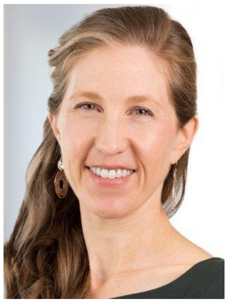
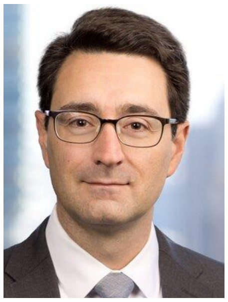
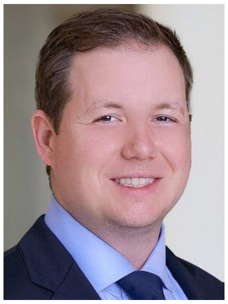
Portfolio Media. Inc. | 230 Park Avenue, 7th Floor | New York, NY 10169 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

The Ups And Downs Of SEC's Now-Dissolved ESG Task Force

By **Elizabeth Dawson, Jeffrey Severson and Ryne Duffy** (October 24, 2024, 5:06 PM EDT)


Elizabeth Dawson


Jeffrey Severson


Ryne Duffy

The U.S. Securities and Exchange Commission quietly dissolved its Climate and ESG Enforcement Task Force sometime over the summer.[1] The ESG Task Force was part of the SEC's broader push to increase investors' access to environmental, social and governance information about public companies, registered advisers and investment companies.

The dissolution of the ESG Task Force comes after three years of resistance from some stakeholders to ESG regulation, and a mixed record in the courts. While the ESG Task Force has been dissolved, the SEC is still pursuing a number of its proposed ESG and climate-related rules, and has continued to bring ESG and climate-related disclosure enforcement actions.

Launch of the ESG Task Force and Additional Regulation

The ESG Task Force was created in March 2021 under the leadership of acting SEC Chair Allison Herren Lee, with the goal of "develop[ing] initiatives to proactively identify ESG-related misconduct."[2]

The ESG Task Force initially included more than two dozen SEC staffers and was focused on identifying "material gaps or misstatements in issuers' disclosure of climate risks under existing rules."[3] Additionally, it set out to analyze "disclosure and compliance issues relating to investment advisers' and funds' ESG strategies."[4]

At the outset of his term, SEC Chair Gary Gensler indicated his support for the task force and stated his intention to prioritize enforcement actions involving misleading or inaccurate statements on climate and ESG issues.[5] While the ESG Task Force focused on enforcing existing regulations as applied to statements concerning climate or ESG, Gensler also worked with the staff to support a variety of new climate and ESG rules throughout his tenure.

Most notably, the SEC proposed and, in March, adopted the enhancement and standardization of climate-related disclosures for investors. This rule requires regulated issuers to disclose information regarding their greenhouse gas emissions and other climate-related information.

However, the rule was swiftly challenged in court by multiple states, as well as industry participants.[6] In response to these legal challenges, the SEC has voluntarily stayed the implementation of this rule as the consolidated challenge plays out in the U.S. Court of Appeals for the Eighth Circuit.

The SEC has faced additional delays in the related, but separate, rule regarding enhanced disclosures by certain investment advisers and investment companies about environmental, social and governance investment practices.[7] If adopted, the proposed enhanced ESG disclosure regulations would amend regulations under the Investment Advisers Act and the Investment Company Act to require investment advisers to disclose information such as the carbon footprint of a fund that advertises that such information is part of the fund's strategy.

The enhanced ESG disclosure rules were originally proposed in 2022, and a set of final rules on the Federal Register was scheduled for adoption in April 2024. However, the rules were not finalized and remain pending on the SEC's latest regulatory agenda for 2024.

While the SEC's climate-related disclosures and enhanced ESG disclosure regulations have not come into force, the agency has successfully adopted and implemented a number of other ESG-related rules during Gensler's term, such as the Nasdaq's corporate board diversity rule from 2021 and the 2023 amendments to the investment company names rule.[8]

The Nasdaq's corporate board diversity rule requires Nasdaq-listed companies to have, or publicly disclose why they do not have, at least two diverse directors, and publicly disclose board diversity statistics using a standardized format on an annual basis.[9] The rule was upheld by a three-judge panel of the U.S. Court of Appeals for the Fifth Circuit in October 2023, but the court's decision was subsequently appealed, and the Fifth Circuit heard oral arguments en banc in May 2024. The Fifth Circuit's decision on the rule is currently pending, and if upheld, will take effect in 2026.

In addition, a coalition of 22 state attorneys general on Oct. 3 challenged the rule by sending a letter to Nasdaq Chair Adena Friedman inquiring into the listing company's "commitment to ensuring federal and State anti-discrimination laws are followed."[10] Specifically, the letter asserted that the rule is an improper quota system, particularly in light of the U.S. Supreme Court's 2023 Students for Fair Admissions v. Harvard ruling that race-based admissions policies in universities are unconstitutional.

The names rule amendments are meant to promote "truth in advertising," according to Gensler. They require funds with names that reference a thematic investment focus — such as incorporation of ESG factors — or that suggest an investment portfolio with certain characteristics, such as "growth" or "value," to invest at least 80% of the value of their assets in those named focus areas.[11]

Significant ESG Task Force Actions

The ESG Task Force brought a number of significant enforcement actions involving public representations about the ESG practices of issuers and advisers.

One of the task force's largest actions was brought against Vale SA, a publicly traded Brazilian mining company. Vale had built a series of dams as part of its mining business and made statements in its sustainability reports assuring investors that Vale's dams were certified as stable. In 2019, Vale's Brumadinho dam collapsed, killing hundreds.

In 2022, the SEC brought an enforcement action alleging that Vale's statements about its dams were misleading because the dams had not met internationally recognized safety standards for years prior to the sustainability reports. In March 2023, the SEC and Vale reached a settlement including a $25 million civil penalty, as well as disgorgement and prejudgment interest of $30.9 million.

The task force also brought actions against registered investment advisers including Goldman Sachs Asset Management and DWS Investment Management Americas Inc.

From 2017 until 2022, Goldman Sachs advised a separately managed account strategy and two ESG mutual funds — the Goldman Sachs International Equity ESG Fund and the Goldman Sachs ESG Emerging Markets Equity Fund. Goldman Sachs publicly referenced its use of ESG factors when promoting its separately managed account strategy and ESG funds.

In its November 2022 enforcement action, the SEC alleged that Goldman Sachs failed to adopt and implement written policies and procedures governing how Goldman Sachs evaluated ESG factors as part of the investment process. Further, the SEC alleged that once Goldman Sachs adopted policies and procedures related to evaluating ESG, it failed to consistently follow its own procedures when selecting fund assets. To settle the action, Goldman Sachs agreed in November 2022 to pay a civil fine of $4 million.

In September 2023, the SEC brought a similar enforcement action against DWS, a subsidiary of Deutsche Bank. In its order, the SEC alleged that DWS made materially misleading statements about its use of ESG factors in developing research and investment recommendations for ESG investment products. It also alleged that DWS failed to implement its own ESG Integration Policy, and had failed to adopt policies and procedures to ensure that its public statements about ESG were accurate. DWS agreed to pay a $19 million civil penalty to settle the SEC's action.

Widespread Criticism of the SEC's ESG Efforts

The SEC's ESG Task Force and its ESG-related rulemaking agenda has faced widespread criticisms. Its rulemaking agenda has been hampered by extensive industry criticism, delays in the rulemaking procedure and challenges in court.[12]

These challenges are occurring concurrently with a broader set of challenges posed to the SEC's rulemaking authority by Supreme Court decisions from this past term limiting the deference given by courts to agency interpretations of federal statutes and expanding the ability of private litigants to challenge existing regulations, as seen in its Loper Bright Enterprises v. Raimondo ruling.[13] Additionally, the Supreme Court's recent SEC v. Jarkesy decision, also from this past term, has imposed further enforcement challenges by limiting the SEC's ability to use its in-house administrative law judges.[14]

While ESG rules have faced significant scrutiny, the ESG Task Force has remained focused on identifying material misstatements or omissions under existing SEC rules. And though the ESG Task Force's dissolution may be viewed as a concession to the anti-ESG constituency, it may also reflect the fact that SEC enforcement is, ultimately, subject-matter agnostic. That is, whether related to climate or not, a material misstatement is a material misstatement and will be enforced as such.

ESG Enforcement Priorities Going Forward

The dissolution of the task force comes at a time when the SEC has toned down its full-throated support of climate and ESG issues. In fact, prior to the task force's dissolution, the agency notably removed ESG issues from its annual Examination Priorities Report, which provides areas of particular focus during SEC examinations.[15]

While the SEC has publicly retreated from its focus on ESG issues, the agency has not abandoned ESG issues entirely. The previously mentioned names rule amendments came into force on Dec. 10, 2023, and provide the SEC with a new enforcement avenue against registered investment companies and their managers. The SEC is likely to pursue enforcement actions against registered investment companies with names that misleadingly suggest a focus on ESG investment strategies.

Additionally, the enhanced disclosures by certain investment advisers and investment companies about ESG investment practices rule remains on the SEC's rulemaking agenda.[16]

Despite dissolving the ESG Task Force, the SEC has also continued to pursue enforcement actions against issuers related to ESG claims made in securities filings.

For instance, on Sept. 10, the SEC announced a settlement with Keurig Dr. Pepper Inc. after the SEC charged Keurig with filing inaccurate annual reports, claiming that Keurig's statements regarding its tests validating that its K-Cups could be "effectively recycled," without any qualification, were incomplete and inaccurate because they did not disclose any of the negative feedback conveyed by two recycling companies about the K-Cups' recyclability.[17] The SEC concluded that Keurig's statements misled investors by omitting the fact that two of the largest recycling companies in the country had already informed Keurig that they would not accept K-cups for recycling at their facilities. Keurig agreed to pay a $1.5 million civil penalty.

The Keurig enforcement action demonstrates that despite disbanding its ESG Task Force, the SEC remains committed to ensuring that claims companies make regarding their sustainability and ESG achievements and goals are not misleading or false. Notably, the Keurig statements at the center of the SEC's enforcement action were made in the company's 2019 and 2020 annual reports, which serves as a reminder that public companies must not only be forward-looking when it comes to reviewing their filings.

The SEC's ongoing regulatory oversight, while no longer siloed in one task force, is also consistent with actions by governments in multiple other jurisdictions.[18] Thus, SEC-reporting companies need to carefully scrutinize and substantiate ESG and climate-related disclosures and claims, especially in their securities filings, including those outside the current or prior year. Similarly, when highlighting to customers their sustainability successes, companies need to ensure that their claims are carefully crafted and substantiated.

Elizabeth Dawson is a partner, Jeffrey Severson is counsel and Ryne Duffy is an associate at Crowell & Moring LLP.

Crowell & Moring associate Jessica Franzetti contributed to this article.

[1] https://news.bloomberglaw.com/daily-labor-report/sec-quietly-dissolves-climate-and-esg-enforcement-task-force.

[2] https://www.crowell.com/en/insights/client-alerts/sec-enforcement-warms-up-commission-creates-climate-and-esg-task-force

[3] SEC.gov | SEC Announces Enforcement Task Force Focused on Climate and ESG Issues.

[4] Id.

[5] https://www.govinfo.gov/content/pkg/CHRG-117hhrg44837/pdf/CHRG-117hhrg44837.pdf (Pg. *17-18).

[6] https://news.bloomberglaw.com/esg/sec-freezes-climate-rules-after-challengers-pushed-for-pause.

[7] https://www.crowell.com/en/insights/client-alerts/sec-proposes-rules-governing-esg-investment-disclosures.

[8] https://www.sec.gov/newsroom/speeches-statements/gensler-statement-nasdaq-proposal-disclosure-board-diversity-080621; https://www.crowell.com/en/insights/client-alerts/whats-in-a-name-a-lot-says-the-sec.

[9] https://www.sec.gov/newsroom/speeches-statements/gensler-statement-nasdaq-proposal-disclosure-board-diversity-080621.

[10] https://www.crowell.com/en/insights/client-alerts/state-ags-challenge-nasdaqs-diversity-disclosure-rule-as-discriminatory.

[11] https://www.crowell.com/en/insights/client-alerts/whats-in-a-name-a-lot-says-the-sec.

[12] See https://news.bloomberglaw.com/esg/sec-to-make-companies-reveal-their-pollution-without-scope-3; https://www.reuters.com/legal/conservatives-challenging-nasdaq-board-diversity-rule-appeal-full-5th-circuit-2023-10-25/.

[13] https://www.crowell.com/en/insights/client-alerts/the-supreme-courts-double-hammer-to-agencies-loper-bright-and-corner-post-set-new-precedents-for-challenging-federal-agency-action.

[14] See https://www.law360.com/articles/1803073/justices-limit-sec-s-use-of-in-house-courts.

[15] https://www.sec.gov/files/2024-exam-priorities.pdf.

[16]https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=4FB81865C27880600FC07EC015CDDBB339B64718C13D026BB30E0FB11231BEAB026F85C4E1172EE834D36EFA13F8A3DA506F.

[17] https://www.sec.gov/files/litigation/admin/2024/34-100983.pdf.

[18] See e.g., https://www.crowell.com/en/insights/client-alerts/preparing-for-cs3d-early-lessons-from-france; https://www.crowell.com/en/insights/client-alerts/green-claims-german-climate-neutral-product-case.