



Directors' Duties Navigator: Climate Risk and Sustainability Disclosures*

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**Previously titled 'Primer on Climate Change: Directors' Duties and Disclosure Obligations'*



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United States

1. Legal and Regulatory Landscape Regarding Climate Change

1.1. Government approach to climate change

In the US, climate change is a political divisive issue. During the Biden administration (2021-present), climate change became an integral part of both US foreign and domestic policy. On his first day in office, 20 January 2021, President Biden declared support for the Paris Agreement and its threefold goals of “a safe global temperature, increased climate resilience, and financial flows aligned with a pathway toward low greenhouse gas emissions and climate-resilient development”, and his administration’s commitment to the climate agenda has been steadfast since then.¹ However, the climate and ESG agenda in the US has become highly politicised and polarised, with a significant Republican backlash against pro-ESG measures playing out in the judicial and legislative branches of government.

1.1.1. Climate change legislation

The US does not have a single legislation focussed on climate change. Instead, its climate policy is shaped by a combination of laws and regulations at the federal and state level.²

Federal level: Notable federal legislation used to regulate climate change includes:

- *The Clean Air Act* (1970 and subsequent amendments): although not originally designed as climate legislation, in *Massachusetts v EPA* (2007),³ the US Supreme Court ruled that GHGs are “air pollutants” under the Clean Air Act, granting the federal environmental agency, the Environmental Protection Agency (EPA), authority to regulate them. However, this authority was significantly limited by the 2022 Supreme Court decision in *West Virginia v EPA*.⁴
- *The Bipartisan Infrastructure Law* (2021): this legislation makes

significant funding available for clean energy projects, electric vehicle (EV) infrastructure, and climate resilience measures.

- *The Inflation Reduction Act (IRA)* (2022): the IRA is the most significant federal legislation that directly addresses climate change and the energy transition. The IRA aims to reduce US GHG emissions by approximately 40% below 2005 levels by 2030. The IRA allocates USD 369 billion over ten years to promote clean energy technologies (including wind, solar, hydrogen, nuclear and battery storage), and supports EVs and energy-efficient buildings. It also extends and expands tax credits for renewable projects.

State level: several US states have also enacted significant legislation to address climate change. Examples include:

- **California:** The *Global Warming Solutions Act* (2006) set California’s emissions reduction targets, led to the creation of the California cap-and-trade program, renewable energy standards and other emissions-reducing measures; *Senate Bill 100* (2018), requires California to achieve 100% carbon-free electricity by 2045, with an interim target of 60% renewable electricity by 2030; *Executive Order B-55-18* (2018) targets carbon neutrality by 2045 and net-negative emissions thereafter; and the 2023 *Climate Accountability Package*, comprising the *Climate Corporate Data Accountability Act* (Senate Bill 253) and *Climate-Related Financial Risk Act* (Senate Bill 261) require larger Californian companies to publicly disclose GHG emissions by 2026, although these laws are the subject of ongoing litigation (discussed below).⁵

¹ The White House, *Paris Climate Agreement: Acceptance on Behalf of the United States of America* (20 January 2021).

² The tension between federal and state legislation addressing climate change has been the topic of extensive judicial scrutiny, particularly in the numerous cases filed by US states, cities and municipalities against oil and gas companies, seeking damages for their contributions to climate change and for allegedly knowingly misleading the public as to the harmful impacts of burning fossil fuels for decades. Defendant oil and gas companies consistently argue that such claims are not appropriate for state law consideration and are instead pre-

empted by federal law. Judgments on this point to date have been mixed, but the US Department of Justice has been invited to submit its views on this point in the context of Shell and Sunoco’s appeal against the State and City of Honolulu’s climate liability claims against them.

³ *Massachusetts v. EPA*, 549 U.S. 497 (2007).

⁴ *West Virginia v. EPA*, 597 U.S. 697 (2022)

⁵ On 30 January 2024, the US Chamber of Commerce, Western Growers Association and four business groups filed a lawsuit against the California Air Resources Board alleging that Senate Bills 253 and

- **New York:** The *Climate Leadership and Community Protection Act* (2019), requires New York to reduce its GHG emissions by 85% below 1990 levels by 2050, and mandates 70% renewable electricity by 2030; and the *Community Risk and Resiliency Act* (2014) requires the state to consider climate change in permitting, funding, and regulatory decisions. New York is also pushing through a *Climate Superfund Act* (see below).
- **Washington:** The *Clean Energy Transformation Act* (2019) requires 100% clean electricity by 2045, with coal power phased out by 2025 and a GHG-neutral grid by 2030; and the *Climate Commitment Act* (2021) establishes a cap-and-invest program and targets carbon emissions reductions of 95% below 1990 levels by 2050.
- **Massachusetts:** The *Global Warming Solutions Act* (2008) and its amendment in 2021 target net zero GHG emissions by 2050 and create a municipal program to help communities adapt to climate change.
- **Colorado:** *House Bill 19-1261* (2019) targets GHG emissions reductions of 26% by 2025, 50% by 2030 and 90% by 2050, below 2005 levels; and *Senate Bill 19-096* (2019) requires Colorado state to monitor and report data on GHG emissions.

'Climate Superfund' Legislation. Notably, on 30 May 2024, the Vermont General Assembly passed the *Climate Superfund Act*,⁶ which will impose strict liability on major fossil fuel companies for their contributions to climate change, with the penalties paid into a superfund to cover the State of Vermont's costs of adapting to climate change. New York's State Assembly similarly passed a *Climate Change Superfund Act* on 7 June 2024.⁷ California,

Massachusetts and Maryland are also considering establishing superfunds.

Anti-ESG/Climate legislation. Nearly every state in the US has introduced legislation related to climate change and/or ESG, with over 200 ESG-investment related bills introduced since 2020. However, not all such legislation is pro-climate or pro-ESG. As of August 2024, 39 states have collectively introduced 185 bills restricting ESG initiatives, 31 of which have passed.⁸ These 'anti-ESG' laws and proposals generally seek to restrict state pension funds and other public investments from considering ESG factors in their financial decisions, arguing that such considerations depart from the pension funds' primary objective of achieving the highest financial return for shareholders. Such anti-ESG legislation exists in Texas,⁹ Florida,¹⁰ Kentucky,¹¹ West Virginia,¹² and is pending in many more.

However, anti-ESG laws are being challenged – and in some cases defeated – in court. For example, on 7 May 2024, an Oklahoma state judge blocked Oklahoma's 2022 *Energy Discrimination Elimination Act* (House Bill 2034),¹³ which restricts state pension funds from investing in, and state contracts from engaging with, companies that boycott or divest from fossil fuel energy companies "without an ordinary business purpose". The law prevented state pension funds from engaging with companies including BlackRock, Wells Fargo and JP Morgan Chase. In the decision, Judge Stinson found that the dominant purpose of the Act – namely, to "counter the 'political agenda' of certain financial companies" and "to assist the [...] oil and gas sector" – conflicted with pension funds' constitutional mandates to base decisions solely on the benefits of their investors. She also found the Act to be unconstitutionally vague.¹⁴

Similarly, on 14 August 2024, a Missouri district court permanently blocked Missouri's anti-ESG

261 are unconstitutional under the First Amendment (free speech) and are pre-empted by the federal Clean Air Act.

⁶ Vermont General Assembly, *Vermont Climate Superfund Act*, S.259 (2024)

⁷ New York State Assembly, *Climate Change Superfund Act Senate Bill S02129B* (May 2024).

⁸ Debevoise & Plimpton, *State-Level ESG Investment Developments Tracker* (March 2024).

⁹ Texas was the first state to pass such 'anti-ESG laws' in September 2021, approving *Senate Bill 13* and *Senate Bill 19*, which prevent state and local entities from engaging with financial firms that boycott Texas's energy (oil and gas) and firearms industries for ESG reasons.

¹⁰ Florida's 2023 *House Bill 3* is a comprehensive anti-ESG law that prohibits consideration of ESG factors in state and local investment decisions, requiring only financial factors to be considered.

¹¹ Kentucky's 2022 *Senate Bill 205* requires the state to divest from financial institutions that engage in boycotts against energy companies, and prohibits state contracts with companies that use ESG criteria to exclude such businesses.

¹² West Virginia's 2022 *Senate Bill 262* mandates the state to identify and prohibits it from conducting business with financial institutions that boycott energy companies.

¹³ Oklahoma's *House Bill 2034* prohibits the state from contracting with or investing in companies that divest from oil and natural gas in an attempt to protect the state's economic interests in these industries, which are seen as vital to Oklahoma's economy and job market.

¹⁴ *Keenan v. Oklahoma*, No. 5:2023cv01121 (W.D. Okla. 2023). See the final decision [here](#).

rules¹⁵ that limited the ability of financial advisors to integrate so-called “nonfinancial” ESG into their advice without express consent from clients, finding that the rules were “unconstitutionally vague”, violated the First Amendment and were pre-empted by federal laws.¹⁶

1.1.2. Transition plans and targets

Mitigation. In addition to the GHG emissions reduction targets set out in the federal and state legislation above, in April 2021, the US updated its Nationally Determined Contribution (NDC) under the Paris Agreement, setting an economy-wide target of reducing its net GHG emissions by 50-52% below 2005 levels by 2030.¹⁷

Furthermore, in November 2021, the Biden administration submitted an updated long-term strategy to the UNFCCC officially committing the US to net zero emissions (across all GHG emissions) by “no later than 2050”.¹⁸

To achieve these targets, in December 2021, the Biden administration passed Executive Order 14057, titled *Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability* (the **Federal Sustainability Plan**). The Federal Sustainability Plan aims to achieve:¹⁹

1. 100% carbon pollution-free electricity by 2030, at least half of which will be locally supplied clean energy to meet 24/7 demand;
2. 100% zero emission vehicle sales by 2035, including 100% zero emission light-duty vehicle acquisitions by 2027;
3. Net zero emissions from federal procurement by 2050;
4. Net zero emissions buildings by 2045, including a 50% emissions reduction by 2032;

5. Net zero emissions operations by 2040, including a 65% reduction by 2030;
6. Climate resilient infrastructure and operations; and
7. Other targets relating to equity and sustainability in the workforce and through partnerships.

The Federal Sustainability Plan is overseen by the Federal Chief Sustainability Officer, who coordinates federal agencies on its implementation.

Adaptation. In November 2021, the US submitted its first Adaptation Communication under the Paris Agreement,²⁰ which noted five cross-cutting adaptation priorities for the US: (1) improving community resilience planning; (2) designing and building resilient infrastructure; (3) measuring, disclosing, managing and mitigating climate-related financial risks to communities and the US economy; (4) conserving and restoring lands and waters; and (5) advancing innovative and measurable resilience solutions.

These adaptation measures are achieved through domestic policies, executive orders,²¹ and agency specific plans, such as the EPA’s *2024-2027 Climate Adaptation Plan*, which was published in June 2024.²²

1.1.3. Wider government approach to climate change

President Biden’s January 2021 Executive Order on *Tackling the Climate Crisis Home and Abroad* established a process to embed climate risk mitigation in every executive agency of the federal government,²³ including establishing an inter-agency coordinating process and appointing both a foreign and domestic policy lead in newly established positions within the White House.

¹⁵ The Rules are set out in two chapters of the Missouri Code of State Regulations, *Chapter 51 – Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives*, CSR 30-51.170, on Dishonest or Unethical Business Practices by Broker-Dealers and Agents, and CSR 30-51.172, on Dishonest or Unethical Business Practices by Investment Advisers and Investment Adviser Representatives.

¹⁶ *Securities Industry and Financial Markets Association v Missouri*, Case No. 23-cv-04154-SRB (W.D. Mo. 2023). See the Judge’s order [here](#). In particular, the Judge held that the rules are pre-empted by the 1996 National Securities Markets Improvement Act and the 1974 Employment Retirement Income Security Act.

¹⁷ UNFCCC, *The United States of America Nationally Determined Contribution* (2021).

¹⁸ US Department of State and the US Executive Office of the President, *The Long-Term Strategy of the United States: Pathways to Net-Zero Greenhouse Gas Emissions by 2050* (November 2021).

¹⁹ The White House, *Executive Order on Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability* (8 December 2021).

²⁰ UNFCCC, *Adaptation Communication of the United States*, (November 2021).

²¹ For example, Executive Order 14008, *Tackling the Climate Crisis at Home and Abroad* (27 January 2021), which established the National Climate Task Force and directed federal agencies to integrate climate resilience and adaptation into their operations and planning; and Executive Order 14057, *Catalyzing Clean Energy and Jobs Through Federal Sustainability* (December 2021), which includes adaptation measures to ensure federal operations are resilient to climate impacts.

²² US Environmental Protection Agency, *2024-2027 Climate Adaptation Plan* (June 2024).

²³ The White House, Executive Order 14008, *Tackling the Climate Crisis at Home and Abroad* (27 January 2021).

In October 2021, the White House issued a *Roadmap to Build a Climate-Resilient Economy*,²⁴ where it acknowledged that “climate change poses serious and systemic risks to the U.S. economy and financial system”. The roadmap presents a climate risk accountability framework that identifies core principles for addressing climate-related financial risk, following with a roadmap and implementation strategy for action.

The December 2021 Federal Sustainability Plan also pledged to reduce emissions across all federal operations, invest in local clean energy industries and manufacturing, and create clean, healthy and resilient communities.²⁵

Climate Finance. Regarding climate finance, on 20 May 2021, President Biden issued an *Executive Order on Climate Change Financial Risk*,²⁶ setting out responsibilities for the Treasury, the Office of Management and Budget (OMB), and the Financial Stability Oversight Council (FSOC) and its constituent agencies. This:

- a) required the development of a federal government-wide strategy to assess, measure, mitigate, and disclose climate change financial risk;
- b) requested analysis of the capital needed to transition the American economy to net-zero by 2050;
- c) required the Treasury to work with FSOC and its constituent agencies to identify actions within each agency to identify, measure, mitigate, and disclose climate change financial risk;
- d) identified financial risk from climate within the insurance industry;
- e) identified actions that can be taken by the Department of Labor to protect pension savings and Federal pension insurance from climate change financial risk; and
- f) identified how the Federal Government can incorporate climate change financial risk into its lending, risk

underwriting, procurement, and budgeting.²⁷

In 2021, Secretary of the Treasury Janet Yellen stated that climate change will be a priority, creating a hub within Treasury that focuses on financial system-related risk posed by climate change and tax policy incentives to effect change.²⁸ In April 2021, she vowed to build a “whole of economy” approach to climate change,²⁹ and released a *Climate Action Plan* in July 2021.³⁰ On 27 July 2024, speaking in Brazil after meeting with G20 finance ministers, Yellen emphasised the need for stronger climate finance policies through 2050 to address the “existential threat” to communities and economic strain posed by climate change, also identifying the global transition to a low-carbon economy as the “single greatest opportunity of the 21st century”.³¹ In the same speech, Yellen noted that USD 3 trillion in new capital is required each year to combat climate change.

The US national budget for FY 2024 (the **2024 Budget**)³² “prioritizes tackling climate change with the urgency that climate change demands”, providing USD 12.08 billion to fund the EPA’s efforts to “clean up air, land, and water pollution, tackle the climate crisis, [and] advance environmental justice”. This is 19% higher than the FY 2023 budget for the EPA. Amongst other measures, the 2024 Budget proposes an additional USD 64.4 million to fund the phase out of hydrofluorocarbons (potent GHGs); an additional USD 71.5 million (totalling USD 181 million) for the Climate Protection Program to tackle climate crisis at home and abroad through integrated regulations, partnerships and technical assistance, including supporting the GHG Reduction Fund set up by the IRA; provides USD 150 million for the Diesel Emission Reduction Act Grant Program; and an additional USD 45.3 million for climate adaptation measures.³³

Green Taxonomy and Carbon Trading. The US does not currently have a green taxonomy, federal carbon tax or federal carbon pricing legislation. However, 13 states that account for

²⁴ The White House, *U.S. Climate-Related Financial Risk Executive Order 14030: A roadmap to build a climate-resilient economy* (14 October 2021).

²⁵ The White House, *Executive Order on Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability* (8 December 2021).

²⁶ The White House, *Executive Order on Climate Related Financial Risk* (20 May 2021).

²⁷ *Ibid.*

²⁸ Reuters, *Yellen says would appoint senior climate official at Treasury* (19 January 2021).

²⁹ US Department of the Treasury, *Secretary of the Treasury Janet L. Yellen's Remarks to the Institute of International Finance* (21 April 2021).

³⁰ US Department of the Treasury, *Climate Action Plan* (July 2021).

³¹ US Embassy & Consulates in Brazil, *Secretary of the Treasury Janet L. Yellen's Travel to Brazil* (22 July 2024).

³² The White House Office of Management and Budget, *Budget of the U.S. Government Fiscal Year 2024*, (March 2023).

³³ US Environmental Protection Agency, *Fiscal Year 2024, Justification of Appropriation Estimates for the Committee on Appropriations*, (March 2023).

over a quarter of the US population and a third of US GDP have active carbon-pricing programs. Those states are California, Washington, and the 11 states in the Regional Greenhouse Gas Initiative (RGGI) (Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania,³⁴ Rhode Island, Vermont).

1.2. Regulatory approaches to climate change

1.2.1. Climate change as a systemic financial risk

US regulators have also recognised climate change as a systemic financial risk to the US economy.

1.2.2. Financial regulation and guidance

Financial Stability Oversight Council: On 21 October 2021, the FSOC issued a report on climate-related financial risk, noting that “[t]he increasing economic effects of climate change imply that climate-related financial risks are an emerging threat to the financial stability of the United States”, and recommending that regulators of financial institutions require increased climate change-related disclosures and the use of scenario analysis to identify climate-related risks.³⁵

Federal Reserve: The US Federal Reserve Bank Board of Governors (the **FED**) first identified climate change as a risk to the American financial system in its 2020 *Financial Stability Report* (the **2020 Report**).³⁶ The 2020 Report stated that “Federal Reserve supervisors expect banks to have systems in place that appropriately identify, measure, control, and monitor all of their material risks, which for many banks are likely to extend to climate risks.”³⁷ The FED’s 2021 *Financial Stability Report* noted that climate change “poses significant challenges for the global economy and the financial system”.³⁸

However, in January 2023 FED Chair Jerome Powell stated that the FED’s role should be

limited to supervising banks’ management of climate change-related material financial risks.³⁹ Accordingly, the 2023 *Financial Stability Report* noted that the FED’s responsibilities with respect to climate change are “*narrow but important*”, albeit “*tightly linked to its role in promoting*” financial stability.⁴⁰ In 2023, the FED announced that it was “*working to better understand [climate-related risks] to individual banking organisations in the financial system*”, coordinating with domestic and international groups to develop models for quantifying climate risks, and engaging with both the FSOC and other international groups such as the Financial Stability Board, the Basel Committee on Banking Supervision, the Networks of Central Banks and Supervisors for Greening the Financial System, and the International Monetary Fund. However, the FED’s April 2024 *Financial Stability Report* makes no reference to climate change whatsoever.⁴¹

Commodity Futures Trading Commission: In September 2020, a subcommittee of the US Commodity Futures Trading Commission (**CFTC**) also recognised the “*serious emerging risks*” to the US financial system posed by climate change and urged US financial regulators to “*move urgently and decisively to measure, understand, and address these risks*”.⁴² In March 2023, Commissioner Romero of the CFTC similarly recognised climate change as a “*significant financial risk*”, highlighting the need for CFTC to consider a more “*thoughtful*” approach “*by first categorizing products as environmental/climate-related, and then conducting oversight*” similar to the US approach for overseeing digital assets. He also suggested “*heightened review, targeted law enforcement, and increased market surveillance can ensure the integrity of these markets, so that they are resilient to set backs and contribute to a sustainable future*”.⁴³

On 4 December 2023, the CFTC published proposed guidance for consultation on the listing of voluntary carbon credits (**VCC**)

³⁴ Pennsylvania is a participating state in RGGI but is currently not participating due to litigation.

³⁵ Financial Stability Oversight Committee, *Report on Climate-Related Financial Risk* (21 October 2021).

³⁶ United States Federal Reserve Bank Board of Governors, *Financial Stability Report* (November 2020), 59-60.

³⁷ *Ibid.*

³⁸ Board of Governors of the Federal Reserve System, *Financial Stability Report* (November 2021).

³⁹ Board of Governors of the Federal Reserve System, Jerome H. Powell, Speech at Panel on *Central Bank Independence and the Mandate – Evolving Views* (10 January 2023).

⁴⁰ Board of Governors of the Federal Reserve System, *Financial Stability Report* (October 2023).

⁴¹ Board of Governors of the Federal Reserve System, *Financial Stability Report* (April 2024).

⁴² The Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, *Managing Climate Risk in the U.S. Financial System* (September 2020).

⁴³ CFTC, *Remarks of Commissioner Christy Goldsmith Romero at ISDA’s ESG Forum on Promoting Market Resilience: A Thoughtful Approach to the Daunting Challenge of Climate Financial Risk* (07 March 2023).

derivatives on CFTC-regulated exchanges.⁴⁴ The *Voluntary Carbon Market Proposed Guidance* (the **Proposed VCM Guidance**) aims to advance the standardization of VCC derivative contracts in a manner that “fosters transparency and liquidity, accurate pricing, and market integrity”.⁴⁵ Public consultation on the Proposed VCM Guidance ended on 16 February 2024, but no finalised guidance has been published as of September 2024.

Federal Deposit Insurance Corporation: The Federal Deposit Insurance Corporation (**FDIC**), which insures consumer deposits and supervises financial institutions for financial stability and consumer protection, has also identified addressing climate-related financial risks as a top priority.⁴⁶

In October 2023, FDIC, the FED Board, and the Office of the Comptroller of the Currency (**OCC**), jointly issued specific guidance of principles for climate-related financial risk management for large financial institutions.⁴⁷ The final guidance contains high-level principles covering six areas: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement, and reporting; and scenario analysis. The principles provide a framework for financial institutions to manage exposures to climate-related financial risks consistently with existing FDIC rules and guidance.

Securities and Exchange Commission: The US Securities and Exchange Commission (**SEC**) has been particularly proactive in implementing measures to address climate change.

SEC Shareholder petition rules: Besides taking action to enhance transparency around and disclosures of climate-related risks (discussed in section 3 below), the SEC has taken steps to support the role of shareholders pushing for corporate action on climate change through its oversight of the proxy voting process. In November 2021, the SEC issued new guidance on SEC Rule 14a-8, which governs shareholder proposals (the **New Guidance**),⁴⁸ that withdrew companies' ability to exclude shareholder

proposals under the ‘ordinary business’ or ‘economic relevance’ exceptions if the proposals did not pertain directly to the company's core business.⁴⁹ Under the New Guidance, proposals focussed on significant social policies, including climate change, cannot be excluded simply because they aren't tied directly to the company's operations, making it easier for shareholders to table proposals related to environmental and social objectives.

The New Guidance came under attack in January 2024, when ExxonMobil Corp (**ExxonMobil**) sued two of its investors (Arjuna Capital LLC and Follow This) in a Texas federal district court, seeking permission to exclude the shareholders' proposal that called on ExxonMobil to accelerate its direct and indirect GHG emissions reductions.⁵⁰ ExxonMobil alleged that the climate-focussed investors filed the proposal for consideration at ExxonMobil's May 2024 AGM with the intention to “diminish the company's existing business” and argued that the New Guidance was at odds with wider shareholder proposal rules and customs. Although the shareholders withdrew and promised not to re-table the proposal, ExxonMobil maintained its lawsuit, stating that court guidance is needed on the New Guidance. However, on 17 June 2024, the Texas federal district court struck out the claim, finding that the shareholders' “unconditional and irrevocable” promise not to file similar climate proposals at future AGMs “eliminated any case or controversy”, rendering ExxonMobil's case moot. The court did not comment on the SEC's New Guidance on Rule 14a-8.

Financial greenwashing: The SEC has also taken significant steps to address financial greenwashing. These actions respond to growing concerns about misleading marketing practices within the rapidly expanding ESG fund market.

In March 2021, the SEC established a dedicated Climate and ESG Taskforce in its Enforcement Division (the **ESG Taskforce**) to investigate potentially misleading practices by companies,

⁴⁴ CFTC, *CFTC Issues Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts* (4 December 2023).

⁴⁵ Ibid.

⁴⁶ FDIC, *Acting Chairman Martin J. Gruenberg Announces FDIC Priorities for 2022* (7 February 2022).

⁴⁷ FDIC, *Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (October 2023). See also FDIC, *Summary of Principles for Climate-Related Financial Risk Management for Large Financial Institutions* (24 October 2023).

⁴⁸ US Securities and Exchange Commission, Division of Corporation Finance, *Shareholder Proposals: Staff Legal Bulletin No. 14L (CF)* (3 November 2021).

⁴⁹ Specifically, the Division of Corporation Finance of the SEC issued Staff Legal Bulletin 14L which rescinds its prior positions in Staff Legal Bulletins 14J, 14K and 14L, regarding Rule 14a-8(i)(5), the economic relevance exception, and Rule 14a-8(i)(7), the ordinary business exception.

⁵⁰ *ExxonMobil Corp v Arjuna Capital LLC, et al*, 4:24-cv-00069 (N.D. Tex., 2024). See the final decision [here](#).

funds or products labelled as 'ESG',⁵¹ although it was reported in September 2024 that this ESG Taskforce has since been disbanded.⁵²

On 25 May 2022, the SEC published draft anti-greenwashing disclosure rules (**Proposed Greenwashing Rules**),⁵³ which would introduce additional disclosure requirements for ESG-focussed funds, impact funds and integration funds, including disclosure of ESG-related proxy voting and other forms of engagement and the carbon footprint and GHG emissions of their portfolios. ESG-focussed and impact funds would also need to include additional metrics in their annual reports, detailing progress towards their ESG objectives and KPIs, and registered investment advisors would need to enhance their Form ADV Part 2a brochures to include information on how they integrate ESG factors into their investment advice and methodologies.

In June 2022, the SEC announced a series of enforcement actions against firms for overstating their ESG commitments (see section 1.2.3 below).

In May 2023, SEC Chair Gary Gensler reiterated the importance of transparency in ESG disclosures during a public statement, highlighting the ongoing risks of greenwashing as more funds market themselves as 'green' or 'sustainable'.

In September 2023, the SEC officially adopted amendments to the Rule 35d-1 in the *Investment Company Act* (the **Names Rule**)⁵⁴ which addresses fund names that are likely to mislead investors about the fund's investments and risks. The amended Names Rule now requires ESG funds (and other funds with names suggesting a focus on investments with particular characteristics, such as 'growth funds') to adopt an 80% investment rule, meaning at least 80% of the value of assets in those funds must be invested in ESG holdings. Compliance with the 80% investment rule must be reviewed at least on a quarterly basis. Furthermore, the amendments require enhanced prospectus disclosure for terminology used in the fund name, including a requirement that the name is 'plain English', and includes additional reporting and

recordkeeping requirements for ESG funds regarding compliance with names-related regulations. Funds with net assets over USD 1 billion must comply by 11 December 2025, and all other funds by 11 June 2026.

On 23 February 2024, the Director of the SEC Enforcement Division confirmed the SEC's focus on greenwashing in a speech,⁵⁵ highlighting that ESG issues are increasingly material to investors, and that, as such, there has been an "explosion" in companies disclosing ESG-related information, which the SEC will analyse in line with general anti-fraud and other provisions of federal securities law.

On 13 May 2024, a group of 21 Democrat senators and members of Congress wrote to the SEC and the SEC Chair urging it to finalise its Proposed Greenwashing Rules.⁵⁶ The letter recognises and applauds the SEC's actions to date to combat financial greenwashing, including amending the Names Rule, but notes that "investors need disclosures to know whether the ESG-branded and marketed services and investment products align with their investment needs, preferences, and expectations". The letter makes recommendations for the final ESG disclosure rules, including only allowing funds to use 'ESG' language in their names if ESG factors are the main or significant factor in their investment decisions, and requiring certain funds to disclose their engagement and proxy voting records and/or GHG emissions.

1.2.3. Liability risk: enforcement action by regulators

The legislative and regulatory developments discussed in sections 1.1 and 1.2 could give rise to liability for corporations that fall within scope of but fail to adhere to the new laws, regulations and guidelines.

Since establishing its ESG Taskforce in 2021, the SEC has been active in enforcing its anti-greenwashing policies, resulting in tens of billions in fines handed out to financial institutions over misrepresentations or omissions about a fund or products ESG considerations:

⁵¹ SEC, *SEC Announces Enforcement Task Force Focussed on Climate and ESG Issues* (4 March 2021).

⁵² See Bloomberg Law, *SEC Abandons ESG Enforcement Group Amid Broader Backlash* (12 September 2024).

⁵³ SEC, *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices* (proposed) (May 2022).

⁵⁴ SEC, 17 CFR Parts 230, 232, 239, 270 and 274, *Final rule: Investment Company Names* (September 2023).

⁵⁵ US Securities and Exchange Commission, Gubir S. Grewal *Remarks at Ohio State Law Journal Symposium 2024: ESG and Enforcement of the Federal Securities Laws* (23 February 2024).

⁵⁶ US Congress, *Letter from Democrat politicians to SEC Chair* (13 May 2024).

- On 23 May 2022, the SEC reached a (then) historic USD 1.5 million settlement with BNY Mellon Investment Adviser, Inc (**BNY**), after finding that BNY had materially misrepresented that its investments were screened against ESG credentials.⁵⁷ Without admitting or denying the allegations, BNY settled the matter by agreeing to a cease-and-desist order and paying the USD 1.5 million penalty.
- In March 2023, the SEC reached a USD 55.9 million settlement with Brazilian mining company Vale S.A., without admitting or denying liability, over its false and misleading disclosures about its ESG efforts in advance of the Mariana dam collapse.⁵⁸
- In August 2023, the SEC reportedly subpoenaed several fund managers over ESG disclosures, seeing statements on green and social investing as 'fertile ground' for enforcement action.⁵⁹
- On 25 September 2023, the SEC found that DWS Investment Management Americas Inc (**DIMA**), a New York-based subsidiary of Deutsche Bank AG, had made materially misleading statements about its controls for incorporating ESG factors into research and investment recommendations for so-called ESG-related products.⁶⁰ The SEC found that DIMA, which "marketed itself as a leader in ESG", failed to implement its own ESG policies, and had "wilfully" violated sections of the Investment Advisers Act. Without agreeing to the charges, DIMA agreed to a cease-and-desist order and a fine of USD 19 million. Compared to the then-record breaking USD 1.5 million settlement with BNY Mellon in May 2022, this decision demonstrates the SEC's commitment to stamping out ESG-related financial greenwashing.
- On 22 November 2023, the SEC charged Goldman Sachs Asset Management L.P. (**Goldman Sachs**)

over misleading claims made by several of its mutual funds purporting to invest on the basis of ESG standards. The SEC found that Goldman Sachs violated the Investment Advisers Act. Without admitting or denying the SEC's findings, Goldman Sachs agreed to a cease-and-desist order and a USD 4 million fine.⁶¹

In September 2024, it was reported that the SEC had disbanded its ESG Taskforce discreetly in the preceding months, amidst the ongoing 'ESG-backlash' in the US.⁶² US companies may take comfort in this news, but are not entirely 'off the hook'. While the Taskforce's disbandment may dampen the threat of immediate regulatory investigation and enforcement, companies should continue to avoid financial greenwashing and ensure the robustness of their procedures for, and accuracy and consistency of, their climate- and ESG-related disclosures (discussed in section 3.1.5 below). It is likely that the climate and ESG-focussed responsibilities and expertise of the ESG Taskforce will be dispersed throughout the wider SEC agency, meaning companies could still be subject to regulatory investigation relating to ESG disclosures, product or fund naming, and wider greenwashing, which is a focus of the SEC.

Furthermore, companies still face civil liability for any material misstatements or omissions in their disclosures (see section 3.1.5 below).

As such, boards should continue to take all reasonable measures to avoid financial greenwashing and ensure the robustness of climate- and ESG-related disclosures.

2. Directors' Duties and Climate Change

2.1. Legal framework for directors' duties

The US is a common law jurisdiction. Directors' fiduciary duties in the US derive from the common law, as developed by the courts, and state corporate legislation, particularly the Delaware General Corporation Law (**DGCL**), since most US public companies are incorporated in the state of Delaware.

⁵⁷ SEC, *SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations*, (May 2022). See the SEC Order [here](#).

⁵⁸ Vale, *Vale announces agreement with the United States Securities and Exchange Commission* (28 March 2023); SEC, *SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse* (April 2022).

⁵⁹ Financial Times, *SEC lawyers subpoena fund managers over ESG disclosures* (August 2023).

⁶⁰ SEC, *Deutsche Bank Subsidiary DWS to Pay \$25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments*, (September 2023).

⁶¹ SEC, *SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments* (November 2022).

⁶² See Bloomberg Law, *SEC Abandons ESG Enforcement Group Amid Broader Backlash*, (12 September 2024).

Directors' core fiduciary duties are the duty of loyalty and the duty of care. These apply to directors and officers of privately owned and publicly listed companies.

Duty of Care. The duty of care is a fiduciary duty that requires directors and officers to make lawful, informed and prudent decisions in the best interest of the corporation, after reasonable inquiry and deliberation.⁶³ Directors must act in good faith with the care that a reasonably prudent person would use in similar circumstances.⁶⁴ The duty of care is concerned with the *process* of information gathering and deliberation, rather than the substance of the eventual commercial decision; i.e. it is not concerned with whether the 'correct' decision was made or an optimum financial outcome was achieved, but rather that the correct process was followed in reaching that decision.

Duty of Loyalty. The fiduciary duty of loyalty requires directors to act in good faith and in the best interest of the company and its shareholders, and to avoid conflicts of interests and self-dealing. The duty of loyalty also includes a duty to provide adequate oversight of legal compliance and 'mission-critical' operations, which includes ensuring that reasonable information and reporting systems are implemented and maintained to provide the board and senior management with timely, accurate information to support informed decision-making. This ancillary duty, known as the duty of oversight, is often called the board's *Caremark* duty, based on the case that established it.⁶⁵ Directors may be liable for a breach of their *Caremark* duty of oversight for (a) failing to implement any reporting or information system or controls; or (b) having implemented such controls, consciously failing to monitor them, leading to directors being uninformed of risks and failing to act on extreme 'red flags'.

2.2. Guidance on interpretation of directors' duties

2.2.1. Legal guidance

Long term focus. The Delaware Chancery Court has provided extensive legal guidance on directors' duties of loyalty, care, and good faith. In exercising their fiduciary duties, directors are charged with maintaining a long-term focus. In a 2017 case involving a conflict between short-term and longer-term shareholder interests, the Delaware Chancery Court confirmed "*the fiduciary relationship requires that the directors act prudently, loyally, and in good faith to maximize the value of the corporation over the long-term ...*"⁶⁶ It added: "[t]he fact that some holders of shares might be market participants who are eager to sell and would prefer a higher near-term market price likewise does not alter the presumptively long-term fiduciary focus."

Guidance on Duties of Loyalty and Oversight. Claims alleging a directors' breach of the *Caremark* duty of oversight were rarely successful prior to the 2019 Delaware Supreme Court decision in *Marchand v. Barnhill*,⁶⁷ which allowed a duty of oversight claim to proceed and gave helpful guidance on directors' responsibilities for oversight of 'mission critical' operations and compliance risk. In *Marchand*, the Court allowed the claim to proceed because the plaintiff had provided enough facts to potentially prove a lack or "*dearth of any board-level effort at monitoring*" or oversight of the ice-cream company's health, safety, and sanitation controls.⁶⁸ In so doing, *Marchand* expanded on directors' duty of oversight, requiring directors and officers to be alert to less extreme warnings (i.e. 'yellow flags' as well as 'red flags'), when those warnings relate to 'mission-critical' areas. In other words, *Marchand* sets higher expectations for boards when overseeing core business operations. This conclusion has been upheld by

⁶³ *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963) established that directors are required to make decisions after reasonable inquiry and consideration of relevant information; *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) found that directors could be held liable for gross negligence under Delaware law for failing to adequately inform themselves before making decisions; and *Delaware General Corporation Law* (DGCL) § 141(a) establishes the board's authority to manage the corporation, implying the need for informed and prudent decision-making.

⁶⁴ *Model Business Corporation Act* (MBCA) § 8.30 outlines the general standards for directors, requiring them to act in good faith and with the care an ordinarily prudent person would exercise under similar circumstances.

⁶⁵ *In re: Caremark Int'l Derivative Litigation*, 698 A.2d 959 (Ch. Ct. Del. 1996). *Caremark* construed the duty of oversight as part of the board's duty of care, but a later Delaware Supreme Court opinion

reconceptualized it as an aspect of the duty of loyalty, not care. See *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

⁶⁶ *Frederick Hsu Living Trust v. ODN Holding Corp.*, No. 12108-VCL, 2017 WL 1437308 (Del. Ch. Apr. 24, 2017).

⁶⁷ *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019). The board had exercised no oversight of operations or food safety in the company's ice cream plants, leading to a *listeria* outbreak in which three people died, and the company's entire inventory had to be recalled and destroyed. These facts were sufficient to allege a breach of the board's duty of loyalty under *Caremark*. The parties agreed to a \$60 million settlement less than a week prior to the scheduled commencement of the trial: Jennifer F Longhurst and Joseph DiPonio, *Canada: Canadian Directors Should Heed Recent US Caremark Litigation*, *Mondaq* (18 June 2020).

⁶⁸ *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

subsequent decisions on directors' duty of oversight.⁶⁹

Guidance on Duty of Care. Directors in the US are given a wide discretion when exercising their duty of care under the 'Business Judgment Rule'. The Business Judgment Rule protects directors and officers from personal liability for decisions that result in loss or harm to the company if those decisions were made in good faith and in the belief that they were in the best interests of the company. It also recognises that judges are not business experts qualified to evaluate companies' complex commercial transactions,⁷⁰ and therefore limits the scope of judicial review regarding the merits of most business decisions.⁷¹ Under the Business Judgment Rule, directors are therefore presumed to have acted lawfully, with loyalty, honesty, good faith, and due care in their decision making functions,⁷² unless there is evidence of fraud⁷³ or a breach of the directors' duties of care or loyalty.⁷⁴

The *Trans Union Case*⁷⁵ was the first US case where the Delaware Supreme Court held directors personally liable for breaching solely their duty of care owed to the company. The directors' loyalties were not in question – there were no allegations of fraud, bad faith, conflict of interest or self-dealing – but the court held the directors liable for failing to avail themselves of all the necessary information to make an informed decision, therefore overturning the Business Judgment Rule's presumption of reasonable care. In so doing the court established the standard of care required of directors, determining that directors could be held liable for gross negligence and a breach of duty of care for failing to adequately inform themselves before making decisions.⁷⁶

After the *Trans Union* decision, the Delaware legislature passed DGCL § 102(b)(7), which

allows full or partial exculpation for directors – i.e. eliminating or limiting the risk of directors' personal liability – for breaches of duty of care (but not breaches of the duty of loyalty). In 2022, this protection was extended to officers. This is discussed further in section 2.3 below.

Directors' Duties and Climate Risk. In October 2021, the CCLI published a paper on *Fiduciary Duties and Climate Change in the United States (CCLI Paper)*⁷⁷ which considers directors' and officers' fiduciary duties under Delaware law. The CCLI Paper notes that climate change represents material financial risks across the short, medium and long-term horizons for many businesses, and therefore that directors' duties of care and loyalty require directors and officers to adequately consider climate-related risks when governing the company. Failure to do so could breach their duties, giving rise to potential liability and litigation. This risk is particularly high for boards that have not begun considering the relevance of climate risks to the company, its operations, long-term strategy, or disclosure.

For example, directors may breach their duty of loyalty (including the duty of oversight) by:

- failing to adequately consider climate-related risks (for example by failing to identify, ignoring entirely or improperly managing how the company handles climate-related risks);
- failing to implement climate-related legal risk controls;
- failing to monitor mission-critical regulatory compliance, including specific climate change-related regulations that impact the company (such as sustainability reporting regulations), or other regulations that require consideration or disclosure of climate change risks (such as securities law); or

⁶⁹ *In re Clovis Oncology Inc. Derivative Litigation*, C.A. No. 2017-0222-JRS (2019) (failure of oversight of pharmaceutical company's research protocols); *Hughes v. Xiaoming Hu*, C.A.No.2019-0112-JTL (Apr. 27, 2020) (failure of oversight over audited financial statements and internal accounting function); *Teamsters Local 443 Health Servs. v. Chou*, C.A. No. 2019-0816-SG (Del. Ch. Aug. 24, 2020) (failure of oversight over indirect subsidiary's criminal activities regarding handling of pharmaceutical injections); *In re The Boeing Co. Derivative Litig.* No. 2019-0907-MTZ, 2021 WL 4059931 (Del. Ch. Sept. 7, 2021) (failure to establish a monitoring system regarding aircraft safety).

⁷⁰ *Davis v. Louisville Gas & Elec. Co.*, 142 A. 654, 659 (Del. Ch. 1928) held that questions of corporate policy and business management are best resolved outside of courtrooms.

⁷¹ See e.g., *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979): the Business Judgment Rule "bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate

purposes." *Id.*; *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971).

⁷² See, e.g., *Panther v. Marshall Field & Co.*, 646 F.2d 271, 293 (7th Cir. 1981); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

⁷³ See, e.g., *Gimbel v. Signal Cos.*, 316 A.2d 599 (Del. Ch.), *affd per curiam*, 316 A.2d 619 (Del. 1974).

⁷⁴ See, e.g., *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979), at 999-1000; *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) at 720.

⁷⁵ *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (the *Trans Union Case*).

⁷⁶ See also *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), the Delaware Supreme Court held that the duty of care under the Business Judgment Rule is based upon the standard of gross negligence.

⁷⁷ Sarah Barker, Cynthia A. Williams, and Alex Cooper, CCLI, *CCLI Fiduciary Duties and Climate Change in the United States* (October 2021).

- failing to monitor climate-related mission-critical business risks (although liability for a failure to monitor business risks has not yet been imposed in a Delaware case).⁷⁸

Directors may breach their duty of care by:

- overlooking or inadequately considering material climate risks relevant to a business decision; or
- making a decision about climate-related risks or opportunities in a grossly negligent or uninformed manner.

In addition to the October 2021 CCLI Paper, several prominent legal scholars in the US have addressed the topic of directors' or fiduciary duties in relation to climate risk and sustainability.⁷⁹

Despite such legal academic commentary, directors' duties with respect to climate change have received limited judicial scrutiny in the US.

Fiduciary Duties and ESG Investing. By contrast, the fiduciary duty owed by asset owners and managers to their shareholders and clients has been the topic of considerable attention.

Direct challenges to asset managers. On the one hand, asset managers and pension trustees are being challenged over measures taken to invest along ESG-considerations. For example, in 2022 and 2023, several state Attorneys General wrote to high profile asset managers that are members of the Glasgow Financial Alliance for Net Zero (**GFANZ**) stating, among other things, that they risked breaching their fiduciary duties by investing in ESG for alleged political reasons.⁸⁰

In May 2023, an NGO and several individual members sued the New York City Employees'

Retirement System and two other pension funds, alleging that the funds breached their fiduciary duties by divesting USD 3.9 billion from fossil fuel assets allegedly for political motivations.⁸¹ However, this case was dismissed in July 2024, with the New York court finding that the plaintiffs had failed to demonstrate financial harm from the decision.⁸²

In June 2023, a group of American Airlines pilots filed a class action against American Airlines (**AA**) and its advisors for allegedly breaching fiduciary duties under the *Employee Retirement Income Security Act 1974 (ERISA)* when investing in ESG funds.⁸³ In June 2024, a Texas federal court denied AA's request for summary judgment, finding that there were genuine material issues over whether the defendants had violated their duties of prudence and loyalty under ERISA.

However, on the other hand, asset managers are also coming under fire for not doing enough to mitigate climate-risk. For example, in March 2023, over 1,400 individual investors signed a letter expressing "*concerns about how the long-term risks of climate change affects [their] portfolio value – and Vanguard's failure to sufficiently manage these risks*" and alleging that Vanguard was violating: (a) its duty of care by falling behind "*prudent investors*" who were then more active in casting proxies consistent with their climate expectations and, unlike Vanguard, had joined industry coalitions like Climate Action; and (b) its duty of loyalty by withdrawing in 2021 from the Net Zero Asset Managers initiative,⁸⁴ which investors claim it did in response to political pressure to the detriment of Vanguard's clients.

Challenges to ESG investing legislation. In November 2022, the US Department of Labor amended its 'Investment Duties' regulation (29 CFR § 2550.404a-1) to clarify the application of the fiduciary responsibility duties under ERISA to ESG factors (the **2022 Amendments**). The

⁷⁸ See Commonwealth Climate and Law Initiative, *Fiduciary Duties and Climate Change in the United States* (October 2021).

⁷⁹ See, for example, L. Benjamin, 'The Road to Paris Runs Through Delaware: Climate Litigation and Directors' Duties' 2(1) *Utah L. Rev.* 313-381 (2020); B. McDonnell, H. M. Osofsky, J. Peel & A. Foerster, 'Green Boardrooms?', 53 *Conn. L. Rev.* 335-408 (May 2021); C.A. Williams, S. Barker and A. Cooper, *Directors' Fiduciary Duties and Climate Change: Emerging Risks*, Harvard Law School Forum on Corporate Governance (December 2021); C. A. Williams, 'Fiduciary Duties and Corporate Climate Responsibility', 74 *Vand. L. Rev.* 1875-1916 (2021); Thomas Clarke, 'The Widening Scope of Directors' Duties: The Increasing Impact of Corporate Social and Environmental Responsibility', 39 *Seattle University of Law Review* 531, 551 (2016).

⁸⁰ See Attorneys General M. Brnovich, D. Peterson, S. Marshall, L. Rutledge, C. Carr, L.G. Wasden, T. Rokita, D. Schmidt, D.

Cameron, J. Landry, L. Fitch, E. Schmitt, A. Knusden, D. Yost, J. O'Connor, A. Wilson, K. Paxton, S. Reyes and P. Morrissey, *Letter to BlackRock Inc.* (4 August 2022); Attorneys General S. Marshall, C. Carr, T. Rokita, D. Schmidt, D. Cameron, J. Landry, L. Fitch, A. Knusden, D. Yost, A. Wilson, K. Paxton, S. Reyes, T. Griffin, R. Labrador, B. Bird, K. Kobach, A. Bailey, J.M. Formella, B. Hill and P. Morrissey, *Letter to Asset Managers* (30 March 2023).

⁸¹ *Wong & Ors. v New York City Employees' Retirement System & Ors.* 652297/2023 (N.Y. Sup. Ct. 2024).

⁸² *Wong & Ors. v New York City Employees' Retirement System & Ors.* 652297/2023 (N.Y. Sup. Ct. 2024). See decision [here](#).

⁸³ *Spence v American Airlines, Inc., et al* 4:23-cv-00552 (N.D. Tex). See order [here](#).

⁸⁴ Vanguard, *An update on Vanguard's engagement with the Net Zero Asset Manager's Initiative (NZAM)* (7 December 2022).

2022 Amendments retain the core principle that the fiduciary duties of loyalty and prudence require investment managers to focus on risk-return factors and not subordinate the interests of beneficiaries to unrelated objectives. However, the definition of risk-return factors was widened to expressly include consideration of ESG factors, as well as the economic effects of climate change. This DOL explains that this additional language is to “*dispel the perception*” that climate change and other ESG factors are “*unlikely to be relevant*” to the risk and return of an investment.

In January 2023, 25 Republican states, two energy companies, an oil and gas trade group, and an individual filed a lawsuit in Texas challenging the 2022 Amendments. The plaintiffs alleged that the amendments undermine fiduciary duties imposed by ERISA by (allegedly) mandating ESG considerations that (allegedly) could reduce investment returns.⁸⁵ In September 2023, the federal district court found in favor of the US Department of Labor, ruling that its regulations did not violate ERISA as they included provisions that clarified that fiduciaries could consider ESG factors in a risk and return analysis. The district court did not accept that ESG factors were “*non-pecuniary*”. The plaintiffs appealed to the Fifth Circuit Court,⁸⁶ who returned the claim to District Court due to procedural reasons.⁸⁷ The appeal will now be re-heard by the District Court.⁸⁸

At the same time, many US states have revised their fiduciary laws and have enacted legislation that either explicitly permits (typically in Democrat states)⁸⁹ or expressly prevents (in Republican states)⁹⁰ state pension funds from considering ESG factors in investment decision-making. Both types of laws have also been challenged in court.

2.2.2. Regulatory guidance

Various regulators have also issued guidance on directors' duties, particularly focussed on corporate governance and fiduciary duties, but none have focussed on the application of these duties to climate risks.⁹¹

2.3. Directors' liability and litigation risk

US directors who breach their fiduciary duties of care or loyalty may face significant penalties, including personal liability for damages, equitable remedies, and possible loss of business opportunities or profits gained through self-dealing.

However, such liability for directors would only materialise if the corporation suffered harm as a result of the director's breach. Furthermore, the Business Judgment Rule (discussed in section 2.1.1 above) affords directors protection from liability over decisions that have led to financial loss or other damage to the company, provided those decisions were made in good faith, with the care of an ordinarily prudent person, and in the best interest of the corporation. Under Delaware law, directors are only exposed to damages liability for a breach of duty if they commit gross negligence, which is a “*higher level of negligence representing an extreme departure from the ordinary standard of care*”.

In particular, if a director breaches the duty of care, they may be held personally liable for damages resulting from their (gross) negligence. Shareholders could do so by filing a derivative lawsuit against the director on behalf of the corporation.⁹² However, as discussed in section 2.2.1 above, DGCL § 102(b)(7) allows corporations to include in their charters a provision that limits or eliminates personal liability of directors and officers for

⁸⁵ *Utah v Walsh*, 2:23-cv-00016 (N.D. Tex., 2023). See complaint [here](#) and December 2023 decision [here](#).

⁸⁶ *Utah v Walsh*, 2:23-cv-00016 (N.D. Tex., 2023). See October 2023 notice of appeal [here](#).

⁸⁷ See Fifth Circuit Court of Appeals decision [here](#).

⁸⁸ The plaintiff states and oil-interest companies [appealed](#) in October 2023, but in July 2024, the Fifth Circuit Court of Appeals [sent](#) the claim back to district court, following the US Supreme Court's decision in *Loper Bright Enterprises v Raimondo*, which overturned the decades-old doctrine that enabled courts to federal agencies' interpretations of ambiguous laws (known as the *Chevron deference* doctrine). In *Loper Bright Enterprises et al. v Gina Raimondo, Secretary of Commerce et al. and Relentless Inc., et al. Petitioners v Department of Commerce et al.* the US Supreme Court held that courts “*need not... defer to an agency interpretation of the law simply because a statute is ambiguous*” and following “*judicial practice ... that courts decide legal questions by applying their own judgment*”.

⁸⁹ See, for example: Delaware, *Del. Code Ann. tit. 12, § 3302(a)* (2021); Georgia, *Ga. Code Ann. § 53-12-340(D)* (2021); New Hampshire *N.H. Rev. Stat. Ann. § 564-B:9-902(c)* (2021); Illinois *760 Ill. Comp. Stat. 3/902(c)(7)-(8)* (2021); and Oregon *Or. Rev. Stat. § 130.755(3)(i)-(j)* (2021).

⁹⁰ For example, anti-ESG initiatives in Florida, Oklahoma and Missouri, discussed in section 1 above.

⁹¹ For example, see: Office of the Comptroller of the Currency (OCC), *The Director's Book: Role of Directors for National Banks and Federal Savings Associations* (November 2020); Financial Industry Regulatory Authority (FINRA)'s *FINRA Regulatory Notice 19-31* (2019) provides guidance on senior management responsibilities; The Department of Justice, *Evaluation of Corporate Compliance Programs* (March 2023).

⁹² In *The Trans Union Case*, the Delaware Supreme Court found that directors of Trans Union Corporation breached their duty of care by failing to adequately inform themselves before approving a merger. The court held the directors personally liable for \$23 million in damages.

monetary damages, but only for breaches of the duty of care. Furthermore, exculpation is not available in cases of bad faith, intentional misconduct, or breaches of the duty of loyalty.

If a director breaches the duty of loyalty, they may be held personally liable for damages, and may be ordered to rescind any contract entered into or disgorge any profits obtained through self-dealing or via a conflict of interest. Shareholders can also bring a derivative lawsuit against the director for breaches of loyalty.⁹³

However, DGCL § 144 outlines how transactions involving interested directors (those with a conflict of interest) can be cleansed if their conflict of interest is approved by disinterested directors or shareholders after full disclosure, or if the transaction is fair to the corporation at the time it is approved.

There have been no reported cases against directors in the US specifically related to a breach of duty in respect of climate risk.

3. Directors' Duties and Disclosure Obligations

3.1. Narrative sustainability disclosures

3.1.1. Sustainability disclosure frameworks

The US does not have a single comprehensive sustainability disclosure framework for all companies. However, the SEC has recently launched mandatory disclosure requirements for listed entities (discussed below).

Furthermore, as discussed in section 1.1.1. above, several Democrat states have passed legislation requiring certain companies to make climate-related and ESG/sustainability disclosures. The state of California has enacted the most comprehensive mandatory sustainability disclosure laws to date in the US in its October 2023 *Climate Accountability Package* (discussed above). This comprises:

- The *Climate Corporate Data Accountability Act* (SB 253), which requires companies with over USD 1 billion in annual revenue doing business in California to disclose Scope

1, 2, and 3 GHG emissions, with disclosures for Scopes 1 and 2 due by 2026 and Scope 3 by 2027; and

- The *Climate-Related Financial Risk Act* (SB 261), which mandates that companies with over USD 500 million in revenue disclose climate-related financial risks and measures to mitigate those risks, with the first reports due by 2026.

However, California's *Climate Accountability Package* has attracted significant opposition. On 30 January 2024, the US Chamber of Commerce, Western Growers Association and four business groups sued the California Air Resources Board (CARB)⁹⁴ alleging that the laws are unconstitutional under the First Amendment for "*compelling speech to combat climate change*", violate constitutional limitations on extraterritorial regulation, and are pre-empted by the federal Clean Air Act; in other words: that California lacks the authority to regulate GHG emissions outside of its state borders.

Similar climate and sustainability disclosure laws have been proposed in New York, Illinois, Washington, Massachusetts, Oregon, Colorado, and Connecticut.

Voluntary sustainability reporting. There has also been an increase in US companies voluntarily reporting on sustainability under frameworks like the Task Force on Climate-related Financial Disclosures (TCFD) and the International Sustainability Standards Board (ISSB).

TCFD has become increasingly popular, particularly for US-listed companies, due to strong investor demand for TCFD-aligned reports and the TCFD's influence over regulatory developments. For example, the SEC's climate disclosure rules (discussed in section 3.1.2 below) draw heavily on the TCFD framework.

The ISSB standards, which aim to create a global baseline for sustainability reporting, have also integrated TCFD recommendations. While these standards are relatively new, they have

⁹³ For example, in *Guth v. Loft, Inc* 5 A.2d 503 (Del. 1939), the Delaware Supreme Court held that a director who usurps a corporate opportunity breaches the duty of loyalty. In this case, the court ordered the director to transfer the usurped business back to the corporation; *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. Ch. 2006), the Delaware Chancery Court clarified that gross negligence

leading to bad faith can be considered a breach of the duty of loyalty. However, the court ultimately found that the Disney directors did not breach their fiduciary duties.

⁹⁴ *Chamber of Commerce of the United States of America v. California Air Resources Board*, 2:24-cv-00801 (C.D. Cal).

been endorsed by global bodies like International Organization of Securities Commissions (**IOSCO**), signalling their growing importance. Forward-thinking US companies may consider these standards to stay aligned with best global practice.

3.1.2. *Specific sustainability disclosure requirements for listed entities*

Public companies' disclosure obligations are governed by federal securities laws⁹⁵ and regulations,⁹⁶ and are overseen by the SEC.

As part of its wider efforts to tackle financial greenwashing (discussed in section 1.2.2 above), on 21 March 2022, following public consultation launched in March 2021,⁹⁷ the SEC issued proposed climate-related disclosure rules for listed companies (the **Proposed Rules**).⁹⁸ The Proposed Rules would have required in-scope listed companies to disclose climate change-related information, including:

- The company's processes for identifying, overseeing and managing climate-related risks and impacts;
- The impact of climate-related events on line items of financial statements;
- Attested GHG emissions data for Scope 1 and 2 emissions and, if material, Scope 3 emissions (although these would not be subject to attestation); and
- Climate-related targets, metrics and transition plans, if any.

The ambitious Proposed Rules attracted significant criticism and record levels of feedback,⁹⁹ which were reflected in the final sustainability disclosure rules adopted by the SEC on 6 March 2024 (the **Climate Disclosure Rules**).¹⁰⁰ The final Climate Disclosure Rules reflected stakeholder concerns by dropping all reporting requirements relating to Scope 3 emissions, pulling back on Scope 1 and Scope 2 disclosure requirements by exempting smaller reporting companies (**SRCs**), emerging growth companies (**EGCs**) and non-accelerated filers (**NAFs**), and requiring large

companies to only disclose material emissions. Furthermore, the final requirements for climate-related disclosures in financial statements (discussed further in section 3.2 below) are less extensive than in the Proposed Rules and the timeline for compliance has been lengthened, giving large, accelerated filers nearly two years to provide most disclosures, three years to provide GHG emissions information, and six years to obtain limited assurance over GHG emissions data.

The SEC Climate Disclosure Rules apply to US and foreign companies listed in the US, and prescribe disclosure requirements depending on the company type:

- Large Accelerated Filers (**LAFs**) are companies with a public float of USD 700 million or more.
- Accelerated Filers (**AFs**) are companies with a public float between USD75 million and USD700 million.
- Non-Accelerated Filers (**NAFs**) are smaller public companies (with a public float below USD 75 million), that are generally exempt from the Climate Disclosure Rules, although they are encouraged to disclose climate-related risks voluntarily.

The Climate Disclosure Rules are in part based on the TCFD recommendations, and require in-scope companies to disclose:

- Climate-related risks that have had or are reasonably likely to have a material impact on the company's business strategy, results of operations, or financial condition;
- The actual and potential material impacts of any identified climate-related risks on the company's strategy, business model, and outlook;
- If, as part of its strategy, the company has undertaken activities to mitigate or adapt to a material climate-related risk, a quantitative and qualitative

⁹⁵ See generally *Securities Act of 1933* and *Securities Exchange Act of 1934* (for public disclosures).

⁹⁶ See generally *Regulation S-K, Standard Instructions for Filing Forms under Securities Act of 1933, Securities Exchange Act of 1934, and Energy Policy and Conservation Act of 1975*, 17 C.F.R. §§ 229.10-229.1016 (2020).

⁹⁷ SEC, *Public Input Welcome on Climate Change Disclosures* (15 March 2021).

⁹⁸ SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (proposed rules) (21 March 2022).

⁹⁹ The SEC received more than 24,000 comment letters, including more than 4,500 unique letters in response to the Proposed Rules.

¹⁰⁰ SEC, Press Release, *SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors* (6 March 2021). See summaries of the feedback received in consultation in the final rules: SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*.

description of material expenditures incurred and material impacts on financial estimates and assumptions that directly result from such mitigation or adaptation activities;

- Specified disclosures regarding the company's activities, if any, to mitigate or adapt to a material climate-related risk including the use, if any, of transition plans, scenario analysis, or internal carbon prices;
- Any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks;
- Any processes the company has for identifying, assessing, and managing material climate-related risks and whether and how any such processes are integrated into its overall risk management system or processes;
- Information about the company's climate-related targets or goals, if any, that have materially affected or are reasonably likely to materially affect the company's business, results of operations, or financial condition;
- For LAFs and AFs that are not otherwise exempted, information about material Scope 1 emissions and/or Scope 2 emissions;
- For those required to disclose Scope 1 and/or Scope 2 emissions, an assurance report at the limited assurance level, which will be increased to reasonable assurance for LAFs following an additional transition period;
- The capitalized costs, expenditures expensed, charges, and losses resulting from severe weather events; and
- Information about the company's use of carbon offsets and RECs.

The Climate Disclosure Rules were due to become effective on 28 May 2024, but on 4 April 2024, the SEC voluntarily stayed their implementation pending the outcome of several lawsuits challenging the Climate Disclosure Rules in court. Legal challenges were filed by parties on both sides of the ESG policy debate: Republican states and industry lobby groups seeking to overturn the rules on the basis that they exceed the SEC's statutory authority and are unconstitutional, on the one hand, and environmental organisations arguing that the rules do not go far enough, on the other.

On 21 March 2024, these lawsuits were consolidated before the US Court of Appeals for the Eighth Circuit,¹⁰¹ and the Climate Disclosure Rules are currently stayed pending the outcome of these proceedings.

The politicisation and controversy surrounding the SEC Climate Disclosure Rules are creating uncertainty for US businesses and directors, particularly those large businesses that will soon be required to comply with the more extensive sustainability disclosure requirements in the EU.

3.1.3. *Specific sustainability disclosure requirements for financial institutions*

US financial institutions are not currently subject to any uniform mandatory sustainability disclosure regime. However, many financial institutions will be – and indeed are already – caught by sustainability disclosure legislation at the federal and state level and regulatory guidelines and rules. Many financial institutions may also choose to report on sustainability information voluntarily, in response to stakeholder pressure and market expectations.

Many public financial institutions will be caught by the SEC's Climate Disclosure Rules, and several states have implemented climate-related financial disclosure requirements for financial institutions (discussed in sections 1.1.1 and 3.1.1 above).

For example, California's *Climate Accountability Package* (discussed in section 1.1.1 and 3.1.1) will require in-scope financial institutions to publicly disclose climate-related information. Furthermore, in April 2022,

¹⁰¹ However, after the claims were consolidated, on 28 March 2024, two oil and gas companies filed a second complaint against the SEC Climate Disclosure Rules in a Texas federal court, acknowledging that

the claims had been consolidated but arguing that jurisdiction had not yet been determined.

California's Department of Insurance released a *Climate Risk Analysis* report disclosing information and detailed analysis of insurance companies' investments in fossil fuel assets and fossil fuel investments, which demonstrates the greater regulatory attention being paid to financial institutions in the state.¹⁰²

In December 2023, the New York Department of Financial Services (**NYDFS**) issued guidance on how banks and mortgage institutions under its supervision should manage climate-related financial and operational risks.¹⁰³

In addition, many US financial institutions have voluntarily adopted the TCFD sustainability reporting framework (discussed in section 3.1.1 above), and the Sustainability Accounting Standards Board (**SASB**) provides sector-specific guidance for financial institutions on disclosing material sustainability information, which are likely to be increasingly integrated into reporting practices.¹⁰⁴

Finally, financial institutions in the US are facing significant pressure from investors and stakeholders to disclose more information about sustainability and climate risks. ESG ratings agencies and institutional investors often set their own ESG disclosure expectations, which can influence the transparency and reporting practices of financial institutions.

As such, although US financial institutions are not yet subject to comprehensive, mandatory sustainability disclosure requirements across the country, there is a clear trend towards increased regulatory and market-driven expectations in this area.

3.1.4. Directors' duties regarding sustainability disclosures

Directors' duties with respect to narrative sustainability disclosures are less stringent than those regarding financial reporting (discussed in section 3.2.2 below). However, directors and officers must comply with their fiduciary duties of loyalty and care when preparing narrative sustainability disclosures on behalf of the company and must ensure that narrative

sustainability disclosures are accurate and not misleading.

To comply with their duty of care when preparing narrative sustainability disclosures, directors must, for example, comply with SEC and other applicable regulations and/or guidance to ensure that material and climate-related ESG risks, impacts, and other information (such as GHG emissions data and information around climate governance) are properly and accurately disclosed and explained.

Furthermore, cases like *Caremark* (discussed in section 2.1 above) suggest that directors have a duty to monitor corporate compliance programs, including accurate disclosure of material risks like ESG issues. As such, directors may consider establishing a dedicated ESG or sustainability committee to oversee the company's narrative sustainability disclosures, although this should complement and not substitute for wider efforts to embed sustainability issues into the company's overall governance and risk management frameworks.

3.1.5. Liability risk arising from narrative sustainability disclosures

Directors who (knowingly, recklessly and/or negligently (in proxy communications)) fail to ensure that narrative sustainability disclosures are accurate and complete expose themselves to liability risk. This is particularly so given the growing regulatory scrutiny and investor interest in companies' sustainability disclosures.

Directors may face liability for:

- **Breach of the fiduciary duty of loyalty.** For example, if a director of a Delaware company fails to oversee the company's sustainability disclosures, which transpire to be inaccurate or misleading, they could be held liable for a breach of the duty of care, especially if the failure is linked to material financial or reputational harm. Shareholders could file derivative action claims against the directors personally on behalf of the company for

¹⁰² California Department of Insurance, *Press Release: Commissioner Lara holds insurance companies accountable in push for more investment in solutions to fight climate change* (18 April 2022). See also the California Department of Insurance's *Summary of the Climate Risk Analysis and Climate Risk Analysis Tool*.

¹⁰³ NYDFS, *Governor Hochul Announces Guidance To Manage Climate Risk For New York State-Regulated Banking And Mortgage Institutions* (21 December 2023).

¹⁰⁴ See SASB Standards on 'Financials' here: [Download SASB Standards - SASB \(ifrs.org\)](https://www.sasb.org/standards)

such breaches, to hold the directors accountable for any financial or reputational damage caused by misleading or inadequate disclosures.

- **Securities fraud.** Directors may face liability under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 if the company's sustainability disclosures contain materially false or misleading statements or omissions. This could involve:
 - o A securities class action lawsuit filed by investors who relied on, and were misled by, the company's inaccurate sustainability information when making investment decisions, or by investors who allege that material omissions or misrepresentations in sustainability disclosures led to a decline in the company's share price when the misrepresentation came to light and caused them financial harm. Such lawsuits can result in substantial settlements or damages.
 - o SEC enforcement actions, where the SEC investigates and/or penalises companies and their directors for making false or misleading sustainability disclosures. The SEC may impose fines, require restatements or corrective disclosures, and, in serious cases, pursue individual liability against directors and officers.
- **Greenwashing.** Finally, if the company exaggerates or misrepresents its sustainability information in a misleading way, it may be sued by shareholders and/or consumers for greenwashing. Investors' claims could be filed under securities laws (discussed above) and the consumers' claims could be filed under false advertising and/or consumer protection laws. In addition to any financial damages and/or settlement

that may be awarded, greenwashing lawsuits attract significant media attention and can lead to significant reputational damage for companies.

The SEC's Climate Disclosure Rules, if enacted, will likely heighten these liability risks for directors.

3.2. Climate-related disclosures in financial statements

3.2.1. Climate-related disclosures in financial statements

US companies may already be required to consider and, if material, disclose climate-related information in their financial statements as part of their obligations under Rule 408 of the 1933 *Securities Act* (the **Securities Act**) and Rule 12b-20 of the 1934 *Securities Exchange Act* (the **Securities Exchange Act**) to disclose "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading".

Recent developments further strengthen this expectation. For example, in 2010, the SEC issued specific guidance clarifying public companies' obligations to disclose climate change-related information in financial statements (the **2010 Guidance**).¹⁰⁵ The 2010 Guidance emphasised that every company should consider how climate change impacts their operations and financial statements, including both direct and indirect impacts, such as impacts on suppliers and customers. The 2010 Guidance stated that climate change would be relevant to a company's management discussion and analysis (**MD&A**) of financial statements. The 2010 Guidance stated that:

"Legal, technological, political, and scientific developments regarding climate change may create new opportunities or risks for registrants. These developments may create demand for new products or services, or decrease demand for existing products or services... These business trends or risks may be required to be disclosed as risk factors or in

¹⁰⁵ SEC, *Commission Guidance Regarding Disclosure Related to Climate Change*, Release No. 33-9106 (Feb. 2, 2010) [75 FR 6290] (8 February 2010).

MD&A".¹⁰⁶

The objective of MD&A is to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management. MD&A may identify and disclose known trends, events, demands, commitments, and uncertainties that are reasonably likely to have an effect on the company's financial condition or operating performance.

The 2010 Guidance identified potential climate change-related risks and issues that companies could evaluate and consider disclosing in financial statements, including: regulatory and legislative developments at a state, federal, and transnational level that could increase or decrease prices (such as cap-and-trade arrangements among various states and countries or new fuel standards); the indirect consequences of regulation on business trends; and the physical impacts of climate change, such as increased frequency and intensity of storms, that may have financial implications on (for example) insurance companies, property firms, and mortgage lenders.

In September 2021, by way of guidance for how companies should be approaching disclosure of climate-related information in financial statements, the SEC published a sample letter setting out example questions or comments that the SEC may ask companies regarding their climate-related disclosure (or absence thereof).¹⁰⁷

If they survive the ongoing legal challenges, the SEC's 2024 Climate Disclosure Rules will require listed companies to provide climate-related information in the footnotes to financial statements about:

- the specific impacts of severe weather events and other natural conditions on the company's financial position;
- the company's climate-related targets or goals, if any, that have materially affected or are reasonably likely to materially affect the company's business, results of operations, or financial condition (for example, material expenditures, material impacts on financial estimates, and

assumptions that directly result from the target or goal, or actions taken to achieve such target or goal);

- the capitalized costs, expenditures expensed, charges, and losses incurred as a result of extreme weather events and other natural conditions, (such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise) subject to applicable 1% and de minimis disclosure thresholds;
- the capitalized costs, expenditures expensed, and losses related to carbon offsets and renewable energy certificates (**RECs**) if used as a material component of the company's transition plan; and
- a qualitative description of how (if at all) the company's estimates and assumptions used to produce its financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans.

Importantly, these disclosures will be subject to existing audit requirements for financial statements. Although these requirements are less extensive than those in the Proposed Rules, which would have required companies to evaluate financial statement impacts on a line-item-by-line-item basis, they clearly and unequivocally reflect the fact that climate change is a material financial risk to companies that must be appropriately accounted for.

In parallel, the US Financial Accounting Standards Board (**FASB**), which issues US Generally Accepted Accounting Principles (**US GAAP**) standards for public and private companies, has also been actively considering how ESG issues, particularly climate change, should be reflected in financial statements, although it has not yet issued comprehensive standards directly addressing this point.

Nevertheless, FASB has taken several important steps to integrate ESG considerations into existing frameworks. For example, in March 2021, FASB published an educational paper highlighting how US GAAP

¹⁰⁶ SEC, *Commission Guidance Regarding Disclosure Related to Climate Change*, Release No.33-9106; 34-61469; FR-82 (8 February 2010).

¹⁰⁷ SEC, *Sample Letter to Companies Regarding Climate Change Disclosures* (September 2021)

standards should be applied to ESG, particularly when ESG issues have a material impact on financial statements (the **FASB Guidance**).¹⁰⁸ The FASB Guidance addresses how companies can consider environmental risks and uncertainties (including climate change), when evaluating assets, liabilities and disclosures. For example, it notes that ESG issues could be relevant to whether the company is operating as a going concern, the value of the company's inventory, goodwill and intangibles, and the fair value measurement of the company's assets.

In May 2022, FASB added to its technical agenda a project on the accounting for environmental credit programs (**ECP**) (e.g. carbon offsets and credits),¹⁰⁹ with the objective to improve the recognition, measurement, presentation and disclosure requirements related to environmental credits. There are currently no accounting requirements under GAAP specific to carbon offsets, allowances and credits, which has led to diverse practices in how companies disclose these assets and liabilities in financial statements. In January 2024 FASB made tentative decisions related to this project,¹¹⁰ and it completed its initial deliberations in June 2024.¹¹¹ At its June meeting, FASB discussed a fair value policy election for certain credits, ECP disclosures, and transition. FASB will now draft a proposed Accounting Standards Update with a 90-day public comment period.

3.2.2. Directors' duties regarding climate-related disclosures in financial statements

Directors' duties regarding financial statements stem from federal and state laws, stock exchange regulation, and general corporate governance principles. They are generally more onerous and rigorous than directors' duties in relation to narrative disclosures, which are generally not formally audited to the same extent as financial statements.

When preparing financial statements, directors must comply with their fiduciary duties of care and loyalty. Directors are expected to be informed about the company's financial health

and to make decisions with reasonable diligence, and are responsible for ensuring accurate disclosure in corporate reports. Courts have interpreted these duties under the principle of good faith and reasonable care, notably in cases like *the Trans Union Case* (1985) (discussed above).¹¹² To comply with their duty of care, directors must ensure that financial statements and reports are accurate and fairly represent the company's financial position. With respect to their duty of loyalty, directors must prepare the financial statements with accuracy, integrity and in good faith.

However, directors have additional legal obligations when preparing financial statements.

The Securities Exchange Act (sections 13(a) and 15(d)) requires public companies to file periodic reports with the SEC in the forms of the annual Form 10-K and quarterly Form 10-Q. These reports must include financial statements that comply with US GAAP. The SEC specifies the requirements of these financial statements through regulations; Regulation S-K generally deals with narrative disclosure and Regulation S-X deals with the form and content of financial statements. When the SEC's Climate Disclosure Rules come into force, in-scope public companies will be required to include climate-related information as footnotes to the financial statements in their Forms 10-K and 10-Q.

Directors and officers must appoint independent external auditors to review and attest public companies' Form 10-K financial statements and issue an audit opinion. Quarterly financial statements must be prepared according to GAAP but are not required to be audited, although they must be reviewed by an independent accountant prior to filing.¹¹³

Public companies' financial statements must comply with US GAAP; there is a presumption that financial statements that do not comply with US GAAP are misleading. However, the burden for certifying compliance with US GAAP does not fall on directors or officers. Instead, directors and officers must appoint

¹⁰⁸ FASB, *FASB Staff Educational Paper Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards* (19 March 2021).

¹⁰⁹ FASB, *Accounting for Environmental Credit Programs* (updated 17 June 2024).

¹¹⁰ FASB, *Tentative Board Decisions 01-31-24* (31 January 2024). FASB tentatively decided that recognised credits and ECOs would not be evaluated under derivatives guidance, and that an entity would

recognise nonrefundable deposits for credits that are not probably of being used to settle an ECO or transferred as an expense.

¹¹¹ FASB, *Tentative Board Decisions 06-12-24* (12 June 2024).

¹¹² *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (the *Trans Union Case*).

¹¹³ See SEC Regulations *17 CFR § 210.10-01*, Rule 10-01(a)(1) and Rule 10-01(d).

independent auditors to review and certify that the account *"present fairly, in all material respects, in conformity with US GAAP."*¹¹⁴

The CEO and CFO of public companies are required to sign off and certify the accuracy of the company's disclosures in Forms 10-K and 10-Q under section 302 of the *Sarbanes-Oxley Act* of 2002 (**SOX Act**). Section 302 requires CEOs and CFOs to personally certify that the financial information in the company's reports is accurate and that the report *"fairly presents"* the financial condition and results of operations. As discussed above, this certification does not explicitly require directors and officers to state that the financial statements comply with US GAAP, but rather that the financial information is fairly presented.

Furthermore, directors have a duty to oversee financial reporting processes and internal controls.¹¹⁵ This duty is typically discharged by an audit committee, often composed of independent directors, which is responsible for overseeing the integrity of the company's financial statements, compliance with legal and regulatory requirements, and the independence and performance of external auditors. Section 404 of the SOX Act requires management to assess and report on the adequacy of internal controls over financial reporting (**ICFR**) (section 404(a)), and auditors to attest management's assessment (section 404(b)).

In addition, as mentioned above, directors and officers responsible for preparing a company's public reporting are required to disclose all additional material information required to make any statements made not misleading. These general requirements apply to the financial

statements and disclosures about the financial statements (MD&A) as well.

3.2.3. Liability risk arising from financial statements

Directors and officers who prepare and/or certify false, inaccurate, or misleading financial statements face significant liability. This includes the liabilities and penalties discussed in Section 3.1.5 above, namely: shareholder class action lawsuits alleging securities fraud or misrepresentation; SEC enforcement action; lawsuits alleging common law torts of fraud or negligent misrepresentation; greenwashing lawsuits filed under securities and/or consumer protection laws; and derivative lawsuits by shareholders of Delaware companies for breaches of fiduciary duties of care and loyalty. For example, a directors' failure to sign off accurate financial statements (including financial statements that omit or misrepresent climate change-related issues) could constitute a breach of the duty of care or the duty of oversight – both discussed above.

These lawsuits can lead to significant financial and reputational damages for the company and/or individual directors.

Directors also face criminal liability for preparing and filing inaccurate or misleading financial statements under section 906 of the SOX Act and federal securities laws. Penalties include imprisonment, significant fines, and personal liability for any damages flowing from the misleading or incorrect financial statements.

We are not currently aware of any claims against directors specifically related to the disclosure (or non-disclosure) of climate-change related issues in financial statements.

4. Biodiversity Box

The US is host to an estimated 13% of the world's 1.5 million recognised species¹¹⁶, and it has one of the world's highest absolute amounts of GDP in nature-dependent sectors at USD 2.1 trillion.¹¹⁷ As a result it is highly likely that nature loss represents a financially material risk to business across all sectors.¹¹⁸ The CCLI has published a report on how companies in the US and other jurisdictions may depend on biodiversity for the functioning of their business models.¹¹⁹ In particular, biodiversity risks

¹¹⁴ See Accounting Standard 3101 of the *Public Company Accounting Oversight Board (PCAOB)'s Auditing Standards*.

¹¹⁵ See, for example, Section 13(a) and 13(b) of the *Securities and Exchange Act 1934*, in particular: Section 13(b)(2) and (5) which require companies to "devise and maintain a system of internal accounting controls"; and SOX Act, section 404(a), which requires management to assess and report on the effectiveness of internal control over financial reporting and Section 404(b), which requires that

an independent auditor attests to management's assessment of the effectiveness of those controls.

¹¹⁶ Stein Bruce A., et al, *Biodiversity in the United States*, March 2001

¹¹⁷ World Economic Forum, *Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy*, January 2020.

¹¹⁹ CCLI, *Biodiversity Risk: Legal Implications for Companies and their Directors*, December 2022.

may constitute material financial risks which boards are required to consider within the purview of directors' duties.

Whilst the US has not ratified the Convention on Biodiversity, it is party to several multilateral agreements relevant to biodiversity, including the Convention on International Trade in Endangered Species in Wildlife Flora and Fauna (**CITES**)¹²⁰, the International Treaty on Plant Genetic Resources for Food and Agriculture (**ITPGRFA**)¹²¹, the International Plant Protection Convention (**IPPC**)¹²², the Convention on Wetlands (**Ramsar Convention**)¹²³, the United Nations Framework Convention on Climate Change (**UNFCCC**)¹²⁴ and the Paris Agreement.¹²⁵ In 2021, President Biden publicly recognised the importance of biodiversity to the US by committing significant financial investment towards the first national conservation goal of conserving at least 30% of US lands and waters by 2030¹²⁶. In 2022 the US Department of State published a factsheet highlighting the efforts being made by the US to combat the biodiversity crisis.¹²⁷ This framework may be relevant in framing biodiversity loss in relation to fiduciary duties in the United States. Of particular relevance is its ambition to incorporate nature into national economic statistics and accounts to support decision-making.

Disclosure of biodiversity-related risks and information by corporates has, until recently, been nascent. However, there is emerging evidence to show that companies listed on the US stock exchanges are moving towards the adoption of biodiversity disclosure frameworks. In 2022, one third of companies in the S&P 500 and 13% of Russell 3000 firms made biodiversity disclosures – roughly double that from 2021.¹²⁸ Drivers of this trend appear to include increased corporate attention on the topic alongside growing investor pressure.

The US remains the country with the highest number of documented climate litigation cases, with 1,745 cases in total and 129 new cases filed in 2023.¹²⁹ This may indicate that the US has the potential to be a forum for biodiversity claims.

5. Practical Implications for Directors

Given that legislators and regulators in the US have become increasingly emphatic about the need for companies and their directors to adopt climate resilience measures in business practices and disclosure, well-counselled boards will:

- a) delegate climate risk identification and evaluation to a clearly identified team in management which reports directly to the CEO and board;
- b) put on the agenda for the board within 3 or 6 months a process to start developing a climate transition roadmap to 2050 with transparent carbon neutrality or reduction targets, with clear interim targets to 2040, 2030, and within the current rolling multi-year strategic plan, and periodically thereafter report back to the board;
- c) delegate to the appropriate committee(s) of the board, such as risk, audit, legal and governance, scenarios/strategy, nominations/remuneration, or sustainability/corporate responsibility, the task of translating the long-term strategy into a clear decision-making process for each aspect that is relevant to each committee; and
- d) discuss with disclosure counsel, to develop an external engagement and communications plan and to oversee rigorous disclosure and accounting.

Practical Implications for Directors of Banks, Insurance Companies and Asset Managers

¹²⁰ *Convention on International Trade in Endangered Species in Wildlife Flora and Fauna*, last accessed on 22 September 2024

¹²¹ *International Treaty on Plant Genetic Resources for Food and Agriculture*, last accessed on 22 September 2024

¹²² *International Plant Protection Convention*, last accessed on 22 September 2024

¹²³ *Convention on Wetlands*, last accessed on 22 September 2024

¹²⁴ *United Nations Framework Convention on Climate Change*, last accessed on 22 September 2024

¹²⁵ *The Paris Agreement*, last accessed on 22 September 2024

¹²⁶ The White House, *Executive Order on Tackling the Climate Crisis at Home and Abroad*, January 2021

¹²⁷ U.S Department of State, *Highlighting the U.S Efforts to Combat the Biodiversity Crisis*, December 2022

¹²⁸ Melodie Michel, *Biodiversity disclosures have doubled among U.S listed companies*, January 2024

¹²⁹ J. Setzer and C. Higham, *Global Trends in Climate Change Litigation: 2024 Snapshot*. London: Grantham Research Institute on Climate Change and the Environment (May 2024).

Given the special attention paid by the Treasury to the implications of climate risk for systemic financial stability, and the focus of FSOC on the insurance sector, well-counselled boards of companies in the banking, insurance, and fund management sectors will:

- a) Monitor closely the evolution of the Network of Central Banks and Supervisors for Greening the Financial System (**NGFS**), of which the US FED became a member in December 2020, as it develops specialized guidance for prudential regulators aimed at addressing climate-related systemic financial risk;
- b) Engage with their Chief Risk Officers to ensure the robustness of internal control systems to assess, mitigate, and monitor exposure to climate risk embedded in their portfolios of loans, insurance customers and investments, insofar as the exposure of these companies to climate risk may affect their credit quality, insurance risk profile, and market valuations;
- c) Incorporate climate-related scenario-modelling and stress-testing within their regular risk oversight responsibilities;
- d) Oversee innovation and product development opportunities related to expansion of the low-carbon economy; and
- e) Monitor the emergence of new disclosure criteria affecting the finance sector.

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