ALM | LAW.COM

New York Law Journal

Corporate Update

CORPORATE COMPLIANCE

2024 ESG Outlook: Key Trends To Follow

By Dave Curran and Madhuri Pavamani

February 8, 2024

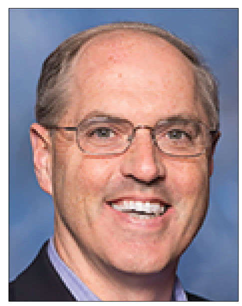
2023 was a noteworthy year in the environmental, social and governance (ESG) space. From rapid technology advances and regulatory shifts to developments affecting diversity, equity and inclusion (DEI) and the global political landscape, the past year saw significant changes to many factors that influence ESG strategies. And we expect the momentum to continue into 2024.

Given ESG's dynamic nature, it is particularly important that general counsel track changes and plan for potential impacts. This piece will cover key trends for companies to consider as they prepare for the year ahead, including developments related to the ESG regulatory space, DEI programs, artificial intelligence (AI) and supply chains.

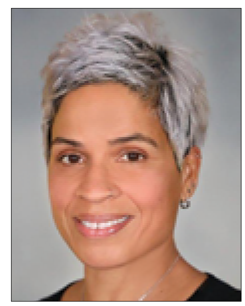
Regulatory Developments

The past year saw the ESG regulatory space experience near-constant shifts and changes, both in the U.S. and abroad. In the U.S., states such as California, Illinois, New York and Washington have begun to take action in the absence

DAVE CURRAN *is co-chair of the Sustainability and ESG Advisory Practice at Paul, Weiss, Rifkind, Wharton & Garrison and executive director of the ESG and Law Institute, a forum of solutions-oriented ESG intelligence. Madhuri Pavamani is the Sustainability & ESG Advisory Practice Director at Paul, Weiss and a Lecturer in Law at Columbia Law School.*



Dave Curran



Madhuri Pavamani

of a final SEC climate disclosure rule, potentially creating a patchwork of disclosure requirements, the likes of which we have not seen since the data privacy days of the 2010s. In October 2023, California passed its landmark Climate Accountability Package, requiring mandatory disclosures from U.S. companies doing business or operating in California. A few months later, it added a third act to the package—the Voluntary Carbon Markets Disclosure Act—intended to address greenwashing claims. Other states, like Illinois, New York and Washington, are considering similar disclosures. The SEC is expected to act on its proposed rule in April, although the final requirements, particularly regarding Scope 3 emissions reporting, remain to be seen.

The European Union (EU) has taken swifter action than the U.S., moving forward several regulations in 2023, including the Corporate Sustainability

Reporting Directive (CSRD), which became effective in January 2023. The CSRD requires companies to report on the impacts of corporate activities on the environment and society, including Scope 3 emissions. The EU also reached a provisional agreement on its Corporate Sustainability Due Diligence Directive (CSDDD), which will require entities to report on their environmental and human rights impacts, as well as take an extra step to provide a strategy for decreasing any negative environmental and human rights impacts a company might have.

Companies with global footprints—including those based in the U.S.—may fall under these broader EU regulations. Notably, should the U.S. adopt reporting regulations at the federal level, the rules may not meet the potentially stricter standards of the EU and other jurisdictions. As a result, it is critical for companies to keep track of the global, ESG-related, mandatory reporting regulations in jurisdictions where they operate and stay on top of developments in the ESG regulatory space more generally. Companies may want to consult with counsel to build frameworks to keep tabs on reporting requirements. AI tools, as described further below, may be particularly useful in staying up to date.

DEI Programs

The U.S. Supreme Court's June 2023 affirmative action decisions—*Students for Fair Admissions, Inc.* v. *President and Fellows of Harvard College* and *Students for Fair Admissions, Inc.* v. *University of North Carolina, et al.*—held that the consideration of race during the admissions processes at Harvard and UNC was unconstitutional. The decision immediately injected uncertainty into boardrooms as companies across the country worried about their continued efforts to develop and execute DEI policies, programs and goals. While the decision itself does not directly affect private corporations, litigants have already begun to bring actions in the private space, challenging various corporate DEI-related efforts.

Despite this uncertainty, it is important that companies continue to consider their DEI efforts. Indeed, the New York State Bar Association's (NYSBA) Task Force on Advancing Diversity states that organizations "need not—and should not—abandon their commitment to advance DEI within their organizations," especially given the myriad benefits of greater diversity. And as Paul, Weiss litigation partner Loretta Lynch recently noted, "you can see that companies who have greater diversity, particularly at the board level and at the senior executive level where decisions are made, do better. They do better financially, they do better in generating strong results for their shareholders." Companies may also consider assuring their employees that their commitment continues.

Should the U.S. adopt reporting regulations at the federal level, the rules may not meet the potentially stricter standards of the EU and other jurisdictions.

Now more than ever, it is critical that organizations engage knowledgeable counsel to assess the risk (if any) of their current DEI practices, policies, programs and goals, and develop a plan to move forward in a way that focuses on continuing to build out their DEI efforts while at the same time, mitigating risk. As the NYSBA's Task Force on Advancing Diversity notes, "it is prudent for companies to evaluate their DEI programs and initiatives to assess and mitigate any legal and reputational risks."

Artificial Intelligence

One of the hottest topics in 2023, AI is quickly becoming an essential tool for ESG governance. It is an invaluable means to review data to ensure compliance with ESG guidelines and regulations, to track and measure ESG progress, and to ensure company policies and procedures are aligned with publicly stated ESG goals. However, AI is experiencing such incredible growth—with new applications coming to the market nearly every day—that a significant risk exists for biases to be built into the tools themselves. This concern will only grow in 2024, as AI applications continue to evolve and new tools emerge even more quickly.

Consequently, while AI tools are valuable, they pose potential challenges in the ESG space, specifically in relation to data set biases, governance and reputational considerations; litigation concerns; environmental tradeoffs; and deal-related risks. Despite these challenges, companies are hesitant to move backward and forego the immense benefits of this modern technology. To address this conundrum, companies can develop strategies to evaluate their AI needs and chosen tools and make plans to mitigate risk. Some areas companies may consider include establishing an appropriate inventory of tools, designating an AI lead or committee responsible for the inventory and risk assessment process, and pressure-testing AI tools and monitoring them throughout their life cycle.

Supply Chains

Another facet of ESG that has seen increased scrutiny is supply chains, specifically in relation to forced labor. The U.S. government has increased its engagement on enforcement in this area, including through the passage of the Uyghur Forced Labor Prevention Act in 2021 to prevent goods mined, produced or manufactured with forced labor in China. Together with Japan, the U.S. recently launched the Task Force on the Promotion of Human Rights and International Labor Standards in Supply Chains. On a global level, the EU's previously-mentioned CSDDD will require companies to report on, and develop mitigation processes for, adverse human rights impacts, including forced labor and child labor, in their supply chains.

Additionally, following the global pandemic and in the face of rising and ongoing geopolitical tensions, wars and trade disruptions, companies are increasingly revisiting their supply chain resiliency, and assessing the suppliers and affiliations in their value chain to identify potential risks and ensure compliance with relevant regulations.

Consequently, while AI tools are valuable, they pose potential challenges in the ESG space, specifically in relation to data set biases, governance and reputational consideration.

The growing focus on supply chains raises the possibility of increased and changing regulations. As with the regulatory developments discussed earlier, it is critical that companies take an organized approach to tracking and understanding regulations in this space to ensure they are in compliance.

As areas intersecting with ESG continue to rapidly develop and evolve in 2024, companies will have to be nimble to stay abreast of important developments and continue to meet their ESG goals.