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The GC Role in ESG? Leader

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CHEAT SHEET

- ***Natural leaders.*** GCs are well positioned to drive their company's environmental, social, governance (ESG) program given their roles as trusted advisors, generalist sensibilities, and familiarity managing areas that overlap with ESG.
- ***ESG program.*** To build an ESG program, develop a plan and strategy, benchmark ESG programs in your industry, establish program governance and operation processes, conduct a materiality assessment, and promote ESG efforts internally.
- ***Anchored in law.*** ESG programs must be lawful and mindful of the board and CEO obligations. GCs should advise companies on legal restrictions to ESG efforts depending on the jurisdiction.
- ***ESG disclosure.*** GCs should support ESG disclosure efforts by asking questions, ensuring accuracy, reviewing with management, and posting disclaimers and statements. They should also make informed judgments about long-term effects of disclosure on shareholders and stakeholders.

News floods in daily about corporate responsibility for issues ranging from social justice movements to climate change to fair labor practices and spanning everything from cocoa production (reducing deforestation and eradicating child labor) to air travel (carbon offsets and safety for flight employees and travelers). Amid this, the modern general counsel continues to evolve into a true generalist and should play a central role in driving cross-functional corporate environmental, social, and governance (ESG) initiatives.

> **What is different is the fast-rising prominence of the "E" and "S" issues and the role GCs are positioned to play in propelling ESG programs. The situation is heightened in small- and mid-cap companies that face this challenge without the dedicated sustainability groups that most large-cap companies have.**

Amid the pandemic and all that implies, amid the climate crisis, amid protests against systemic racism, amid challenges to the rule of law, amid all of this and more, companies are reckoning with their corporate responsibility to shareholders, employees, customers, suppliers, and their communities. The world has changed, but what has not changed is corporate responsibility. It is now in even sharper relief as companies grapple with different needs and urgency. What has changed is how companies challenge themselves to do more and how we challenge ourselves to do more. General counsel can help lead the way.

General counsel are accustomed to managing governance, the "G" issues in ESG. They regularly advise the board of directors and work with the C-suite to develop policies and programs. GCs also have some experience with environmental and social issues, like conflict minerals with supply chain managers, hazardous waste oversight with facilities operators, fair labor and employment practices with human resource partners, data privacy and security with CISOs, and climate disclosure under Securities and Exchange Commission Reg S-K.

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ESG drivers and legal framework

Propelling ESG, the Business Roundtable's (BRT) August 2019 "Statement on the Purpose of a Corporation" committed to a consideration of all stakeholders, including customers, employees, suppliers, communities, and shareholders. Specifically, it commits companies to delivering value to customers; investing in employees (such as through compensation and benefits, training and education, diversity and inclusion, dignity and respect); dealing fairly and ethically with suppliers; supporting the communities in which we work (such as by respecting people and protecting the environment through sustainable practices); and generating long-term value for shareholders. The BRT recently reinforced its position on a key issue encompassed within ESG — climate change — by supporting cutting greenhouse gas emissions by at least 80 percent from 2005 levels by 2050 and endorsing a price on carbon.

Nearly 40 years ago, in fact, as noted corporate lawyer Ira Millstein recently pointed out, the BRT had issued a (nearly forgotten) statement on corporate responsibility, stating that boards should not focus only on shareholders, but should instead consider other constituents including, importantly, the broader community and labor. This "new" model for governance, with consideration of all stakeholders, draws support from business and academic thinkers, who have reacted against the monolithic shareholder primacy model and its weakly built underpinnings.

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The investment management community is also behind this shifting dynamic from a strict shareholder primacy, profit-oriented approach, to one that accounts for the needs of all stakeholders, as noted by investment firm Blackrock's chief executive officer, Larry Fink, who has written about corporations' "sense of purpose" as well as his firm's commitment to holding companies accountable for sustainability. State Street similarly propounded a position on sustainability that requires companies to meet certain benchmarks. Both of those firms reiterated their intent to focus on ESG even amid the pandemic.

While it remains to be seen how companies will further implement the BRT principles, the statement represents a clear articulation of how companies are thinking about their places in society. Many chief executive officers, other corporate executives, and GCs already have these sorts of goals in their portfolios, as ESG also presents opportunities for differentiation from competitors and better management of supply chains, along with better operational risk management, talent retention, and customer appeal. ESG goals are not trade-offs with profitability but instead can, if properly aligned, amplify the company's mission.

Even before the BRT statement, corporate investor relations staff and in-house corporate and securities counsel had been seeing investors and investment advisory services firms becoming more active in their ESG engagement with companies. As institutional investors devote more resources and staff to ESG, companies will need to respond. And while shareholder engagement in the governance area had been well-understood — the movement to environmental and social considerations is burgeoning.

Whether driven by employees, customers, suppliers, investors, or the public, or by directors and executives themselves, companies are under increasing pressure to address ESG and articulate their philosophy of long-term value creation amid obligations to the broader community. In other words, aside from any other imperatives, practicality mandates business operators have an ESG program. Chief executive officers understand that they will need to lead on ESG as appropriate to their industries. And in-house counsel must support ESG initiatives while focusing on the state of the law currently and how courts, including Delaware courts, view boards' duties to their shareholders.

The ABCs of ESG

ENVIRONMENT: Greenhouse gas emissions/climate change, energy use, water use, pollution, hazardous waste, recycling, sustainability

SOCIAL: Corporate giving and philanthropy, working conditions, workplace health and safety, compensation and benefits, equal pay, employee opportunity, labor and human rights, child and forced labor, non-discrimination, ethics and compliance, diversity and inclusion, engagement, supplier practices, data privacy

GOVERNANCE: Board structure and composition (including tenure and diversity), executive compensation, shareholder rights, enterprise risk management, audit oversight, environmental management, disclosure and reporting, data privacy, anti-corruption, ethics and Code of Conduct

Delaware Law

ESG programs must be anchored in law and mindful of the board and chief executive officer's obligations. Although the specifics of what constitutes ESG has not yet been fully tested and settled, boards and executives will have latitude to implement ESG programs.

Because a majority of US public companies are incorporated in Delaware, Delaware law has been the focus of commentators' attention in determining how companies might be restricted — or unrestricted — in their ESG efforts. In brief, Delaware law should allow enough room under the "business judgment rule" for companies to adopt ESG initiatives that, over time, would tend to benefit shareholders, even if the benefit is not immediate and direct.

According to Wall Street lawyer Martin Lipton, "As long as the directors discharge their duty of care and loyalty in managing the business of the corporation to achieve sustainable long-term growth in value, they are protected by the business judgment rule from any liability to any stakeholder argument that they should have received greater consideration or value than any other stakeholder." In this light, the BRT statement is not a radical departure in governance if you consider the longer-term implications of investment in ESG efforts and how they might enhance shareholder value.

Delaware law has never prohibited companies from taking other stakeholders' positions into account. In other words, giving weight to other stakeholders' views or to environmental or social issues is entirely consistent with, and likely to advance, shareholder value. According to McKinsey &

Company, among other benefits, a “strong ESG proposition correlates with higher equity returns” and “reduction in downside risk.” Recent NASDAQ studies confirm ESG correlates with lower cost of capital and better talent recruitment and retention, to name a few benefits.

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Companies incorporated outside the United States or in other states should confirm applicable law. California, and other states with benefit corporations, might provide more flexibility for adoption of ESG initiatives, while companies in stricter states might have less room to depart from shareholder primacy. M&A is another area for caution. M&A differs materially, where the focus would likely remain on obtaining the greatest economic value for shareholders, regardless of the effect on other stakeholders.

It is important to note that since laws, regulations, and interpretations change, a “rules check” should be run, and applicable law updated for the board and company’s obligations.

Directors’ fiduciary obligations remain relevant under Delaware law. In complying with their duty to stockholders, directors owe a duty of care and a duty of loyalty, and must properly inform themselves of attendant business risks. However, longer-term but positive effects in favor of the corporation could include enhanced reputation, attraction and retention of employees, reduced costs of energy, maintenance of good relations with suppliers, customers, and investors. Boards should proceed with eyes open, fully informed, and with proper caution as the law settles.

Weighing each business decision against shareholder value is fact-specific. For example, improving employee compensation, beyond industry standards, might decrease profitability in the short term but at the same time reduce turnover (and recruiting and training costs) and ensure that experienced employees are building the business, inventing new products, and driving into new markets. Similar benefits might accrue to a large manufacturer that decides to strive for carbon neutrality — at this point in the climate crisis, that company would make that commitment to maintain its reputation and retain customers. In the long run, the benefits run to the shareholders.

CVS decided to stop selling tobacco products. Dick’s Sporting Goods decided not to sell guns. Goldman Sachs decided to no longer invest in companies that drill in the Arctic. Biogen, already carbon neutral, declared it would invest US$250 million over the next 20 years to eliminate fossil fuels in its operations. Companies are rethinking how they invest in their employees’ well-being amid the pandemic. More than 80 percent of the Fortune 500 publish sustainability reports. In other words, companies, and presumably their boards and executives, think that these steps are not only responsible, but also create real value. This value can take many shapes, including brand awareness and differentiation, appeal to potential employees and engagement of current employees, and compliance with supply chain requirements.

ESG disclosure

Most Fortune 500 companies provide sustainability or ESG reports. The SEC requires disclosure regarding “human capital” and the effects of climate change. So, for small- and mid-cap companies accelerating their ESG efforts, how does the resourceful GC support ESG and provide legal guidance to the company and operational management of the ESG effort?

Broadly, the GC should help the company:

- Develop the right team, with an executive sponsor, a steering committee, and working groups covering all functional areas;
- Document and benchmark existing ESG efforts, whether called ESG, corporate responsibility, or corporate social responsibility;
- Understand company-specific materiality and relevance (where you can move the needle and get the biggest return on resource and time investment);
- Engage with stakeholders;
- Integrate risk and strategy; and
- Involve the board.

Most ESG legal issues concern the scope of what the company can and cannot do and the disclosure around ESG efforts. For legal scope, as noted above, the company has latitude to consider actions that affect other stakeholders.

For questions of disclosure, the approach is similar to any other public communication, whether investor communication, SEC filings, or other financial disclosures.

Disclosure keys for GCs

Ensure accuracy. As with any other issue, make sure you have an accurate understanding of the facts. This tenet does not differ from what GCs are already doing, sometimes in conjunction with controls put in place by the finance department or operational playbooks and other checks.

Ask questions. As with any cross-functional effort, make sure you understand the issues at a fundamental level and probe the completeness of what you are being told.

Determine if the issue is one that is required to be disclosed or that the company would like to disclose. Make informed judgments about the nature and timing of the initiative and the long-term effects on shareholders and stakeholders. Depending on the materiality, the board may need to be informed.

Coordinate disclosures. Once you understand the issue and disclosure obligation or preference, write it up and circulate to internal stakeholders for review. Incorporate comments as necessary. How to respond to investors who may have different views requires companies have an articulated philosophy, program, communication plan, and good internal communication among legal, investor relations, and sustainability groups or designees. Companies should be consistent when speaking to institutional investors' ESG teams and portfolio managers.

Review with management, and, if appropriate, the board. Be sure to keep the board informed, so that it can comply with its obligations by providing the board information, an opportunity to ask questions, and an overview of the processes and controls in place. Conduct regular reviews of the specific disclosure items and the process. For example, if the company sets specific targets, the board should be updated on progress against goals.

Consider that sustainability reports, corporate website postings, and presentations could expose the company to liability or reputational harm if the well-defined processes for public disclosures are not followed. GCs should understand materiality and requirements regarding disclosures about the business, legal proceedings, MD&A, and risk factors. If the statements are material and later found to be false or misleading, the company could be subject to liability under Section 10(b) of the Exchange Act. So, follow the usual processes and controls.

Post disclaimers and forward-looking statements regarding the aspirational nature of the initiative.

ESG program launch

Creating an ESG program follows the pattern of developing other new programs. At its core, you should set up a steering committee, consisting of operations leads along with a leader who may be the general counsel or a dedicated sustainability leader or someone else in the company who can ensure cross-collaboration and project success. Establish a day-to-day operational team and project management plan. On the disclosure side, create an integrated team consisting of legal, investor relations, and any sustainability group lead.

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Companies face increasing demand for ESG engagement and disclosure. They are under pressure to respond to customers who have adopted different rating systems, investment advisory services firms with sometimes opaque criteria, varied institutional investors' approaches, and even public and governmental demands that differ in scope and emphasis.

A company will need to understand which ratings systems it may be subject to and which ones to opt in or select for its own reference or actual use. Some assessment frameworks include the Global Reporting Initiative, Sustainability Accounting Standards Board (SASB), Responsible Business Alliance Code of Conduct, Task Force on Climate-Related Disclosure, International Integrated Reporting Council, OECD Guidelines for Multinational Enterprises, ISO, and the UN Global Compact. Some customers are using scorecards like Ecovadis, based on the Global Reporting Initiative. ISS provides a "quality score" on ESG that sweeps across many different areas. SASB reports that 100 companies are using its standard, with its 77 industry-specific reporting standards, which seems to illustrate that the complexity of the challenge has not been resolved.

The initial steps for creating an ESG program are:

- Developing a preliminary plan and strategy;
- Benchmarking ESG programs against the industry, peers, and competitors;
- Using investor engagement to determine importance of various factors;
- Establishing program governance and operation processes;
- Making a materiality assessment and setting priorities;
- Promoting ESG efforts internally;
- Considering disclosure obligations and making appropriate disclosures;
- Supporting investor relations communications;
- Working with the board on the above as well as strategic decision-making and support (such as executive compensation), including making oversight formal (as through a committee charter); and
- Continually working to integrate, reassess, and improve the ESG program.

GCs are the natural leaders for ESG programs

Trusted advisors

In the unique role of legal counselor, department manager, business and ethics advisor, and sometime operational lead for cross-functional corporate initiatives, the GC has succeeded the outside counsel as the immediate legal advisor for the board and management. No longer limited to dealing with narrow legal issues like contract negotiation, the GC's responsibility has grown to include navigating among legal, policy, regulatory, and business issues in cooperation with other departments within the company.

This positions GCs to captain initiatives around risk management and regulatory compliance because they are able to identify gaps, build consensus, develop teams, manage projects, and collaborate with stakeholders within and outside the company. This has been demonstrated through complex global corporate challenges, like the EU General Data Protection Regulation and enterprise risk management programs (as well as the material and central role GCs have played on their companies' pandemic response teams), and can now be applied to new areas like ESG.

Adaptable generalists

GCs operate in dynamic environments, and, central to success in the role, must be able to navigate volatility, uncertainty, complexity, and ambiguity. Today, GCs have to be nearly perfect in applying law and regulation to novel subjects — everything from antitrust to artificial intelligence to autonomous vehicles, from bond issuance to bounties for computer vulnerabilities to quantum computing, from compliance to contracts to cloud computing, from drones to divestitures to deep fakes — all in the context of new markets and emerging technologies, and while under scrutiny from internal and external stakeholders. The pandemic underscored the challenges, and most GCs appear to be navigating their way successfully through.

Narrowly focused legal counsel may struggle in this situation. By contrast, this is where the modern GC, applying core legal domain expertise, business and operational acumen, and emotional intelligence, can excel. As David Epstein argues in the recent popular book Range, in dynamic environments generalists will outperform specialists.

Positioned to lead

GCs are already well positioned to drive the ESG program within corporations, in cooperation with business operations teams. ESG covers areas that GCs are used to addressing: governance, risk and opportunity management, investor engagement, government relations and policy, and value creation. According to the ACC's *2019 ACC Chief Legal Officers Survey,* over half of companies surveyed had corporate social responsibility plans, with the listed foci being environment (74 percent), organizational governance (66 percent), community involvement and development (65 percent), fair operating practices (53 percent), labor practices (51 percent), human rights (44 percent), consumer issues (32 percent), and other (five percent). With the pandemic and rise of social justice movements, I would expect any new survey to reflect increased attention to employee issues, D&I, voting rights, and the like.

Additionally, because GCs are used to considering multiple stakeholders' perspectives, including that of shareholders, they are able to integrate the ESG plan with the ultimate corporate goals. This presents a real leadership opportunity for GCs in companies without designated responsibility for ESG.

Conclusion

ESG plays into long-term value creation as part of companies' commitment to addressing issues of importance to all stakeholders. GCs sit at the nexus of law, policy, investor relations, risk management, and business operations. Working right at the coalface, GCs can take the lead to help their companies drive ESG and create long-term value.

ACC EXTRAS ON… In-house counsel and ESG

Articles

Guide for General Counsel on Corporate Sustainability Version 2.0 (Sept. 2019).

Environmental, Social, and Governance (ESG) issues pose risks to companies. Can Chief Legal Officers help drive solutions? (Nov. 2019).

Future-proof Investment: A Legal Guide to ESG and Creating Sustainable Financial Products (June 2020).

ACC HAS MORE MATERIAL ON THIS SUBJECT ON OUR WEBSITE. VISIT WWW.ACC.COM, WHERE YOU CAN BROWSE OUR RESOURCES BY PRACTICE AREA OR SEARCH BY KEYWORD.

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