HUNTON ANDREWS KURTH

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ESG Hot Topics

CONTENTS

Welcome to the spring issue of our ESG Hot Topics report. We have collected articles from thought leaders from across the firm highlighting some of the emerging issues in ESG. Should you have any questions about any of the topics discussed herein, please do not hesitate to contact any of the authors of this publication or your regular contact at Hunton Andrews Kurth LLP.

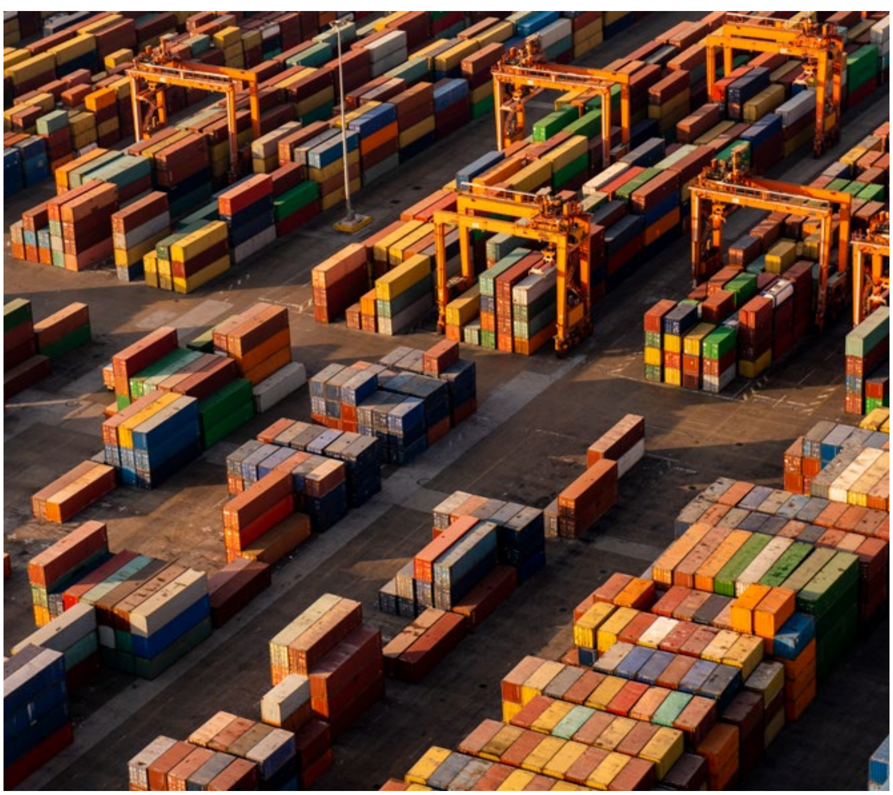
Hunton Andrews Kurth LLP's interdisciplinary sustainability and ESG practice provides strategic counseling to boards, management teams, and investors on a broad range of ESG issues. We support our clients in setting and meeting their sustainability goals. As a component of this practice, and in coordination with sustainability strategy-setting, we help our clients identify and manage ESG risks associated with regulatory requirements and increasing pressure from investors and private litigants. Rather than advise on isolated legal issues, our team works with our clients on core business strategy and sustainability goals, and we collaborate across practice groups to provide integrated, strategic advice.

Supplier Engagement: Navigating Legal Trends on Multiple Fronts

A confluence of legal developments and voluntary corporate measures are reshaping how many companies engage with their supply chains. Companies that sell products are facing increasing legal obligations to seek information from their suppliers both about the contents of their products and the conditions surrounding how those products are made. At the same time, companies that set voluntary sustainability targets—or that are subject to mandatory sustainability disclosure regimes—must seek information from their suppliers in order to demonstrate progress against defined metrics or key performance indicators. All of these trends lead to an increasing need to have well-defined corporate processes for collecting and evaluating supply-chain related information in a coordinated, well-organized manner that appropriately manages risk for the organization.

PRODUCT CONTENT DISCLOSURES

Many companies have long managed compliance obligations to identify and disclose the presence of certain substances in their products (e.g., under California's Prop 65 law). More recently, the evolution of federal chemical regulation under the Toxic Substances Control Act (TSCA) has expanded to regulate finished products, focusing on the substances present in those products rather than solely on regulating neat chemicals. This includes imposing broad information-gathering requirements on companies whose products have not historically been regulated under TSCA, substantially increasing the number of TSCA-impacted stakeholders. In 2023, EPA finalized a rule under TSCA that imposes reporting and recordkeeping requirements on manufacturers and importers of products containing per- and polyfluoroalkyl substances (PFAS). Unlike Prop 65, this rule does not entail undertaking any risk-based analysis about the potential for exposure to a particular substance, but is instead focused solely on whether PFAS are present in a particular product. This far-reaching rule requires reporting of information "known to or reasonably ascertainable by" the manufacturer or importer. What that duty looks like depends on the industry and how the company is situated, but because PFAS are a large class of chemicals found in numerous applications, and because there is no de minimis threshold for reporting, this rule may, for some companies, trigger intensive engagement with suppliers.



In order to appropriately manage both compliance obligations and broader legal risks, companies engaging with suppliers in response to EPA's PFAS reporting rule should work with counsel to make well-considered decisions about whether and when to engage with suppliers, which suppliers should be contacted and what specifically should be asked, what level of follow-up is "reasonable" in the event that a supplier does not respond, and what to do with information once it is received.

HUMAN RIGHTS AND ENVIRONMENTAL DUE DILIGENCE

As in the product content context, some companies have long faced targeted supply chain due diligence requirements. For example, (1) companies that manufacture products containing tin, tantalum, tungsten, and gold (3TG) and that are listed with the US Securities and Exchange Commission must implement due diligence procedures and report annually on efforts to eliminate conflict-implicated 3TGs from their supply chains; and (2) companies that import plant products – such as timber, paper, or furniture – must ensure that such products were not harvested in violation of foreign laws. Within the past three years, supply chain due diligence requirements have become more broadly applicable to a range of industries. In the US, the Uyghur Forced Labor Prevention Act (UFLPA) creates a presumption that goods containing components from Xinjiang, China or produced by an entity on the UFLPA Entity List are prohibited from importation into the US as the product of forced labor. In order to rebut the presumption, an importer must demonstrate that the goods are not produced wholly or in part by convict labor, forced labor, or indentured labor; the importer has complied with due diligence requirements; and the importer has been responsive to follow-up inquiries by Customs and Border Protection (CBP). CBP guidance indicates that, to demonstrate compliance with UFLPA, importers must conduct regular, systematic due diligence, including supply chain mapping and engagement with suppliers.

Meanwhile, in Europe, certain countries (including Germany and France) have imposed supply chain due diligence laws that require companies doing business within their borders to implement measures to identify, escalate, and mitigate environmental and human rights risks within their supply chains. Most recently, the EU Council formally adopted the Corporate Sustainability Due Diligence Directive (CSDDD) following approval by the EU Parliament in April 2024. The CSDDD will impose similar measures across the EU for companies—including non-EU companies doing a certain level of business in the EU—meeting defined size and revenue thresholds. Twenty days following the CSDDD's publication in the Official Journal of the European Union, it will enter into force, requiring subject companies to follow its due diligence requirements with respect to their entire "chain of activities" and exposing them to significant administrative fines and even civil liability for certain violations. Member states will have two years to implement procedures to comply with the CSDDD's standards.

Although supply chain due diligence principles are not new, these legal developments counsel in favor of reassessing not only which specific due diligence laws apply (or have the potential to apply) to a particular organization, but also whether existing processes to engage with suppliers – including through contractual provisions or direct engagement – are appropriately tailored to satisfy changing and overlapping obligations.

SUSTAINABILITY DISCLOSURES

Over the past several years, many companies have set sustainability targets that cannot be reached without making changes across the value chain. In particular, net zero targets require decarbonization by entities that contribute to a company's Scope 3 emissions. Similarly, post-consumer recycled (PCR) content targets require expanded availability of PCR materials that can be used as feedstock for affected products. The emergence of mandatory Scope 3 disclosure requirements in California and the EU, together with PCR requirements in a number of US states and escalating PCR requirements in the EU, are intensifying the need for companies to work collaboratively with suppliers to make meaningful progress.

KEY TAKE-AWAYS

These overlapping trends mean that companies must increasingly engage with their suppliers on multiple compliance-related fronts. To streamline the burden on suppliers and maximize the chances of success, companies should think comprehensively about what they need from suppliers to support their expanding compliance needs. Where possible, companies should develop processes for information collection, audit, and pass-through due diligence to sub-suppliers that are coordinated across programs.

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White House Executive Order on AI Rulemaking Advances as NTIA and OMB Issue Reports and Guidance

With the increase in artificial intelligence (AI) technology and the demand for regulation on the use of AI, new guidance in the wake of the Biden Administration's Executive Order (EO) on AI was recently issued in the form of an AI Accountability Report from the National Telecommunications and Information Administration (NTIA) and a government-wide policy on AI risk management announced by the White House Office of Management and Budget (OMB).

The NTIA's AI Accountability Report (March 27, 2024) focuses on the idea that AI accountability policies and mechanisms are critical to optimizing AI technology. In particular, evaluation of AI systems, both pre- and post-release, and transparency around AI systems, are necessary for innovation and adoption of trustworthy AI and for fostering stakeholder trust.

The report details recommendations around the following aspects of the "AI accountability chain":

- Access to information: disclosures, documentation, access;
- Independent evaluation: evaluations, audits, red teaming; and
- Consequences for responsible parties: liability, regulation, market.

The report also includes eight major policy recommendations related to the AI accountability chain, under the broad categories of Guidance, Support, and Regulatory Requirements. The recommendations may be accessed in the full report, but one example impacting the private sector will be requirements for entities contracting with the government.

The OMB Policy to Advance Governance, Innovation and Risk Management in Federal Agencies' Use of Artificial Intelligence (March 28, 2024) was announced by Vice President Kamala Harris and is a "core component" of the EO on AI. The policy provides a basis for multiple areas of AI accountability and governance and will be a foundation for other agencies to develop subsequent regulations, many of which will impact the private sector.

According to the White House fact sheet, this policy would, among other things:

- Address risks related to the use of AI (e.g., mandatory assessments and safeguards);
- Expand transparency of AI (e.g., reporting AI use cases and metrics);
- Advance responsible AI innovation for high priority societal challenges (e.g., climate change, public health, public safety);
- Grow the AI workforce (e.g., hiring AI professionals and setting pay and leave guidance); and
- Strengthen AI governance (e.g., designating Chief AI officers and establishing AI Governance Boards).

The White House also announced several upcoming AI-related actions, including a request for information for responsible AI procurement, expanding the government's AI Use Case Inventory, and hiring 100 AI professionals by summer 2024.

President Biden's EO on AI requires various agencies to generate guidance and rules, and to take actions on staggered timelines. The OMB policy represents one such action at the 150-day mark of the EO. This type of policy, the NTIA report, and subsequent actions, similar to those noted above, are anticipated to inform compliance efforts in the rapidly evolving AI environment, including in the privacy and security arenas.

As agencies continue to issue such AI-related guidance and rules, they may not directly impact all private companies immediately, but there likely will be some direct impact to certain sectors.

From an ESG perspective, we expect the guidance to be among the foundational standards in the private sector given the lack of comprehensive federal AI legislation in the United States. The regulatory framework will build on existing efforts such as NIST guidelines and FTC enforcement, but will likely have more far-reaching impacts as the EO broadens or reinforces current agency mandates and scope to address AI across the government.

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Recent Developments in Climate Disclosures and Sustainability Reporting

For nearly twenty years, many companies have issued voluntary sustainability reports or published information about their sustainability efforts, often in conjunction with brand building. For the first time now, companies are becoming subject to mandatory sustainability and disclosure requirements, often in multiple jurisdictions. The uncertain and shifting landscape around new disclosure requirements, including numerous ongoing legal challenges, creates a new set of challenges for companies as they seek to advance their compliance planning under these three frameworks.

CLIMATE DISCLOSURE REQUIREMENTS IN CALIFORNIA

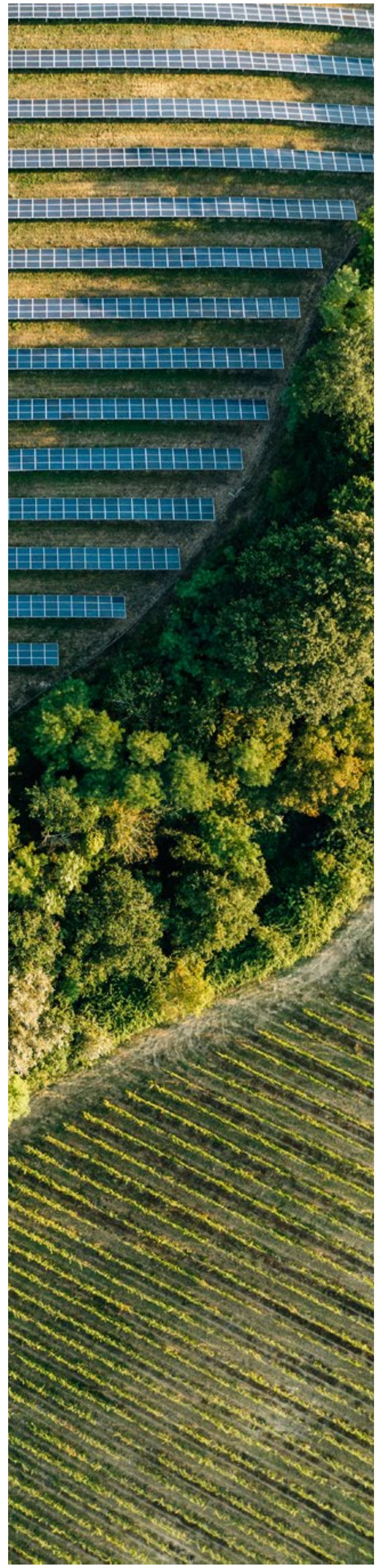
In October 2023, California Governor Newsom signed into law three bills that require companies that conduct certain activities in California to disclose greenhouse gas emissions and other climate-related information.

Senate Bill (SB) 253 requires companies to disclose, on an annual basis, their Scopes 1, 2, and 3 emissions for the prior fiscal year, with Scopes 1 and 2 reporting starting in 2026, and Scope 3 reporting starting in 2027. SB 261 requires companies to publish a public report of climate-related financial risks before January 1, 2026, and biennially thereafter. Reports must address measures that companies have adopted to reduce and adapt to the identified risks, which must be reported in alignment with the framework developed by the Task Force on Climate-Related Financial Disclosures (TCFD).

These laws apply to US companies that do business in California and that had total revenue in the prior fiscal year in excess of $1 billion, in the case of SB 253, or $500 million, in the case of SB 261. The legislature tasked the California Air Resources Board (CARB) with issuing SB 253 implementing regulations by January 1, 2025, which should provide clarity on what it means to "do business in" California, a criteria not currently defined in either Senate bill. However, due to a lack of funding allocated to implementation efforts, it seems unlikely that CARB will finalize a rulemaking package before the January 1, 2025 deadline.

Assembly Bill (AB) 1305 targets three types of entities: (1) those that market or sell voluntary carbon offsets; (2) those that purchase or use voluntary carbon offsets and make emissions reduction claims; and (3) those that make net zero, carbon neutrality, or significant emissions reduction claims of any kind. The basic obligation under AB 1305 is for entities to publicly disclose on their public websites specific information intended to provide transparency with respect to the offsets that they purchase, use, market, and sell, and to substantiate their emissions-related claims. While the bill did not specify a compliance date, the bill's author clarified in a letter to the chief clerk of the assembly his intent that AB 1305 disclosures should be posted by January 1, 2025.

Although the implementation of these novel California requirements is in flux, companies subject to the requirements under these three laws should begin to prepare for compliance by engaging technical and legal support, creating emissions inventories, reviewing claims, and marshaling required substantiation.



SEC'S FINAL CLIMATE DISCLOSURE RULE

In March 2024, the US Securities and Exchange Commission (SEC) adopted its final climate-related disclosure rules requiring most public companies to disclose climate-related information in registration statements and annual reports filed with the SEC, which we discuss in greater detail in our previous publication. While the final rules are a scaled-back version of the proposal, compliance with the rules will require a considerable amount of time and effort for many companies.

As expected, the rules were swiftly met with numerous legal challenges in multiple federal courts. Some parties allege the SEC has gone too far and overstepped its mandate as securities regulator while other parties allege that the SEC has not gone far enough. In late March, the lawsuits were consolidated in the Eighth Circuit, and on April 4, in a surprise move, the SEC issued an order voluntarily staying implementation of the rules until resolution of the pending litigation. In its order, the SEC indicated that it intends to continue vigorously defending the rules in court, and it issued the stay to avoid potential regulatory uncertainty for companies if the rules went into effect before the litigation is resolved.

While the stay comes as a relief to many companies, the outcome and timing of the litigation is by no means predictable. If the SEC does prevail in the litigation, it is not immediately clear what the timeline for implementation will be. Practically, if the SEC prevails in the litigation, the compliance deadlines are likely to be extended to some extent, but it is unclear by how much. The SEC has alluded to extending the deadlines at least one day for each day that the rules are in litigation, and has indicated it will eventually publish a revised compliance timeline in the Federal Register, but what that means for deadlines beyond 2025 is uncertain. If the rules survive challenge, there may simply not be enough time to develop the necessary compliance framework if a company is starting from scratch.

While the rules are stayed, companies that may be subject to the rules should begin to prepare for compliance, including conducting a gap assessment to consider how the rules could apply to the company, what data is currently available to satisfy the requirements, whether the company has the right personnel available to collect that data and oversee reporting, and consider the potential shortcomings in any of these categories that would need to be addressed to comply with the rules if upheld.

IMPLEMENTATION OF THE EU'S CORPORATE SUSTAINABILITY REPORTING DIRECTIVE (CSRD)

The EU is further along and forging a broader path than the US in developing and implementing an ESG reporting framework. The CSRD—the EU's mandatory reporting law encompassing all three pillars of ESG—entered into force in January 2023. The CSRD is far broader both in substantive scope and jurisdictional reach than its precursor, the Non-Financial Reporting Directive (NFRD). Following a phased implementation approach, based on corporate size and revenues, the CSRD is projected ultimately to cover around 50,000 subject companies. The first tranche of subject companies—large public interest entities that were subject to the NFRD—must submit initial CSRD-aligned reports next year, covering 2024 data. The last group of subject entities will be non-EU companies surpassing certain thresholds for business done in the EU, which will be subject starting in 2028, with reports due the following year.

While the CSRD framework sets general parameters for EU sustainability reporting, most of the substantive requirements will be established via European Sustainability Reporting Standards (ESRS). The first set of ESRS took effect January 1, 2024, and provides two cross-cutting reporting standards of general applicability and ten topical standards under the distinct ESG pillars. These include five environmental standards, covering energy and emissions data, water use, circular economy, pollution, and biodiversity; four social standards, including working conditions, diversity, inclusion, and human rights; and one corporate governance standard related to board oversight of sustainability functions. Additional sets of ESRS are expected to be finalized in June 2026, and will provide sector-specific standards as well as standards specific to non-EU companies subject to the CSRD.

As a high-level roadmap for implementation, the first step for companies is to determine the applicability of the CSRD and identify the relevant compliance date. Next, companies must conduct a materiality assessment under the CSRD's "double materiality" standard, which requires analysis of both financial materiality to the company as well as material impacts of the company's operations on people and the environment. Based on that assessment, companies will determine which of the ESRS apply and whether there are any additional company-specific material topics not covered by the ESRS that nonetheless require reporting because they are material to the company. Forthcoming guidance from the European Financial Reporting Advisory Group, the body developing the ESRS, on the materiality assessment, metrics related to the value chain, and some detailed ESRS data points may help companies navigate these new standards.

WHAT YOU SHOULD BE DOING NOW

Some companies are further along than others because of work done for voluntary reporting or NFRD reporting in the past, but disclosing to a detailed prescriptive set of reporting standards is new for everyone and will require substantial effort. Meanwhile, in the US, there is remaining uncertainty about what needs to be done for compliance purposes, not only because the requirements are new, but also because of delayed regulatory processes and ongoing judicial challenges. A key focus for many companies right now is to move forward with compliance planning in the face of some legal uncertainty without spending unnecessary time and money on efforts that may not ultimately be the right ones.

A good first step is to document a well-structured decision framework for developing a sustainability reporting compliance program.

Companies should determine what different disclosure programs apply, what deadlines are applicable, and any uncertainties about when the requirements will come into force. From there, companies can identify common reporting elements across programs and prioritize. For example, a company subject to any of the three programs will likely need to prepare a greenhouse gas inventory and a TCFD report. Moreover, companies need to assess the state of past reporting, what internal controls need to be developed, and what resources may be needed to comply with escalating assurance requirements. These are all issues that companies will ultimately have to confront, regardless of how the remaining uncertainties are ultimately resolved.

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Class Action Alleging That ESG Investments Violated ERISA Rules Survives Motion to Dismiss

Retirement plans such as 401(k)s and pensions are governed by the Employee Retirement Income Security Act of 1974 (ERISA), which imposes duties on retirement plan fiduciaries regarding what investments may be offered to employees and how plan assets are invested. Those duties under ERISA, known as the duties of loyalty and prudence, affect the extent to which (if at all) plan fiduciaries and investment managers can consider factors other than risk-weighted returns when evaluating investment options. Many investment funds have begun to consider ESG factors when making investment decisions. A recent opinion from a federal district court in Texas, however, suggests that employers should be cautious about ESG investments in plans covered by ERISA.

The plaintiff in *Spence v. American Airlines, Inc.*, Civ. No. 4:23-cv-00552-0 (N.D. Tex. February 21, 2024) alleged that his employer and its employee benefits committee violated ERISA's prudence and loyalty duties and monitoring requirements by including in his retirement plan funds "that are managed by investment managers that pursued non-financial and nonpecuniary ESG policy goals through proxy voting and shareholder activism." Several of the plans' investment managers were alleged to have converted the plan's investments and core index portfolios to ESG funds by engaging in proxy voting and shareholder activism that promoted ESG goals. In support of his claims, the plaintiff cited to his employer's annual ESG report and to public statements from plan investment managers that allegedly reflected support for investments that furthered ESG goals. The plaintiff also cited studies finding that ESG funds underperformed returns of the broader market.

The defendants had argued that the plaintiff provided no meaningful benchmark against which the plans' performance should be measured. The court rejected this argument and held that a plaintiff was not required to identify a benchmark at the pleading stage "given the inherent fact questions such a comparison involves." The court went on though to suggest that the plaintiff had sufficiently identified a comparator benchmark "given the data provided on ESG funds' established record of underperformance."

The defendants also argued that the plaintiff failed sufficiently to plead any facts connecting the investment managers' proxy voting to investment underperformance. But the court also rejected this argument: a plaintiff at the pleading stage "need not plead the exact connection between the investment managers' alleged ESG proxy voting and the financial harm Plaintiff suffered as a result." One of the investment managers cast proxy votes that allegedly caused the stock of a few large energy companies to fall. The complaint itself alleged nothing showing how the proxy voting, rather than something else, had caused the alleged underperformance. The court held that the plaintiff had pled enough to link the two, because the proxy voting allegations, combined with the fact that "various sources have reported on the underperformance of ESG funds," were enough to "infer a flawed process."

The court also held that the plaintiff sufficiently pled a claim for breach of the duty of loyalty. Whether the defendants' company-wide ESG policy motivated the choice to invest in ESG-oriented funds, said the court, is a fact question that need not be resolved at the pleading stage.

The court's decision sets a low bar for plaintiffs alleging ERISA claims based on alleged ESG investments in at least two ways. First, the court accepts as sufficient plaintiff's allegations that some analyses have found that ESG investments underperform other investments ("the Court finds that Plaintiff has pointed to at least some benchmark for inferring the quality of the investment managers' performance given the data provided on ESG funds' 'established record of underperformance'"). This implies that a plaintiff alleging a duty of prudence/monitoring claim need only allege that an investment is an "ESG fund" to establish underperformance, at least at the motion to dismiss stage. Second – and this point is related to the first – what constitutes an "ESG fund" apparently can be based on public statements made by investment managers, regardless of whether those statements resulted in actions with respect to any funds at issue or whether any actions actually caused investment underperformance. Note that none of the funds held by the plaintiff were denominated as "ESG funds." They were instead typical stock and index funds. But the public statements of the investment managers, combined with the purported chronic underperformance of "ESG funds," were enough according to the court to state a claim that the plans' investments underperformed in violation of the duties of prudence and loyalty.

Jurisprudence on ERISA's new ESG investing rules is not yet well-developed. It is important to note that the *Spence* opinion, which came at the motion to dismiss stage, considered only whether the plaintiff's allegations were sufficient for the case to move forward, and so is not a determination that the defendants were in fact liable under ERISA. But if the *Spence* court's reasoning is adopted more widely, we would expect to see an increased number of cases surviving motions to dismiss and reaching discovery.

Companies, looking to avoid similar ERISA claims, should ensure that retirement plan fiduciaries review investment plans with their investment managers to confirm that their selections are supported by the traditional risk-return analysis. Companies should be particularly mindful that when they invest for a collateral purpose (i.e., they think it is the right thing to do, or it is in line with the company's ethos/goals) they have an economic justification to support the investment. Investing for a collateral purpose alone is not sufficient. Bottom line, fiduciaries must evaluate ESG factors just like any other potential factor in the risk-return analysis.

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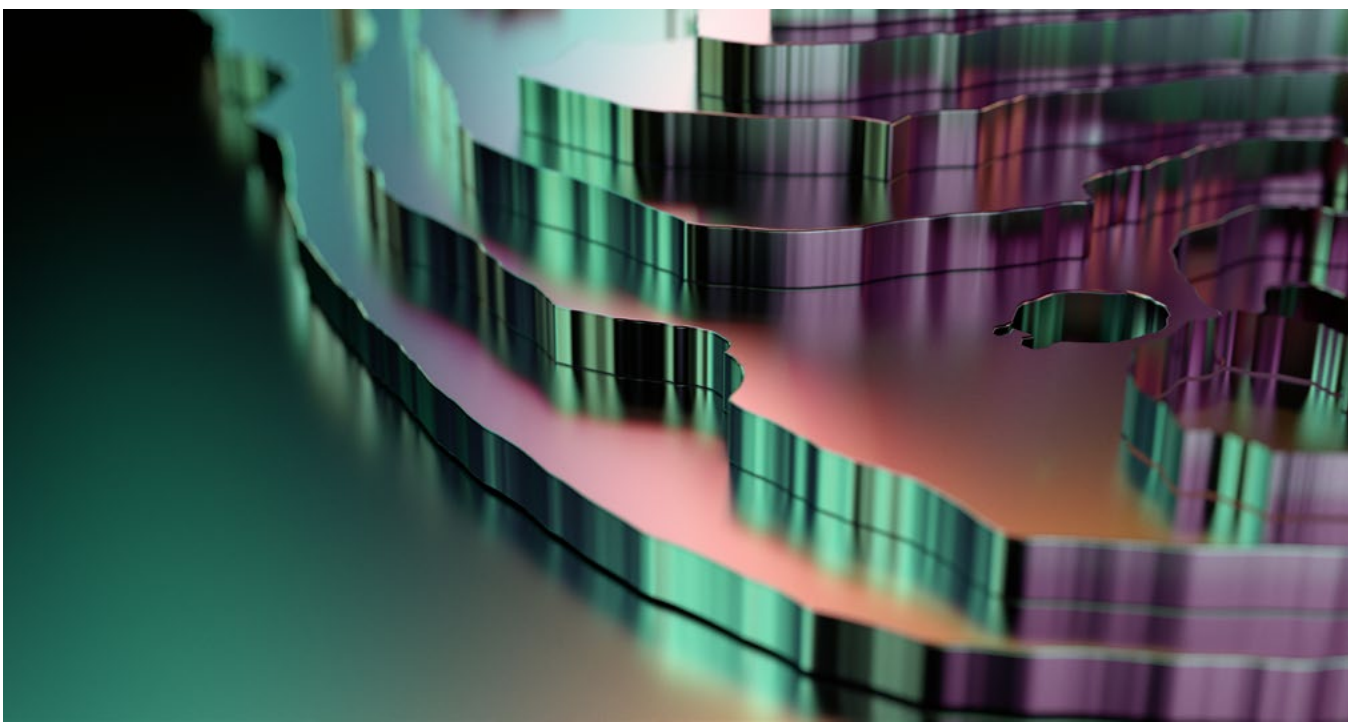

Pay Equity Claims Are On The Rise—How are Courts Handling the Differences in Law?

Pay equity continues to be a hot topic for employee retention and compliance. This principle of equal pay for equal work has been mandated since the Equal Pay Act of 1963 (EPA) and reiterated in Title VII of the Civil Rights Act of 1964. More recently, legislators at the federal, state, and local level have increased their focus on pay equity and pay transparency initiatives. Because of this legislative activity, pay equity has also received increased attention from the Plaintiffs' bar, and in recent years, pay equity lawsuits have been brought with increasing frequency. Against this backdrop, employers face the tough task of navigating a complex patchwork of pay equity laws in order to achieve fair and legally-compliant compensation practices, while ensuring that their compensation decisions can reflect the reality of a workforce with differing job positions, responsibilities, and performance outcomes.

This brings us to one of the principal questions in a pay equity claim: what is "equal work"? To prove a claim under the EPA, an employee must show that the jobs being compared are "substantially equal." Unlike the EPA, there is no requirement under Title VII that the jobs being compared must be "substantially equal"; instead, Title VII focuses on "similarly situated" employees. At the state level, different variations of these standards proliferate.

IN A PAY DISCRIMINATION CLAIM, WHO COUNTS AS A "COMPARATOR" PERFORMING "EQUAL WORK" FOR GREATER PAY?

In assessing a pay discrimination claim on the basis of a protected characteristic (like sex, sexual orientation, gender, gender identity or expression, race, color, ethnicity, national orientation, religion, creed, familial status, marital status, veteran status, domestic victim status, disability, and/or age), one commonality between all jurisdictions is the courts' focus on comparators—individuals who are not members of a plaintiff's protected class.

For example, in *Freyd v. Univ. of Oregon*, 990 F.3d 1211 (9th Cir. 2021), the Ninth Circuit considered the case of a female professor who brought an EPA suit against a state university for pay discrimination. The *Freyd* court held that the plaintiff professor's four comparators all performed a "common core" of tasks and did "substantially equal work." The court reached this conclusion despite the fact that the comparators performed different research, did not teach the same courses, did not supervise the same doctoral students, did not manage the same centers, and obtained different types of funding. According to the Ninth Circuit, it was the "overall job," and not "its individual segments," which formed the basis for comparison. *Freyd* cautions against drawing overly fine distinctions in deciding whether a plaintiff and her comparators perform "substantially equal work."

In a different, albeit similar, pay discrimination case, the Fifth Circuit considered the question of comparators, but reached a different conclusion under Title VII. As noted above, a pay discrimination plaintiff in a Title VII case must prove, among other things, that other similarly situated employees outside the plaintiff's protected class were treated more favorably. The Fifth Circuit held that the comparators cited by the plaintiff-professor did not share plaintiff's research responsibilities, section assignments, or historical performances, and held that plaintiff could not establish a case of sex discrimination under Title VII. *Saketkoo v. Administrators of Tulane Educ. Fund*, 31 F.4th 990, 999 (5th Cir. 2022).

Even when courts are analyzing the same pay discrimination statute, the courts take different approaches to the comparator analysis. For example, in contrast to the Ninth Circuit's focus in *Freyd* on a "common core" of tasks and an employee's "overall job" under the EPA, the Fourth Circuit recently held that, in making a finding of "substantially equal work" under the EPA, the "[s]imilarity of work is not enough." *Polak v. Virginia Dep't of Env't Quality*, 57 F.4th 426, 430 (4th Cir. 2023). Rather, according to the Fourth Circuit, the proffered "comparator [needs] to have performed work '*virtually identical*' (or the apparent synonym, 'substantially equal') to the plaintiff's in skill, effort, and responsibility."

Polak considered the case of a female coastal planner who worked for a state environmental agency. While the plaintiff and her male comparator (also a coastal planner) were both members of the same team, worked closely together, and collaborated on issues of planning, grant progress, and program performance, the Fourth Circuit concluded that only "the general description of their work was similar." Like the plaintiff and her comparators in *Freyd*, the plaintiff and her comparator in *Polak* had different responsibilities involving different projects. The Fourth Circuit made several observations. First, plaintiff's and her proposed comparator's background, experience, and the subject matter for which they were tasked differed. Second, the *Polak* court reasoned that "Polak could *not* have full comparative knowledge of both [her comparator's] job and hers, as they each performed their work simultaneously in different contexts and on distinct projects to which each were assigned." (emphasis added). As a result, the Fourth Circuit held that plaintiff and her comparator did not perform "equal work", but acknowledged that they did perform "*similar* work." Importantly, the *Polak* court noted "the differences in the actual worked performed and the level of complexity involved were significant enough that their work cannot be fairly described as 'substantially equal' or 'virtually identical,' as required to establish a claim under the Equal Pay Act." Unlike the Ninth Circuit, a "common core of tasks" is not enough to meet the "substantially equal standard" in the Fourth Circuit.

Similar to the Fourth Circuit in *Polak*, the Tenth Circuit recently held that the equal work requirement of the EPA is "not to be construed broadly." *Ferroni v. Teamsters, Chauffeurs & Warehousemen Local No. 222*, 297 F.3d 1146, 1149 (10th Cir. 2002). According to the Tenth Circuit, "[l]ike or comparable work does not satisfy this standard, and it is not sufficient that some aspects of the two jobs were the same."

WHAT ARE SOME DEFENSES TO PAY DISCRIMINATION CLAIMS?

Recent pay equity cases have focused on the relative job experience of plaintiffs with their purported comparators:

- In a recent Tenth Circuit decision, the court dismissed the plaintiff's EPA and Title VII claims because the plaintiff was a first-year physician and her comparators had at least seven years' or more experience.
- The Eighth Circuit recently dismissed a professor's pay discrimination claims for similar reasons. There, the comparator had five years' experience teaching, and ten years' experience as a case worker and case manager at a nearby correctional institute. In contrast, plaintiff had no teaching experience and only three years' relevant professional experience as a probation officer.
- In another case, the Eighth Circuit dismissed another pay discrimination claim under Iowa state law involving a cleaner for a building maintenance company who was not offered a position in the special services department. The court held that the pay differential was due to differences in experience. One male comparator operated the relevant machinery for the special services position in a previous special services position with another company. Another male comparator had over a decade of experience in cleaning services and special services combined. In contrast, plaintiff had only ever worked in general cleaning services.

ARE THERE ALTERNATIVES?

Another recent case focused on a more formalized and proactive way to ensure pay equity—the practice of internal equity. *Korty v. Indiana Univ. Health, Inc.*, No. 4:21-CV-33-PPS, 2022 WL 17830485 (N.D. Ind. Dec. 21, 2022). There, the court considered the practice of assessing new hires' compensation rates against incumbent employees' pay rates to ensure that current and new employees in the same job code have consistent rates of pay. In *Korty*, the employees who hired a new nurse compared the pay rates of ten other clinical nurse quality coordinators in other job locations. The court held that this practice of internal equity was "a sex-neutral basis for coming up with [the plaintiff's] salary." As such, any differential in pay was not attributable to sex.

The *Korty* court also held that an employee's prior salary is also a valid reason "other than sex" to explain a pay differential. However, employers should be cautious in relying on prior salary to justify any pay differentials. For example, the Ninth Circuit has held that "prior salary alone or in combination with other factors cannot justify a wage differential" because, otherwise, employers could "capitalize on the persistence of the wage gap and perpetuate that gap ad infinitum." *Rizo v. Yovino*, 887 F.3d 453 (9th Cir. 2018). The opinion was vacated on unrelated grounds, but sheds a light on how some courts will view an employee's prior salary in disputes over pay differentials.

As is evidence from the discussion above, the differences between laws and jurisdictions create a complicated pay equity patchwork for employers to navigate. Employers should consult with experienced counsel to avoid any pitfalls in making compensation decisions and proactively assessing compensation to ensure proper comparators and appropriate justifications depending on the jurisdiction.

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ESG and Biodiversity

The "E" of ESG has long focused on climate-related metrics and targets (such as greenhouse gas emissions and energy use). Biodiversity and other nature-related initiatives, however, are steadily gaining importance in ESG policies and frameworks. As governments strive to shift investments toward more sustainable land management, habitat protection, and species conservation, companies and investors are likely to face more attention to and requirements on curbing degradation of natural resources and preserving habitats and biodiversity. This article surveys emerging biodiversity frameworks and initiatives around the world, then discusses potential impacts and strategic considerations for industry, including in regions where specific government policies are not yet in place.

RECENT TRENDS AND DEVELOPMENTS

Global leaders have recently committed to new ambitious biodiversity targets, with many signing onto the Kunmig-Montreal Global Biodiversity Framework at the UN Biodiversity Conference in 2022, and agreeing at COP 28 in 2023 to emphasize biodiversity and land restoration in their next round of Nationally Determined Contributions. The UN's Biodiversity Framework contains action-oriented global targets signed onto by more than 190 countries, including: no net loss of biodiversity by 2030, a net gain in biodiversity beyond 2030, and full recovery of biodiversity by 2050. The UN Framework sets short term goals to achieve the 2030 targets, including restoring 30 percent of all degraded ecosystems, shifting incentives from subsidies that are harmful to biodiversity to those that are more sustainable, and leveraging private finance to implement national biodiversity strategies. While neither the UN Framework nor the COP agreement imposes requirements on companies directly, both represent commitments to scaling investments to restore and regenerate nature and ecosystems which are likely to lead to requirements on and commitments by industry.

The European Union (EU) has thus far been at the forefront of rolling out ESG due diligence and disclosure requirements for companies and investors, both for European entities and those based elsewhere who do business in Europe, and it may be the first region where industry sees mandatory ESG rules on biodiversity. The EU has begun rolling out a biodiversity strategy as part of its expansive "Green Deal" to protect nature and reverse ecosystem degradation. The strategy contains specific commitments and actions to be delivered by 2030. The EU aims to pass its first-ever "Nature Restoration Law," to include binding restoration targets for specific habitats and species. Under this strategy the EU has also expanded existing protected areas, adopted new guidance for reforestation and afforestation, adopted a proposal for a Soil Health Law, and adopted a proposal for a Regulation establishing an EU forest monitoring framework. The EU's mandatory disclosure framework, the Corporate Sustainability Reporting Directive and its European Sustainability Reporting Standards (ESRS), impose biodiversity disclosure requirements on subject companies.

The recent framework released by the Task Force on Nature Related Financial Disclosures (TNFD) is likely to provide the basis for mandatory reporting regimes focused on natural capital in some regions. The TNFD contains recommendations and guidance for companies to measure, manage, and report on their nature-related dependencies, in the same manner that its predecessor, the Task Force on Climate Related Financial Disclosures (TCFD) did for climate-related risk management and disclosure. TNFD was launched in November 2023, and hundreds of companies have already signed on as "early adopters," committing to align their disclosures with the TNFD recommendations by either 2024 or 2025. The United Kingdom is likely to formally adopt the TNFD recommendations into policy, and the EU's ESRS biodiversity disclosures are generally TNFD-aligned. Other voluntary reporting frameworks, including the Global Reporting Initiative and International Sustainability Standards Board, are moving forward toward including biodiversity standards, as well.

IMPLICATIONS FOR INDUSTRY

From a business standpoint, this increasing attention to biodiversity, ecosystems, and other nature-related dependencies may lead to both requirements and incentives for nature-related risk assessment and risk management. As for requirements, companies are likely to face more stringent policies governing use of natural resources throughout their supply chains, which could limit (or further limit) access to certain resources. In the EU, for example, the proposed Nature Restoration Law would require EU countries to submit National Restoration Plans showing how they would meet specific targets for biodiversity in forest ecosystems, urban ecosystems, agricultural ecosystems, and marine ecosystems. These plans may require changes in company operations in covered ecosystems, and potentially increased disclosure obligations to demonstrate how ecosystem risks and impacts are taken into account in those areas. Similarly, as national governments work to incorporate a new focus on biodiversity into national policies to achieve commitments made in Montreal and Dubai, companies may experience higher costs and less access to natural capital over time.

In addition to a likely growth in biodiversity-related policies facing industry in the future, companies will also face increasing pressure from investors and other stakeholders to demonstrate they are adequately considering and managing for nature-related risks and impacts. Investors and financial institutions may incorporate biodiversity into ESG screening criteria through their impact investing strategies, in much the same way they have taken into account climate-related risks and impacts to their investment portfolios. As with climate change, we may see the market encourage companies to implement management structures for biodiversity issues to remain competitive.

Companies may also find that shifting attention toward biodiversity comes with new opportunities to shift capital toward nature- and ecosystem-based solutions. The UN's 2030 targets noted above include a goal of reducing harmful incentives by $500 billion per year by 2030, and scaling up positive incentives for biodiversity. A separate goal targets mobilizing $200 billion per year from all sources, including public and private finance. Environmental Finance data already shows biodiversity-related conservation is featured in more ESG bonds each year, and these global commitments are likely to facilitate further opportunities for financing to invest in nature restoration efforts.

STRATEGIC CONSIDERATIONS

For businesses in the United States, the growing shift toward biodiversity commitments and policies is unlikely to result in imminent mandatory compliance requirements. However, companies should be aware of potential risks and opportunities associated with this new movement within ESG. Just as companies have been both required and incentivized in recent years to measure, manage, and disclose climate-related risks and opportunities, such as carbon emissions, energy use, and risks from climate change, they may want to consider developing similar structures for other natural resources and biodiversity. Companies should consider building out monitoring, oversight, and management of biodiversity-related and other nature-related risks alongside other environmental and social issues throughout their supply chains, in order to understand and evaluate potential risks and impacts from reliance on natural capital. This will allow for identification and management of material risks that could come from reduced access to natural resources or more stringent regulatory requirements around use of those resources. As industry turns more attention toward supplier engagement (as required by many of the emerging climate and social ESG frameworks), it has an opportunity to engage on potential risks stemming from the ecosystems in which suppliers operate.

Companies should consider establishment of mechanisms to account for biodiversity and ecosystem impacts—both positive and negative. For example, where companies are already required to comply with nature-related requirements under other legal frameworks, they should consider working to translate those compliance actions to ESG biodiversity metrics in order to demonstrate to interested stakeholders how the company is managing impacts to natural capital. Many US entities undertake both mandatory and voluntary efforts to preserve species' habitat under the Endangered Species Act, and to mitigate and offset impacts to wetlands and other aquatic resources under the Clean Water Act. In order to translate these efforts into ESG metrics under a biodiversity framework, companies could document actions such as purchasing credits from wetland and species mitigation banks, enhancement and restoration of aquatic ecosystems, and protection of wildlife through relocation projects, and show how those actions mitigate material risks to the company and impacts to the ecosystem.

Accounting for the role of and impacts to biodiversity, nature, and ecosystems throughout the value chain may pose new challenges for even those entities with advanced ESG programs. Companies may have a harder time concretely quantifying these risks and impacts and demonstrating progress compared to climate-related efforts which often can be boiled down to emissions calculations. As such, as biodiversity related polices and expectations evolve, we will need to look to governments and investors for signals on how progress will be measured against emerging ambitious global targets.

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Clean-Energy Tax Credits Generate Investment in Sustainable Power

The Inflation Reduction Act of 2022 (IRA) expanded existing renewable energy tax credits and introduced several new tax incentives designed to support the transition to clean energy. The IRA is expected to drive investment by expanding the pool of tax credits available for renewable energy resources and allowing, for the first time ever, the direct purchase and sale of clean energy tax credits. Taxpayers with clean energy goals or federal tax liability both stand to benefit greatly from the IRA.

AN EXPANDED POOL OF TAX CREDITS

The expanded tax credits include (1) production tax credits (PTCs) under Section 45 of the Internal Revenue Code (IRC), (2) investment tax credits (ITCs) under Section 48 of the IRC, and (3) carbon oxide sequestration tax credits under Section 45Q of the IRC. Taxpayers can earn PTCs by generating and selling electricity from clean energy projects and ITCs by investing in clean energy projects. PTCs and ITCs may be earned from qualifying solar, wind, biomass, and geothermal energy projects. ITCs may also be earned from qualifying energy storage and biogas projects. For projects placed in service after 2024, PTCs and ITCs will be technology-neutral.

In addition, the IRA introduced new tax credits for zero-emission nuclear, clean hydrogen, advanced manufacturing, clean transportation fuel, and advanced energy projects. Further, the IRA allows for additional "bonus" tax credits for certain projects that (1) meet certain domestic content requirements, (2) are placed in service in "energy communities" (brownfield sites, statistical areas meeting certain fossil fuel and employment criteria, or census tracts containing, or directly adjacent to census tracts with, closed coal mines or retired coal-fired electric generating units), or (3) are placed in service in low-income communities. Lastly, the IRA allows for increased tax credits for projects that satisfy (or are exempt from satisfying) certain prevailing wage and apprenticeship requirements in constructing (and altering or repairing) the project.

DIRECT PAY AND TAX CREDIT TRANSFERABILITY

Beyond expanding the tax credits available for clean energy, the IRA has also revolutionized the monetization of such tax credits through direct pay and transfer mechanics. Under Section 6417 of the IRC, tax-exempt and government entities are eligible to receive a direct payment of the amount of tax credits earned through any qualifying clean energy project. Taxable entities may only claim a direct payment for qualifying carbon oxide sequestration, clean hydrogen, and advanced manufacturing projects.

Under Section 6418 of the IRC, tax credits earned through qualifying projects may be sold by a taxpayer (Transferor) directly to an unrelated taxpayer (Transferee) for cash. The cash received for the tax credits is not included in the Transferor's gross income, and the cash paid is not deductible by the Transferee. The Transferee may use the transferred tax credit in full without including any discount (i.e., the difference between the cash paid for the tax credits and the amount of tax credits) in the Transferee's gross income. Subsequent transfers are not permitted but Transferees may carryback or carryforward the transferred tax credits. Transferors may use a portion of the tax credits and transfer the rest, and may transfer portions of tax credits

to multiple Transferees. Taxpayers are required to register before filing the tax return on which a transfer election is made and provide certain information on a transfer election statement related to each project. The Transferor is also required to provide the Transferee with certain required minimum documentation.

Ultimately, the IRA provides a simple and effective way for taxpayers to fund clean energy projects and reduce their federal tax liability.

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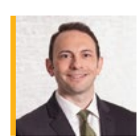

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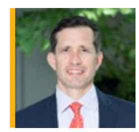
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