Checklist

ESG Issues for Aerospace & Defense Companies

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The checklist provided below outlines the steps aerospace and defense companies can take to develop and report their ESG disclosures. For the purposes of the checklist below, disclosure recommendations correspond with the issues identified and presented in the Overview – ESG Issues for Aerospace & Defense Companies. Companies should refer directly to the Sustainability Accounting Standards Board (SASB) Standards and other guiding frameworks for additional recommendations.

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1. Establish an ESG Plan

> **Practice Tip:** Investors are looking for how ESG related factors impact the financial performance of the entity, including but not limited to climate risk, reputational effects and futureproofing for upcoming regulatory requirements. The key is to focus on material factors that produce a substantial impact and which investors will be most interested in, not just qualitative disclosures but also quantitative measures.

- ☐ Consider forming an ESG/sustainability committee. See Overview - ESG & Sustainability Governance Structure.

- ☐ The ESG committee should engage with in-house counsel, compliance and risk teams, third-party advisers, members of the board, senior management, shareholders, and other stakeholders to agree on ESG goals and to develop procedures and plans to reach such goals. See Checklist – Stakeholder Engagement.

> **Practice Tip:** Companies may want to carry out a materiality assessment to identify ESG issues that could significantly affect their long-term value creation. A materiality assessment process usually involves cross-departmental collaboration. With experience engaging with a wide variety of company stakeholders, corporate lawyers are uniquely situated to take the lead with regard to companies' ESG initiatives, including materiality assessment exercises. See Overview – Role of the General Counsel in ESG.

- ☐ Develop ESG disclosure and reporting policies and procedures.

2. Prepare Disclosures.

- ☐ Determine ESG related factors that are material for entities in aerospace and defense for disclosure purposes. Entities should be able to explain why certain factors and quantitative and qualitative measures are selected for disclosure.

> **Practice Tip:** The SASB Standards recommend that the following ESG factors are financially material for entities in the aerospace and defense industry. The successful management of these factors are integral to such entities' value creation.

- **Energy Management**. The manufacturing process within the aerospace and defense industry requires the use of energy. The type of energy used, magnitude of consumption and energy management strategies impact the entity's exposure to fluctuations in costs of energy inputs.

- **Hazardous Waste Management**. The manufacturing process within the aerospace and defense industry produces waste products that can be hazardous and require appropriate disposal in compliance with applicable regulations. Compliance with such regulations is necessary to avoid penalties and reputational damage that can have material financial impact.

- **Data Security**. Entities in aerospace and defense create advanced aviation and sensitive military products and may therefore be at a higher risk of cyber-attacks which compromise the information of the entity and its clients. Ensuring data security is necessary, not only to avoid regulatory penalties but, to improve the marketability and quality of the product and services delivered. For more general information on data security, see our Privacy & Data Security Practice Center.

- **Product Safety**. Incidents arising from lack of product safety could result in material financial impacts, regulatory penalties, and reputational loss, which could result in loss of market share. For additional guidance for product counsel, see our Product Counsel Toolkit.
- **Fuel Economy & Emissions in Use-Phase**. Regulatory pressures, industry group recommendations and customer preferences are increasing the demand for more energy efficient products within the aerospace and defense industry. Products that are more fuel efficient and produce lower emissions in use-phase will be more attractive to customers and are less likely to trigger regulatory penalties.
- **Materials Sourcing**. Exposure to supply chain risks is a key factor for entities in aerospace and defense which often rely on technology where there may be few or no available substitutes for component parts or raw materials. Entities that are able to adapt to the use of substitutes and innovate to reduce reliance on materials that are limited in supply will be more resilient to any supply chain shocks and price volatility.
- **Business Ethics**. Aerospace and defense entities can find themselves exposed to regulatory scrutiny because of their operations in regions with weaker enforcement of business ethics laws. A developed policy and corporate culture will protect revenue growth and reduce reputational risks.

- [ ] Review ESG disclosures made by competitors, customers, and peers.
- [ ] Consider the target audience in drafting disclosures.
- [ ] Present disclosures in plain English, without technical jargon.
- [ ] Disclosures should include areas for improvement, which can be crafted in aspirational language.

Practice Tip: It is important to be transparent and show that the entity has a process for tracking its progress in the context of the wider ESG plan.

Targets phrased in aspirational language are less likely to be considered false or misleading for purposes of securities law liability. For example, in its 2021 Global Impact Report, Workday stated "[w]e aim to use as little energy as possible, because the cleanest energy is the energy you never use."

- [ ] Because of the greater legal liability with respect to disclosures included in documents filed with the SEC—Form 10-Ks and proxy statements—companies should carefully consider the location of the disclosure.

Practice Tip: Intentional misstatements made in sustainability reports may be subject to fraud claims, even if such reports are not filed with the SEC. Companies can face private litigation or other enforcement if there are knowing, negligent or reckless misstatements or omissions of material facts.

- [ ] Involve the corporate compliance officer and risk officer, or similar employee or adviser, in the review process for any ESG disclosures to make sure that the disclosures are validated either internally, or by external third-party experts, and appropriately qualified with suitable disclaimers in order to manage liability risk.
- [ ] Companies may want to consider drafting a separate "Sustainability Discussion and Analysis" (SD&A) section in their financial reports.

Practice Tip: Under SEC rules, an "SD&A" discussion is not required in the financial statements to investors. Companies should be prepared for the possibility that the SEC might adopt such a provision. The SEC is reviewing its ESG disclosure rules and has previously required a narrative discussion of corporate practices when it mandated a Compensation Discussion & Analysis review for executive pay. Companies that draft SD&A section in their financial reports could get ahead of the curve with regard to their peers if the SD&A discussion becomes mandatory. However, companies should bear in mind that disclosures included in documents filed with the SEC are exposed to greater legal liability and should be carefully drafted and reviewed.

- Disclosures should be consistent across all public statements by the company, including marketing and promotional materials.
- Disclosures should be complete and specific, but they should not be lengthy or repetitive.
- Disclose areas for improvement.

Practice Tip: Companies are not perfect. Even with a robust ESG program in place, progress can still be made. Identify where the company can do better.

