Sustainability

The People, Planet, Purpose, Profit and Politics of Sustainability

The Paris Accord: Sustainability Bookends of the [First?]Trump Administration

The Paris Accord (the "Accord") was signed by 196 nations with the stated objective "to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty." The Accord came into force on November 4, 2016, the day after Donald Trump became President-elect, and with the US election hanging in the balance at the time this goes to publication, as far as the US is concerned, it ended on November 4, 2020, the date the US became the only Signatory to opt-out of the global effort to combat climate change. Mr. Biden has pledged to immediately rejoin the agreement if elected.

The four years in between the two November 4 dates serve as convenient bookends to a US administration that has been indifferent if not outright hostile to sustainable development goals generally and climate action specifically. The New York Times reported that, over the four years in office, the Trump administration has dismantled major climate policies and rolled back many more rules governing clean air, water, wildlife, and toxic chemicals.[i] The NYT reported more than 70 environmental rules and regulations officially reversed, revoked or otherwise rolled back under Mr. Trump with another 26 rollbacks still in progress as of the date of the report.

As a reminder, the Paris Accord aims to achieve its objective by (a) holding the increase in the global average temperature to well below 2° C above pre-industrial levels and specifically trying to limit the temperature increase to 1.5° C above pre-industrial levels; (b) increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low GHG emissions development while not threatening food production; and (c) making finance flows consistent with a pathway towards low GHG emissions and climate-resilient development.

How Ya Gonna Keep 'em Down on the Farm (After They've Seen Paree Accord)?

Due apologies to the famous WWI song that highlighted concern that American soldiers from rural environments would not want to return to farm life after experiencing the life and culture of Paris. But the analogy is apt insofar as the Paris Accord likely succeeded in bringing climate action to the consciousness of many Americans including corporations and state governments, many of whom have pledged to carry on with efforts to combat climate change.

The Accord provided for Signatories to communicate their intended nationally determined contribution or "NDC." The US NDC set an economy-wide goal of reducing GHG by 26-28% below its 2005 level by 2025. While unlikely to meet the NDC, efforts by private and public entities to address de-carbonization will likely endure despite the US withdrawal.

A bipartisan coalition of 25 Governors have organized under the banner of the US Climate Alliance has pledged to continue scaling up climate action regardless of the election outcome.[ii] On the corporate side, the Business Roundtable has recently issued a new set of principles and policies to address climate change and is calling on businesses and governments to work together "to limit global temperature rise this century to well below 2 degrees Celsius above pre-industrial levels, *consistent with the goals of the Paris Agreement*." (emphasis added).[iii] While progress will no doubt come in fits and starts over the next few years, climate action aligned with the Paris Accord in some form or other will remain on the American agenda.

Finally, the irony should not be missed by the fact that in 2020, the Trump administration has presided over what may appear to be lowest rate of energy-related CO2 emissions in decades in the US if recent monthly statistics by the US Energy Information Administration continues to bear out.[iv] Of course, the cause of the low rate is due to the impact of COVID-19 on energy consumption globally; a topic addressed in great detail by this year's World Energy Outlook.

International Energy Agency ("IEA") issues 2020 World Energy Outlook

Last month the IEA published its annual World Energy Outlook ("WEO"), its flagship publication, which this year (in 464 pages) examines in detail the continuing impact of Covid-19, and in particular how the pandemic will affect prospects for rapid clean energy transition for the next ten years.[v] The WEO typically provides long-term (multi-decade) modelling horizons but in this year's issue, because of the immediate impact of Covid-19, the WEO focuses on the next 10 years and targets key uncertainties facing the energy sector globally under a number of scenarios based on differing pathways out of the current pandemic-induced economic slowdown. The primary thesis of this year's WEO is that "the pandemic is far from over" and has caused "more disruption to the energy sector than any other event in recent history, leaving impacts that will be felt for years to come."

Key Takeaways from the 2020 WEO

- "A Huge shock to the system." Global energy demand is set to drop by 5% in 2020, energy-related CO2 emissions down by 7%, energy investments to drop by 18%. A drop of 2.4 gigatons takes annual CO2 emissions back to where they were a decade ago.

- Uncertainty over the duration of the pandemic, its economic and social impacts and the political and policy responses creates a wide range of possible energy (and renewables) futures.
- Four scenarios are presented in great detail ranging from one in which it is assumed that Covid-19 is gradually brought under control in 2021 with the global economy returning to pre-crisis levels the same year. A second "delayed recovery scenario" models a two year delay in economic recovery to 2023, which "ushers in a decade with the lowest rate of energy demand growth since the 1930s." The WEO includes two other scenarios, one of which envisages a surge in clean energy policies and investment to achieve sustainable energy objectives aligned with the Paris Accord. The final scenario, new to this WEO, is a net zero emissions by 2050 scenario, which includes the first detailed IEA modelling of what would be needed in the next ten years to put global CO2 emissions on track for net zero by 2050.
- Solar photovoltaics ("PV") becomes the new king of electricity. Because of supportive policies and maturing technology along with significant reduction in cost, the WEO concludes that solar PV "is consistently cheaper than new coal- or gasfired powerplants in most countries, and solar projects now offer some of the lowest cost electricity ever seen."
- Coal's not coming back. By 2040 coal's share of the energy mix falls below 20% for the first time since the Industrial Revolution.
- Global oil demand flattens out in the 2030s and the era of growth in global oil demand comes to an end within 10 years, but the shape of the economic recovery is a key uncertainty, although "in the absence of a larger shift in policies, it is still too early to foresee a rapid decline in oil demand."

The WEO concedes significant uncertainties lie ahead with respect to the shape of the global economic recovery and the policy responses by both governments and private enterprise. As things stand now, the WEO concludes that the "world is not set for a decisive downward turn in emissions," although it predicts that global emissions will recover at a slower pace than after the Great Recession of 2008-2009. In short, "the world is still a long way from a sustainable recovery."

Au courant à Europe

As indicated above one of the three pillars of the Paris Accord is making finance flows consistent with a pathway towards low GHG emissions and climate-resilient development. Perhaps no Signatory to the Accord has taken that to heart as much as the EU. As part of the European Green Deal the EU promulgated, among other regulations, Regulation (EU) 2019/2088 on the sustainability-related disclosures in the financial sector ("SFDR").

The SFDR mandates specific disclosures to investors on the integration of sustainability risks and consideration of principal adverse impacts in the investment decision-making process regardless of whether a product or investment manager is offering sustainability products or advice. Moreover, the SFDR provides further disclosure obligations on financial products that promote, among other things, "environmental or social characteristics, or a combination of those characteristics," so-called Article 8 funds; and financial products that have "sustainable investment as its objective and an index has been designated as a reference benchmark," so-called Article 9 funds.

Investment managers and investment products (e.g., UCITS, AIFs) in scope under the SFDR should take note that in late October, the European Securities and Markets Authority ("ESMA") due to delays caused by Covid-19 postponed the deadline for public consultation on the draft regulatory standards ("RTS"), which were originally issued in April 2020 and had set September 1, 2020 for submission of public comments. ESMA did not set a new deadline for public consultation, which means the RTS (which were due to be issued by 30 December 2020) has been delayed presumably into 2021. As a reminder, the RTS set forth in detail (including a template of 32 mandatory metrics) disclosures of principal adverse impacts.

Importantly, ESMA reiterated that the SFDR is still scheduled to come into force on 10 March 2021, and "financial market participants" (as that term is defined in the Regulation) must comply with the general sustainability-related disclosures set forth in the SFDR by that effective date. In short, the delay in releasing the RTS does not in any way relieve financial market participants from preparations to comply with the SFDR by 10 March 2021 — less than six months away.

Unabated European Appetite for Sustainable Investment Products

As we have written in a recent column, the demand for sustainable investment strategies is investor driven. That observation is echoed recently in the Financial Times ("FT"), which reports that assets in sustainable investment products in Europe are expected to reach over € 7 trillion over the next 5 years, outnumbering conventional funds, as investors continue to focus on strategies that focus on climate action and social inequality as these strategies move into the mainstream.

The article reported that, according to research conducted by PwC, "ESG funds will experience more than threefold jump in assets by 2025, increasing their share of the European fund sector from 15 per cent to 57 per cent." While the focus of the study was on equity securities, there is no reason why the same motivations driving investor demand for equity funds will not extend to bond funds as well.

The increasing popularity of sustainability funds also brings along increasing government scrutiny. Securities regulators are focused on clamping down on so-called greenwashing, which is an overarching concern in the SFDR and other regulatory initiatives. Quoting the head of asset management at the Autorité des Marchés ("AMF"), the French securities regulator, the FT reports that recent regulatory measures were taken because the regulator believed that in some cases, "asset managers were not taking ESG factors significantly into account, but they were stating in marketing documents that ESG was core to their investment strategy."

Anti-Corruption

As a signatory to the UN Global Compact, SKY Harbor supports the Ten Principles of the Compact, which includes Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery. In that regard we note approvingly that the Goldman Sachs Board of Directors decided to claw back $174 million in forfeitures and compensation from current and former, culpable and non-culpable executives including C-suite executives as part of the firm's resolution of the Malaysian 1MDB scandal. Readers' awareness of the scandal is assumed given the extensive publicity and the multi-billion dollar fine imposed on Goldman Sachs.[vi] Clawback policies, many of which were established in the aftermath of the Great Recession, may find increasing relevance in an era of stakeholder primacy that prioritizes an ethical approach to doing business and where reputational harm may be have material adverse impacts on a company's bottom line.

The Board's duty of oversight

Many if not the vast majority of US high yield corporate issuers are incorporated under the laws of the state of Delaware in the US. At the risk of over-simplifying a nuanced and heavily interpreted Delaware judicial decision, a Delaware landmark case styled as *In re Caremark International Inc. Derivative Litigation* ("Caremark") stands for the proposition that boards are responsible for oversight, which means that boards must "satisfy their obligation to be reasonably informed concerning the corporation," and must assure themselves "that information and reporting systems exist in the organization that are reasonably designed to provide senior management and the board itself timely, accurate information sufficient to allow management and the board, within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance." [vii]

Caremark cases alleging board failures of oversight have generally been difficult for plaintiffs, but recently a handful of cases in the Delaware courts suggest a more open-minded approach allowing cases to proceed that were in earlier years dismissed during the pleadings stage.

The board's responsibility of oversight concerning a corporation's commitment to corporate sustainability, particularly with respect to climate action and social matters may have reached a tipping point during recent years.

While such lawsuits in past years were probably given little chance of success under conventional legal precedent, shareholder derivative lawsuits have recently been filed under a *Caremark theory of the case* in US federal court against Facebook, Qualcomm, the Gap, Oracle and others seeking to hold directors and senior officers accountable for alleged failures to uphold diversity commitments particularly with respect to the lack of African-American directors.

Regardless of the outcome of these lawsuits, the fact they have been filed and not dismissed out of hand as frivolous attests to the growing importance of corporate sustainability as a matter meriting serious board attention. Thoughtful, alert, and engaged corporate boards are well-advised to keep in mind that customers, investors, employees, communities, suppliers, creditors and others form a mosaic of stakeholder interests that will look to hold the board accountable for its oversight of corporate sustainability writ large.

[i] See https://www.nytimes.com/interactive/2020/climate/trump-environment-rollbacks-list.html. The Trump Administration Is Reversing Nearly 100 Environmental Rules. Here's the Full List. Updated October 15, 2020.
[ii] See http://www.usclimatealliance.org/publications/2020/9/23/coalition-of-25-governors-leading-most-ambitious-state-climate-agenda-in-us-history-vows-to-continue-climate-action.
[iii] See https://www.businessroundtable.org/business-roundtable-market-based-solutions-best-approach-to-combat-climate-change.
[iv] See https://www.eia.gov/todayinenergy/detail.php?id=44837

[v] Available for purchase at: https://webstore.iea.org/world-energy-outlook-2020.
[vi] See https://www.nytimes.com/2020/10/23/business/dealbook/goldman-sachs-clawback.html.
[vii] In re Caremark Int'l Derivative Litig., 698, 970 A.2d 959 (Del. Ch. 1996).

- US officially withdraws from Paris Accord on November 4, 2020. What now?
- International Energy Agency issues 2020 World Energy Outlook detailing impact of COVID-19 on energy demand and prospects for clean energy transition
- ESMA extends deadline for level 2 draft Regulatory Technical Standards but keeps March 10, 2021 deadline for sustainability-related disclosures in the SFDR
- FT reports that assets in sustainable investment products in Europe are expected to reach over € 7 trillion over the next 5 years, outnumbering conventional funds
- Goldman Sachs claw backs $174 million from current and former, culpable and non-culpable executives in aftermath of 1MDB scandal
- Shareholder derivative lawsuits against large public companies for alleged failures to uphold Board diversity commitments seen as new cause of action for plaintiffs' bar

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