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Patchwork Gov't Rules Complicate ESG Plans, Survey Says

By **Rachel Rippetoe**

Law360 (July 30, 2024, 2:05 PM EDT) -- Environmental, social and governance programming is becoming a bigger headache for companies around the world as regulations continue to develop and conflict with one another, according to a law firm report published Tuesday, but this doesn't mean industry is backing down from ESG, in-house counsel say.

According to the Thompson Hine LLP survey tracking companies' ESG progress and challenges over the past two years, private companies in particular are considering a "more cautious, reactive approach rather than a proactive one," as anti-ESG sentiment rises along with more sophisticated regulations coming out of the U.S. Securities and Exchange Commission, the European Union and states like California.

But while companies in the survey might have been griping about a lack of clarity, concerns about data collection and storage and the risk of greenwashing litigation, this actually indicates that most companies have developed a more sophisticated understanding of what ESG programming really requires, the report's authors and members of Thompson Hine's ESG leadership team Jurgita Ashley and Heidi B. Friedman told Law360 Pulse.

"We hear about all this anti-ESG movement and a potential pullback, but we're not seeing that from our day-to-day," Ashley said. "If anything, companies are investing more in the ESG programs but using different words, rebranding."

Of all the varying levels of regulation, public companies surveyed reported that their greatest concern was with the final SEC rules for climate-related disclosures, and they reported having a "wait-and-see" approach to adopting some of the more granular details of the requirements, which are currently tied up in legal challenges.

But on the private side, the SEC requirements' exclusion of "scope 3" emissions, or indirect emissions that occur in a company's value and supply chain, has actually stalled a variety of ESG programming in private companies, the report found. SEC regulations don't apply to private entities, but many were gearing up to comply with a similar framework of reporting anyway, because the public companies they work with would need to require it.

"Private companies were almost getting ready to have programs at the levels that public companies were having, because with scope 3, if you're a public company, their private company suppliers would be included," Friedman said. "But that wasn't included, so many thought, 'Oh, maybe we don't need to put in the type of investment that we thought we did.'"

This presents an added challenge for global companies, which often have to comply with the EU's corporate sustainability reporting directive and its due diligence directive, which does require companies to disclose information about their supply chain emissions, as well as meet certain standards.

While almost 63% of public companies reported that they were preparing to comply with the EU sustainability reporting directive, only 13% of private companies said the same, and similarly 55% of public companies said they were planning to comply with the EU's due diligence directive and only 15% of private companies said the same.

However, with both the EU's and California regulators' inclusion of scope 3, "the 'flow down' effect to private companies will most certainly continue," the report said. For now, it's a challenge for in-house counsel to determine the best path forward for ESG programming amid a shifting regulatory landscape.

"Working with global companies, there are a lot of decision points for in-house counsel," Ashley said. "Do you build a program at the global parent level, sort of picking the strictest standard and going with it, or do you prep the global company that might be based in the U.S. for the U.S. standards and just incorporate a few frameworks for the EU regulations?"

The survey noted that far fewer public companies, just 35%, planned to comply with the California ESG regulations as opposed to other regulations. This is largely because many of those California laws are being challenged in litigation, "so some companies are electing not to spend money until they know they will in fact be required to comply," the report said.

Something of growing concern for all companies, according to the survey, was greenwashing litigation, or civil suits challenging whether a company is actually as sustainable and environmentally and socially conscious as it claims to be. The report found that among the specific industries surveyed, private financial service providers were most affected by this.

While only 3% of public companies and 4% of private companies reported having faced any kind of greenwashing allegations or claims, this litigation and enforcement volume will likely increase in two or three years as the SEC regulations take some time to set in, Ashley and Friedman said.

"It takes up to three years for the litigation based on those disclosure requirements to really start up," Ashley said. "We're starting to see the greenwashing claims. We're definitely not at the level yet of where it's heading."

The threat of these suits is causing companies to narrow their ESG goals and be more discerning about making broad declarations on sustainability.

"Because people are putting more out there, they're more subject to scrutiny," Friedman said. "It's the same golden rule, you should not state anything you cannot back up. So as long as companies are thinking about, you know, not overstating and making sure they have the information they should be foolproof if someone does question them."

Friedman said that the Federal Trade Commission's upcoming "green guide" will help offer companies a guide for correctly marketing and reporting their sustainability and environmental efforts.

The impact on ESG of the U.S. Supreme Court's recent decision Loper Bright Enterprises v. Raimondo, which dealt a severe blow to the ability of federal agencies to interpret the laws they enforce, is still unknown, Friedman said. But so far, she said she has not seen companies change their programming because of it, and said it would be unwise of in-house counsel to advise companies to do so.

"Agencies aren't going to have the discretion they used to have, but I do not think that these obligations are going away," Friedman said. "There's already an enormous level of commitment and identification of resources. So I don't think that it's going to make a major change."

And in-house counsel should be encouraging companies to incorporate ESG into all levels of their operations anyway, because it's good for business, Friedman said.

"Companies that really embrace ESG perform so much better," she said. "When you're thinking and trying to decide where your values lie and where you're investing your time, the business is better. So it's actually a task for in-house counsel to add value, rather than be reactive like our usual job."

--Editing by Nicole Bleier.
