ESG: More Than Just “Big” Business

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Environmental, Social, and Governance (ESG) is at the center of a roiling political debate (and in some instances even a legal one) about whether businesses should take into consideration environmental and social factors in measuring risk and mapping opportunity. And, yet the shape of ESG continues to develop and expand. Markets continue to demand products and services with ESG-related attributes. Legal frameworks and tools continue to come online in the United States and overseas demanding that businesses not only address ESG factors but also that those businesses make disclosures as to their efforts in doing so and that those representations be sound. With all that—and, as posited here, perhaps because of it—ESG is quickly pushing past the biggest businesses and is increasingly reaching deep into those businesses' value and supply chains. The result is that every business along those chains could be made to take up ESG efforts—regardless of size, sector, or ongoing debate.

Outlined here are some key indicators of ESG's increasing reach into value and supply chains. These range from developments whose impact is just as a practical matter to those developments whose impact is the most pointed. But, taken together, these

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indicators signal a consequent need for all businesses to tune into ESG.

Heightened Scrutiny and High Stakes

As the adage goes, no good deed goes unpunished. And, overlooking supply chains in crafting and implementing ESG strategies—even if inadvertently—could subject businesses to repercussions. Businesses that fail to address ESG factors in their supply chains expose themselves to regulatory, litigation, and reputational risk based on claims that their ESG representations do not accurately reflect what the business is doing and how it is doing it.

A significant harbinger of that risk came in 2021 when the United States Securities and Exchange Commission (SEC) instituted its Climate and ESG Task Force in the Division of Enforcement. As described by the SEC, "[c]onsistent with increasing investor focus and reliance on climate and ESG-related disclosure and investment, the Climate and ESG Task Force will develop initiatives to proactively identify ESG-related misconduct."[1]

Even more generally, it would appear that SEC scrutiny around ESG is dialing up—and at a steep price to businesses caught in the crosshairs. In the last few years, a handful of SEC enforcement actions have come to a head. In one involving charges against DWS Investment Management Americans Inc. (DIMA) in 2023, a subsidiary of Deutsche Bank AG, the SEC took aim at misstatements regarding DIMA's ESG investment processes. That action (along with related a counterpart) was resolved by DIMA for $25 million in penalties. As to the charges, the SEC's press release aptly summarized its own order: "DIMA made materially misleading statements about its controls for incorporating ESG factors into research and investment recommendations for ESG integrated products, including certain actively managed mutual funds and separately managed accounts."[2] In another matter in April

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1 Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), https://www.sec.gov/news/press-release/2021-42 [https://perma.cc/MWG6-BQNM].

2 Press Release, U.S. Sec. & Exch. Comm'n, Deutsche Bank Subsidiary DWS to Pay $25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments (Sept. 25, 2023), https://www.sec.gov/news/press-release/2023-194 [https://perma.cc/88VK-U763].

2022, the SEC charged Brazilian mining company Vale S.A. with making false and misleading ESG-related disclosures about the safety of dams before one major dam collapsed in 2019. Those charges were resolved for $55.9 million.[3] In May 2022, the SEC charged BNY Mellon Investment Advisor, Inc. with misstatements and omissions about ESG considerations in mutual fund investments managed by BNY Mellon. Those charges were resolved for $1.5 million in penalties.[4] In November 2022, the SEC charged Goldman Sachs Asset Management, L.P. with failing to adopt and implement policies regarding its ESG-related investments. Those charges were settled for $4 million.[5] Added to these enforcement actions are comment letters from the SEC issued to more than 12 businesses in August and September 2023 seeking more detailed disclosures around those businesses' ESG issues.[6] While the particular SEC enforcement efforts noted here may not initially appear to have anything to do with supply chains, they do suggest the SEC is focused on ensuring that what businesses say lines up with what they do—and that could very well include investigatory reach into value and supply chains.

Moreover, regardless of the trajectory of SEC enforcement efforts, the fact is the SEC has not been alone in its attention to ESG representations. On June 20, 2023, the United States Commodity Futures Trading Commission (CFTC) issued a Whistleblower Alert inviting information about suspected fraud and manipulation around carbon credit markets.[7] And, just days later, the CFTC's Division of

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3 *See* Press Release, U.S. Sec. & Exch. Comm'n, Brazilian Mining Company to Pay $55.9 Million to Settle Charges Related to Misleading Disclosures Prior to Deadly Dam Collapse (Mar. 28, 2023), https://www.sec.gov/news/press-release/2023-63 [https://perma.cc/EM5K-CCNE].

4 *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations

5 *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments (Nov. 22, 2022), https://www.sec.gov/news/press-release/2022-209.

6 *See* Lillian Brown et al., *SEC Staff Comment Letters Continue to Seek Enhanced Climate-Related Disclosures*, JDSUPRA (Jan. 12, 2024), https://www.jdsupra.com/legalnews/sec-staff-comment-letters-continue-to-7222059/ [https://perma.cc/ZYY7-TTVX] (giving a breakdown of the types of comments relayed by the SEC).

7 *See CFTC Whistleblower Alert: Blow the Whistle on Fraud or Market Manipulation in Carbon Markets*, U.S. COMMODITY FUTURES TRADING COMM'N (June 20, 2023), https://www.whistleblower.gov/sites/whistleblower/files/2023-

Enforcement established its own Environmental Fraud Task Force to "combat environmental fraud and misconduct in derivatives and relevant spot markets."[8]

The Federal Trade Commission (FTC) has also trained its attention on ESG representations and taken its own enforcement steps. For example, in April 2022, the FTC brought claims against Kohl's and Walmart alleging the companies marketed rayon-based products as being made with eco-friendly bamboo when the process actually requires toxic chemicals to turn wood pulp into rayon. That matter resulted in a total of over $5 million in penalties[9] and is a stark example of regulatory authority looking behind the curtain into production process—an inquiry leading directly to value and supply chains.

Independent regulators have also homed in on ESG-related representations as of late. For example, the United Kingdom's Advertising Standards Board Authority has concluded that advertisements as to sustainability on the part of several businesses were unsubstantiated or insufficiently qualified. Those have ranged across products and services, including, for example, airlines and the banner "Connecting the World. Protecting its Future;"[10] laundry soap manufacturers promoting themselves as "kinder to our planet;"[11] and non-dairy milk manufacturers advertising their products as "good for the planet."[12] And, in 2022, the Australian Competition and Consumer Commission (ACCC) launched an

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06/06.20.23%20Carbon%20Markets%20WBO%20Alert.pdf.

8 Press Release, U.S. Commodity Futures Trading Comm'n, CFTC Division of Enforcement Creates Two New Task Forces (June 29, 2023), https://www.cftc.gov/PressRoom/PressReleases/8736-23?utm_source=govdelivery.

9 *See* Lesley Fair, *$5.5 million Total FTC settlements with Kohl's and Walmart Challenge "Bamboo" and Eco Claims, Shed Light on Penalty Offense Enforcement,* FED. TRADE COMM'N BUS. GUIDANCE BLOG (Apr. 8, 2022), https://www.ftc.gov/business-guidance/blog/2022/04/55-million-total-ftc-settlements-kohls-and-walmart-challenge-bamboo-and-eco-claims-shed-light [https://perma.cc/MCC6-SSLP].

10 *See ASA Ruling on Deutsche Lufthansa AG t/a Lufthansa,* ADVERT. STANDARDS AUTH. (Mar. 1, 2023), https://www.asa.org.uk/rulings/deutsche-lufthansa-ag-a22-1169419-deutsche-lufthansa-ag.html [https://perma.cc/XRJ3-X9J7].

11 *See* Beth Timmins, *Persil Advert Banned for Misleading Green Claims*, BBC (Aug. 30, 2022), https://www.bbc.com/news/business-62726666.

12 *See* John McCarthy, *ASA Bans Alpro 'Good for the Planet' Ads as Brand Urged to Tighten up Sustainable Claims*, THE DRUM (Oct. 20, 2021), https://www.thedrum.com/news/2021/10/20/asa-bans-alpro-good-the-planet-ads-brand-urged-tighten-up-sustainable-claims [https://perma.cc/4Z67-LXUH].

effort targeting environmental claims across a range of business sectors, indicating that at least 200 company websites would be reviewed for misleading environmental claims about their products or services.[13] That ACCC effort spanned sectors including "energy, vehicles, household products and appliances, food and drink packaging, cosmetics, clothing and footwear."[14] Again, described here are examples of the kind of inquiry that might reach back into supply and value chains.

In fact, in the United States, attention from the National Advertising Review Board (NARB) may just have laid the foundation for litigation against JBS USA Holdings, Inc. regarding its ESG-related claims. JBS is one of the largest food companies in the world and the largest producer of animal protein. On June 20, 2023, the NARB took issue with JBS's stated goal of reaching net zero carbon emissions by 2040.[15] JBS disagreed with those findings, and, on February 28, 2024, New York Attorney General Letitia James filed suit against JBS's American subsidiary "for misleading the public about is environmental impact" and, in particular, its stated emissions targets.[16]

Indeed, regulatory-type risk is not the only risk to businesses that fail to address ESG factors in their supply chains. Litigation risk also abounds. In particular, litigation based on ESG misrepresentations—or "greenwashing"—is on the rise. According to one summary of greenwashing litigation as of 2022, "the recent wave of greenwashing-related litigation can be divided into three types of cases, namely cases challenging misrepresentation, omissions, misleading evidence and mislabeling in respect of organizations' claims regarding '(1) corporate and governmental commitments, (2) product attributes, and (3) disclosure of climate

13 *See ACCC 'Greenwashing' Internet Sweep Unearths Widespread Concerning Claims*, AUSTL. COMPETITION & CONSUMER COMM'N (Mar. 2, 2023), https://www.accc.gov.au/media-release/accc-greenwashing-internet-sweep-unearths-widespread-concerning-claims [https://perma.cc/KWN2-XTP8].

14 *Id.*

15 *See National Advertising Review Board Recommends JBS Discontinue "Net Zero" Emissions by 2040 Claims*, BBB NATI'L PROGRAMS (June 20, 2023), https://bbbprograms.org/media-center/dd/narb-jbs-net-zero-emissions.

16 Press Release, Office of the N.Y. State Att'y Gen., Attorney General James Sues World's Largest Beef Producer for Misrepresenting Environmental Impact of Their Products (Feb. 28, 2024), https://ag.ny.gov/press-release/2024/attorney-general-james-sues-worlds-largest-beef-producer-misrepresenting.

investments, financial risks and harm caused by companies.'"[17] Issues at a business's supply chain might implicate any one of those claims and give rise to actions on behalf of consumers, shareholders and, in some instances, actions directly against officers and directors. Consider *Rawson v. Aldi Inc.*, brought in the United States District Court for the Northern District of Illinois, in which the plaintiffs took issue with Aldi's labeling of salmon from Chile as "Simple. Sustainable. Seafood."[18] The plaintiffs alleged Chilean salmon farming failed sustainability tests based on the use of preservatives and inhumane net pens.[19] Similarly, in *Corporate Accountability Lab v. The Hershey Co.*, filed in the District of Columbia, the plaintiff alleged that Hershey failed to address its purchase of cocoa from African farms relying on child labor.[20] These are but a few examples. As indicated, others abound.[21]

With this backdrop, we return to the starting premise of this article: Increasingly, businesses along value and supply chains will be called upon to undertake ESG efforts and to make ESG disclosures on which the businesses to whom they supply goods and services (and who may ultimately be the subject of heightened scrutiny, enforcement, or even litigation) can rely. Simply put, and as all the foregoing indicates, a weak link in the chain exposes businesses to risk on several fronts.

Consumer and Investor Market Demands

Market demands are also creating ESG pressure for supply chains—both consumer markets and investor markets.

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17 Peter Pears et al., *Greenwashing: Navigating the Risk*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2023), https://corpgov.law.harvard.edu/2023/07/24/greenwashing-navigating-the-risk/ [https://perma.cc/T5J6-XLU7].

18 Rawson v. ALDI, Inc., No. 21-CV-2811, 2022 WL 1556395, at *1 (N.D. Ill. May 17, 2022).

19 *See id.*

20 *See* Corp. Accountability Lab v. Hershey Co., No. 2021 CA 3981 B, slip op. at 1-2 (D.C. Super. Ct. June 20, 2023); *see also* Allie Brudney, *CAL Files Suit Against Hershey and Rainforest Alliance,* CORP. ACCOUNTABILITY LAB (Nov. 2, 2021), https://corpaccountabilitylab.org/calblog/2021/11/2/cal-files-suit-against-hershey-and-rainforest-alliancenbsp [https://perma.cc/S98L-ZNWM].

21 *See*, *e.g.*, Compliant at 1-2, *Tyrnauer v. Ben & Jerry's Homemade, Inc.*, No. 23-CV-01877 (S.D.N.Y. Mar. 3, 2023) (regarding a class action based on alleged misrepresentations of ethical supply chains); Complaint at 2, *Ellis v. Nike USA, Inc.*, No. 23-CV-00632 (E.D. Mo. May 10, 2023) (concerning a class action based on claims of sustainability and products made from recycled fibers).

In 2021, PwC reported that 76 percent of consumers would "discontinue [their] relationship[s] with companies that treat the environment, employees, or the community in which they operate poorly."[22] More recently, in 2023, McKinsey reported on a five-year survey of U.S. sales data across 44,000 brands in 32 different categories.[23] The results indicated higher consumer loyalty to brands with more ESG claims.[24] To the extent the expectations of consumer markets may be shifting in favor of ESG, so may be the manner in which businesses are meeting those consumer demands. That will most likely include adjustments at the supply chain level and a preference for suppliers whose processes are also in line with those consumer demands. Any continued push from the consumer for sustainable products and services will increase demand that the processes underlying those products and services are also sustainable.

In fact, under a Federal Acquisition Regulatory Council rule finalized in April 2024, federal United States agencies are required to purchase "sustainable products and services to . . . the maximum extent practicable," with limited exceptions.[25] In that respect, federal agencies stand in as a significant consumer base for such products and services. For context, note that by its own calculation, in 2022, the federal government purchased $700 billion in products and services.[26]

Moreover, as indicated, it is not only consumer markets that are creating ESG pressure. For example, in 2023, Forbes cited to a 2020 report by Edelman indicating that 92% of U.S. investors believe "a

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22 *Beyond Compliance: Consumers and Employees Want Business to Do More on ESG*, PRICEWATERHOUSECOOPERS (2021), https://www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/consumer-and-employee-esg-expectations.html [https://perma.cc/AV3D-MTN4].

23 *See* Jordan Bar Am et al., *Consumers Care About Sustainability – and Back It Up with Their Wallets*, MCKINSEY & CO. (Feb. 6, 2023), https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/consumers-care-about-sustainability-and-back-it-up-with-their-wallets [https://perma.cc/C39C-QDHH].

24 *See id.*

25 Federal Acquisition Regulations for Sustainable Procurement, 89 Fed. Reg. 30212 (May 22, 202)(to be codified at 48 C.F.R. pt. 23).

26 *See Fact Sheet: Biden-Harris Administration Announces New Better Contracting Initiative to Save Billions Annually*, THE WHITE HOUSE (Nov. 8, 2023), https://www.whitehouse.gov/omb/briefing-room/2023/11/08/fact-sheet-biden-harris-administration-announces-new-better-contracting-initiative-to-save-billions-annually/.

company with strong ESG performance deserves a premium valuation to its share price."[27] And, while there has been some fluctuation in investment inflows into ESG-labeled funds over the last few years (or at least mixed messages on that front), the ESG investment line has not dissipated.[28] In fact, in 2023, PwC reported on its survey of more than 300 investors across 30 countries, finding that 70% agree ESG should be embedded directly into corporate strategy; 75% perceive management of sustainability-related issues as key in investor decision-making; 69% would increase their investments in companies that demonstrate successful management of sustainability-related issues; and 67% would increase investment in companies that demonstrate a positive impact on society and the environment.[29] And, like consumer demand, investor demand around ESG could continue to give way to inquiry into what underlies ESG representations by businesses in which those investors are investing, either directly or in connection with ESG-labeled funds. And, again, that inquiry could also lead increasingly to inquiry into those businesses' value and supply chains.

In fact, the SEC recently applied more pressure in this vein. In September 2023, the SEC finalized previously proposed amendments to "enhance and modernize" the Investment Company Act of 1940 "Names Rule."[30] The SEC's Press Release announcing the amendments summarized them as follows:

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27 Carolyn Berkowitz, *Following The Data: Why Companies Should Prioritize ESG And Tips For Success,* FORBES (Oct. 4, 2023, 9:00 A.M.), https://www.forbes.com/sites/forbesbusinesscouncil/2023/10/04/following-the-data-why-companies-should-prioritize-esg-and-tips-for-success/?sh=54113be36df5 [https://perma.cc/ZX6M-KASK].

28 *See, e.g.,* Jennifer Wu, *ESG Outlook 2022: The Future of ESG Investing*, J.P. MORGAN ASSET MGMT. (Jan. 2, 2022), https://am.jpmorgan.com/us/en/asset-management/liq/investment-themes/sustainable-investing/future-of-esg-investing/ [https://perma.cc/443E-NBJY]; Natalie Runyon, *Six Predictions for ESG in 2024: The Year ESG Emerged from Fad to Essential Business,* THOMSON REUTERS (Jan. 3, 2024), https://www.thomsonreuters.com/en-us/posts/esg/esg-predictions-2024/ [https://perma.cc/WB9J-XS9G]. *But see* Nicole Goodkind, *The Responsible Investing Boom Is Over. Can Anything Replace ESG?,* CNN (July 26, 2023, 7:28 A.M.), https://www.cnn.com/2023/07/26/investing/premarket-stocks-trading/index.html [https://perma.cc/L86Z-ZZ9Z] (discussing the recent "downward spiral" of ESG investing, but also indicates that the term will simply be replaced with more specific terms for areas of investment).

29 *See PwC's Global Investor Survey 2023*, PRICEWATERHOUSE COOPER (2023), https://www.pwc.com/gx/en/issues/c-suite-insights/global-investor-survey.html.

30 *See* Rule 35d-1.

> The Names Rule currently requires registered investment companies whose names suggest a focus in a particular type of investment (among other areas) to adopt a policy to invest at least 80 percent of the value of their assets in those investments (an “80 percent investment policy”). The proposed amendments would enhance the rule’s protections by requiring more funds to adopt an 80 percent investment policy. Specifically, the proposed amendments would extend the requirement to any fund name with terms suggesting that the fund focuses on investments that have (or whose issuers have) particular characteristics. This would include fund names with terms such as “growth” or “value” or terms indicating that the fund’s investment decisions incorporate one or more environmental, social, or governance factors. The amendments also would limit temporary departures from the 80 percent investment requirement and clarify the rule’s treatment of derivative investments.[31]

For the purposes of this article, the theory is that substantiating that 80% will likely demand looking into ESG representations of businesses included in any funds falling within the rule.

Relatedly, along with investor demand for ESG investment opportunities has come attention to—and increased examination of—ESG scores or ratings. These aim to measure how a business addresses ESG issues and, more precisely, afford investors insight across businesses and sectors to compare apples to apples in selecting investment opportunities. Putting aside questions as to the standardization of the many scores and ratings methodologies that have emerged, there is the fundamental concern as to any individual business’s ESG representations in furtherance of its ESG score or rating and the quality of that representation in light of any number of factors, including value and supply chain factors. ESG scores and ratings are the subject of particular attention as the frameworks for applying them continue to develop. It might be expected that close attention will also be paid to the degree to which value and supply chains factor into those scores and ratings.

“Amazonian” Upstream Demands

Perhaps a standalone indicator of market demand around ESG and the resulting reach into value and supply chains can be found in

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31 Press Release, U.S. Sec. & Exch. Comm’n, SEC Proposes Rule Changes to Prevent Misleading or Deceptive Fund Names (May 25, 2022), https://www.sec.gov/news/press-release/2022-91 [https://perma.cc/YWT5-XKPP].

Amazon's 2022 sustainability report.[32] The opening letter from Kara Hurst, Vice President of Worldwide Sustainability for Amazon, announced that within the year, Amazon would update its "Supply Chain Standards to require regular reporting and emissions goal setting on behalf of its suppliers.[33] The report that followed Hurst's letter was evident in its emphasis on Amazon's supply chain as a critical component in Amazon's ESG efforts.[34] While sources indicate pressure from Amazon on its supply chains to adhere to any such standards have not yet taken full hold, the announcement by Amazon in 2022 remains notable given Amazon's sheer size and breadth. Given how far and varied Amazon's supply chain extends, the question arises whether Amazon has effectively stepped in (or will step in) to fill any void that might be left anywhere as to value and supply chains and, in particular, the pressure on them to take up ESG.

Regulatory and Legislative Green Guides

At a basic level, and as already stated, whether and how businesses label products as sustainable can have serious supply chain implications. In addition to the above indications to that effect, legal frameworks at both the federal and state levels in the U.S. are zeroing in on product labels and, in doing so, dialing up the degree to which those labels will be tested.

For starters, there are the FTC's Green Guides. Revised most recently in 2012, the Green Guides are aimed at preventing unfair or deceptive environmental marketing claims, applying to "claims about the environmental attributes of a product, package, or service in connection with the marketing, offering for sale, or sale of such item or service to individuals."[35] The Green Guides have been the subject of some attention since December 2022, when the FTC announced it was "seeking public comment on potential updates and changes" to the guides based on the above-noted "increasing consumer interest in buying environmentally friendly products."[36]

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32 *See* AMAZON, BUILDING A BETTER FUTURE TOGETHER: 2022 AMAZON SUSTAINABILITY REPORT (2022), https://sustainability.aboutamazon.com/2022-sustainability-report.pdf [https://perma.cc/E9BC-TT8H].

33 *See id.* at 3.

34 *See id.* at 42-47.

35 16 C.F.R. § 260.1(a), (c) (2023).

36 Press Release, Fed. Trade Comm'n, FTC Seeks Public Comment on Potential

As Bureau of Consumer Protection Director Samuel Levine put it:

> Consumers are increasingly conscious of how the products they buy affect the environment and depend on marketers' environmental claims to be truthful. We look forward to this review process and will make any updates necessary to ensure the Green Guides provide current, accurate information about consumer perception of environmental benefit claims. This will both help marketers make truthful claims and consumers find the products they seek.[37]

In addition to the FTC's Green Guides, California has its own "Truth in Labeling" law for recyclable materials.[38] California's rule significantly narrows the types of items labeled as "recyclable," requiring criteria to be met to use "the chasing arrows or any other indicator of recyclability on products and packaging."[39] Not unlike the FTC's stated aims for updates and changes to the Green Guides, CalRecycle has described the aim behind California's amendments to its rules as twofold—namely, to "[h]elp vendors and consumers make informed decisions about products," and "[p]rovide an objective basis for holding manufacturers, distributors, and retailers responsible for misleading consumers about whether products get recycled."[40]

Finally, and just this year, the E.U. has adopted its own set of rules aimed at the use of product claims such as "environmentally friendly," "climate neutral," and the like.[41] Promoting the rule's institution, the E.U. Parliament's rapporteur Biljana Borzan

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Updates to its 'Green Guides' for the Use of Environmental Marketing Claims (Dec. 14, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/12/ftc-seeks-public-comment-potential-updates-its-green-guides-use-environmental-marketing-claims [https://perma.cc/QN44-PAFA].

37 *See id.*

38 *See* Senate Bill No. 343, https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB343.

39 *Accurate Recycling Labels*, CALRECYCLE, https://calrecycle.ca.gov/wcs/recyclinglabels/ [https://perma.cc/K9W5-S9H6] (last visited Apr. 2, 2024).

40 *Id.*

41 *See* Press Release, Eur. Parliament, MEPs Adopt New Law Banning Greenwashing and Misleading Product Information (Jan. 17, 2024), https://www.europarl.europa.eu/news/en/press-room/20240112IPR16772/meps-adopt-new-law-banning-greenwashing-and-misleading-product-information/ [https://perma.cc/D899-JC22].

expressed hope that the rule will allow for more market transparency and reliability in terms of labeling products as sustainable.[42]

It is no stretch to conclude that compliance with regulations like the FTC's Green Guides, California's Truth in Labeling rules, or the E.U.'s most recent legislation will demand that businesses ensure value and supply chains align with the labels applied to their products and, thus, that businesses along those value and supply chains take up ESG efforts consistent with those labels.

Scope 3 Emissions Reporting

Perhaps the most talked-about reach into value and supply chains in the U.S. stemmed from the SEC's proposed rule requiring businesses to disclose information about greenhouse gas emissions.[43] In particular, as proposed in 2022, that rule would have required businesses to disclose their direct emissions (Scope 1), "indirect emissions from purchased energy" (Scope 2), and—the clincher for purposes of this article—"emissions from upstream and downstream activities" (Scope 3).[44] Scope 3 upstream activities included purchased goods and services, capital goods, waste generated from operations, and employee business travel and commuting. Scope 3 downstream activities were, in turn, the transportation and distribution of products, a third-party's use of those products, and its investments. As such, the reach of Scope 3 into value and supply chains would have been extensive. The SEC's proposal provoked intense reactions upon release, including both significant support and fierce criticism. And, above all else, the inclusion of Scope 3 emissions has been hotly debated. If the rule had passed with Scope 3 intact, every publicly listed company would have been required to look back into its supply chain for emissions data, and businesses in those supply chains, in turn, could have been called upon to deliver that data. In March 2024, nearly

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42 *See* Mark Segal, *EU Parliament Approves New Law Banning Misleading Product Sustainability Claims,* ESG TODAY (Jan. 18, 2024), https://www.esgtoday.com/eu-parliament-approves-law-banning-misleading-product-sustainability-claims/ [https://perma.cc/TFM4-F86A].

43 *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2022), https://www.sec.gov/news/press-release/2022-46 [https://perma.cc/S8ZK-8HUD].

44 *See id.*

two years following the initial proposal, the SEC finalized its rule.[45] The final rule includes significant revisions from the 2022 proposal. Most notably, Scope 3 emissions disclosure requirements were removed from the rule.[46] As of the publication of this note, the SEC's final rule is the subject of litigation consolidated in the United States Court of Appeals for the Eighth Circuit and implementation of the rule is stayed.[47]

Regardless, the pressure is on for businesses in supply chains to level up as ESG frameworks coming online elsewhere do include Scope 3 emissions. The most recent development in the United States on this front is California's passing its own emissions reporting rules in October 2023. California's Governor Gavin Newsom signed SB 253 into law in October 2023.[48] Upon signing the bill into law, he expressed concerns about the implementation deadlines for the law. But, as passed, the law directs the California Air Resources Board to issue regulations mandating greenhouse gas disclosures by the end of 2024, with reporting requirements to kick in later in 2026. Those disclosure requirements extend to anyone meeting the definition of a "reporting entity" under the law, which means (1) a partnership, corporation, limited liability company, or other business entity formed under the laws of California, the laws of any other state of the United States or the District of Columbia, or under an act of the Congress of the United States; (2) with total annual revenues over $1 billion; and (3) that does business in California.

California's emissions disclosure law largely mirrors the proposed SEC emissions disclosure rule. Scope 1 emissions are defined under SB 253 as "all direct greenhouse gas emissions that stem from sources that a reporting entity owns or directly controls, regardless of location, including, but not limited to, fuel combustion activities." Scope 2 emissions are defined as "indirect greenhouse

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45 *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 6, 2024), https://www.sec.gov/news/press-release/2024-31.

46 *See id.*

47 *See* Order Issuing Stay in the Matter of the Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Relase No. 11,280, Exchange Act Release No. 99,908, 89 Fed. Reg. 25,804 (Apr. 4, 2024), https://www.sec.gov/files/rules/other/2024/33-11280.pdf.

48 *See* Climate Corporate Data Accountability Act, CAL. HEALTH & SAFETY CODE § 38532 (West 2024).

gas emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity, regardless of location." And Scope 3 emissions include "indirect upstream and downstream greenhouse gas emissions, other than scope two emissions, from sources that the reporting entity does not own or directly control," which may include "purchased goods and services, business travel, employee commutes, and process and use of sold products." Thus, California's Scope 3 disclosure requires an extensive breadth of emissions sources reaching deep into reporting businesses' value and supply chains.

In fact, also of note are the additional directives SB 253 outlines for disclosure form and content, requiring that disclosures conform with the Greenhouse Gas Protocol developed by the World Resources Institute and the World Business Council for Sustainable Development, and requiring independent third-party assurances as to disclosures. Failure to comply with SB 253's reporting requirements and timely file the required annual report could result in administrative penalties of up to $500,000 per reporting year. In other words, the rules not only demand an extensive breadth of data but do so applying a rigorous standard and significant consequences for failure to comply.

Finally, while it remains to be seen how SB 253 is applied, including how the threshold elements for its application are interpreted, it is expected SB 253 will cover a vast number of businesses. Given the anticipated reach of California's emissions disclosure requirements, the implications of the rules are significant. California is an enormous market where most major businesses operate and, thus, will qualify as reporting entities under the law. Importantly, there is no distinction in SB 253 between private and publicly held businesses as is inherent in the SEC rule. Even with its $1 billion threshold requirement, at signing, SB 253 was expected to apply to approximately 5,000 businesses. That means that the value and supply chains behind those 5,000 businesses might also be implicated.

As with the SEC's rule, implementation of California's rules has been slowed by legal challenges.[49] But, it also bears emphasizing that California may not be the lone state to take such action for long. New York, for example, has also proposed its own rules requiring

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49 *See* Complaint for Declaratory and Injunctive Relief, Chamber of Com. of the U.S. v. Cal. Air Res. Bd., No. 2:24-cv-00801 (C.D. Cal. filed Jan. 30, 2024).

certain businesses within the state to annually disclose Scope 1, 2, and 3 emissions.[50] Though as of yet no such law has been passed in New York or anywhere other than California, it would be reasonable to expect other states to consider and even advance greenhouse gas emissions disclosure rules, including Scope 3 disclosure requirements. And, of course, with every additional set of rules mandating Scope 3 emissions reporting comes another set of businesses obliged to comply with those rules and, in doing so, look back into their own value and supply chains.

In fact, last but not least here is the fact that pressure as a consequence of Scope 3 reporting requirements is also coming from sources outside the United States. Foremost is the E.U.'s Corporate Sustainability Reporting Directive (CSRD), which went into effect in January 2023.[51] The CSRD's reach is the most sweeping to date. It extends to E.U. companies but also to non-E.U. companies that meet certain net turnover criteria. Overall, the CSRD has been noted as extending reporting obligations from 11,000 businesses to more than 50,000. And, the first phase of European Sustainability Reporting Standards (ESRS), which applies to businesses subject to the CSRD and issued in the summer of 2023, includes disclosures as to Scope 3 emissions (not to mention other supply chain issues).[52] While in many instances reporting as mandated by the CSRD is subject to a materiality assessment, the disclosures it requires raise at least the specter of inquiry into the value and supply chains of the 50,000 businesses to whom it is expected to apply. Moreover, sources indicate the CSRD could be emerging as the "gold standard" in meeting investor demand for ESG-related disclosures.

Likewise, the recently finalized International Sustainability Standards Board disclosure standards also require Scope 3

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50 *See S.B. S897A, 2023-2024 Leg. Sess.*, N.Y. State Senate (2023), https://www.nysenate.gov/legislation/bills/2023/S897/amendment/A.

51 *See* Council Directive 2022/2464, 2022 O.J. (L 322) 15 (E.U.).

52 *See The First Set of ESRS - the Journey from PTF to Delegated Act (Adopted on 31 July 2023)*, EFRAG, https://www.efrag.org/lab6?AspxAutoDetectCookieSupport=1 [https://perma.cc/NEX8-K9R8]. In January 2024, the European Financial Reporting Advisory Group announced its release of drafts of proposed sustainability reporting standards for small and medium size businesses. These also include Scope 3 emissions disclosure provisions. *See also EFRAG's Public Consultation on Two Exposure Drafts on Sustainability Reporting for SMEs,* EFRAG (Jan. 22, 2024), https://efrag.org/news/public-479/EFRAG%E2%80%99s-public-consultation-on-two-Exposure-Drafts-on-sustainability-reporting-standards-for-SMEs [https://perma.cc/VRT5-3NF2].

disclosures.[53] That framework is a voluntary one. However, many jurisdictions worldwide have already indicated they will adopt those standards into law. In fact, the International Organization of Securities Commissions has called on its member jurisdictions (all 130) to consider incorporating those standards into their regulatory frameworks,[54] and the U.K. Department for Business and Trade announced it would create standards-based thereon.[55] Again, with each additional set of rules put in place comes an additional set of businesses assessing their value and supply chains in order to ensure their own compliance.

Direct Supply Chain Reach

In addition to frameworks reaching into supply chains just as a practical matter, others are doing so with express intention. Of most recent vintage is the E.U.'s Corporate Sustainability Due Diligence Directive (CSDDD) approved by the European Parliament's Legal Affairs Committee on March 19, 2024, and extending on its face to the entire supply chain of in-scope [56] In particular, the CSDDD is aimed at violations of human rights and environmental-related violations along those supply chains. The CSDDD applies to both E.U. and non-E.U. businesses operating in the E.U. It was initially proposed in February 2022, and the approved version is somewhat ratcheted down, extending to businesses with more than 1,000 employees (rather than 500 as proposed) and a net turnover exceeding €450M (rather than €150M as proposed). But, as noted, the CSDDD is not limited to E.U. businesses, and, even in its ratcheted down version, it is expected to reach far and wide—well

[53] *See Introduction to ISSB and IFRS Sustainability Disclosure Standards*, IFRS, https://www.ifrs.org/sustainability/knowledge-hub/introduction-to-issb-and-ifrs-sustainability-disclosure-standards/ [https://perma.cc/U6AQ-82KR] (last visited March 3, 2024).

[54] *See IOSCO endorses the ISSB's Sustainability-Related Financial Disclosures Standards*, INT'L ORG. OF SEC. COMM'NS (July 25, 2023), https://www.iosco.org/news/pdf/IOSCONEWS703.pdf [https://perma.cc/8RGM-NTVT].

[55] *See* Sukhvir Basran et al., *UK Announces Plans to Publish Sustainability Disclosure Standards by July 2024*, JDSUPRA (Sept. 19, 2023), https://www.jdsupra.com/legalnews/uk-announces-plans-to-publish-5783243/ [https://perma.cc/U6GD-ESVK].

[56] *See* Mark Segal, *Watered Down Supply Chain Sustainability Due Diligence Law Passes First Hurdle in EU Parliament*, ESG TODAY (Mar. 19, 2024), https://www.esgtoday.com/watered-down-supply-chain-sustainability-due-diligence-law-passes-first-hurdle-in-eu-parliament/.

beyond the E.U. into value and supply chains.

And, meanwhile, other E.U. frameworks target supply chains directly—including, for example, the Conflict Minerals Regulation, which requires supply chain due diligence reporting for importers of tin, tantalum, tungsten, and gold;[57] the European Carbon Border Adjustment Mechanism, which imposes charge on products imported from non-E.U. countries for emissions released during product's production; [58] and the Regulation on Deforestation, which addresses cattle, cocoa, coffee, palm oil, rubber, soya, and wood products.[59]

There are examples outside the E.U. as well. The German Supply Chain Due Diligence Act was passed in 2021 and requires that in-scope businesses make efforts to ensure there are no violations of human rights and environmental obligations in their supply chains—bringing businesses along those value and supply chains squarely into focus. And, since 2015, the U.K.'s Modern Slavery Act[60] has required efforts to ensure there are no violations of human rights and environmental obligations in supply chains.

Along these same lines, in the United States, the Uyghur Forced Labor Prevention Act[61] creates a presumption that goods from the region were mined, produced, or manufactured wholly or partially by forced labor and requires evidence to the contrary to rebut that presumption; and California's Transparency in Supply Chain Act[62] requires disclosure of efforts to eradicate slavery and human trafficking in supply chains.

Finally, of note are the climate clauses proposed by The Chancery Lane Project (TCLP) and cooperating U.S. attorneys for

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57 *See Conflict Minerals Regulation: The Regulation Explained*, EUROPEAN COMM'N, https://policy.trade.ec.europa.eu/development-and-sustainability/conflict-minerals-regulation/regulation-explained_en (last visited Apr. 29, 2024).

58 *See Carbon Border Adjustment Mechanism*, EUROPEAN COMM'N, https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en (last visited Apr. 29, 2024).

59 *See Regulation on Deforestation-free Products*, EUROPEAN COMM'N, https://environment.ec.europa.eu/topics/forests/deforestation/regulation-deforestation-free-products_en (last visited Apr. 29, 2024).

60 *See* Modern Slavery Act 2015, (UK), https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted.

61 *See* Act of Dec. 23, 2021, Pub. L. No. 117-78, 2023 U.S.C.C.A.N. (135 Stat.) 1525.

62 *See* Cal. Civ. Code § 1714.43 (West 2012).

use in contracts under U.S. law. In particular, included among those are clauses specific to supply chain contracts.[63] The first, addressing deforestation and land use, includes a questionnaire about environmental impacts relating to land use within supply chains. And the second, addressing renewable energy requirements, requires suppliers to procure energy from renewable sources. The TCLP is a global network of lawyers and business leaders promulgating such climate-oriented contract clauses, glossary terms, and other tools for public use with the determined aim of decarbonizing contracts. Its influence in encouraging businesses to include provisions like those noted here in those businesses' supply chain contracts could have significant implications for the businesses party to those contracts even in the event none of the legal frameworks or tools noted here were in play.

Takeaways

Outlined here is a varied and sizeable list of market and legal indicators of ESG's increasing reach into value and supply chains and the resulting need for any business delivering goods or services upstream to prepare for ESG. Whether as a consequence of the interconnected and cumulative impact of supply chains on ESG factors and related scrutiny (not to mention associated regulatory, litigation, and reputational risk), consumer and investor demand for ESG products, behemoths like Amazon establishing their own baselines for ESG efforts from their suppliers, or legal frameworks and tools online and coming online in the U.S. and overseas directly addressing supply chains or doing so by extension, the fact is that value and supply chains are increasingly within the ambit of ESG. Note too that, given the speed at which developments around ESG are emerging globally, this article is at best a selection of only some key indicators; it is hardly comprehensive. With that caveat, and taking together just the indicia noted here, the signal is clear: ESG is reaching far enough into value supply chains that every business along those chains would do well to prepare—again, regardless of size, sector, or ongoing debate.

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[63] *See Climate Clauses: Supply Chain,* CHANCERY LANE PROJECT, https://chancerylaneproject.org/practice-areas/supply-chains/ [https://perma.cc/2JBU-2MP8] (last visited March 3, 2024).