Corporate Counsel Business Journal
Jul ▪ Aug 2021
VOLUME 29, NUMBER 4

CCBJ

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Corporate Focus on ESG Evolves With Times

JEROEN OUWEHAND AND THAIS GARCIA, PARTNERS WITH CLIFFORD CHANCE, DISCUSS THE GROWING SCOPE AND INFLUENCE OF ESG DEVELOPMENTS.

Corporate Counsel
Business Journal
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CCBJournal.com

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▸Jeroen Ouwehand and Thais Garcia, partners with Clifford Chance, are members of the firm's ESG Board. Ouwehand, who is the firm's senior partner serves as the ESG Board's chair. Here, they discuss the growing scope and influence of ESG developments, what it means for businesses worldwide, particularly around environmental issues, and the important role general counsel play in the picture.

CCBJ: Are environmental, social and corporate governance factors (ESG) a risk or an opportunity for businesses out there?

Jeroen Ouwehand: Both a risk and an opportunity, which explains why ESG has really risen to the top of the agenda for many general counsel (GC) and boards of directors.

Companies are increasingly aware that a failure to address ESG matters can be detrimental to their business, both financially and reputationally. There's a tidal wave of investors, employees, customers and stakeholders putting pressure on companies to drive for a more sustainable future, environmentally and socially, organized through good governance.

Risk mitigation is important, but at the same time, ESG creates tremendous opportunities for businesses. Look at investment funds for example: S&P Global has recently reported that in the first 12 months of the COVID-19 pandemic, many large investment funds with ESG criteria outperformed the broader market.

What else is driving organizations to prioritize ESG, particularly around environmental matters?

Thais Garcia: Public policies are a key driver behind this increased focus on ESG, particularly when it comes to the environment. It is very interesting to see the different policies that governments across the world are implementing and how much the agenda changes depending on which party has power.

For instance, the Biden-Harris administration has made it clear from day one that tackling the climate crisis is a priority. At the Climate Change Summit earlier this year, President Biden declared, among other things, that the United States would cut its global warming emissions by at least half by the end of the decade.

Public policy can accelerate the pace of change. There is no question that entire businesses and industries are impacted by these policies, and they in turn help shape the businesses of the future. Here's a concrete example from the International Climate Finance Plan announced by the Biden-Harris administration at the aforementioned summit: the Development Finance Corporation (DFC) will now update its development strategy not only to include climate for the first time but also to make investments in climate mitigation and adaptation top priorities. They're committed to scaling back public investments in carbon-intensive fuel and fossil-based energy. That will also apply across the spectrum of other agencies and entities, with a goal of transitioning the portfolio to net-zero emissions by 2040. This will release calls for applications for climate-focused investment funds and other climate-related investments. Two years from now, in 2023, at least one-third of all of its investments should be linked to addressing the climate crisis. This creates a new wave of opportunities for climate-focused businesses.

At the same time, we see legislative initiatives going in the opposite direction, such as the two bills that were recently advanced by the Texas Legislature in an attempt

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>
> **–Jeroen Ouwehand**

to protect the state's oil and gas industry from efforts to reduce greenhouse gas emissions. The bills require state entities – including state pension funds – to divest from companies that cut ties with or boycott fossil fuel companies. The proposed legislation essentially pushes back at investors that have pulled financial support for the oil industry in an effort to curb carbon emissions that contribute to climate change.

Ouwehand: As Thais suggests, the pace of progress is not the same in every country and region, but overall we have seen many developments in the fight against climate change and environmental degradation.

The European Union (EU) is still driving the ESG movement globally at the moment, particularly when it comes to climate change. Europe is determined to become the first climate-neutral continent. The goal is to achieve that mark by 2050, and the EU is driving that agenda through compulsory requirements such as the Sustainable Finance Disclosure Regulation, which lays down harmonized rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes. The European Commission recently unveiled a number of proposals under the "Fit for 55" initiative that aim to help it achieve the EU's new target of a 55 percent reduction in greenhouse gas emissions by 2030 (against 1990 levels). One such proposal is a Regulation on a Carbon Border Adjustment Mechanism (CBAM) to deal with the long-standing problem of 'carbon leakage' that impedes the EU's decarbonisation plans, and protection for European firms against lightly regulated rivals; a regulation on imports which would mean foreign companies would pay a levy to sell polluting products to the EU. Other EU requirements include a provision about sustainability-related information with respect to financial products, and the EU Taxonomy, a classification system established to clarify which investments are environmentally sustainable, in the context of the European Green Deal.

In China, while historically we have seen relatively few regulatory interventions when it comes to the environment, they've announcement net-zero targets for 2060, which is huge. Japan has pledged to reach net-zero by 2050. If we couple that with the return of the United States to the Paris Agreement and some of the new policies of the Biden-Harris administration, there is just so much momentum, and rightly so. The environment is the biggest issue of our generation.

How is your firm positioning itself to be at the forefront of some of these environmental challenges?

Ouwehand: With regard to public policies, at the World Economic Forum this year, I spoke at the Greening Trade panel, and we announced that Clifford Chance would be working with the World Economic Forum on the Climate Trade Zero Project. We are interviewing businesses globally to really understand what obstacles and policy changes are needed for them to achieve their net-zero commitments and climate goals. We're focused on obstacles and policy changes, and more specifically on trade obstacles and how trade policies can help them achieve those targets.

We are also working with the International Human Rights and Business Organization to develop policies and a white

paper around Just Transition, a framework developed by the trade union movement to encompass a range of social interventions needed to secure workers' rights and livelihoods when economies are shifting to sustainable production, primarily combating climate change and protecting biodiversity.

As to our own commitments, we have committed to becoming net-zero by 2030. We are also a founding member of the Net Zero Lawyers Alliance.

Garcia: We have been helping our clients design and implement net-zero strategies for companies and carbon offsetting (many were firsts of their kind), and we've assisted clients with managing shareholder activism around climate.

We have also been very active in helping clients navigate standards and requirements across the globe in relation to sustainability and ESG reporting. It's a complex area for GCs and boards to navigate, because there are numerous different frameworks. It is really important for companies, especially those with cross-border operations, to approach these matters from a global perspective.

ESG carries quite a broad definition. Beyond environmental, what other topics you are discussing with your clients?

Ouwehand: The social (S) aspects of ESG are at the forefront of many GCs and boards' minds. The S really focuses on how a company manages its relations with its stakeholder groups – its employees, suppliers, customers and the communities in which it operates. It broadly encompasses areas such as business and human rights, as well as corruption, transparency, supply chain management, consumer protection issues, investments in local communities, labor and employment issues, and obviously diversity, equality and inclusion. As we emerge from the pandemic, there's also a lot of concern around public health, mental health, social justice and economic stability. These are all areas that are not new, obviously, but there's a big spotlight on them right now, and that will continue.

An active example is our current work for extractive sector multinationals on the management of human rights risk within business relationships through contractual provisions – this includes guidance for the

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business on use of contractual clauses and issues in negotiations. All of this is also relevant in the context of Just Transition, which is driving the energy transition in a way that also respects human rights. We think Just Transition is becoming an increasingly important theme and trend, and rightly so.

We are also advising private-equity firms, manufacturers and other businesses on their approach to business and human rights in due diligence and management of portfolio companies or targets once acquired. Relating directly to people – we advise on reporting requirements for the Gender Pay Gap regime, internal investigations into human rights abuses in supply chains, risk mapping as it relates to forced labor, and we provide counsel in the context of operation expansion and expropriation or relocation of local communities.

Garcia: I would say the intersectionality between the E, the S and the G is a big topic. The G – governance – is often the piece that brings the puzzle, the E and the S, together. There's an increased focus lately on developing management structures to ensure that good governance is in place, including good ethical standards as well as a focus on corporate responsibility.

Companies are under high scrutiny these days and boards and GCs need to be prepared to manage that. More and more, we're advising clients on the full spectrum of governance-related issues, from compliance reviews to implementing corporate governance structures and crisis management. Corporate management of social-related issues, including human rights, employee well-being and community relations, as Jeroen mentioned earlier, is a key part of that.

Ouwehand: Another element of ESG that I find particularly interesting that permeates all of these issues is corporate purpose and ethics. There's been a significant amount of discussion around whether corporations must have a defined purpose and set of values, beyond just profit generation, that will guide their governance, decision-making and long-term strategy.

This discussion around purpose and profit is sometimes framed as this sort of dichotomy, which I believe is actually a false dichotomy. It's suggested that businesses have to choose: It's either purpose or profits, but actually there's plenty of evidence that having a clear purpose, and being a purpose-driven business, is good for the bottom line as well. It's good for business.

Over the past months I've been interviewing board members from many different businesses, as well as representatives from nongovernmental organizations (NGOs), governments and academia, about business ethics and purpose. Because of the pandemic, many businesses have really been looking in the mirror, and as we know, this is also part of a trend whereby many businesses are moving away from a purely shareholder-driven model to a larger stakeholder model.

You both mentioned risks earlier – what other trends should GCs be thinking about as it relates to ESG?

Garcia: The rise in ESG litigation and shareholder activism is a growing risk for businesses across a range of sectors. We are seeing investors begin to pursue claims against companies for inaccurately representing their ESG credentials or for failing to manage and disclose climate change and other ESG risks.

Shareholder activism as it relates to ESG is also on the rise. We have just seen two significant climate change–related votes take place at the general meetings of ExxonMobil and Chevron. At ExxonMobil, a majority of shareholders selected at least two of the four directors nominated by the activist hedge fund Engine No. 1, which claimed that the company faces an "existential risk" because of its focus on fossil fuels. It was the first time the company has faced a contested shareholder vote of this nature. Meanwhile, Chevron's shareholders voted for a resolution calling on the company to substantially reduce its Scope 3 emissions.

Ouwehand: Regarding litigation, another interesting trend is NGOs using litigation in efforts to combat climate change and protect human rights, often as part of a strategy to call attention to these issues and drive legislative and regulatory changes.

In Germany, a group of German activists, backed by NGOs including Greenpeace and Germanwatch, challenged Germany's Climate Change Act. The plaintiffs invoked the "Right to a Future" and argued that Germany's climate change targets to reduce CO2 emissions by 55 percent by 2030 were too low. In another landmark ruling, Germany's Federal Constitutional Court held earlier this year that certain provisions of the act were indeed incompatible with fundamental constitutional rights, that the reduction targets provided for in the Climate Change Act were imbalanced as they shift major reduction burdens to the future, which could result in a considerable limitation on the freedom of future generations. In response, the German cabinet has approved a reform of the Climate Change Act with a new target of a 65 percent cut to CO2 emissions.

There is another very interesting case brought by NGOs and other individual claimants that was recently ruled on by the District Court of The Hague. In a landmark judgment on May 26 of this year, Royal Dutch Shell (RDS) was ordered by the District Court of The Hague to reduce its CO2 emissions by 45 percent by 2030, as compared with 2019 levels. This is the first time that any court has ordered a company to reduce CO2 emissions. The judgment may have significant consequences for companies with significant CO2-emissions that have a link to the Netherlands. This is clearly an issue for companies headquartered in the Netherlands, but it cannot be ruled out that this judgment might affect other companies that have a clear connection with the country as well. Also, we may well see other similar cases brought in other jurisdictions on the back of this Dutch Shell judgment. Companies doing business in different regions need to prepare themselves; they may need to adapt their processes to stricter requirements and accelerate the transition sooner than they think.

Also recently, climate organization Urgenda announced a new case against the state of the Netherlands, claiming the forfeiture of penalties for the alleged failure of the state to live up to an earlier judgment obtained by Urgenda in which the state was held to reduce carbon emissions in the Netherlands by 25 percent by 2020 compared to 1990. This judgment was the first of its kind

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and got a lot of international attention. Urgenda has also announced that it intends to address the European Court of Human Rights in relation to this matter.

Garcia: The point Jeroen is making is a very important one. Businesses with cross-border operations will face increasingly complex and sometimes very different requirements. Even though climate-related litigation has had limited success in the U.S. federal courts to date compared to what we are seeing in Europe, companies should prepare themselves with a comprehensive strategy for adapting to this ever-changing environment, and that applies across the spectrum of ESG.

How can GCs help their companies navigate this new ESG environment?

Ouwehand: ESG is here to stay. But the E, the S and the G are constantly evolving, so the way companies and their GCs approach these issues also needs to evolve. They must now look at the full spectrum from A to Z of ESG and the intersectionality between the various ESG factors.

More and more, I see the focus on ESG moving away from a mere risk-management exercise. ESG is taking center stage and becoming a key component of companies' value-driven propositions, and GCs have a role to play in driving such a strategy forward. I see that across all sectors and jurisdictions.

Garcia: As ESG evolves, this new reality means that the role of general counsel is also evolving. The GC's role has always encompassed identifying and dealing with risks, conflicts of interests, whistleblowing and the like. However, as ESG evolves, coming back to Jeroen's earlier point, there is an increasing tendency for GCs to be expected to be attuned to the broader spectrum of ESG matters, and often to act as moral arbiters, while also focusing on the technical, legal and regulatory issues. It's a very interesting shift.

We also have to be mindful that not every company is at the same stage of development when it comes to ESG, or may not have dedicated ESG functions or the resources necessary to really invest in the full spectrum of ESG, which puts even more burden on GCs. Prioritizing certain elements of ESG and developing a strategy around these issues is key. ■

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