April 2016

Weil

Corporate Sustainability

Governance Goes Green

It's not just us tree-huggers. Increasingly, institutional investors, pension plans and regulators are calling for (and in some cases requiring) companies to assess and report on the sustainability of their business operations and investments. Climate change and other environmental concerns are at the forefront of these calls. Institutional investors are focusing on sustainable business practices – a broad category in which environmental and social risks, costs and opportunities of doing business are analyzed alongside conventional economic considerations – as a key factor in long-term financial performance. Sustainability proponents are looking to boards of directors and management to integrate these considerations into their companies' long-term business strategies.

Key Highlights

- Institutional investors increasingly regard environmental and other sustainability issues as strategic matters for companies.
- Shareholders continue to submit environmental and other sustainability proposals, successfully garnering attention and prompting companies to make changes, despite their failure to win majority votes.
- Independent organizations are developing standards for sustainability and environmental reporting to provide investors with consistent metrics for assessing and comparing the sustainability of companies' practices.
- Sustainability and environmental reporting remains in the SEC's sights as it evaluates the effectiveness of current disclosure requirements and considers changes for the future.

Public Company Sustainability Reporting Requirements: State of Play

In 2010, the SEC issued an interpretive release clarifying existing requirements for public companies to disclose in management's discussion and analysis ("MD&A") the "material impacts" of climate change on their business, financial condition, or results of operations.[1] The release underscored the importance of disclosing not just known risks, but also, those uncertainties that, if they were to occur, could have a material effect. Although the release suggested the various kinds of climate-related information that companies might disclose, including the direct physical impacts of climate change, the impact of climate-related legislation and treaties, and changing trends in consumer demand based on environmental concerns, there continues to be wide variation in the type, extent, and quality of climate disclosures.

The SEC exhibited continued interest in climate change disclosure in its April 13, 2016 "Concept Release on Business and Financial Disclosure Required by Regulation S-K," acknowledging that some investors and interest groups have expressed a desire for greater disclosure of sustainability matters on the ground that such matters are of increasing significance to voting and investment decisions.[2] In the Concept Release, the SEC solicited feedback on which, if any, sustainability measures are important to an understanding of a public company's business and financial condition, and whether there are other considerations that make these disclosures important to investment and voting decisions. It remains to be seen if the SEC will endorse or otherwise implement new reporting standards amid pressures for heightened sustainability disclosure. We describe some of these pressures below.

Investors Focus on Sustainable Investing and Reporting

More than 1,300 institutional investors worldwide, representing $59 trillion in assets under management, have signed on to the U.N. Principles of Responsible Investing, which seek to integrate sustainability concerns into investment objectives. Some of the largest pension plans, endowments, and other institutional investors are also becoming vocal advocates for sustainable investing and reporting:

- Large institutional investors are not only urging companies to consider sustainability in their long-term strategic plans, but are also developing their own guidelines for sustainable investing.[3] For example, in February 2016, Lawrence D. Fink, BlackRock's Chairman and CEO, wrote a letter to the CEOs of the S&P 500, endorsing the creation by companies of plans to generate long-term value that include consideration of environmental, social, and governance (ESG) issues, and highlighting BlackRock's efforts to integrate sustainability considerations into its investment processes.[4]
- Leading pension funds such as CalSTRS, CalPERS, and the New York Common Retirement Fund have adopted investment strategies that are committed to low-carbon, sustainable investments.[5] CalSTRS and CalPERS, in particular, have strongly asserted their commitment to corporate engagement on climate change through policy advocacy, engagement with portfolio companies, and investing in climate change solutions.[6] The New York City Comptroller's Office, acting on behalf of the city's five pension funds, has cited the failure of companies to address climate risks as a primary reason for its large and influential campaign to expand "proxy access."[7]
- Yale University recently announced progress in minimizing its endowment portfolio's exposure to what it considers environmentally unsound investments, such as companies that contribute to climate change. Yale directed its investment managers to take into account

the financial risks of climate change and the risks posed by potential government action on climate change, such as carbon taxes.

Not all institutional investors have put their weight behind sustainability shareholder proposals. Vanguard, for example, has been facing pressure from Walden Asset Management and Ceres to increase its support of climate-related shareholder proposals. Walden Asset Management and Ceres cite Vanguard's record of abstaining from voting on all climate-related shareholder proposals in 2015, and its general policy to continue doing so. State Street, despite proxy voting guidelines that support efforts by companies to demonstrate how sustainability fits into their operations and business activities, also expressly considers sustainability implications as secondary to financial and economic issues, a policy demonstrated by State Street's mixed voting record of supporting 13.3%, opposing 62.0%, and abstaining from voting on 24.7% of sustainability and environment-related shareholder proposals in 2015 and 2016 to date.[8]

Environmental and Sustainability Proposals Continue Apace, and Have Impact

Since 2010, over 250 proposals submitted under Rule 14a-8 aimed at sustainability and environmental issues have appeared in proxy statements. Of these, 97 sought an annual report describing the company's present policies, performance, and improvement targets related to key sustainability risks and opportunities, as well as the company's environmental and sustainability goals for the future.[9] In 2016 so far, 63 sustainability and environment-related proposals are included on annual meeting agendas.

Although sustainability and environmental proposals have consistently failed to receive majority support from shareholders, they continue to attract significant attention and, in reality, have been more successful than voting results indicate. As proponents submit proposals year after year, they keep the pressure on companies to engage with shareholders, enhance disclosure, and make substantive changes. Early in this 2016 proxy season, a proposal from Walden Asset Management seeking a sustainability report received a passing vote with 54.5% support from shareholders of CLARCOR Inc., and others may follow.

According to the Governance & Accountability Institute, about 81% of companies in the S&P 500 produced sustainability reports in 2015, up from 20% in 2011.[10] At the recent U.N. Climate Change Conference in Paris, significant attention was paid to the private sector, with the largest U.S. financial institutions announcing goals to finance environmental initiatives, and 141 large global corporations pledging to set emissions targets.[11] The goal set in Paris of holding temperature increases below 2 degrees Celsius is also the basis of at least eight of the shareholder proposals submitted so far in 2016.

Proxy Advisory Firms Support Environmental and Sustainability Proposals

ISS and Glass Lewis proxy voting guidelines generally support a variety of environmental concerns. ISS recommends that shareholders "generally vote for proposals requesting that a company report on its policies, initiatives, and oversight mechanisms related to social, economic, and environmental sustainability."[12] Glass Lewis, which recently partnered with Sustainalytics to integrate ESG metrics throughout its proxy research platform, indicates that it generally supports shareholder proposals when it sees a clear link to value enhancement or risk mitigation and believes that the company has failed to or inadequately addressed the issue.[13]

Glass Lewis has said that, beginning with the current proxy season, it will recommend against directors responsible for risk oversight in cases where the board or management failed to sufficiently identify and manage a material environmental risk that did or could negatively impact shareholder value. Glass Lewis reasons that the identification, mitigation and management of environmental risks, such as oil or gas spills, contamination, hazardous leakages, explosions, or reduced water and air quality, are integral components of evaluating a company's overall risk exposure.

Further demonstrating the call for greater board accountability when it comes to sustainability issues, CalPERS's updated governance principles state that board members should have expertise and experience in climate change risk management strategies, and that companies should explicitly assign oversight responsibilities on climate change to at least one board member.[14] "Climate" may soon become as important a board competency as "cyber" or "China".

Push for Uniform Disclosure Standards

In response to investor concerns, independent organizations have been developing recommendations for more uniform disclosure standards relating to sustainability issues. The Sustainability Accounting Standards Board (SASB) is writing industry standards for identifying and disclosing material corporate sustainability and environmental factors that can be included in MD&A. On April 7, 2016, SASB announced the completion of provisional standards for 79 industries and a process for their codification.[15]

In addition, the Financial Stability Board (FSB), which coordinates international efforts to develop and promote effective financial regulatory policies, launched a task force to make recommendations for consistent company disclosures that will help financial market participants understand climate-related risks.[16] Former SEC Chair Mary Schapiro, a member of both FSB and SASB, stated that the task force aims to leverage existing reporting frameworks and synthesize them in a way that makes reporting less complex for companies and more informative to regulators and investors.[17] The task force released its first report on March 31, 2016, setting out fundamental principles for effective disclosures, and is currently preparing a report specifically focused on how companies can and should disclose the financial impact of climate change.[18]

Enforcement Attention on Climate Disclosure

The Attorney General of the State of New York is scrutinizing energy companies' disclosures regarding the risks they face from future government policies and regulations related to climate change and other environmental issues that could reduce product demand, and disclosures that may raise public doubt concerning climate change. After a years-long investigation launched pursuant to the State of New York's Martin Act, the New York Attorney General recently announced a settlement with Peabody Energy in which the company agreed to make more robust disclosures in its SEC reports.[19] (Peabody has since filed for bankruptcy.) A similar investigation of Exxon-Mobil is ongoing, and has been joined by the attorneys general of several other states.[20]

What To Do Now:

As attention to sustainability issues by investors and regulators continues to grow, and as more companies respond by providing enhanced disclosures and launching sustainability initiatives, boards of directors and management should prepare an action plan to ensure their company is not left behind. To do so, companies should evaluate their own sustainability profiles and take action to address the findings, as they deem appropriate.

- Identify sustainability issues that could affect your company's performance and that may be material to an understanding of your company's business and financial condition.

- Understand key issues of interest to your shareholders with respect to ESG issues. In engagement with investors, be prepared to address particular sustainability factors that they consider in assessing investment risk.
- Understand sustainability regulations that apply to your business.[21]
- Ensure that your disclosures properly state the risks and uncertainties that your company faces in sufficient detail to allow investors to make informed decisions.
- Understand where you stand among your peers with respect to sustainability reporting, as many environmental and social issues are not just faced by individual companies, but by entire industries.
- Consider "climate" expertise when doing a gap analysis of your board of directors' skills.

Corporate Sustainability is published by the Litigation Department of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

If you have questions concerning the contents of this alert, or would like more information about Weil's sustainability efforts, please speak to the editors or any member of Weil's Public Company Advisory Group listed below:

Editor:

Richard L. Levine (NY)	Bio Page	richard.levine@weil.com	+1 212 310 8286

Associate Editors:

Lauren Hoelzer (NY)	Bio Page	lauren.hoelzer@weil.com	+1 212 310 8581
Jay Minga (NY)	Bio Page	jay.minga@weil.com	+1 212 310 8378

Weil's Public Company Advisory Group:

Howard B. Dicker	Bio Page	howard.dicker@weil.com	+1 212 310 8858
Catherine T. Dixon	Bio Page	cathy.dixon@weil.com	+1 202 682 7147
Lyuba Goltser	Bio Page	lyuba.goltser@weil.com	+1 212 310 8048
P.J. Himelfarb	Bio Page	pj.himelfarb@weil.com	+1 214 746 7811
Ellen J. Odoner	Bio Page	ellen.odoner@weil.com	+1 212 310 8438
Adé K. Heyliger	Bio Page	ade.heyliger@weil.com	+1 202 682 7095
Kaitlin Descovich	Bio Page	kaitlin.descovich@weil.com	+1 212 310 8103
Joanna Jia	Bio Page	joanna.jia@weil.com	+1 212 310 8089
Megan Pendleton	Bio Page	megan.pendleton@weil.com	+1 212 310 8874
Reid Powell	Bio Page	reid.powell@weil.com	+1 212 310 8831
Niral Shah	Bio Page	niral.shah@weil.com	+1 212 310 8316

We thank our colleagues Kaitlin Descovich and Niral Shah for their contributions to this alert.

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ENDNOTES

1 *See* Securities and Exchange Commission Guidance Regarding Disclosure Related to Climate Change, 17 CFR Parts 211, 231 and 241, *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

2 *See* Securities and Exchange Commission Guidance Regarding Business and Financial Disclosure Required by Regulation S-K, 17 CFR Parts 210, 229, 230, 232, 239, 240 and 249, *available at* https://www.sec.gov/rules/concept/2016/33-10064.pdf.

3 *See*, e.g., BlackRock, "Global corporate governance and engagement principles" (June 2014), *available at* https://www.blackrock.com/corporate/en-cn/literature/fact-sheet/blk-responsible-investment-1engprinciples-global-122011.pdf (setting forth BlackRock's ESG investment principles); *see also* T. Rowe Price, "Building on Our Values: Corporate Social Responsibility Report" (2014), *available at* http://corporate.troweprice.com/ccw/home/responsibility/corporateSocialResponsibilityReports.do. Mutual funds are also taking positions on sustainable investing after the Department of Labor's recent guidance that fiduciaries may take into account ESG factors as "tiebreakers" when investment are otherwise equal with respect to their economic and financial characteristics – a shift from 2008 guidance discouraging use of such factors, *available at* http://www.dol.gov/opa/media/press/ebsa/ebsa20152045.htm.

4 *See* Letter to Chief Executives at S&P 500 Companies from Lawrence D. Fink, Chairman and CEO of BlackRock, *available at* http://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2.

5 *See*, e.g., CalSTRS Investments Studied for Low-Carbon Economy Opportunities (Mar. 15, 2016), *available at* http://www.calstrs.com/news-release/calstrs-investments-studied-low-carbon-economy-opportunities; CalPERS Sustainable Investing – ESG Policies, available at https://www.calpers.ca.gov/page/investments/governance/sustainable-investing/esg; State Comptroller DiNapoli Positions New York Pension Fund for Low Carbon Future (Dec. 4, 2015), *available at* http://osc.state.ny.us/press/releases/dec15/120415.htm.

6 CalPERS and CalSTRS, *The Importance of Corporate Engagement on Climate Change, available at* http://www.calstrs.com/sites/main/files/file-attachments/calpers-calstrs_climate_change_fact_sheet.pdf.

7 See New York City Comptroller's Office, *Boardroom Accountability Project, available at* http://comptroller.nyc.gov/boardroom-accountability/.

8 Data summarized from ISS Corporate Solutions Voting Analytics (Apr. 18, 2016).

9 Data summarized from ISS Corporate Solutions Voting Analytics (Apr. 18, 2016).

10 *See FLASH REPORT: Eighty One Percent (81%) of the S&P 500 Index Companies Published Corporate Sustainability Reports in 2015, Governance & Accountability Institute, Inc.* (Mar. 15, 2016), *available at* http://www.ga-institute.com/nc/issue-master-system/news-details/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html.

11 *See Joint Statement by Bank of America, Citi, Goldman Sachs, JP Morgan Chase, Morgan Stanley, and Wells Fargo, In Support of Prosperity and Growth, available at* http://www.ceres.org/files/bank-statement-on-climate-policy; *see also*, List of Companies Setting Emissions Targets, *available at* http://sciencebasedtargets.org/companies-taking-action/.

12 *See* Institutional Shareholder Services, *2016 U.S. Summary Proxy Voting* Guidelines, at 63 (updated February 23, 2016), *available at* https://www.issgovernance.com/file/policy/2016-us-summary-voting-guidelines-23-feb-2016.pdf.

13 *See* Glass Lewis, *Proxy Paper™ Guidelines: 2016 Proxy Season – An Overview of the Glass Lewis Approach to Proxy Advice, United States* (Nov. 2016) (Glass Lewis 2016 Proxy Season Voting Guidelines), *available at* http://www.glasslewis.com/assets/uploads/2015/11/GUIDELINES_United_States_20161.pdf.

14 Veena Ramani, *CalPERS raises bar on corporate directors' role in tackling climate change,* CERES (Apr. 6, 2016), *available at* http://www.ceres.org/press/blog-posts/calpers-raises-bar-on-corporate-directors2019-role-in-tackling-climate-change.

15 *See* SASB Completes Provisional Standards for All Industries; Launches Next Phase of Standards Development (Apr. 7, 2016), *available at* http://www.sasb.org/sasb-launches-phase-standards-development/.

16 *See* FSB to establish Task Force on Climate-related Financial Disclosures (Dec. 4. 2015), *available at* http://www.fsb.org/wp-content/uploads/Climate-change-task-force-press-release.pdf.

17 *See* Vibeka Mair, *Former SEC Chair Mary Schapiro on climate disclosure task force*, Responsible-Investor.com (Apr. 1, 2016), *available at* https://www.responsible-investor.com/home/article/mary_schapiro_int_fsb/.

18 *See* FSB, Phase 1 Report (Mar. 31, 2016), *available at* https://www.fsb-tcfd.org/phase1report/

19 *See* Clifford Krauss, "Peabody Energy Agrees to Greater Disclosures of Financial Risks," *The New York Times* (Nov. 9, 2015), *available at* http://www.nytimes.com/2015/11/09/business/energy-environment/peabody-energy-agrees-to-greater-disclosures-of-financial-risks.html

20 *See* John Schwartz, "Exxon Mobil Climate Change Inquiry in New York Gains Allies," *The New York Times* (Mar. 29, 2016), *available at* http://www.nytimes.com/2016/03/30/science/new-york-climate-change-inquiry-into-exxon-adds-prosecutors.html.

21 For example, the Modern Slavery Act of 2015 applies to all companies that do business in the UK in excess of a monetary threshold. In the U.S., SEC rules require conflict minerals disclosure at the federal level, but be aware that there is legislation at the state level as well (e.g., the California Transparency in Supply Chains Act, which requires retailers and manufacturers doing business in California to disclose on their websites what efforts they are making, if any, to eradicate human trafficking and slavery in their supply chains). See Office of the California Attorney General, The California Transparency in Supply Chains Act: A Resource Guide (2015), *available at* https://oag.ca.gov/sites/all/files/agweb/pdfs/sb657/resource-guide.pdf.