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Greenpeace Sues European Commission Over Inclusion of Gas and Nuclear in EU Taxonomy

May 23, 2023

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On April 18, 2023, eight Greenpeace organizations (the organizations) **filed a lawsuit** against the European Commission at the European Court of Justice following the Commission's inclusion of natural gas and nuclear energy in the EU taxonomy for sustainable activities.

The **Taxonomy Regulation**, which came into force on July 12, 2020, provides a classification system for economic activities that are considered environmentally sustainable. It is supplemented by a number of delegated acts. On July 15, 2022, a Complimentary Climate Delegated Act (the delegated act) was **published**, which provided for the inclusion of natural gas and nuclear energy in the taxonomy.

Following publication of the delegated act, on September, 8, 2022, the organizations submitted a request for internal review to the Commission relating to the inclusion of natural gas and nuclear energy in the EU taxonomy. They argued that such inclusion was not only in contravention of the Regulation itself, but also the **European Climate Law** and the EU's obligations as set out in the **Paris Agreement**. On February 8, 2023, the Commission rejected the request, leading the organizations to file the lawsuit.

Taking the Temperature: As we discussed recently, we are seeing an accelerating trend in climate-related litigation, particularly in the EU. Greenpeace's lawsuit is the latest in a number of challenges to the EU taxonomy, and in particular, its inclusion of fossil gas and nuclear energy. Last month, a number of environmental NGOs filed a lawsuit against the Commission in relation to its decision to include fossil gas and nuclear energy in the EU taxonomy, following their submission to the Commission of a request for internal review. On October 7, 2022, the Austrian Government filed a similar case, challenging the inclusion of nuclear and natural gas in the Taxonomy Regulation. Austria's case has been brought in the Court of Justice of the European Union.

More generally, we have reported frequently on efforts by different countries to develop sustainability taxonomies, including efforts by Canada, Singapore, the Association of Southeast Asian Nations and the UK. As we have observed, taxonomies are essential in allowing investors and companies to understand what industries, businesses and projects will be considered sustainable. However, the development of regional

taxonomies with varying approaches and rubrics underscores not only the difficulty in defining a sustainable activity or project, but also increases the regulatory and practical burdens investors and financial market participants will likely face in making investment decisions.

Regulator’s Review of Pension Scheme Climate Reports Finds Room for Improvement

May 23, 2023

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A review by The Pensions Regulator (TPR) of the published annual climate reports of more than 71 UK pension schemes found several areas where improvement is needed as well as emerging “good practices.”

The review follows the enactment of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, which took effect on October 1, 2021. The Climate and Governance Regulations require trustees of certain pension schemes to identify, assess and manage climate-related risks and opportunities and report on these activities. The reporting requirements under the Climate and Governance Regulations were developed from the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), according to a March 23 statement by TPR.

TPR conducted a qualitative and quantitative assessment of the data and disclosures provided in 71 pension scheme reports. The regulator’s review found that the reports ranged from 10 to 85 pages, and averaged 34 pages. Just under half of the reports (43%) set a formal net zero target. The report identified disclosure subjects that “need improvement” and emerging “good practices” in a variety of areas, including governance, strategy and scenario analysis, risk management, metrics and targets. For example, in the governance section, the report identified as good practices “clear descriptions of the trustees’ high-level approach to climate change;” conducting a “skills audit or gap analysis, to identify the specific areas where trustee training is needed;” “clear descriptions of the roles performed by individual consultancy firms or advisers;” and “robust processes for reviewing the competency of in-house teams or advisors.” Governance-related disclosure areas where improvement was necessary included discussing the “ roles of those undertaking scheme governance activities, other than trustees, in identifying, assessing and managing climate-related risks and opportunities relevant to those activities,” and the “processes the trustees have established to satisfy themselves that the person undertaking, advising or assisting takes adequate steps to identify and assess any climate-related risks and opportunities which are relevant to the matters on which they are advising or assisting.”

The report found a variety of “good examples of trustees taking action,” including:

- planning climate and sustainability training for trustees and those involved in the governance of climate-related risks and opportunities;
- developing a trustee policy on climate change investment views;
- working with investment managers to obtain better data;
- allocating more funds to sustainable investments;
- using stewardship to manage climate-related risk; and
- switching to climate-tilted pooled funds.

TPR's review also highlighted several areas for improvement, finding:

- a lack of sufficient background information on the pension scheme itself, which made the disclosures difficult to interpret;
- disclosures of strategy and scenario analysis that did not always reach the appropriate level **described in statutory guidance** issued by the Department for Work and Pensions (DWP);
- accessibility issues—including long or complicated web addresses and use of PDFs not compatible with those using reader accessibility requirements—that could make it difficult for savers and others to find and access reports online; and
- failure to include disclosures required by DWP's statutory guidance.

Trustees of pension schemes covered by the regulations who fail to publish their annual report may be subject to a mandatory fine of at least £2,500. Trustees that do not comply with the regulations in preparing their report may be further fined a penalty of up to £5,000 for individual trustees and up to £50,000 for corporate trustees.

Taking the Temperature: TPR's review of pension scheme reports is the regulator's latest initiative to tighten the rules around trustees' disclosure of climate-related data. As we previously reported, TPR recently launched a campaign to assess whether trustees are properly discharging their ESG reporting duties. Among other things, the regulator is assessing whether trustees of covered pension schemes have published a statement of investment principles (SIP) detailing how a scheme invests, including consideration of financially material ESG and climate factors, and whether the SIP has been implemented. The focus on reporting accuracy by pension regulators in the UK is also in line with the position taken last year by three European supervisory authorities (ESAs), including the Occupational Pensions Authority, on sustainability-related disclosures in the financial services sector. As we reported, the ESAs issued a joint statement on March 25, 2022, updating guidance on the application of Regulation (EU) 2019/2088 (the Sustainable Finance Disclosure Regulation) and providing new guidance on the application of Regulation (EU) 2020/852 (the EU Taxonomy Regulation).

Study Explores Links Between a Company's ESG Focus and its Financial Performance

May 23, 2023

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A **recent study** by Bain & Company and sustainability ratings provider EcoVadis "examined how various aspects of sustainability and ESG activities—things like setting ESG targets, tracking results, embedding sustainability into management processes, procuring sustainably, and putting in place programs to reduce carbon and improve diversity, equity, and inclusion—correlate with both ESG outcomes and financial performance." The study concludes that, for the companies surveyed, 80% of which were private, "ESG activities have no strong negative correlations with financial outcomes; in fact, they are associated with encouraging revenue growth and EBITDA margins." The Study was geared to the private equity industry, with the authors observing that "investment policies of 70% of the limited partners surveyed by Bain & Company and the Institutional Limited Partners Association in 2021 included an ESG approach."

Researchers found the following four correlations between ESG activities and financial results:

1. Companies that focus on sustainable procurement within their supply chain are more profitable, with margins of three to four percentage points higher than those that do not have a comparable focus on their suppliers' ESG efforts.
2. Companies in the carbon-intensive industries of the natural resources, transportation and industrial goods sectors that use more renewable energy have higher EBITDA margins. This is particularly the case in the EU where there is a carbon tax and therefore lowering emissions directly impacts that expense.
3. Companies in the top 25% of their industry for executive team gender diversity have annual revenue growth that is approximately 2% more than companies in the bottom 25%. These companies' EBITDA profit margins are also approximately 3% higher.
4. Companies with high levels of employee satisfaction have a projected three-year revenue growth up to five percentage points higher than those with less-satisfied employees and margins as much as six percentage points higher. Benefits that promote the highest employee satisfaction, aside from fair pay and a safe work environment, are career training, mental and physical healthcare, childcare, and educational opportunities.

"These findings should motivate companies at all levels of ESG maturity to redouble their investment in accelerating their sustainability journey," said Sylvain Guyoton, chief rating officer

at EcoVadis in an **April 17 statement**. "For companies in nascent stages, this means developing sustainability management systems with policies, action plans and reporting. Companies at mature stages can pursue more advanced capabilities such as regenerative resource management and product circularity. Ultimately, cascading these practices into their value chains can support, for example, Scope 3 decarbonization and circularity initiatives, and also puts those trading partners on the same path to value creation."

Taking the Temperature: While the Study's target audience is private equity, we frequently discuss investor interest in ESG issues, including shareholder activity. For example, in April, climate activist shareholder group Follow This filed shareholder resolutions seeking stronger energy transition strategies from oil majors BP, Chevron and Shell. In January 2023, As You Sow sent climate-focused shareholder resolutions to five major U.S. banks, Bank of America, Goldman Sachs, JP Morgan Chase, Morgan Stanley and Wells Fargo, requesting that they disclose their climate transition plans. In 2021, the board of Rio Tinto backed shareholder resolutions requiring the company to set emissions targets consistent with the Paris Climate Accords and suspend memberships in industry associations that lobby against climate change action. We also have previously discussed how ESG-related activism is developing in certain industry sectors, such as the insurance sector and the pensions sector in the UK.

Whatever one's position on the strength of the link between a company's relative ESG focus and its financial performance, we continue to hold the view that directors and officers need to inform themselves about material climate-related issues as part of their overall governance responsibilities. Doing so will permit boards and management to assess and act on material sustainability risks and opportunities. Among other things, directors and senior executives should focus on climate-related governance (i.e., 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) to avoid litigation exposure. Data collection, in particular, is a challenging area, which we have commented on frequently. Companies relatively new to ESG reporting will likely incur significant one-time costs in developing data gathering and reporting infrastructure, as well as ongoing costs tied to periodic reporting, particularly given the lack of consensus regarding what constitutes high-quality data.

EU Approves State Aid to Bolster Czech Sustainability Scheme

May 23, 2023

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On April 21, 2023 the European Commission **approved** a €401 million scheme proposed by the Czech Republic to promote green district heating from renewable energy and waste heat. The scheme represents another environmentally focused initiative recently approved by the EC under EU State Aid rules, and will contribute to the implementation of the Czech Republic's **National Energy and Climate Plan (the NEC Plan)**. The Czech Republic has described the new infrastructure as crucial to achieving its target to reduce total greenhouse gas emissions by 30% by 2030. Scheduled to run until December 31, 2025, the scheme will promote the decarbonization of heat generation units that are connected to district heating systems.

Under the NEC Plan, the Czech Republic will develop renewable heat generation units powered by biomass and waste with a capacity above 500 kilowatts. This in turn is expected to support the installation of approximately 345 megawatts of renewable heat generation capacity. Under the NEC Plan, the Czech Government advocates using locally available heat sources as it helps to decentralize the energy sector, reduce dependence on fossil fuel imports and strengthen the local economy. The scheme is open to owners of heat generation installations holding a heat energy product license and producing heat from biomass or waste that is considered a renewable energy source within the meaning of the **Renewable Energy Directive**. The Renewable Energy Directive is the EU's legal framework requiring that 32% of the energy consumed within the European Union is classified as "renewable" by 2030.

It is hoped that the scheme will not only contribute towards Czech Republic achieving its own energy transition targets but will also contribute towards the implementation of the **European Green Deal**, under which the Commission adopted a set of proposals to aid in the reduction of net greenhouse gas emissions by at least 55% by 2030.

Taking the Temperature: The approval of the Czech scheme is another example of the EC approving EU State Aid to fund energy transition projects in Member States. The Commission approved State Aid to Spain and Germany to build Hydrogen-powered steel plants in February and to a German electric rail scheme in March. As we previously discussed in reporting on those State Aid grants, certain conditions must be satisfied in order to obtain EC State Aid approval because an award of government support confers a competitive advantage in the jurisdiction and the EU generally on the companies benefiting from the aid. Here, the EC found that the Aid was warranted because it "is

necessary and appropriate for the decarbonisation of the district heating sector in" the Czech Republic; the aid is "proportionate and limited to the minimum necessary;" and "positive effects of the aid on the decarbonisation of district heating systems in Czechia outweigh any potential negative effects on competition and trade between Member States."

The Commission's continued support for green transition projects by Member States underlines the importance to the EU of its Fit for 55 plan, which we have discussed in detail previously.