[Securities Regulation Daily Wrap Up, TOP STORY—House passes expanded ESG bill with no room to spare, (Jun. 17, 2021)]

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

The bill, cobbled together via several amendments, made it through the House by a single vote, thus indicating how slim the odds are that the most comprehensive ESG legislative package to date will pass the Senate.

The narrow margin of victory in the House for Democrats pushing the most extensive ESG disclosure package yet proposed may signal big trouble in the Senate where the bill is almost surely to die, but individual pieces of the legislative package could remain viable, especially a component that would address diversity in the boardroom and the C-suite, which previously garnered bipartisan support in Congress and in the private sector. The final legislative package would require new public company disclosures regarding ESG metrics, climate change, political spending, executive pay, tax havens, workforce data, workplace harassment, cybersecurity, diversity and inclusion, and the conduct of businesses operating in China regarding alleged abuses by the Chinese government of the Uyghur minority. One amendment, offered outside of the initial legislative package and the later package of *en bloc* amendments, and which was adopted with overwhelming bipartisan support, would require the SEC to study how ESG disclosures impact smaller companies. The final, amended legislative package contained in the retitled Corporate Governance Improvement and Investor Protection Act (H.R. 1187) passed by a vote of 215-214.

The underlying bill and initial amendments. The underlying bill that became the Corporate Governance Improvement and Investor Protection Act was built around a bill previously introduced by Rep. Juan Vargas (D-Calif) that would have the SEC establish ESG metrics. A key aspect of the debate on the underlying bill focused on whether ESG disclosures are or are not already required under existing securities regulations. Democrats asserted that the SEC needs specific legislation to ensure consistency and comparability among companies making ESG disclosures. Republicans, such as Rep. Bill Huizinga (R-Mich), argued that companies already can make ESG disclosures if the content of the disclosure is material and, thus, ESG legislation is unnecessary, may push the SEC to speak on topics for which it lacks expertise, and could incentivize companies to remain private or for public companies to opt to go private in order to avoid having to make ESG disclosures.

Republicans also cited what they see as a "tension" between Title I (the Vargas bill) and Title IV, which contains a more prescriptive climate change disclosure requirement offered by Rep. Sean Casten (D-Ill). According to Rep. French Hill (R-Ark), the Vargas bill requires a company’s annual report to disclose long-term strategy based on current metrics, while the Casten bill adds disclosures of social, economic, and reputational costs that refer to both current and future metrics. Representative Hill had made the same point when the House Financial Services Committee marked up and reported the Casten bill earlier this year.

Title I contains the ESG Disclosure Simplification Act of 2021 (H.R. 1187), sponsored by Rep. Vargas. The title would direct the Commission to adopt rules to implement an ESG disclosure regime for public companies. Specifically, any company with securities registered under Exchange Act Section 12 or which reports to the Commission under Exchange Act Section 15(d) would have to disclose in its proxy statement or solicitation: (1) a clear description of the company’s views regarding the link between ESG metrics and long term business strategy; and (2) a description of the process the company used to determine the impact of ESG metrics on long-term business strategy.

A sense of Congress included in the bill would state that ESG disclosures are de facto material. This is significant because, under the SEC’s existing disclosure regime, materiality is the key touchpoint for disclosures of all types, and ESG disclosures may or may not always be material.

The bill also would define "ESG metrics" by reference to rules the Commission will develop if the bill becomes law. The Commission would have discretion to incorporate international ESG standards. The Commission also would have discretion to delay the disclosure requirement for small issuers.

The Vargas bill also would create the Sustainable Finance Advisory Committee within the SEC to make recommendations about ESG disclosure to the Commission. "Sustainable finance" would mean "the provision of finance with respect to investments taking into account environmental, social, and governance considerations." The Commission would have to respond to a report issued by the committee within six months.

An amendment that was included in a group of en bloc amendments approved by the House would add a provision to the Vargas bill that would require the SEC to study shareholder collective action. The SEC's report could approve certain actions that would not involve corporate control and could recommend safe harbors regarding sustainability guardrails for portfolio company conduct. (The remaining en bloc amendments are discussed in detail below.).

Title IV contains the Climate Risk Disclosure Act of 2021 (H.R. 2570), sponsored by Rep. Casten. This title would require the SEC to adopt rules mandating public companies filing reports under Exchange Act Section 13(a) or 15(d) make certain disclosures about the climate risks inherent in their businesses. The bill was previously introduced in the 116th Congress and was at that time reported by the House FSC along party lines by a vote of 34-25; the Senate version received no activity (See H.R. 3623; S. 2075). The latest version of the bill was reported by the House FSC by a vote of 28-24.

Congressional findings included in the Casten bill would state, among other things, that near- to long-term climate change risks are a type of information companies should reasonably expect will alter investment decisions by shareholder and, thus, should be identified, evaluated, and disclosed on a regular basis. A sense of Congress contained in the bill, among other things, likewise would posit that climate change is a "significant and increasing threat" to U.S. economic growth and stability and that the SEC "has a duty to promote a risk-informed securities market." The term "climate change" would be defined consistent with the concept of the Anthropocene era to mean climate change resulting from human activity that alters the composition of the global atmosphere in addition to natural climate cycles. The SEC would have to adopt rules to implement the bill within two years of enactment, although, if the SEC failed to do so, companies could demonstrate compliance with the bill by following the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) of the Financial Stability Board as reported in June 2017.

With respect to the content of the SEC’s rulemaking, the bill would require the SEC to address: (1) rules for specialized industry sectors, including finance, insurance, transportation, electric power, mining, and non-renewable energy; (2) reporting standards for companies to estimate and disclose greenhouse gas emissions (GHG) emissions, including, if possible, disclosure about each GHG a company releases; (3) reporting standards for companies that own or manage fossil fuel-related assets with a disclosure of the percent of total assets that are fossil fuel related assets; and (4) standards for disclosing inputs and assumptions regarding climate scenario analyses, including present value discount rates and time frames, such as 5, 10, and 20 years.

The SEC’s rulemaking also would have to provide for companies to incorporate into their disclosures: (1) quantitative information to back up qualitative disclosures; (2) industry-specific metrics; (3) specific risk management actions; (4) a discussion of the short-, medium-, and long-term resilience of risk management strategies; and (5) the total cost of the company’s GHG emissions which, at a minimum, must incorporate the social cost of carbon.

Any qualitative or quantitative risk analysis statement disclosed must consider a baseline scenario of the physical impacts of climate change (i.e., a widely-recognized analysis in which GHG emissions raise the global average temperature by 1.5 degrees Celsius or more above pre-industrial levels), a 1.5 degrees scenario (i.e., a scenario in which GHG emissions are curbed so that global warming is limited to 1.5 degrees Celsius above pre-industrial levels), and other scenarios the SEC deems appropriate after consultation with federal government climate principals. For companies that engage in the commercial development of fossil fuels, additional detailed disclosures would be required.

Lastly, the SEC, after consulting with the climate principals, could require still more disclosures that are: (1) necessary; (2) appropriate to safeguard the public interest; or (3) directed at ensuring that investors have information consistent with the Congressional findings in the bill.

Other titles in the amended underlying bill include:

- ***Title* II—**Title II contains the Shareholder Political Transparency Act of 2021, sponsored by Rep. Bill Foster (D-Ill). This title would require quarterly and annual reporting by companies of their political donations. The SEC would have to adopt rules to implement the bill within 180 days of enactment. The bill has been previously introduced in various forms, but this time, with a Democrat White House and Congress, it is possible that an appropriations policy rider will be dropped from FY22 appropriations legislation thereby freeing the SEC to implement a political spending disclosure regime should Congress enact one. The Foster bill was reported out of committee by a vote of 28-23. Quarterly reports would be mandatory for any company with securities registered under Exchange Act Section 12. Specifically, such reports would have to disclose: (1) a description of expenditures on political activities in the prior quarter; (2) the date of each expenditure; (3) the amount of each expenditure; (4) if an expenditure was made to support/oppose a candidate, the name of the candidate, office sought, and the candidate's political party affiliation; and (5) the name of any trade association or other organization exempt under Internal Revenue Code Sections 501(a) and 501(c) which received dues that are or could be reasonably anticipated to be transferred to another association or organization for political expenditures or electioneering communications.
- ***Title* III—**Title III contains the Greater Accountability in Pay Act of 2021 (H.R. 1188), sponsored by Rep. Nidya Velazquez (D-NY). Under this title, the Exchange Act's reporting requirements would be amended to mandate that any company filing reports under the Exchange Act, and that is not an emerging growth company, disclose additional information about how much more money its executives are paid via pay raises versus other employees. The proposed disclosure would be similar to the pay ratio disclosure required under Dodd-Frank Act Section 953(b). The bill was previously introduced in the 116th Congress and was reported by the House FSC by a vote of 32-21 (See H.R. 4242). The latest version of the bill was reported by a vote of 29-23. Specifically, a company would have to disclose in its annual report the ratio of the percentage resulting from a comparison of the percentage increase in the median of the annual total compensation of all executive officers to the percentage increase in the median of the annual total compensation of all non-executive officer employees. Moreover, a company would have to compare the percentage increase in the median of the annual total compensation of all executive officers and the percentage increase in the median of the annual total compensation of all non-executive officer employees to the percentage change in the Consumer Price Index for the same period.
- ***Title* V—**Title V contains the Disclosure of Tax Havens and Off shoring Act (H.R. 3007), sponsored by Rep. Cynthia Axne (D-Iowa). Under this title, public companies with constituent entities located overseas would have to make disclosures about the taxes paid by those entities in their resident tax jurisdictions. The bill was previously introduced in the 116th Congress, where it and its Senate companion received no committee or floor action (See H.R. 5933; S. 1609). The latest version of the bill was reported by the House FSC by a vote of 28-23. Moreover, a company subject to the bill would have to disclose certain aggregated or consolidated information on its multiple constituent entities, including: (1) revenues from transactions with other constituent entities; (2) revenue not from transactions with other constituent entities; (3) profits and losses before income taxes; (4) total income tax paid on a cash basis in all tax jurisdictions; (5) stated capital; (6) total accumulated earnings; (7) total full time-equivalent employees; and (7) net book value of tangible assets (cash, intangible assets, and financial assets would be excluded). A company would report to the SEC on or before the tax due date in the tax jurisdiction in which the company's multinational enterprise group resides. The SEC would be required to propose implementing regulations within 270 days of enactment.

En bloc amendments. House FSC Chair Maxine Waters (D-Calif) offered a group of en bloc amendments that added five more titles to the underlying bill, plus an amendment to the Vargas bill (discussed above). Of these titles, the diversity and inclusion bill likely has the most bipartisan support, having gained the backing of some private sector groups for its emphasis on factors other than quotas. The en bloc amendments were adopted by a vote of 215-211. The numbering of the titles, as provided by the en bloc amendment, created multiple titles numbered "VI" but, for purposes of clarity, the following discussion will number the additional titles sequentially:

- ***Title* VI—**Title VI contains the Workforce Investment Disclosure Act of 2021, sponsored by Rep. Axne. Under this title, a public company would have to include in its annual reports information regarding: (1) workforce demographics; (2) workforce stability; (3) workforce composition, including data on diversity and inclusion; (4) workforce skills and capabilities; (5) workforce health, safety, and wellbeing; (6) workforce compensation and incentives; (7) workforce recruiting and needs; and (8) workforce engagement and productivity. The title would impose liability for the making of untrue statements or omissions but also provides for nonliability if a person had reasonable grounds to believe and did believe that a statement was accurate. The title bars private lawsuits. Moreover, the Commission could elect to exempt emerging growth companies from some, but not all, of the disclosure requirements. The title also would not apply to registered investment companies.
- ***Title* VII—**Title VII contains a bill addressing how public companies prevent and respond to workplace harassment, sponsored by Rep. Lois Frankel (D-Fla). This title would require a public company to disclose in its annual report the following regarding workplace harassment claims: (1) the number of settlements; (2) whether any judgments or awards were entered against the company and whether any payments were made in connection with a release of a claim; and (3) the total amount paid by the company or another party resulting from any settlements and judgments. A company also would have to disclose if it had been subjected to three or more settlements or judgments arising from workplace harassment claims. Previously, Congress had dealt with the issue of workplace harassment claims in the context of the Tax Cuts and Jobs Act which, in Section 13307, amended Code Section 162 to deny a deduction for any settlement or payment related to sexual harassment or sexual abuse if the settlement is subject to a non-disclosure agreement, or for attorney's fees related to the settlement.
- ***Title* VIII—**Title VIII contains the Cybersecurity Disclosure Act of 2021, sponsored by Rep. Jim Himes (D-Conn), which is similar to a bill he has introduced several times before (See H.R. 1731) and is a mirror image of the Senate version sponsored by Sen. Jack Reed (D-RI) (See S. 808). The title would require a public company to disclose if any board member has expertise or experience in cybersecurity. If no board member has such expertise or experience, the company must explain how it considers cybersecurity in selecting board nominees.
- ***Title* IX—**Title IX contains the Improving Corporate Governance Through Diversity Act of 2021 (H.R. 1277), sponsored by Rep. Gregory Meeks (D-NY). This title would mandate that public companies make disclosures about the racial, ethnic, gender, and veteran status of their directors, director nominees, and executives. A version of the bill passed the House in the 116th Congress by a vote of 281-135. The bill was the only one garnering significant bipartisan support on the House FSC when it was marked up earlier this year and reported by voice vote. Companies would have to disclose in a proxy statement: (1) data regarding the voluntary, self-identified racial, ethnic, and gender composition of the board of directors, board nominees, and executives; (2) the voluntary, self-identified status of directors, director nominees, and executives as veterans; and (3) whether the board or a board committee of the company has, as of the date of the disclosure, adopted any policy to promote racial, ethnic, and gender diversity among directors, director nominees, and executives. The bill also would require the director of the SEC's Office of Minority and Women Inclusion (OMWI), within three years of enactment, to publish best practices for complying with the disclosure requirement. The director may ask for public comments regarding best practices. Lastly, the bill would establish within the SEC the Diversity Advisory Group to study issues related to diversity and inclusion and report to the SEC and Congress on its recommendations for increasing gender, racial, and ethnic diversity among public company directors. The SEC also would have to report to Congress annually on the status of gender, racial, and ethnic diversity on public company boards.

- ***Title* X—**Title X contains the Uyghur Forced Labor Disclosure Act (H.R. 2072), sponsored by Rep. Jennifer Wexton (D-Va). This title would require public companies to disclose in their annual reports or proxy statements the following: (1) whether the company engages with an entity that imports certain manufactured goods or imports manufactured goods that contain materials that originated or are sourced in the Xinjiang Uyghur Autonomous Region (XUAR) (this provision would appear to require disclosure for goods, such as electronics, food products, textiles, shoes, and teas, that would be excepted from the SEC disclosure provision in a related sanctions bill); (2) whether goods and materials subject to the disclosure requirement originated in forced labor camps; and (3) a description of the commercial activity, gross revenues, and net profits regarding the goods or materials, and whether the company intends to continue importing the goods or materials. The SEC would have to adopt implementing regulations and post companies' disclosures on its website. The SEC also would have to report to Congress annually regarding its oversight of the regulation. Similarly, the GAO would have to periodically report on the SEC's implementation of the disclosure requirement. The underlying bill previously passed the House in the 116th Congress by a vote of 253-163. Numerous other bills dealing with the XUAR also have been reintroduced in the current Congress, including one bill with related securities law provisions (See, e.g., S. Res. 131; H. Res. 317; H.R. 3306; S. 65; H.R. 1155 (contains securities provisions); H.R. 1630).

Other amendments. Lawmakers proposed four additional amendments, only one of which was adopted, beyond the initial set of amendments to the underlying bill and the en bloc amendments offered later. An amendment offered by Rep. Kim Schrier (D-Wash) would require the SEC, in consultation with the SEC's Office of Small Business Capital Formation and the Office of the Investor Advocate, to conduct a study on the effect that ESG regulations have on small businesses. The Schrier amendment was adopted by a vote of 380-47.

Representative Stacey Plaskett (D-VI) offered an amendment that would have revised language contained in Title V of the underlying bill regarding tax haven disclosures. According to Rep. Plaskett, the definition of "tax jurisdiction" could be understood to treat U.S. territories separately from the United States. Chair Waters replied that that was not the intention of the underlying bill and that the definitions used were consistent with guidance developed during the Obama Administration for IRS country-by-country reporting of taxes. Chair Waters also emphasized that the underlying bill's language should not be understood to suggest that U.S. territories are tax havens. Chair Waters further pledged to work with Rep. Plaskett on future bill language, upon which pledge, Rep. Plaskett withdrew her amendment.

Two Republican amendments also received consideration. The first, offered by Rep. Michael Burgess (R-Texas), would have required companies to disclose the negative effects of tax increases along with the name of the president during whose term the tax increase became law. The Burgess amendment was rejected by a vote of 209-218. An amendment offered by Rep. Hill would have replaced the entire underlying bill with a study and report to be made by the SEC regarding ESG disclosure. The Hill amendment was rejected by a vote of 204-225.

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