ECLA – ESG Presentation

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Agenda

- The ESG context
- Pressure coming from a number of different quarters
- Headline implications for European companies and their directors
- How companies can manage these challenges
- Implication for transactions

The ESG Context

- ESG = environment, social and governance
- Focus on ESG as part of responsible capitalism – and possibly a way to avoid the next Deepwater Horizon or VW emissions scandal
- Environment: energy use, waste, pollution and similar matters affecting sustainability and climate change
- Social: modern slavery, equal pay, supply chain management, health and safety
- Governance: boardroom and general diversity, stakeholder involvement, management of conflicts, anti-bribery policies, general transparency
- Emphasis on long term success rather than short term profitability

New Climate Change in the Headlines

BlackRock pushes companies to adopt 2050 net zero emissions goal

World's largest asset manager warns it may drop climate laggards from active portfolios

Aviva will use its 'ultimate sanction' to force action on global warming

One of the UK's largest asset managers says it is prepared to fully divest from 30 oil, gas and mining companies

Wall Street's new mantra: green is good

Bankers once saw tackling climate change as a niche issue. Now it is a chance to fuel future profits. Is it a turning point?

Too many boardrooms are climate incompetent

There is a striking lack of directors with expertise in climate change and ESG issues

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Introduction

- Climate change currently dominating the ESG agenda.
- Increased focus on climate change risks for companies:
    - Physical (e.g. impact of extreme weather events on operations)
    - Transition (e.g. cost of de-carbonising activities to meet regulations)
    - Liability (e.g. action for damages arising from harm caused by the company)
- Pressure coming from a number of different quarters:
    - Government
    - Shareholders
    - Pressure groups

Governments

- Need private sector action to meet government commitments to achieve net zero GHG by 2050 – e.g. UK Climate Change Act 2008 and French equivalent; EU pending
- EU study on directors' duties
- High priority in UK, with Presidency for COP 26 in Glasgow in November; and US with G7 conference
- Actions include:
  - Direct regulation
  - Carbon pricing
  - Legal action for damages
  - Disclosure obligations – both climate-specific and wider ESG
- EU introduction of SFDR and Taxonomy Regulation
- UK Government focusing on TCFD – initially for financial sector and premium listed companies

Shareholders

- Institutional investors driving increased disclosure – e.g. Investment Association priorities for 2021 and EU equivalent
- They need information from investee companies:
  - to meet their own disclosure obligations
  - to make decisions on investment/capital allocation
- Some shareholders considering exercise of shareholder rights:
  - requisitioning resolutions at AGM – HSBC and Unilever
  - potential derivative actions
  - securities litigation
- Shareholders and resilience

Pressure Groups

- Well funded and willing to take legal action
- Acquire shares if necessary
- Significant risks from adverse publicity – especially consumer-facing businesses
- Targeting of companies and their executives
- Aiming to influence company behaviour – e.g. Siemens involvement in Australian coal mine

Headline implications for UK companies and their directors

- Increased regulatory burden – time and cost (regulator estimated £360k per issuer for first year compliance with new listing rule)
- Risk of liability
  - criminal penalties
  - civil liability
  - FCA sanctions for listed companies
- Reputational damage
- Adverse impact on share price/value
- Increasing D&O premiums

Headline implications for Germany and their directors

- Corporate Governance Index for listed companies
- Stakeholder value vs shareholder value
- No general duty to act sustainable

- Reputational damage
- Adverse impact on share price/value
- Increasing D&O premiums

TCFD Recommendations

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's business, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to asses and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Describe the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHC) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-scenarios, including a 2°C or lower scenario.	c) Describe for processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

SFDR – summary obligations

Firm and product obligations: consider impact of preparation

Firm level

- Sustainability risk policies to be published
- Principal adverse impacts – comply or explain
- Remuneration policy – how is it consistent with "sustainability risks"

Product level (no ESG focus)

- Integration of sustainability risks – comply or explain
- Principal adverse impacts – consider DD policy
- Marketing communications – must not contradict SFDR disclosures

Product level (ESG focus)

- Article 9 disclosures – disclose information on how environmental/social objectives are met (and reference benchmarks)
- Articles 8 disclosures – disclose information on how a designated index is aligned with the investment objective, how it differs from broad/market index and, if there is no index, how the objective will be attained.

Climate Change Litigation

Type of climate cases

2021

1. **Consumer and investor fraud claims**
   Plaintiffs are increasingly filing consumer and investor fraud claims alleging that companies failed to disclose information about climate risk or have disclosed information in a misleading way.

2. **Extreme weather events**
   Recent years suggest a growing number of pre and post-disaster cases premised on a defendant's failure to properly plan for a manage the consequences of extreme weather events.

3. **Courts' orders will raise new challenges**
   As more cases are filed and some reach a conclusion, implementation of courts' order will raise new challenges.

4. **The law and science of climate attribution**
   As cases seeking to assign responsibility for private actors' contributions to climate changes and cases arguing for greater government action to mitigate both advance and proliferate, courts and litigants will increasingly be called on to address the law and science of climate attribution.

5. **International adjudicatory bodies**
   Litigants are increasingly bringing claims before international adjudicatory bodies, which may lack for enforcement authority but whose declarations can shift and inform judicial understanding.

How can boards manage these risks?

- Appoint additional directors to ensure that the board has the right expertise
- Ensure company has the systems and data necessary to allow accurate assessment of risks and opportunities, and therefore adoption of appropriate metrics and targets
- Review strategic plans – for example:
  - Pivot towards long-term sustainable activities
  - Strategic sales of non-sustainable activities
  - Reorganisation of groups into “green” and “brown” divisions
  - Raise capital to cover costs of transitioning to low carbon future
- Manage the scope of disclosures
- Ensure robust verification processes
- Use the “explain” option where necessary (to the extent permitted)
- Take external expert advice

How can boards manage these risks? (cont.)

– Consider where to put the disclosures – eg section 463 Companies Act 2006 contains a partial safe harbour for directors, if the disclosures are in the strategic report or directors' report
– Review disclaimers
– Consider foreign liability risks
– Check D&O policy and prepare for disclosure on renewal, and consider separate indemnities from the company
– Consider Unilever-style advisory vote on climate policy
– Consider seeking certification as a "B Corporation"

How can boards manage these risks? (cont.)

- Business judgement rule
- Articles of association
- Resilient structures
  - updates of 2-year solvency planning
  - monitoring: early crisis detection and duty to take restructuring measures; sustainable development only possible by taking ESG topics into account; 2-years solvency planning

Implications for corporate transactions

– Be aware of the potential need to address climate risks in prospectuses and other public documents – and for appropriate disclaimers
– Due diligence on acquisitions – are companies and advisers asking the right questions? Could the acquisition affect the sustainability profile of the acquirer, or its ability to meet its own disclosure obligations?
– Public takeovers – is there an ESG dimension that can/should be used by bidder or target?
– SPA provisions – does the buyer need additional warranties, or is the general compliance with law warranty sufficient?
– Investment agreements – does the investor have the right to obtain all the information it may need to meet current and future disclosure obligations?

Implications for corporate transactions

- Discuss D&O and director indemnities with directors
- AGM preparation – consider proactive steps and possible shareholder actions
- Section 172 Statement and equivalent

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