August 2024

Asset Management ESG Review

ROPES & GRAY

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Ropes & Gray closely monitors the rapidly evolving ESG landscape, helping asset managers and institutional investors navigate the dynamic ESG regulatory environment and keep on top of emerging ESG trends and industry best practices. This first edition *Asset Management ESG Review* provides an overview of significant ESG developments over the first half of 2024, and compiles related insights from Ropes & Gray attorneys, drawing on the full breadth of the firm's expertise. The following covers a broad range of recent ESG topics, including U.S. and non-U.S. regulatory developments, litigation matters, legislative initiatives, and industry and trade group news.

Rules Proposals/Updates

- **What's in a name? The use of ESG terms in fund names has become a key focus for regulators globally to mitigate the risk of greenwashing.**
  - **In the U.S., fund groups with net assets of $1 billion or more have until December 11, 2025 to comply with the SEC's changes to the Names Rule.** On September 20, 2023, the U.S. Securities and Exchange Commission (SEC) adopted changes to the Names Rule, Rule 35d-1 under the Investment Company Act of 1940 (the "1940 Act") (the "Final SEC Names Rule") and related form amendments. The Final SEC Names Rule, which went effective on December 11, 2023, broadens the scope of current Rule 35d-1's 80% investment policy requirement to apply to fund names that "include terms suggesting that the fund focuses in investments that have, or whose issuers have, particular characteristics." The Final SEC Names Rule defines "investment focus" to mean "a focus in a particular type of investment or investments, a particular industry or group of industries, particular countries or geographic regions, or investments that have, or whose issuers have, particular characteristics." As examples of terms that suggest an investment focus, the Final SEC Names Rule's illustrative parenthetical provides, "the terms 'growth' or 'value,' or terms indicating that the fund's investment decisions incorporate one or more environmental, social, or governance factors." (emphasis added) As such, the Final SEC Names Rule's requirement to adopt an 80% investment policy applies when a fund's name suggests an ESG investment focus, including names with terms indicating that the fund's investment decisions incorporate one or more ESG factors. Fund groups with net assets of $1 billion or more will have until December 11, 2025 to comply with the amendments, and fund groups with net assets of less than $1 billion will have until June 11, 2026 to comply.
  - Funds with third- and fourth-quarter fiscal year-ends that intend to change their 80% test ahead of an annual update may want to start thinking about formulating the test to provide appropriate notice to shareholders ahead of their filings.

- **In the European Union (EU), the European Securities and Markets Authority (ESMA) published its final guidelines on fund names using ESG or sustainability-related terms on May 14, 2024 (the "Final ESMA Names Rule").** The new guidance sets out requirements for fund managers using these terms in fund names with the aim of reducing greenwashing risks and to enhance investor protection from exaggerated or misleading sustainability claims.
  - While the two regimes have certain elements in common, the SEC/ESMA Names Rule Comparison table on the next page compares key aspects of the Final SEC Names Rule and the Final ESMA Names Rule to highlight both their differences and similarities.

- **SEC voluntarily stays Operating Company Climate Rules** On April 4, 2024, the SEC voluntarily stayed the climate disclosure rules applicable to operating companies (the "Operating Company Climate Rules") that it had adopted only a month earlier, in light of litigation challenging the rules being heard in the Court of Appeals for the Eighth Circuit. While the stay of the Operating Company Climate Rules has direct effects and takeaways for operating company registrants, the Operating Company Climate Rules have also been followed closely by asset managers, in part because the SEC's proposed rule and form amendments under both the Investment Advisers Act of 1940 (the "Advisers Act") and the 1940 Act to require registered investment advisers, registered investment companies and business development companies to disclose additional information about their ESG investment practices (the "Proposed Fund/Adviser ESG Rules") would rely in part on data generated by the Operating Company Climate Rules. At a first glance, one might think that the stay of the Operating Company Climate Rules may indicate that the Proposed Fund/Adviser ESG Rules should also be stayed, given that a significant data source for funds and advisers to use in compliance with the Proposed Fund/Adviser ESG Rules is presently unavailable. It is not clear, however, that the stay of the Operating Company Climate Rules will have any effect on the substance or timeline of the adoption of the Proposed Fund/Adviser ESG Rules.
  - Given the political controversy associated with the Operating Company Climate Rules preceding their adoption, the SEC's stay of those rules is far more likely to reflect a procedural/litigation strategy rather than an indication that the SEC was caught by surprise by the challenges to the rulemaking.
  - The climate-data component of the Proposed Fund/Adviser ESG Rules is a relatively small component of the rulemaking. The rest of the Fund/Adviser ESG Rules proposal could stand on its own terms, and even for the carbon-related reporting by funds or asset managers,

Final SEC/ESMA Names Rule Comparison

	Final SEC Names Rule	Final ESMA Names Rule
Scope	Registered investment companies and BDCs	UCITS management companies (including any UCITS which has not designated a management company), Alternative Investment Fund Managers including internally managed AIFs, EuVECA, EuSEF and ELTIF and MMFs managers. While not completely clear, it is likely the rules will apply to non-EU as well as EU managers.
80% Threshold	A fund with a name suggesting that the fund focuses its investments in investments that have, or whose issuers have, particular characteristics (e.g., a name with terms such as “growth” or “value,” or terms indicating that the fund’s investment decisions incorporate one or more ESG factors) must adopt a policy to invest, under normal circumstances, at least 80% of the value of the fund’s assets in accordance with the investment focus that the fund’s name suggests.	Funds using transition-, social-, governance-, environmental-, impact- and sustainability-related terms (terms which derive or give similar impressions as the above will be caught) should meet an 80% threshold linked to the proportion of investments used to meet environmental or social characteristic or sustainable investment objectives in accordance with the binding elements of the investment strategy. Funds with sustainability-related terms in their name must also invest meaningfully in SFDR-aligned sustainable investments.
Excluded Investments	Funds may not use their remaining 20% baskets to invest in assets that are materially inconsistent with the investment focus or risk profile reflected by the fund’s name.	Funds using transition-, social- and governance-related terms should apply the exclusions for the EU Climate Transition Benchmark (CTB). Funds using sustainable-, environmental- or impact-related terms should apply the exclusions for the EU Paris-aligned Benchmark (PAB).
Multiple Terms	When a fund’s name includes terms suggesting an investment focus with multiple elements, the fund’s 80% investment policy must address all elements in the name. A fund can take a reasonable approach in specifying how the fund’s investments will incorporate each element. For instance, “XYZ Technology and Growth Fund” could have an investment policy that provides that each security included in the 80% basket must be in both the technology sector and meet the fund’s growth criteria. Alternatively, the policy could provide that 80% of the value of the fund’s assets will be invested in a mix of technology investments and growth investments.	Funds which combine ESG-related terms such as “sustainable” and “environmental” within its name should apply the guidelines cumulatively (except for funds with “transitional” terms, for which only the CTB exclusions apply).
Definitions	Funds must summarize the definitions of the terms used in the fund’s name, including the specific criteria the fund uses to select the investments the term describes, if any. Definitions must be consistent with plain English or established industry use.	The ESMA Names Rule provides definitions of “transition,” “environmental,” “social,” “governance,” “impact,” and “sustainability.”
Timing	Fund groups with net assets of $1 billion or more will have until December 11, 2025 to comply with the amendments, and fund groups with net assets of less than $1 billion will have until June 11, 2026 to comply.	The rules apply 3 months from the date translated into the official languages of the EU, with an additional 6-month transitional period for existing funds. The lack of grandfathering provisions will present issues for existing funds.

the SEC could either stay that component of an adopted rulemaking and/or require reporting based on other sources.

- For politically controversial rulemakings such as the Proposed Fund/Adviser ESG Rules, the SEC must consider the Congressional Review Act "deadline" by which regulations must be submitted to Congress so as to not be eligible for repeal by resolution of a subsequent Congress. The Congressional Review Act and its implications for the Proposed Fund/Adviser ESG Rules and other ESG-related rulemaking are discussed in further detail below.

- The SEC's recently released Regulatory Flexibility Agenda indicates that the SEC intends to adopt the Proposed Fund/Adviser ESG Rules by October 2024.

- **The Congressional Review Act and how it may impact the SEC's timeline for ESG-related rulemaking** – Following the 2024 U.S. presidential election in November, members of the U.S. Congress may look to unwind certain recently adopted rules from federal agencies, including by the SEC. A number of the SEC's more controversial rules, including the Operating Company Climate Rules and, if adopted, the Proposed Fund/Adviser ESG Disclosure Rules, are likely targets. The following explores the primary mechanism that allows Congress to overturn such federal agency rules—the Congressional Review Act (CRA)—and what it may mean for the SEC's ESG-related rulemaking.

  - ***Background on the CRA.*** The CRA allows either the House or Senate to introduce a joint resolution of Congress to disapprove a final rule of an agency. Once introduced, only a simple majority vote in both chambers of Congress is required for passage. If a CRA resolution passes out of each chamber of Congress, the resolution goes to the president's desk for signature, and may be either signed into law or vetoed. If vetoed, the CRA resolution can override a presidential veto only with a two-thirds vote of each chamber. No CRA resolution has ever overridden a presidential veto. As a practical matter, successful use of the CRA has typically required a "sweep" election where the presidency changes over and both the House and Senate are held by the same party as the incoming president. If enacted into law, a CRA resolution not only rescinds the rule/guidance in question but also prohibits a federal agency from "reissuing" the same regulation in the future or issuing in the future a regulation that is "substantially similar" to the rescinded rule/guidance.

  - ***The "Lookback Period."*** The disapproval timeframe to submit and act on a CRA resolution is generally 60 "working days" from the later of (a) the time the rule is submitted to Congress or (b) the rule is published in the Federal Register. If Congress adjourns its annual session within the 60 day period of a given rule, such as following a presidential election, (1) the period to submit and act on a disapproval resolution resets in its entirety in the next session of Congress, with the period beginning in each chamber on the 15th day of session in each chamber and (2) Congress will "lookback" to determine the date of the 60th working day prior to the annual adjournment (the "CRA deadline"). In order to avoid being subject to the CRA, federal agency rules must have been submitted to Congress and published in the Federal Register prior to the CRA deadline.

- ***Estimated CRA deadline for the 118th Congress.*** Given that the deadlines are determined based on when Congress adjourns, it is not possible to say with certainty ex ante when the CRA deadline for any given year/session of Congress would be. That said, the expected CRA deadline for the 118th Congress is approximately the first week of August 2024. While certain CRA deadlines have been as early as early May, the early-August 2024 estimate is driven by the fact that neither the House nor the Senate can adjourn more than three days without the consent of the other body. Senate Democrats have an incentive to force the Republican House into pro forma session over recess weeks in order to defer the CRA deadline, and presumably they will do so. The early-August 2024 deadline results from an assumption that the House is forced into the pro forma session during session weeks, and the House does the bare minimum of pro forma days in order to push back the CRA deadline as far as it can. As the Proposed Fund/Adviser ESG Rules have not been adopted ahead of this anticipated deadline, it is possible such rules may be subject to a CRA resolution in 2025.

- **Registered funds and Form 13F filers to file first reports on amended Form N-PX by August 31, 2024** – On November 2, 2022, the SEC issued a release containing rule and form amendments that, among other things, amended Form N-PX to significantly enhance and make readily accessible already-public disclosure of registered funds' proxy voting (the "Form N-PX Amendments"). Portions of the Form N-PX Amendments require registered funds to categorize the subject matter of each reported proxy voting matter using a specified list of categories. In addition to topics that may readily come to mind (e.g., board of directors, shareholder rights and defenses, extraordinary transactions), the categories include various ESG topics. The following are examples of categories in amended Form N-PX:

  - Corporate governance (examples: term limits, board committee issues, size of board, articles of incorporation or bylaws, codes of ethics, approval to adjourn, acceptance of minutes, proxy access);

  - Environment or climate (examples: greenhouse gas [GHG] emissions, transition planning or reporting, biodiversity or ecosystem risk, chemical footprint, renewable energy or energy efficiency, water issues, waste or pollution, deforestation or land use, say-on-climate, environmental justice);

  - Human rights or human capital/workforce (examples: workforce-related mandatory arbitration, supply chain exposure to human rights risks, outsourcing or offshoring, workplace sexual harassment);

  - Diversity, equity and inclusion (examples: board diversity, pay gap); and
  - Other social issues (examples: lobbying, political or charitable activities, data privacy, responsible tax policies, consumer protection).

- The Form N-PX Amendments went effective July 1, 2024. Funds will be required to file their first reports on amended Form N-PX by August 31, 2024, with these reports covering the period July 1, 2023 to June 30, 2024. For further discussion of the Form N-PX Amendments, including the requirement that each Form 13F filer annually report on Form N-PX how it voted proxies concerning "say-on-pay votes," see our Insights post.

- **SFDR: Where are we?: The future and shape of SFDR remains unclear and while we are unlikely to see responses to the SFDR 2 consultation until later this year, on June 18, 2024, three European Supervisory Authorities (ESAs) published a joint opinion (the "Opinion") regarding their assessment of the Sustainable Finance Disclosure Regulation (SFDR).** While not binding, the Opinion is an indication of the direction that a revamped SFDR II could take. Among other recommendations, the Opinion suggested that the European Commission (the "Commission") consider the introduction of a product classification system based on regulatory categories and/or sustainability indicators to help consumers navigate the selection of green products. The Opinion encouraged simple categories with clear objective criteria, such as "sustainability" and "transition." To qualify for the "sustainability" label in particular, products would need to meet a minimum sustainability threshold based on investments in economic activities that are aligned with the European Union's classification system that establishes clear definitions of what is an environmentally sustainable economic activity (the "EU Taxonomy"). This would increase the bar considerably for funds that currently make sustainable investments, which do not need to be EU Taxonomy-aligned. Having just two categories could mean that existing Article 8 light-green funds would no longer qualify for a sustainability label under SFDR. Products that do not qualify for a label would be split into those with sustainability features and those without. The Opinion further recommended the development and implementation of a sustainability indicator, such as a graded scale, for all financial products covering environmental sustainability, social sustainability, or both. While the ESAs' opinion may not be accepted by the Commission, we expect more clarity on the direction SFDR II is taking over the coming months. Please see our Viewpoints post for further insights into possible SFDR changes.

State Law Activity Update

- ***ESG-related legislation has slowed but activity has not.*** Compared to the onslaught of ESG-related bills proposed in 2023, a relatively small number of states have proposed ESG-related legislation in the first half of 2024. However, several states that passed ESG-related laws in the last two years are now in implementation mode, grappling with how to apply the new ESG-related laws in their various asset management relationships. As a result, managers of state assets can expect to see an increase in requests from states for side letters and certifications. For a broad overview of ESG lawmaking at the state level in 2024 along with a detailed comparison of this year's activity to the level of activity over the last two years, please see our Alert on the topic.

- ***Anti-Boycott Legislation 2.0*** – In 2022 and 2023, several red states enacted anti-ESG legislation requiring companies, including financial institutions, that do business with the state (such as banks managing state pension system funds) to affirm that they do not and will not boycott energy companies—otherwise, the state will place the financial institution on a restricted list. In the first half of 2024, we've seen an updated approach to anti-boycott legislation. In this new approach, some states have removed the requirement to maintain a list of boycotters of the applicable asset classes or industries. As a result, boycotting rules apply not only to those on a restricted list, but potentially to any manager of state assets. Managers who were otherwise not included on a restricted list may be at increased risk of having their behavior and statements put under a microscope. For example, in March 2024, Idaho adopted legislation that prohibits public entities from entering into a contract with a company for goods or services unless the contract contains a written certification from the company that it is not currently engaged in, and will not for the duration of the contract engage in, a boycott of any individual or company because the individual or company (a) engages in or supports the exploration, production, utilization, transportation, sale, or manufacture of fossil fuel-based energy, timber, minerals, hydroelectric power, nuclear energy, or agriculture; or (b) engages in or supports the manufacture, distribution, sale, or use of firearms. For up-to-the-minutes updates on pro- and anti-ESG rules impacting investment manager, please visit our award-winning interactive State ESG Regulatory Tracker.

- ***Oklahoma Court Blocks Boycott Statute:*** In a May 7 ruling, an Oklahoma state court judge granted a temporary injunction blocking enforcement of the Oklahoma Energy Discrimination Act of 2022. The statute prohibits the state's public retirement plans from investing in companies that "boycott" fossil fuel producers. Under the law, the state treasurer is charged with compiling a list of companies believed to be engaged in boycotting (as broadly defined in the legislation), while any financial institution doing business with the state must verify in writing that it does not and will not boycott energy companies. The court was persuaded by the taxpayer's argument that, because the law's stated purpose is to counter the "political agenda" of asset managers and assist the oil and gas sector, the statute violates the state constitution's requirement that public pensions be managed for the sole purpose of benefitting retirees. As a formal matter, the May 7 court decision applies only to the Oklahoma statute, finding that it likely violates specific provisions of the Oklahoma constitution. That said, the principles animating the court's reasoning should resonate broadly, including in

other states with similar statutes, all of which have similar fiduciary requirements for pension investments. Many of these statutes are vulnerable to the same critique—that using pension assets as a political tool for the supposed "protection" of particular industries runs afoul of state law mandates that pensions must be managed solely in the interest of retirees.

- ***State ESG legislation and the U.S. presidential election.*** Regardless of the outcome of the U.S. presidential election in November 2024, we expect to continue to see an anti-ESG push from red states. If Vice President Harris wins, we expect to see an uptick in anti-ESG legislation from red states in opposition to the administration. If former President Trump wins, we will likely see a return to anti-ESG "pecuniary factors" promulgated under the Trump administration. In October 2020, the U.S. Department of Labor (DOL) released a final rule which provided that an ERISA fiduciary's evaluation of an investment must be based only on pecuniary factors. This rule was superseded in December 2022 by a DOL final rule that permits ESG factors to be considered in making plan investments. We expect that under a second Trump administration, red states will likely look to align state legislation with the prior administration's "pecuniary factors" test.

- ***California Amendments to Venture Capital Diversity Reporting Law Provide Some Respite on Scope of Impacted Funds and Reporting Deadline.*** On June 29, 2024, Governor Newsom signed into law amendments to a recently adopted California law intended to provide transparency with respect to founder diversity in "venture capital investments" made by "venture capital companies" meeting certain criteria (such law, the "VC Diversity Reporting Law"). These amendments, among other things, (i) with respect to funds, reduce the scope of the law to funds that are more traditional venture capital funds and (ii) extend the first date for reporting diversity metrics to the State of California from March 1, 2025 to April 1, 2026. The amendments generally retained the substance of the law's original reporting requirements, and in-scope funds still must wait for administrative action in the form of a designated survey before they can gather required information under the law. Notably, violations of the law could result in an order requiring the payment of monetary penalties.

  - Covered Entities Under the Law. VCCs meeting two criteria—one focused on the VCC's business and the other on a California nexus—are rendered "covered entities" subject to the VC Diversity Reporting Law. Under the original law, the business criterion was triggered if the VCC met one of two prongs: (i) primarily engaging in the business of investing in, or providing financing to, startup, early-stage, or emerging growth companies or (ii) managing assets on behalf of third-party investors. The second prong implicated all VCCs managing assets on behalf of third-party investors, irrespective of whether those VCCs were investors in traditional venture capital companies—the type of investors on which the law was intended to shed light. The amended law, however, has removed this overly broad second prong, which means that a VCC will only be a "covered entity" and subject to the law if the VCC "primarily" engages in the business of investing in, or providing financing to, startup, early-stage, or emerging growth companies, and has a California nexus. "Startup," "early-stage" and "emerging growth" are not defined terms under the law. The California nexus prong is broad and was untouched by the July amendments.

  - Reporting Dates. In addition to narrowing the scope of the entities required to comply with the law, the amendments revise some reporting requirements under the law, including, importantly, giving covered entities an additional year (until April 1, 2026) to report to the State of California specified information. Accordingly, covered entities must attempt to collect the required information with respect to in-scope companies in which they make investments from January 1, 2025. Adding a new requirement, commencing March 1, 2026, the amended law also requires covered entities to report and maintain as current their name and contact information to the California Department of Financial Protection and Innovation (the DFPI).

- We anticipate these amendments to the VC Diversity Reporting Law to be welcome news to many managers because they reduce the number of funds that are within reach of the law and extend the first reporting date for in-scope investments. However, this law remains an additional compliance burden for those managers that have funds that are "covered entities" and requires disclosure of some sensitive information, which some managers may find troubling. While there is now more lead time to prepare for compliance with this law, a few steps managers can take now to prepare for the first report include (i) identifying which of its funds, if any, would be covered entities under the law, (ii) considering the investment pipeline of covered entities in 2025 to determine which are "venture capital investments" under the law; and (iii) assessing internal compliance functions to gather and report the required information with respect to venture capital investments made in 2025 once the prescribed survey is made available by the DFPI. For our previous alert on this topic, please visit California's New Law to Increase Transparency of Founder Diversity in Investments by Venture Capital Companies.

Litigation Update

- **Anti-ESG Legal Theory Spotlight: Fiduciary duty claims and *Spence v. American Airlines, Inc.***

  - In the tidal wave of anti-ESG litigation launched against employer-sponsored benefit plans over the last two years, some plaintiffs have relied on the assertion that asset managers and pension officials breach their fiduciary duties by considering ESG factors in investing. Plaintiffs argue that, according to the duty of loyalty, a fiduciary's sole objective must be maximizing client's financial returns and that other objectives reflect inappropriate mixed motives. For instance, joining pro-ESG initiatives reflects a manager or pension official's mixed motives, even if the

manager offers non-ESG products. Plaintiffs additionally argue that because there is no reasonable basis to believe ESG investing maximizes financial returns because underlying assumptions are factually unsupported, sponsors who incorporate ESG factors into their investment making decisions breach their duty of care.

- The plaintiff in *Spence v. American Airlines, Inc.* relied on similar claims that plan fiduciaries at American Airlines breached their duties of prudence and loyalty merely by offering funds managed by advisers that engage with companies on ESG-related issues and on occasion vote proxies in support of ESG-related proposals. As American spelled out in its motion to dismiss, the complaint did not allege any facts about how the plans' investment products actually performed, and therefore there was no plausible basis to conclude that participants were harmed in any way or that it was imprudent to make those investments available. The plaintiffs also failed to establish benchmark investments for comparison purposes, which is normally a key part of any claim that a plan fiduciary acted imprudently. Nevertheless, Judge O'Connor of the Northern District of Texas has allowed the case to proceed, denying American's motion to dismiss and later its motion for summary judgment. This conclusion turns a blind eye not only to the established standards for what is required for a viable pleading, but also to another recent decision of the same district court acknowledging that ESG considerations further financial goals.
- As of the date of this newsletter, we are awaiting Judge O'Connor's decision in the bench trial that was held June 24–27, 2024. If Judge O'Connor finds a breach of fiduciary duty on the basis of how a manager votes its proxies and without regard to its incorporation of ESG principals in how it manages assets, it could cause a great deal of consternation across the industry. In the event that Judge O'Connor finds in favor of the plaintiff, appeals would be heard in the conservative Fifth Circuit Court of Appeals.

- ***NYC Pension Plan Suit is Thrown Out:*** Last year, NYC pension plan participants, sponsored by conservative anti-union organization Americans for Fair Treatment (AFFT), filed a case in New York State court challenging the decision by the trustees of the NYC pension plan to divest from most of their fossil fuel holdings. On July 3, the New York trial court granted the pension plans' motion to dismiss the litigation. The court agreed with the city's argument that the plan participant plaintiffs have no legal standing to challenge the divestment decision, because the plans are "defined benefit" pensions. While the city's pension obligations are funded in the first instance by the plans' investment portfolios, the retirees' benefits are ultimately backstopped by city taxpayers in the event the investments fall short. Therefore, the plaintiffs' pension benefits will by definition not be affected by the fossil fuel divestment decision or the outcome of the litigation, so the plaintiffs could show no alleged injury as is required to have standing to assert claims. The court's reasoning is directly in line with a 2020 U.S. Supreme Court ruling, which reached the same conclusion in rejecting breach of fiduciary duty claims asserted by defined benefit plan participants under ERISA (the fiduciary duties at issue were very similar to those applicable under New York law). The plaintiffs here were unable to convince the state court that a different result should apply under New York law.

- The defense victory is on solid legal footing and was no doubt welcomed by NYC pension officials. While an appeal is likely, it would seem an uphill struggle for plaintiffs to overturn this decision, especially in light of the helpful Supreme Court precedent in the analogous ERISA setting. However, because the case was decided on procedural standing grounds, the court was not required to address the underlying merits of the plaintiffs' claims. This means that the Republican anti-ESG fiduciary duty theory still remains untested in court.

- ***Assessing the impact of* Loper Bright, Jarkesy, *and* Corner Post *on the SEC's rulemaking authority.***
  - ***Jarkesy:*** On June 27, 2024, the Supreme Court issued a ruling in *Securities and Exchange Commission v. Jarkesy*, U.S. No. 22-859 (2024). In a 6-3 decision, split along ideological lines, the Court stripped the SEC of its authority to initiate adjudicatory proceedings when it seeks to enforce civil penalties (i.e., a monetary fine) for securities fraud. Instead, such an action must be decided in an Article III federal court with the defendant being provided the right to a jury trial. The Court reasoned that the SEC's enforcement action against *Jarkesy* bore a "close relationship" to a suit for fraud at common law, even while acknowledging some differences between federal securities fraud and common law fraud. The two actions were sufficiently similar that the Seventh Amendment's jury trial protections applied.
  - *Jarkesy* is not likely to have a great impact on the SEC itself because the SEC was already moving toward utilizing federal courts. In part, this was a response to prior constitutional challenges against the SEC's administrative proceedings. When it comes to fraud especially, the SEC was already much more likely to bring such cases in federal court than through an administrative proceeding. We note that if the SEC were to bring a greenwashing claim against an asset manager and the manager fought the claim, it would probably be helpful to the manager that the SEC would be forced to sue in court instead of initiating administrative proceeding. However, we note that large asset managers have significant incentives to settle disputes with the SEC out of court and are therefore unlikely to pursue this option. Asset managers will generally try to stay in the good graces of the SEC, which, as the regulator of the asset management industry, is responsible for approving new products. Additionally, asset managers are aware that their customer base does not want to see their service providers crossing swords with the SEC. Consequently, *Jarkesy* seems not likely to lead to a fundamental change in the SEC's own enforcement approach.
  - ***Loper Bright:*** On June 28, 2024, the Supreme Court issued a ruling in *Loper Bright Enterprises v. Raimondo*, No. 22-451(2024). In a major decision on federal agency

power, the Court ruled 6-3, again along ideological lines, to overturn *Chevron v. National Resources Defense Council*, 467 U.S. 837 (1984). The longstanding *Chevron* doctrine required courts to defer to agencies' construction of ambiguous statutes, even as to the scope of those agencies' authorities, so long as the agency's construction of the ambiguous statute was reasonable and thus a "permissible" one. Relying on Section 10(c) of the Administrative Procedure Act (APA) as the definitive authority for this principle in the administrative law context, the *Loper Bright* Court emphasized that "the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action" (emphasis added). Administrative Procedure Act § 10(c), 5 U.S.C. § 706. The majority reasoned that this directive from the APA cannot be squared with *Chevron* deference and its presumption that statutory ambiguities delegate to agencies the authority to determine what the statute says. The Chief Justice argued that courts—not agencies—have the expertise and legal judgment to resolve statutory ambiguities.

- While *Loper Bright* may further embolden litigants to challenge agencies' adverse constructions of statutes, commentators, practitioners, and some appellate courts already had noticed the Supreme Court's move away from *Chevron* over the past eight years. As a result, the SEC has largely stopped relying upon it, which suggests that its reversal may have a more limited practical effect with respect to challenges to the SEC's regulatory determinations (e.g., challenges to rulemakings such as the Proposed Fund/Adviser ESG Rules).

- **Corner Post:** On July 1, 2024, in *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, No. 22-1008 (2024), the Court contended with the question of what the statute of limitations is for an action brought under the APA. Challenges under APA are subject to the general federal statute of limitations of six years from when the cause of action arose, and many courts had held that for a challenge to a regulation, the cause of action arises when the agency action is final (typically when a regulation is adopted and published). In *Corner Post*, the Court significantly extended the time within which a regulation is subject to challenge under the APA, holding that a cause of action with respect to a regulation, such as the Final SEC Names Rule, accrues under the APA when the plaintiff is injured by the regulation and therefore has a right to assert the claim in court. *Corner Post* will have the effect of allowing a new entrant to the industry to bring a challenge against a regulation that was adopted more than six years earlier.

SEC Examination Trends

- ***Examinations:*** For the last three years, ESG and related concerns about greenwashing have been a significant focus of the SEC Division of Examinations (the "Examinations Division"). As a result, a number of registered funds and their advisers experienced examination "sweeps" focused on ESG-related matters in addition to the inclusion of ESG-related requests in routine exams. When the Examination Division published its [2024 Examination Priorities](), however, it signaled a shift in focus, leaving ESG off the list for the first time since 2021. As anticipated, we have seen fewer ESG-specific requests from the Examinations Division since they announced their 2024 exam priorities. For instance, in the last dozen or so routine examinations we've encountered, none has included ESG-related requests—even for funds that are ESG-focused on their face. We note, however, that should the Examination Division discover an ESG-related issue in the course of a routine examination, they will not turn a blind eye.

- ***Enforcement:*** Although the last time the SEC charged an investment adviser over alleged misstatements regarding its ESG investment process was in September 2023, we are aware that ESG-related investigations by the SEC Division of Enforcement (the "Enforcement Division") are still ongoing. As such, it appears that ESG is still a focus of the Enforcement Division.

- As noted above, the [SEC's Spring 2024 Regulatory Flexibility Agenda]() indicates that the SEC intends to adopt the Proposed Fund/Adviser ESG Rules by October 2024. As there is generally enhanced scrutiny any time enhanced disclosure requirements are adopted, we expect to see an uptick in enforcement action when final Fund/Adviser ESG Rules are adopted.

Congressional Update

- **ESG and Antitrust: A Split Judiciary Committee**

  - Congressional Republicans and Democrats recently released dueling reports regarding whether the coordination of engagement with operating companies on ESG issues by groups like CA 100+, the Net Zero Asset Managers (NZAM) initiative, blue state pension funds, environmental non-profit organizations, large asset managers and proxy advisors violates antitrust law. With Republicans and Democrats coming out on opposite sides of the issue, the two reports highlight the continued politicization of ESG issues.

  - Republican members of the U.S. House Judiciary Committee (the "Committee") released an interim staff report on June 11, 2024, titled "Climate Control: Exposing the Decarbonization Collusion in Environmental, Social and Governance (ESG) Investing" (the "Majority Report"), which purports to summarize an investigation into apparent collusion between left-wing activists, financial institutions, non-profit organizations, and proxy advisors, among others, to impose radical ESG goals upon American companies. The authors of the Majority Report claim that a "climate cartel" has colluded to force American companies to both reduce and disclose their carbon emissions, causing American households and businesses to pay

more for gas and fuel. The Majority Report points to tactics employed by pro-ESG actors, such as CA 100+, including negotiating with corporate management and replacing corporate directors, as evidence of anticompetitive behavior. The Majority Report represents one of a number of efforts by the Committee to uncover evidence that financial institutions are colluding with climate activists through initiatives like CA 100+, potentially in violation of U.S. antitrust law. Republican members of the Committee first sent letters to the heads of four major asset managers in July 2023 calling on them to explain corporate ESG efforts that they claim could violate antitrust laws. On July 30, 2024, the Committee chairman Jim Jordan (R-OH) and Thomas Massie (R-KY), chairman of the Subcommittee on the Administrative State, Regulatory Reform, and Antitrust, sent letters demanding information from more than 130 U.S.-based companies, retirement systems, and government pension programs about their involvement with CA 100+.

- Democratic members of the Committee released a rebuttal report titled, "Unsustainable and Unoriginal: How the Republicans Borrowed a Bogus Antitrust Theory to Protect Big Oil" (the "Minority Report") on the same day. The authors of the Minority Report argue that ESG strategies reflect investors' basic judgment that ESG issues can have a material impact on the long-term value of their investments. The Democrats note that when climate-related events such as extreme weather pose a significant risk to corporations' assets, it's unsurprising that investors have undertaken initiatives to better understand how the companies whose securities they own have incorporated climate-related risk into their decision-making. The Minority Report also criticizes the legal claim underlying the Republican's argument that investor-led ESG initiatives violate Section 1 of the Sherman Act, which prohibits anticompetitive agreements in restraint of trade. The Minority Report notes that the parties to the investigation have not entered into agreements that could be subject to antitrust liability and that, even if evidence were sufficient to show an agreement, such an agreement would be subject to a "rule of reason" analysis, which would weigh the effect of the agreement against a number of factors including the facts and circumstances of the industry, the nature of the restraint and its effects, and the history of and context for the restraint.

- **State of play in the Climate Action 100+ membership initiative**

  - A number of large asset managers have exited or reduced their commitment to Climate Action 100+, an institutional investor-led initiative designed to encourage the world's largest corporate greenhouse gas emitters to take action on climate change in order to mitigate financial risk and to maximize the long-term value of assets. Investors who sign on to the initiative agree to its goals and to participate directly in Climate Action 100+ engagements with certain target companies.

  - When asked about the decision to exit the initiative, managers tended to emphasize that they are not changing course with respect to the goals of the initiative, but rather, prefer to take a customized, internal approach to engagement with operating companies on decarbonization. For instance, Invesco said in a statement that it had "decided to withdraw from the Climate Action 100+ initiative as we believe our clients' interests in this area are better served through our existing investor-led and client-centric issuer engagement approach."

  - The decision of large asset managers to exit the initiative seems to coincide with the implementation of Phase 2 of the Climate Action 100+, which would have members put additional pressure on focus companies to cut their emissions.

  - Republican lawmakers have additionally raised anti-trust concerns about asset managers collaborating to influence issuers to take action on climate change. Such concerns, discussed in further detail above, will likely have a chilling effect on membership initiatives like Climate Action 100+.

- **2024 Asset Management ESG Roadshow:**

  - The ESG landscape has evolved dramatically over the last few years for asset managers across the industry, and the evolution continues. Change is being driven by multiple factors, including new regulations, investor and other stakeholder demands, regulatory oversight, and new issues of financial relevance. Navigating these different and, at times, conflicting factors presents challenges for managers. In response to these challenges, Ropes & Gray attorneys hosted a series of in-person events in Boston, New York, Chicago, San Francisco and London to provide their insights and practical guidance on these and other challenges. The event's format consisted of several panel discussions and a session with a choice from several smaller, curated breakout groups, followed by a cocktail reception.

- **Ropes & Gray's Comprehensive ESG Practice**

  - Ropes & Gray has a leading ESG, corporate social responsibility and business and human rights compliance practice. We offer clients a comprehensive approach in these subject areas through a global team with members in the United States, Europe and Asia. In addition, senior members of the practice have advised on these matters for more than 30 years, enabling us to provide a long-term perspective that few firms can match. For more information about our practice and other topics of interest to asset managers and institutional investors, please see visit our Asset Management ESG page and for informed perspectives on a wide variety of important legal and business topics through a range of channels, including alerts, podcasts and articles, please visit our Insights page.

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