging them to stop directly financing new oil and gas fields by the end of this year." For companies and their directors and officers, the best "defense" against, or prevention of, such actions relies on governance and disclosure. Boards and management should focus on climate-related governance (monitoring and assessing material risks and opportunities), data collection/assessment (including alignment with SBTi or other data standard setters) and disclosure (including necessary caveats or qualifications on articulated climate goals).

EC Proposal to Reform EU Electricity Market Underscores Capital Needs

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On March 14, the European Commission (EC) announced a **proposal** to "revise the rules for electricity market design and for improving the EU protection against market manipulation in the wholesale energy market." The proposals envision amendments to several pieces of EU legislation, including the Electricity Regulation, the Electricity Directive and the Wholesale Energy Market Integrity and Transparency Regulation. The proposals, which align with the **European Green New Deal**, were motivated by concerns about energy supply following Russia's invasion of Ukraine, which in addition to causing supply worries also led to volatile energy prices. EU heads of government tasked the EC with working on structural reform of the electricity market with the dual objective of "securing European energy sovereignty and achieving climate neutrality."

If they move forward, the measures seek to incentivize longer-term contracts with non-fossil fuel power generation providers and foster price stability by reducing the risk of supplier failure. The EC also expects that the proposals will better protect consumers from short-term market price volatility and reduce the impact of fossil fuels on consumer electricity bills while also more accurately reflecting the reduced cost of renewables. The EC intends to "decouple[] citizens' energy bills from the prices in short-term wholesale markets." Consumers will be offered greater choice under the proposals, including the option to have "multiple or combined tailor-made" electricity contracts for differing needs.

This announcement follows a **public consultation** carried out by the EC in early 2023. The proposals will now be debated by the European Council and Parliament. The EC is currently accepting feedback on the proposals, which in final form will then be presented to the European Parliament and Council "with the aim of feeding into the legislative debate." The feedback period, which began on March 16, will run for eight weeks. It is, however, currently being extended on a daily basis until the proposal is available in all EU languages.

Taking The Temperature: According to its press release, the EC expects that the share of electricity produced by renewable sources will grow from 37% in 2020 to over 60% by 2030. The shift to renewables "and increased electrification is crucial to achieving carbon neutrality by 2050. The electricity market design, therefore, helps to achieve the goals set out in the European Green Deal and contributes to the creation of jobs and

growth." As we have discussed, however, the transition to a green economy and, with it, increasing reliance on renewables, requires capital to fund the development of renewable energy projects. We recently have observed efforts in the EU to promote such initiatives, where the EC approved, under EU State Aid Rules, a German scheme supporting rail transport operators' use of electric traction and state aid to support the expansion of a Samsung battery cell production facility in Hungary, as well as approval for the Spanish and German governments to subsidize the construction of two renewable hydrogen-powered steel production facilities for Europe's largest steelmaker. Nonetheless, obtaining public or private financing remains a significant challenge globally, and particularly in developing nations, notwithstanding recent signs of limited progress.