2020 PROXY SEASON HOT TOPICS

ESG: the rise of private ordering and the role of the NCGC Committee

DLA PIPER

Executive summary

It is clear that the 2020 proxy season will be dominated by environmental, social and governance (ESG) issues.

The level of scrutiny being given to this topic is not surprising given the public statements of several large influential investors and the revised statement of the Business Roundtable. It has been suggested that the revised BRT Statement on the Purpose of a Corporation represents a paradigm shift towards a more stakeholder-driven approach to governance. A public company's ESG performance presents "important opportunities to mitigate risk and to drive long-term value by integrating material ESG topics into corporate strategies, elevating board acumen, improving governance quality, and enhancing communication with shareholders and stakeholders."

In addition, the coronavirus disease 2019 (COVID-19) pandemic has numerous ESG implications, particularly with respect to health and safety, human capital management, supply chain management and the adoption of sustainable business practices for both the short- and long-term new normal. Boards and management are actively grappling with these issues and are refining how they define and address ESG in this unprecedented environment.

We created this inaugural ESG handbook to help public companies as they develop and maintain a robust ESG program. This handbook is part of our 2020 Proxy Season Hot List series, which we expect to periodically update. In this handbook, we set the stage by discussing topics likely to play a crucial role in the 2020 proxy season related to ESG matters. Next, we examine the role of the nominating and corporate governance committee (NCGC) in this important area. We conclude by presenting our thoughts on some practical aspects of ESG related to several of our practice areas.

This handbook is a cumulative effort of many of our lawyers, and we welcome the opportunity to discuss ESG-related topic with you during the 2020 proxy season and beyond.

Sanjay

Sanjay Shirodkar
sanjay.shirodkar@dlapiper.com

[1] The Age of ESG – Sustainable Governance Partners (February 7, 2020) (https://www.sgpgovernance.com/insights/2020-02-07/the-age-of-esg)

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ESG: The rise of private ordering and the role of the NCGC Committee

Investors are increasingly naming Environmental, Social and Governance (ESG) issues as a top priority. On January 22, 2020, BlackRock, one of the world's largest investment managers, wrote a letter to its clients and a letter to CEOs highlighting sustainability as a key driver of long-term value, and asking that companies publish ESG disclosures by year-end and disclose their climate-related risks. The following week, State Street Global Advisors, stated that because "shareholder value is increasingly being driven by issues such as climate change, labor practices, and consumer product safety," it would start taking "appropriate voting action against board members" at certain companies that are "laggards" based on its own scoring of a company's "business operations and governance as it relates to financially material and sector-specific ESG issues."

ESG is not a destination but rather a journey.

In this alert, we set the stage by discussing topics likely to play a crucial role in the 2020 Proxy Season related to ESG matters. Next we examine the role of the Nominating and Corporate Governance Committee (NCGC) in this important area. We conclude by presenting our thoughts on some practical aspects of ESG related to several of our practice areas.

I. Crucial issues for the 2020 proxy season

In this section, we survey the climate of ESG heading into the 2020 Proxy Season, and the voting policies of ISS and Glass Lewis, relating to ESG.

A. CLIMATE AND SOCIAL RISK MANAGEMENT

ESG refers to a company's exposure to, and management of, environmental and social sustainability and governance risks related to aspects of its business performance. Such risks reflect a company's profile and business model, disclosures and related standards promulgated by international sustainability organizations and reporting agencies, and overall industry peer group performance.

Consistent with this increased attention, management's oversight of ESG risks – and opportunities – should respond to the level of exposure faced by the company and its core business, and reflect a clear understanding of the issues and options associated with such risks. Moreover, management should demonstrate thoughtful consideration of the impacts such risks and responses could have on long-term value creation for shareholders and society.

B. KEY DEVELOPMENTS GOING INTO PROXY SEASON

The following is a list of significant ESG developments that could potentially have long-term impacts on public companies and their interactions with investors going into proxy season:

1. **United Nations Principles for Responsible Investment (PRI): The Sustainable Development Goals (SDGs) Investment Case.** Developed in 2015 to elaborate on the PRI introduced in 2006, the SDGs attempt to provide an international framework for asset managers to monitor and track company performance towards sustainability targets across 17 categories. Although companies may already be excelling in many areas of sustainability, the important variable here is the level of disclosure that the company is making with regards to such efforts. In addition to other forms of disclosure on sustainability performance, the SDGs provide an avenue for companies to communicate to investors their alignment with internationally recognized sustainability initiatives.

2. **Business Roundtable.** In August 2019, the Business Roundtable, an association of chief executive officers of leading American companies, redefined its "Statement on the Purpose of a Corporation" for the first time since 1997 to formalize a shift in boardroom philosophy towards a "stakeholder" approach to corporate governance and away from short-term shareholder value. This shift followed on the heels of engagement efforts of leading investment managers and investors seeking to promote sustainable, long-term growth by challenging their portfolio companies to adopt robust ESG/corporate social responsibility (or CSR) programs.

3. **Rapid growth in ESG investing.** According to Lazard, ESG popularity continues to increase among asset managers and the incorporation of ESG factors in exchange traded funds has risen sharply since 2018. Asset managers representing approximately $86 trillion in AUM have pledged support for the PRI and the inclusion of the 17 SDGs in their investment analysis. We expect company performance relative to ESG, specifically with regards to management level oversight of ESG risks, to factor into voting considerations.

4. **Toward Common Metrics and Consistent Reporting of Sustainable Value Creation: World Economic Forum Consultation Draft.** Published in January 2020 in connection with the World Economic Forum in Davos, Switzerland, the consultation draft considers the creation of a generally accepted international reporting framework for material aspects of ESG. Building off the reporting frameworks already established by organizations such as the Global Reporting Initiative (GRI), Task Force on Climate-related Financial Disclosures (TCFD) and Sustainable Accounting Standards Board (SASB), the consultation draft which was prepared in collaboration with the four major accounting firms, suggests the possibility of sustainability reporting being consolidated under one internationally approved accounting standard.

5. **BlackRock, Inc.** CEO Larry Fink's annual letter signaled to the market the significance of ESG in the investment analysis process and the role it plays in long-term value creation for shareholders and society. See below, "The Larry Fink Effect."

6. **State Street Global Advisors.** State Street conducted research into the views of more than 300 institutional investors and institutions, and determined that the top three significant factors for investor adoption of ESG principles are: (i) viewing ESG as a fiduciary duty (46 percent); (ii) meeting or getting ahead of regulation (46 percent); and (iii) mitigating ESG risks (44 percent). Other important reasons include being ethically or socially responsible, reducing volatility and aligning with shareholder or other stakeholder pressure. State Street has developed resources for boards seeking to disclose financially material ESG information utilizing the Sustainability Accounting Standards Board (SASB) standards, the State Street ESG Oversight Framework, which recommends that companies request their State Street "R-Factor Score" ("R" stands for "responsibility"), an ESG scoring system based on SASB standards.

7. **Other institutional asset managers.** Other asset managers, such as the Vanguard Group, Inc., have also committed to utilizing ESG factors in their investment analysis process. To the extent companies have not already adopted an ESG oversight plan, or, have yet to implement sustainability initiatives in furtherance of such a plan, we expect investors to turn towards the board for accountability.

C. PROXY ADVISORY FIRM GUIDELINES

This proxy season, in addition to the traditional annual proxy voting guidelines published by the major proxy advisory firms, we expect to see the data and analytics developed by major ESG rating agencies to factor into voting recommendations. Here is a brief summary:

1. **ISS voting policies.** ISS, in connection with ISS Corporate Solutions, Inc. (ICS), generates a QualityScore for corporate issuers and rates them across the three Environmental, Social and Governance pillars. Scores reflect decile rankings that range from 1, best, to 10, worst. This proxy season, ISS will generally vote for:

   A. Resolutions requesting that a company disclose information on the financial, physical, or regulatory risks it faces related to climate change on its operations and investments or on how the company identifies, measures, and manages such risks

   B. Requests for reports on the feasibility of developing renewable energy resources unless the report would be duplicative of existing disclosure or irrelevant to the company's line of business

   C. Proposals requesting that a company report on its policies, initiatives, and oversight mechanisms related to social, economic, and environmental sustainability, unless:

      - The company already discloses similar information through existing reports or policies such as an environment, health, and safety (EHS) report; a comprehensive code of corporate conduct; and/or a diversity report or
      - The company has formally committed to the implementation of a reporting program based on GRI guidelines or a similar standard within a specified time frame.

2. **Glass Lewis policies.** This proxy season, Glass Lewis will review a company's overall governance performance with regards to climate and social risk oversight, specifically identifying the members of the board that have been charged with oversight of such issues. Glass Lewis uses Sustainalytics, a leading global provider of ESG and corporate research, ratings and analysis, to provide it this analysis. If the company failed to effectively manage climate or social

risks, or failed to establish board oversight over such risks, Glass Lewis will take this into consideration when making voting recommendations on members of the board. Board members charged with climate and social risk oversight will be primarily accountable, followed by members of the audit committee. Action or inaction that is detrimental to shareholder value will increase the likelihood of a vote against such members of the board.

3. MSCI Inc. Like ISS, MSCI tracks corporate issuers' performance across the three pillars. Scores range from 1, worst, to 10, best. Scores are weighted and adjusted across the industry average. MSCI scores are generally used by institutional investors.

D. THE LARRY FINK EFFECT

BlackRock is the world's largest private investment fund. CEO Larry Fink's January 2020 letter to CEOs continues a recent trend of increasing attention to ESG matters. Moreover, his 2020 letter suggests "a Fundamental Reshaping of Finance," linking long-term value realization and strategies to address climate change. Mr. Fink points to a convergence of public activism and investor concerns about unaddressed climate risks, to predict a near-term "significant reallocation of capital" and predicting long-term stakeholder engagement on climate change.

Mr. Fink asks some rather stark questions: "What will happen to the 30-year mortgage – a key building block of finance – if lenders can't estimate the impact of climate risk over such a long timeline, and if there is no viable market for flood or fire insurance in impacted areas? What happens to inflation, and in turn interest rates, if the cost of food climbs from drought and flooding? How can we model economic growth if emerging markets see their productivity decline due to extreme heat and other climate impacts?"

He suggests that proactively assessing and managing these risks will put companies at a competitive edge and in a better position to respond to future regulations, market changes and the concerns of ESG-minded investors, consumers and business partners.

Along with new pledges about ESG screens on its active investments, the letter highlights BlackRock's increasing focus on disclosure and work to launch a public-private Climate Finance Partnership (together with European governments and global foundations). And BlackRock's pledge to join the Climate Action 100+ investor group marks a turnaround from its consistent past voting against that organization's proposed resolutions, according to activists – like the Sierra Club – who will look to hold BlackRock to more definable and tangible investment shifts (including extending ESG screening to passive investments which make up the majority of its holdings).

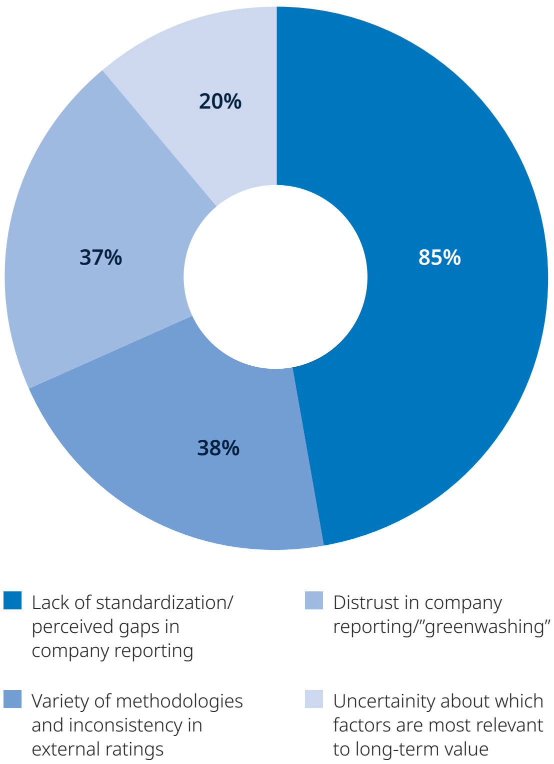
E. 2020 PROXY ESG DISCLOSURES ARE TESTING NEGATIVE FOR CORONAVIRUS (FOR NOW)

The outbreak of the coronavirus disease 2019 (COVID-19) represents one of the most significant global public health crises in the last 100 years and is causing major disruptions and unprecedented volatility in markets, economies and businesses. Businesses and investors in every region and a cross industries are facing a diverse set of challenges and planning for an uncertain future. The COVID-19 outbreak has numerous ESG implications, particularly with respect to health and safety, human capital management, supply chain management and adopting sustainable business practices for both the short and long-term "new normal". As of the date of this publication, DLA Piper Corporate Data Analytics has found that recently-filed proxy statements with ESG disclosures are not mentioning COVID-19 or the company's response measures. However, given the importance of this issue, we may see companies include such discussions in ESG disclosures during the 2020 proxy season.

II. Role of the Nominating and Corporate Governance Committee

An increasingly notable function of the Nominating and Corporate Governance Committee is overseeing the implementation and disclosure of a company's ESG program. At a recent webinar, E&Y noted the following common ESG challenges:[2]

What are the three biggest challenges you face in assessing how companies are managing environmental and social risks and opportunities?



As part of this program, E&Y emphasized the need for a company to "provide accurate data to the market and communicate what factors are financially material to their sustainability and success." Failure to do so may result in third party ESG data providers for presenting information they have derived using estimates for unreported data.

A. WHAT IS ESG TO A PARTICULAR COMPANY?

A crucial step to implementing a successful ESG program is defining its scope and which ESG issues are most likely to impact a company's financial condition and operational results and create sustainable long-term value.[3] According to research by DLA Piper Corporate Data Analytics, virtually all public companies consider ESG to include policies designed to minimize the environmental impact of the company's business, manage environmental risks and promote environmental sustainability. Leading ESG programs tend to adopt a broader definition of ESG and include such issues as: examining a company's human capital practices (for example, its labor practices, how the company promotes employee satisfaction, employee development and engagement and a diverse and inclusive corporate culture), promoting good corporate leadership (for example, promoting ethical behavior, compliance, and good corporate governance) and creating a sustainable and innovative business model (for example, ensuring that customer and vendor relationships reflect the company's ESG values and promoting product safety and quality).

A well-thought-out ESG program can be a competitive advantage in this marketplace and distinguish a company as compared to its peer group.

Most public companies have implemented some form of ESG initiatives at the ground level. For example, cost-saving initiatives like initiatives to reduce electricity consumption are relevant environmental and sustainability programs, and team-building initiatives like a company-sponsored service day are relevant social capital and community service programs. Many companies with ESG programs highlight these initiatives and achievements in an annual ESG report published on the company's

[2] E&Y Webcast: The evolving ESG strategic imperative. March 3, 2020.

[3] Most public companies with leading ESG programs generally consider ESG to include corporate social responsibility (or CSR) and social capital considerations, such as community relations, philanthropy, and community service.

website. In addition, an increasing number of companies also discuss these initiatives in their annual proxy statement by incorporating ESG achievements in the company's annual corporate highlights or in the corporate governance section of its proxy statement."

ACTION ITEMS

1. What are the company's existing ESG initiatives?
2. What are the company's identified ESG risks and the concerns of its stockholders?
3. What are the areas for improvement the company could undertake?
4. Consider engaging an independent third party to evaluate the company's ESG program, and/or obtaining the company's R-Factor Score from State Street and other independent ESG scoring systems.
5. The key question for the NCGC committee to ask is: how will our ESG program promote our long-term business success?

B. WHAT ARE SOME OF THE ESG PRESSURE POINTS?

How a NCGC defines, develops and implements its ESG program is, in part, derived from the external pressure (if any) that the company is or may receive on issues such as:

1. **Shareholder proposals.** According to ISS's 2019 Proxy Season Review, the most common type of shareholder proposal filed last proxy season was Environmental and Social proposals, representing over a majority (56 percent) of all filed proposals. Engaging in a constructive dialog with the shareholder proponent remains the most popular method of resolving shareholder interest in E&S matters – of the 456 E&S proposals identified in the ISS Review,[4] 46 percent were withdrawn by the shareholder, 40 percent appeared on the ballot, and only 14 percent were omitted from the proxy statement. Traditional governance-related shareholder proposals, such as proposals to eliminate or reduce supermajority voting or to declassify the board of directors, also remain popular, but their frequency has been trending downward whereas the frequency of E&S proposals have risen in recent years.

ACTION ITEM

Even if the company has never received a shareholder proposal, the NCGC should be aware of these trends, especially if it receives formal or informal shareholder pressure on ESG matters. Proactively adopting and disclosing policies on ESG initiatives, and maintaining an active shareholder engagement campaign can protect the company from a time-consuming Rule 14a-8 shareholder proposal process.

2. **Human capital.** Human capital has rapidly emerged as a critical focus area for stakeholders. There is clear and growing market appetite to understand how companies are managing and measuring human capital, demonstrated by the recent proposed rules of the Securities and Exchange Commission related to human capital matters, as articulated in August 2019. In addition, institutional investors such as BlackRock and State Street Global Advisors are increasingly making human capital and company culture engagement priorities. BlackRock views human capital management "a potential competitive advantage" and expects "disclosure around a company's approach to ensuring the adoption of the sound business practices likely to support an engaged and stable workforce."

   According to an October 2019 study conducted by the EY Center for Board Matters, 82 of the Fortune 100 companies include human capital management and culture-related disclosures in their proxy statements, and these disclosures most frequently include information regarding workforce diversity (50 percent), workforce compensation (34 percent), culture initiatives (22 percent), workforce health and safety (22 percent), workforce skills and capabilities (22

[4] This number excludes 13 pending E&S proposals.

percent) and workforce stability (6 percent). In order to prepare for this rulemaking initiative, the Nominating and Corporate Governance Committee should understand management's human capital objectives and initiatives, and their materiality with respect to the company's business, taken as a whole.

ACTION ITEMS

While human capital disclosure is still evolving, the following are some issues the NCGC should consider:

A. How does or should the board and its committees allocate oversight of various dimensions of human capital or culture?

B. What are the key performance indicators (KPIs) applicable to the company is this arena? In this respect, it is not necessarily important to quantify the KPIs for public disclosure. This is more of a tangible measurement tool that can be used to quantify the extent to which the company is making progress in achieving its goals.

C. What are the key practices or developments related to compensation of the broader workforce? This would be in addition to the executive team and that company.

D. What are some measures of workforce diversity data (eg, percentage of women and/or people of color across the global or US workforce, at the management level, in leadership positions or across incoming hires) that are relevant to the company?

3. **Workforce and board diversity.** Fortune 100 companies list workforce diversity as the leading goal of human capital management. In addition, diversity at the boardroom and C-suite level continues to be an important focus of shareholder initiatives, including the New York City Comptroller Scott Stringer's Boardroom Accountability Project 3.0, an initiative aiming to increase the number of women and people of color in the boardroom and the C-suite. In October 2019, Comptroller Stringer sent letters to 56 S&P 500 companies, including AT&T, Boeing, the Walt Disney Company, and Walmart, calling for these companies to implement a "Rooney Rule" for director and CEO searches, a rule requiring consideration of both women and people of color for open positions.

   DLA Piper Corporate Data Analytics has found that diversity of skills and experience is the most common disclosed form of board diversity, followed by gender diversity and, to a much lesser extent, racial and ethnic diversity. An increasing number of companies include a matrix in their proxy statement highlighting the board's diversity of skills and experience. The New York City Comptroller's example board matrix also includes demographic information, such as gender or race, but most publicly traded companies omit these additional disclosures and use the matrix simply to highlight diversity of skills and experience.

   Gender diversity has become an especially important topic for publicly traded companies headquartered in California, which were required to have at least one female board member by the end of 2019 pursuant to 2018 California law SB-826, which we discuss in further detail in this DLA Piper alert. As of the date of this publication, this law has not been overturned, but it is currently being challenged as unconstitutional in two cases, Creighton Meland Jr. v. California Secretary of State Alex Padilla, an action brought in the US District Court for the Eastern District of California by a shareholder of OSI Systems, Inc., a publicly traded Delaware company headquartered in California with no female directors, and Robin Crest, et al. v. California Secretary of State Alex Padilla, an action brought in the Superior Court of Los Angeles County by citizens of the state of California.

ACTION ITEMS

As the gatekeeper of the nomination process, it is imperative that the NCGC consider the following issues on an ongoing basis:

A. What is the diversity of the company's board and its C-suite executives?

B. How will the company respond to increased regulatory and shareholder attention to board diversity?

C. Exactly how does the company define diversity? Should the definition be expanded to include other factors, such as LGBTQ+ status, veteran status, or political ideology? In the 2019 proxy season, National Center for Public Policy Research's Free Enterprise Project, a conservative shareholder activism and education program, filed more than a dozen shareholder proposals at leading companies, asking that the companies adopt a "True Diversity Board Policy" and disclose director ideological perspectives. At this point, it is not clear whether these campaigns will continue or their impact.

D. How does the company's proxy statement highlight the diversity of its board and management?

4. **Other formal shareholder pressure.** The NCGC should ensure that it is aware of any formal shareholder pressure on ESG initiatives, including phone calls, letters, or other communications with investor relations, received by the company. In 2019, we observed that BlackRock, State Street and Vanguard and other institutional investors increased engagement with portfolio companies on ESG matters.

ACTION ITEM

It is clear to us that this practice is likely to accelerate during the 2020 proxy season. Accordingly, the NCGC should ensure that it is informed of any such initiatives by large institutional investors.

5. **Knowing your shareholders' ESG priorities.** As described above, large institutional investors are focused on the manner in which a company undertakes ESG priorities.

ACTION ITEM

The NCGC should ensure that it is informed about the company's shareholder base on an ongoing basis and keeps abreast of the "hot topics" of the relevant stockholders.

III. Practical advice from our team

Over the years, there have been several calls for the SEC to adopt rules governing ESG disclosure[5] ; however, unlike what we see in other markets, we do not expect a top-down regulatory scheme any time in the near future. We are then left with the inescapable fact that, much like proxy access, the ESG area is likely to be dominated by some form of private ordering. In the section above, we have included a brief summary of certain schemes and some of the prominent market drivers. In this section, we provide some practical guidance based on input from our lawyers.

It is not only investor groups like BlackRock who are looking to be seen as leaders in the ESG space. Leading US public companies in energy-intensive industries have recently made bold statements of their intent to address their climate impacts, and to empower others to do the same, apparently in parallel responses to public, shareholder and employee activism. The going rate for such commitments over the past several months seems to include $1 billion commitments, 10-year time horizons to achieve net zero emissions, and increased voluntary carbon accounting and public reporting.

Such efforts may be seen as ways to address external perception and impact while preserving core businesses, with focus on compensatory carbon reductions, carbon removal and sequestration, stakeholder engagement, and increased transparency. These moves appear to respond to increased activism by both external shareholder groups and internal/employees, who show

[5] See Request for rulemaking on environmental, social and governance disclosure (File 4-730) filed by Parnassus Investments on October 30, 2018.

increasing willingness to align with walkout and protest groups highlighting climate concerns. And some of these companies seem to see business opportunity in developing products and services to help others address their carbon footprints, as this topic takes hold and may influence more and more customers and other stakeholders, even ahead of public sector regulators.

While the focus here is clearly investors' and a company's new recognition of its stakeholders' climate concerns, look for similar dynamics as companies look to develop and deploy artificial intelligence solutions in ways that look to respond to, rather than provoke, rising public concerns about ethics and long-term economic impacts from that rapidly evolving technology.

A. INTERNATIONAL CLIMATE MARKETS

Five years after the world came together in adopting the Paris Agreement, the regulatory impact of that watershed agreement has yet to fully materialize. That is beginning to change as countries increasingly adopt policies to implement Paris domestically. This year's climate negotiations under the UN Framework Convention on Climate Change (UNFCCC) – the process that produced the Kyoto Protocol and the Paris Agreement – are expected to finalize the rules for a new mechanism that will advance the Paris Agreement's goals by leveraging the power of markets. Governments and many industry actors are watching closely to see how those rules ultimately take shape.

Under the Paris Agreement, each country submits a voluntary commitment to mitigate emissions that contribute to climate change, with the overall goal of keeping global temperature rise below 2˚C above preindustrial levels. Countries then revisit those "nationally determined contributions" in five-year cycles to assess their progress toward meeting their commitments and toward achieving the Paris Agreement's global goals.

A key step for achieving these aims is the creation of a new market mechanism under Article 6 of the Paris Agreement. The Article 6 mechanism (initially dubbed the Sustainable Development Mechanism, or SDM) will replace the Kyoto Protocol's market-based mechanisms. Although profitable for some, the market mechanisms under the Kyoto Protocol suffered from methodological problems that ultimately prevented them from leading to a reduction in global emissions. The ongoing fight over the SDM, whose completion is already two years past due, is rooted in the incentives some countries have in adopting rules that would not fully address these issues and that many observers believe would hamper a reduction in emissions. In contrast, other countries are adamant that the rules governing the SDM ensure emissions reductions, and some have gone so far as to voluntarily adopt strict guidelines – the San Jose Principles – that will govern any international market activity within their jurisdictions.

ACTION ITEMS

Private actors interested in participating in the Paris Agreement's eventual market mechanism should:

1. Pay close attention to the next round of negotiations, which will be held in Glasgow in November, for the final market rules under the Paris Agreement.
2. Consider the potential differences between market regimes adopted by consensus under the UNFCCC and those that will be governed by the San Jose Principles.
3. Understand whether and how the eventual market rules will create space for private actors, both in terms of project-based activities and emissions-trading schemes.
4. Identify applicable laws and regulations governing private-sector participation in the particular countries where climate market engagement is sought.
5. Determine whether participation in international climate markets fits into their overall strategy, and if it does, how to account for and value investments for shareholders and regulators.

B. FINANCE – SUSTAINABILITY LINKED LOANS

Sustainability linked loans in finance are gaining traction in the United States as quickly as any other disruptive movement. The EMEA is at the forefront with sustainability linked loan principles and green bonds, where we have seen an uptick in transactions in 2018 and 2019. The big question remains as to how US lenders will implement sustainable finance characteristics in their financial products with their traditional customers. The LSTA, among with certain other market participants, established its Sustainable Finance Committee and tasked it with the maintenance of the Green Loan Principles and Sustainability Linked Loan Principles. On February 3, 2020, the LSTA distributed an ESG due diligence questionnaire. The ESG due diligence questionnaire is intended to "be completed by the borrower during the due diligence phase of the loan origination process." Although we don't have a crystal ball to predict what changes could go into effect as standard loan documentation, we do have some insight if we look at current models in the EMEA where loans have pricing incentives included in order to promote ESG targets.

C. CLIMATE CHANGE DISCLOSURE PRACTICE IN 2019

Despite significant public attention to climate change and calls for more robust climate change disclosure, we did not see a material deviation from traditional and generic climate change disclosure in public filings in 2019. This continues a trend of non-disclosure of matters that would not be material under existing federal securities laws. The primary climate change related disclosures concern potential impacts from (i) future regulations; (ii) risks relating to the increased frequency and potency of storms; and (iii) supply chain interruptions. By and large, non-financial issues (such as energy efficiency, leadership in energy and environmental design certifications, or waste reduction) continue to be omitted from public company disclosures, and continue to be relegated to sustainability, corporate social responsibility, or other environmental reports. In practice, there has been little change in the quality or nuance of climate change disclosure in the years since the SEC's guidance in 2010 concerning climate change.

Other notable ESG-related developments:

- We are closely tracking the UN Sustainable Development Goals, with an eye on whether and to what extent public companies (as well as public and private equity) tailor their ESG programs to align with the SDGs.
- In some cases we are seeing better pricing for credit facilities involving borrowers that demonstrate achievement of sustainability goals. Some European banks are beginning to provide preferential interest rates to borrowers' who meet designated ESG metrics.
- Moody's has begun to provide ESG ratings of certain borrowers that are reminiscent of its credit ratings for public companies.

D. ESG AND M&A

We expect to see ESG considerations incorporated into the M&A context as well. It is expected that target companies will be evaluated on climate and social performance, such as business initiatives focused on environmentally conscious products, greenhouse gas emission reduction, sustainable supply chain standards, and human capital development. Factors such as these will likely be considered when analyzing a target company's exposure to climate and social related risks and its ability to create long-term value for its stakeholders.

In addition to setting overarching ESG priorities, goals and strategies, boards should be ESG-minded when reviewing business transactions – for example, conducting ESG due diligence on acquisition targets and considering whether a business decision may negatively impact such ESG considerations as environmental sustainability, social capital and human capital, and how these impacts could be mitigated, or eliminated.

About us

DLA Piper is a global law firm with lawyers located in more than 40 countries throughout the Americas, Europe, the Middle East, Africa and Asia Pacific, positioning us to help clients with their legal needs around the world.

Learn more

Find out more about the issues covered in this handbook by contacting any of the authors:

Sanjay Shirodkar
T +1 202 799 4184
sanjay.shirodkar@dlapiper.com

Brooke Goodlet
T +1 512 457 7039
brooke.goodlett@dlapiper.com

Christopher P. Giordano
T +1 212 335 4512
christopher.giordano@dlapiper.com

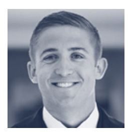
David Lewis
T +1 480 606 5126
david.lewis@dlapiper.com

Deanna Reitman
T +1 713 425 8437
deanna.reitman@dlapiper.com

Glenn Reitman
T +1 713 425 8460
glenn.reitman@dlapiper.com

Jeffrey Salinger
T +1 212 335 4531
jeff.salinger@dlapiper.com

Jesse Medlong
T +1 415.836.2594
jesse.medlong@dlapiper.com



Neil Fogel
T +1 480 606 5139
neil.fogel@dlapiper.com

Braden Penhoet
T +1 206 839 4832
braden.penhoet@dlapiper.com