The Legal Landscape for Navigating the "E" of ESG

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Energy companies are increasingly focusing on the "E" of ESG—environmental, social, and governance issues—to identify paths to address climate change risks and sustainability as part of their business models. Pressure from a wide array of stakeholders, including shareholders, employees, customers, suppliers, governmental entities, and the communities in which they operate, are driving energy producers to develop ESG strategies and set goals to reduce the environmental impacts of their operations and their products. In this context, understanding and anticipating the evolving legal landscape for navigating the "E" of ESG is key to mitigating business risks, ensuring stakeholder confidence, and strengthening long-term financial performance.

First, a refresher on the "E" in ESG. The "E" takes into account a company's environmental impact—including directly, through its energy consumption and fossil fuel production and across its supply chain—to reduce the company's exposure to financial risk. A prevalent focus today is on reducing greenhouse gas (GHG) emissions and the company's carbon footprint. In addressing the interests of a range of key stakeholders, companies have developed ESG strategies, ranging from commitments to reduce GHG emissions and energy consumption to increasing investment in ESG funds—each with its own pros and cons for meeting a company's ESG goals.

Legal considerations relevant to developing an ESG strategy generally fall into three categories: maximizing opportunities in the current legal landscape, anticipating legal risks, and considering future legal landscape in this area.

The current legal landscape specific to the "E" includes existing environmental laws and regulations applicable to the company's operations, environmental permit requirements, and other legal obligations, such as those under consent orders, decrees, or commercial contracts. Any "E" strategy should be consistent with a company's existing legal commitments. For example, a judicially enforceable consent decree might require a company to seek prior government agency and court approval before adjusting operations at a facility to meet GHG reduction targets. On the other hand, the current legal landscape also presents opportunities for a company to demonstrate that existing practices support its ESG goals through legal tools such as federal, state and regional programs providing carbon credit trading and other offset options, or through voluntary methane emissions reductions.

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In establishing ESG goals and reporting to stakeholders on ESG milestones, a company should consider the potential legal risks associated with overreaching or overstating its achievements. Notably, a company could face regulatory scrutiny or shareholder actions arising out of inaccurate or misleading environmental disclosures in its U.S. Securities and Exchange Commission (SEC) filings. "Greenwashing" allegations might also materialize in the form of lawsuits under state consumer protection laws or other novel legal theories. Even when successfully defended, such actions can damage a company's reputation and negatively impact its financial performance. A company should favor achievable ESG goals that it can measure and substantiate over aspirational goals that rely on outside factors beyond its control. In addition, care should be taken to accurately disclose material environmental risks to the company in its public filings.

One of the most significant outside factors beyond a company's control is the future legal landscape. Lawmakers at the state and federal level are increasingly focused on environmental regulation and climate change concerns. Examples of this increased focus include the U.S. House majority's recent 547-page "Climate Crisis Action Plan," the SEC's Investor Advisory Committee's recommendations to update SEC requirements to include ESG factors, and Illinois's enactment of a new law requiring state agencies to develop and implement sustainable investment policies for public funds under their control. The outcome of the U.S. Presidential election could also impact future environmental laws and policies applicable to the energy industry, and the possibility of a carbon tax remains on the horizon. For energy companies developing an ESG strategy, consideration of the future legal requirements will be key to understanding how to best tailor their current approach to addressing environmental risks.

Through the development and implementation of a thoughtful, balanced ESG approach, energy companies can demonstrate their commitment to reducing environmental impacts while also focusing on strategies that can result in stronger financial returns for investors.