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Republican AGs Target 53 Large Asset Managers' ESG Practices

May 9, 2023

By Jason Halper
Partner and Co-Chair | Global Litigation

By Sara Bussiere
Special Counsel | Global Litigation

On March 30, 2023, 21 Republican Attorneys General (AGs) **wrote a letter** addressed to over 50 U.S. asset managers citing "concerns about the ongoing agreements between asset managers to use Americans' savings to push political goals during the upcoming proxy season." The AGs state their intent to "enforce [their] states' civil laws against unfair and deceptive acts and practices and state and federal civil laws prohibiting agreements to restrain competition."

The 21-page letter raises various concerns, including perceived action taken by asset managers that allegedly is inconsistent with their client's financial interests. It highlights the obligations assumed by members of the Net Zero Asset Managers Initiative (NZAM) and Climate Action 100+ in relation to issuer engagement on issues of climate change and decarbonization. We have **written previously** about NZAM, in particular regarding Vanguard's decision to withdraw from membership of the initiative. This decision **led to pushback** against the asset manager from investors claiming Vanguard had violated its fiduciary duty in withdrawing. Other ESG-related industry collaborations have faced similar challenges, including the Glasgow Financial Alliance for Net Zero, which eliminated as a membership requirement committing to the UN-supported Race to Zero campaign after several large financial institutions **threatened to withdraw** their support over concerns of an ESG backlash and potential antitrust implications. Recently, three major insurance companies **exited** the Net-Zero Insurance Alliance with Munich Re citing "material antitrust risks" as its reason for withdrawing. And we just **recently reported** on the latest benchmarking tool introduced by Climate Action 100+, but noted that it has been **subject to inquiry** by Republican members of the House Judiciary Committee regarding antitrust compliance.

The letter also raises greenwashing concerns, stating that some asset managers have committed all assets under management to "certain environmental goals" without labelling or advertising all funds as "ESG funds." According to the letter, "your non-ESG funds do not disclose to investors that their investments will be used to further ESG goals, including pressuring companies to reduce emissions in economically destructive ways." Relatedly, the letter adds, "[i]nvestors looking for low cost, passive indexing investments may be unwittingly funding ... ESG activism. Any misrepresentations regarding the funds [asset managers] are offering is legally troubling." Further, the letter asserts that asset managers have "not adequately explained to investors the downsides and risks of the funds you do market as ESG

funds – even as you charge much higher fees for these funds." According to the letter, "many of your environmental assumptions appear to be dubious, making it perhaps unsurprising that ESG funds perform poorly."

Taking The Temperature: The Attorney General's letter is part and parcel of the ongoing partisan debate among government officials across the United States, an area we report on frequently. Republican Attorneys General in particular have been quite active, recently writing, for example, to two proxy advisory firms, Institutional Shareholders Services and Glass Lewis, over their updated voting guidelines. That earlier letter claimed that the firms' "climate and diversity, equity, and inclusion priorities" may conflict with the contractual agreements they have with states' investment vehicles, including because these agreements "typically require that [the firms] consider only one goal: the economic value of the investments." The more recent Attorney General letter likewise takes aim at proxy advisory firms, stating that Institutional Shareholder Services "has effectively joined the efforts of Climate Action 100+ by committing to use its climate benchmark in board votes. For example, ISS's 2023 benchmark policy states it will recommend "generally vot[ing] against" directors at companies "on the current Climate Action 100+ Focus List" that have not adopted "medium-term [greenhouse gas (GHG)] reduction targets or Net-Zero-by-2050 GHG reduction targets."

The letter's focus on potential greenwashing in the asset management industry also strikes at an issue that is the focus of significant attention globally, including for example, from regulators in the EU and Australia, climate activists and shareholders. The EU's Sustainable Finance Disclosure Regulation (SFDR) is particularly relevant to greenwashing challenges in the asset management area, but that disclosure regime likewise has been the subject of significant criticism due to perceived uncertainty about how to apply its sustainability classification system. That uncertainty has, among other things, resulted in a number of large asset managers announcing downgrades of ESG funds totaling tens of billions of dollars from Article 9 – the highest sustainability classification under the SFDR – to the broader, and less restrictive, Article 8.

The EU ‘Fit for 55’ Package Explained, Along With Its Potential to Spur Litigation

May 9, 2023

By Sukhvir Basran
Partner | Financial Services

By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

As we have been **regularly reporting**, the European Union is pursuing major changes in its climate policy. The next significant development is a new legislative policy package, dubbed **“Fit for 55.”** The planned reforms would amend existing EU legislation such as the European Union Emissions Trading System and introduce new legislation regarding renewable energy, transport and land use, all in furtherance of the EU’s target of reducing net greenhouse gas emissions by at least 55% by 2030. Regardless of their final form, however, the “Fit for 55” reforms may lead to litigation, according to a recent report, **“Climate change law in Europe: What do new EU climate laws mean for the courts?”** by The Centre for Climate Change Economics and Policy (CCCEP), a joint effort by the University of Leeds and the London School of Economics and Political Science. The report suggests that litigation often has accompanied European climate efforts and that “Fit for 55”-linked litigation is likely to follow suit.

EU Climate Policy in Context

The European Commission presented the European Green Deal in December 2019 with the goal of transforming the economy to achieve climate neutrality in Europe. One notable aspect of the European Green Deal was the increased ambition of proposed emissions reduction, raising the bloc’s target from 40% to 55% by 2030 (relative to 1990 levels). The EU Climate Law followed in 2021, making the target of net zero greenhouse gas emissions by 2050 legally binding. Since then, EU legislators have worked to translate these obligations into tangible policies by developing a wide-ranging set of interconnected legislative reforms, the Fit for 55, which references the new 55% emissions reduction target.

Key Components of the Fit for 55 Proposals

Fit for 55’s core proposals can be grouped broadly into the following related categories: direct decarbonization measures, facilitating measures and integrating measures. Direct decarbonization measures are, in many ways, the most straightforward, aiming for greenhouse gas emisssions reductions. Facilitating measures harmonize requirements for EU member states to measure and plan for emission reductions. Integrating measures apply the EU’s climate policies to particular sectors.

The proposed direct decarbonization measures in the Fit for 55 include notable updates to the centerpiece **EU Emissions Trading Directive (ETS)**, which governs the majority of energy-intensive sectors, covering emissions from electricity, heat generation and commercial aviation, among others. The proposed amendment to the ETS mandates emissions be reduced by 61% (relative to 2005 levels) by 2030, and extends ETS to maritime transport. This increase in decarbonization would be achieved largely by reducing the availability of emission allowances. Another major update to ETS would be the creation of a parallel emissions trading system, 'ETS-2,' governing emissions in building and road transport. Additionally, the Land Use, Land Use Change and Forestry Regulation (**LULUCF Regulation**) would be amended to provide more comprehensive rules to calculate greenhouse gas emissions in those sectors. Amendments were also proposed to the complementary **Effort Sharing Regulation (ESR)**, which covers sectors not addressed by the ETS or LULUCF Regulation (for example, agriculture and road transport). The ESR obligates EU member states to meet emissions reduction targets through targeted domestic action.

The Fit for 55 includes two new energy-related decarbonization directives: the **Recast Renewable Energy Directive (RED II)** and the **Energy Efficiency Directive (EED)**. The new provisions in RED II are particularly significant, focusing on biodiversity loss and the degradation of carbon sinks. Other new measures include the **Refuel EU Directive**, which aims to increase the share of sustainable aviation fuels, and the **Fuel EU Maritime Directive**, which represents an effort to reduce emissions associated with shipping. The **Vehicle Emission Performance Standards Regulation** also would be amended, effectively phasing out all new fossil fuel-based cars by 2035.

At present, the primary facilitating measure of current EU climate policy is Regulation (EU) 2019/199 on the Governance of the Energy Union and Climate Action (Governance Regulation), which requires that the EU's energy policies are implemented and coordinated coherently by imposing a set of more than 30 obligations related to planning, reporting and monitoring on EU member states. The Fit for 55 package proposes additional facilitating measures, including amendments to the **Market Stability Reserve**, which aims to correct imbalances between supply and demand in the emission allocations market among member states. The package also introduces two new measures. The first is the proposed establishment of a **Social Climate Fund** to address the disproportionate distributional impact on low-income groups of the anticipated increased price of fossil fuels. The second new measure, the **Carbon Border Adjustment Mechanism (CBAM)**, aims to equalize the carbon price between goods produced in the ETS-regulated EU and those produced elsewhere.

Integrating measures proposed in the Fit for 55 package include amendments to the **Energy Taxation Directive** to incorporate a graduated system of taxes for energy sources based on environmental impact and to extend the directive to apply to maritime and shipping. An additional proposal would replace the existing **Alternative Fuels Infrastructure Regulation** with new targets for member states.

CCCEP Report

The CCCEP report predicts four areas in which the Fit for 55 could prompt litigation:

- The extension of the EU ETS – in keeping with historic trends, the expansion of coverage to new sectors is likely to prompt challenges seeking to prevent or delay the implementation of

the new rules from the private sector, and possibly EU member states. The report also notes the possibility of the EC bringing infringement proceedings against member states as an enforcement strategy.

- Climate targets – cases against the EC or member states challenging the adequacy of member states implementation frameworks, alleging the failure of national governments to properly execute on their national plans, or possibly asserting the inadequacy of the EU framework overall, under a theory of failure to protect fundamental human rights under national or international law.
- “Just transition” – environmental justice cases focusing on the relative impacts of new climate policies across socio-economic strata, questioning whether components of the Fit for 55 are “regressive,” disproportionately falling on low-income households.
- The definition of “low-carbon” energy – which energy sources can be categorized as low carbon, and therefore prioritized in the programs and policies designed to accelerate energy transition continues to be contentious. For example, reforms targeting how existing business practices contribute to biodiversity loss, and on which we have **previously reported**, would expedite the permitting process for renewable energy projects, and is likely to create controversy for multiple stakeholders.

Taking the Temperature: As the CCCEP report suggests, the ambitious and far-reaching policies encompassed by Fit for 55, regardless of their final form, appear likely to result in various types of litigation. This EU policy-related litigation would be in keeping with the global trend, which we have reported on the increasing numbers and variety of climate-related litigation. We have reported on instances of what the report calls “strategic” litigation — typically cases where NGOs or other claimants bring suits in an effort to use both the judicial system and the “court of public opinion” to prompt systemic change. As the report observes, strategic climate litigation can take a number of forms, and can seek to advance either “pro-regulatory” (or “pro-climate”) agendas, as well as “anti-regulatory” (or “anti-climate”) agendas, some of which we have seen recently in the United States.

The report also asserts that, beyond the direct decarbonization elements of Fit for 55, the facilitating and integrating measures have as their aim to shape economic activity within the EU to align with climate goals, in particular in the areas of corporate governance and supply chain, sustainable finance and consumer information. These areas also could be ripe for litigation, as the private sector and regulators struggle with frameworks around issues of responsibility, liability and accountability, as well as disclosures and transparency in reporting, related to climate change, sustainability and the transition to net zero. The report predicts—and we agree—that green-washing suits challenging corporate narratives around ESG initiatives as incomplete or inaccurate could also be on the rise.

UN Requests Opinion from International Court of Justice on Climate Change Obligations

May 9, 2023

By Timbre Shriver
Associate | Global Litigation

By Drew Newman
Associate | Global Litigation

The United Nations General Assembly, the UN's primary policy-making body, has adopted a resolution requesting an advisory opinion from the International Court of Justice (ICJ) on the obligations of its 193 member states regarding climate change.

The resolution requests that the court render an opinion on 1) states obligations under international law to ensure the protection of the climate system from human-generated greenhouse gas emissions and 2) the legal consequences for states where they, by their acts and/or omissions, have caused significant harm to the climate system and, in particular, to small island developing states, and "people of present and future generations," the General Assembly said in a **March 29 statement**.

Advisory opinions issued by the **International Court of Justice**, the UN's principal judicial organ located in The Hague, Netherlands, are legally non-binding but have the potential to impact international law. "Such opinions can provide clarification on existing international legal obligations and could help the General Assembly, the United Nations and member states take stronger climate action. Such opinions could also guide the actions and conduct of States in their relations with each other, as well as towards their own citizens," said UN Secretary-General António Guterres.

A representative of the European Union delegation said the EU expects the court's advisory opinion to answer legal questions on the basis of the current state of international law and to identify and clarify obligations of member states under applicable international law. "The resolution, however, does not prejudge whether and when breaches have occurred, are occurring or will occur in the future but rather focuses on the consequences thereof for all States," the representative noted.

During the debate that preceded the resolution's adoption, many member states expressed concern that the most vulnerable states, which have historically contributed the least to climate change, are being disproportionately affected by its consequences. The introduction of the resolution was organized by Vanuatu, the island nation in the Pacific Ocean that faces significant environmental threats due to climate change, especially from rising sea levels.

Andy Raine, Head of the Frontiers in Environmental Law Unit at the Law Division of the United Nations Environment Programme (UNEP), which sets the UN's environmental agenda, called the resolution a significant development for climate justice. "It is the first time that the world's highest court has been asked clarify the obligations on states to protect the climate system, and the legal consequences of failing to meet them," he said in a **March 31 statement**.

The resolution invites the court to look beyond the Paris Agreement and spotlights the legal consequences of causing significant harm to small developing island states like Vanuatu as well as future generations, said Raine.

Taking the Temperature: While the resolution appears to mark the first time the ICJ has been asked to provide an advisory opinion on environmental justice, it is not the first time the court has considered issues of obligations, liabilities and compensation for environmental damage between member states. A handful of cases based on claims of environmental damage have been brought before the court, including Argentina's litigation alleging damage to water quality from Uruguay's building of pulp mills on the River Uruguay; Australia's challenge against Japan's whaling industry; Ecuador's action alleging that Colombia's use of aerial herbicides caused damage to the crops, animals, humans and the environment in Ecuador's border region; and territorial border disputes between Costa Rica and Nicaragua over a small wetland area in which both countries claimed sovereignty and that the other had intruded on the land in a way that harmed protected rainforests and wetlands.

As highlighted in our article in this edition on the report published by the Centre for Climate Change Economics and Policy (CCCEP) and consistently throughout previous editions, climate-related litigation is on the rise worldwide with both pro- and anti-reform agendas being pursued through the courts. Recent examples include cases in the French courts against major oil companies on the basis of the "Duty of Vigilance" law; a climate-related suit against directors of UK pension plans; the referral of certain EU Member States to the European Court of Justice for failing to transpose the EU's Renewable Energy Directive; and the challenge by Republican state attorney generals to the U.S. Department of Labor Rule on accounting for ESG factors in investment decisions.

MPs Call on the UK Government to Accelerate ESG Efforts

May 9, 2023

By Simon Walsh
Special Counsel | Global Litigation

On April 25, the UK All-Party Parliamentary Group on ESG (APPG) **published a report** on environmental, social and governance issues. All-Party Parliamentary Groups are informal groups of Members of the House of Commons and House of Lords with a common interest in particular issues. The views expressed in the report are those of the group. The report's objective is to "aid parliamentarians' understanding of ESG with the aim of injecting momentum into the UK Government's policy agenda," and also "give clarity of purpose across the political spectrum to how businesses can deliver public goods through the adoption of ESG frameworks." The report defines ESG and related key terms; explains how they relate to business practices and government policy; sets out recommendations for the UK Government; "highlights ESG's capacity to align public policy objectives with commercial ones;" and advocates for legislative and regulatory action by the UK Government to ensure that published ESG data is accurate and comparable.

The APPG report specifically highlights the risks posed by greenwashing as well as the need for standardized definitions and disclosure requirements. "Greenwashing will thrive without common ESG metrics, standards, frameworks and disclosures, and crucially, clearly understood definitions of what constitutes sustainable and socially responsible economic activity." The APPG recommends that a UK ESG strategy should:

- include an action plan for a considerably wider disclosure regime applying to more businesses as well as more ESG factors, and ensure via legislation that regulators have necessary powers;
- mandate the formation of an ESG disclosures Advisory Group composed of small and medium-sized businesses (SME), business groups, investors and larger businesses to provide recommendations for a strategy on how to support SME disclosures; and
- examine ways of developing a larger UK cohort of ESG professionals.

The APPG Report notes concerns around the increasing politicization of ESG in the U.S., describing the situation as a "cynical misunderstanding of ESG" being used as a "weapon in the country's culture wars." Referring to statements by Florida's Republican Governor, **Ron DeSantis**, the APPG further said that it strongly disagrees with the kinds of "disparaging claims" describing ESG as "woke."

Taking the Temperature: The report highlights some key takeaways that, although focused on the UK, have application in other jurisdictions facing similar challenges.

First, the report warns that the UK risks falling behind other leading economies by failing to swiftly develop and implement a regulatory framework that applies to ESG

issues. The APPG suggests that the UK "can and should go further" on ESG regulation if it is to remain globally competitive. We recently reported on delays on key policy initiatives in the UK, including the FCA Policy Statement on Sustainability Disclosure Requirements and investment labels. There also currently is no clear timeline for the UK's green taxonomy to enter into force.

Second, the report argues that the increasing number of ESG-related regulations and guidelines being rolled out necessitates a more coordinated approach both nationally and internationally. The APPG advocates for a UK ESG strategy that links together existing initiatives including, among others, the Green Finance Strategy, the Net Zero Strategy, Sustainability Disclosure Requirements and the UK Green Taxonomy.

Finally, the report emphasizes the need to have a clear understanding on what ESG means for the broader economy, businesses and public policy. In particular, it notes challenges faced by SMEs where there may be a lack of knowledge and resources with regard to monitoring and disclosure of ESG data. Although they may not face statutory reporting requirements in the UK, SMEs are already being required to provide ESG disclosure data to companies they supply to in other markets, such as the EU. As highlighted in the report, policy frameworks are still needed to bring about common and comparable metrics, allied with clear definitions of what qualifies as green or environmentally responsible.