

ESG: Key Trends and Expectations in 2021

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Confidential

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ESG: Key Trends and Expectations in 2021

1. How we got here: Why ESG and why now?
2. The “G”overnance perspective
3. The “S”ocial component
4. The “E”nvironmental component



How we got here: Why ESG and why Now?

The evolution of ESG

- **1980s - 1990s:** Corporate Social Responsibility, Sustainable Development and Triple Bottom Line.
- **2000s:** Carbon Disclosure Project, Principles for Responsible Investment and the introduction of Environmental, Social and Governance.
- **2010s:** Sustainability Accounting Standards Board, International Integrated Reporting Council and Task Force on Climate Related Financial Disclosure.
- **2020s:** ISS adds ESG Scores, S&P ESG indices launched, World Economic Forum Sustainable Value Creation Metrics.



ESG pronouncements to consider

- [Blackrock CEO letter](#)
- [ISS position](#)
- [Glass Lewis position](#)
- [Nasdaq proposal](#)

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3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

I. The Diversity Imperative for Corporate Boards

Over the past year, the social justice movement has brought heightened attention to the commitment of public companies to diversity and inclusion. Controversies arising from corporate culture and human capital management challenges, as well as technology-driven changes to the business landscape, already underscored the need for enhanced board diversity—diversity in the boardroom is good corporate governance. The benefits to stakeholders of increased diversity are becoming more apparent and include an increased variety of fresh perspectives, improved decision making and oversight, and strengthened internal controls. Nasdaq believes that the

Larry Fink's 2021 letter to CEOs



More ESG pronouncements

Business Roundtable Restatement of Corporate Purpose

Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy That Serves All Americans’

AUG 19, 2019

Updated Statement Moves Away from Shareholder Primacy, Includes Commitment to All Stakeholders

Statement on the Purpose of a Corporation

Americans deserve an economy that allows each person to succeed through hard work and creativity and to lead a life of meaning and dignity. We believe the free-market system is the best means of generating good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity for all.

Businesses play a vital role in the economy by creating jobs, fostering innovation and providing essential goods and services. Businesses make and sell consumer products; manufacture equipment and vehicles; support the national defense; grow and produce food; provide health care; generate and deliver energy; and offer financial, communications and other services that underpin economic growth.

While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:

Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.

Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.

Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.

Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.

Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.

Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.

The “G”overnance Perspective

How do you think about ESG from a governance perspective?

ESG Governance risks and opportunities

- **Corporate commitments:** purpose and guidelines, statement of ethics and conduct and committee charters.
- Board decision making including CEO selection, executive compensation and Board composition.
- California Board diversity laws.
 - On September 30, 2020, Governor Gavin Newsom signed into law Senate Bill (SB) 979, a measure that will require publicly held corporations in California to achieve diversity on their Boards of Directors by January 2023.
 - Similar to its 2018 predecessor (SB 826), which focused on increasing female representation on Boards of Directors, SB 979 requires each covered corporation to have at least one director from an underrepresented community on its Board by the end of 2021. By the close of 2022, a covered corporation with between five and eight directors must have at least two directors from underrepresented communities, and a covered corporation with nine or more directors must have at least three directors from underrepresented communities. Under the new law, the California Secretary of State may impose a \$100,000 fine “[f]or failure to timely file Board member information” for the first violation and \$300,000 for each subsequent violation. Approximately 35 percent of California company Boards consist of all-white members.
- Growing shareholder focus on Board diversity and recruiting directors with ESG experience.
- Board approvals of corporate transactions and capital allocation.

How do you address the need for board oversight of ESG?

Board oversight of ESG compliance

- Recent Delaware cases including
 - *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996): a breach of fiduciary duty may be shown if: “the directors knew or should have known that violations of law were occurring and, in either event the directors took no steps in a good faith effort to prevent or remedy that situation, and that such failure proximately resulted in the losses complained of.”
 - *Marchand v. Barnhill*, 2019 WL 2509617 (Del. June 18, 2019): Board failed to implement a system of controls, resulting in deaths from tainted ice cream
 - *In re Clovis Oncology*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019): Board failed to monitor the controls and respond to “red flags” regarding disclosure of trials for oncology drug
 - *Hughes v. Hu*, 2020 WL 1987029 (Del. Ch., Apr. 27, 2020): Board failed to exercise financial oversight
- Understanding the boards role in ESG oversight
- Full board or committee responsibility for ESG

How do you address external expectations and communications?

Board oversight of ESG disclosures

- SEC requirements for public companies
- Proxy advisory firm guidelines
- Expectations of employees, consumers, suppliers and communities
- Reporting trends



“Beware of what you say.....”

“Facebook Beats Derivative Suit Over Board Diversity, For Now” - *Law360*

In [Ocegueda v. Zuckerberg](#), No. 20-CV-04444, 2021 WL 1056611 (N.D. Cal. Mar. 19, 2021)

The [United States District Court for the Northern District of California](#) became the first court to rule on a motion to dismiss claims alleging deficiencies in a company’s compliance with policies intended to promote diversity.

Managing reputation risk

Board oversight of high risk areas domestic and worldwide

Supply chain

Anti-bribery

Anti-human
trafficking

Foreign
sanctions and
the *Global
Magnitsky Act*



Bribery, human rights abuses and human trafficking

Three key laws

1. **US Foreign Corrupt Practices Act of 1977**, as amended, 15 U.S.C. § 78dd-1, *et seq.*
 - Unlawful for US persons or entities to make payments to foreign government officials to assist in obtaining or retaining business.
2. **Global Magnitsky Human Rights Accountability Act**, Pub. L. 114-328, Title XII, Subtitle F, 130 Stat. 2533 § 1261 (2017); 22 U.S.C. § 1261 note
 - Authorizes the President to impose economic sanctions and deny entry into the US to any foreign person engaging in human rights abuse or corruption.
 - Expanded by Executive Order 13811 of September 29, 2017, 82 Fed. Reg. 46,363 (Oct. 4, 2017).
3. **California Transparency in Supply Chains Act**, 2010 Cal. Stat. 93 (SB 657); Cal. Civ. Code § 1714.43
 - Requires every retail seller and manufacturer doing business in the State of California and having annual gross receipts exceeding \$100M to disclose efforts to eradicate slavery and human trafficking from its direct supply chain for tangible goods offered for sale.

Bribery and corruption

- Both US FCPA and GloMag cover bribery and corruption.
- FCPA punishes US persons and entities bribing foreign government officials with civil and criminal penalties.
- GloMag targets foreign corrupt persons and entities with sanctions.



FCPA

Foreign Corrupt Practices Act, 15 U.S.C. § § 78dd-1, *et seq.*

1. **Who?** US persons or entities (briber) but not foreign government official (bribee) and foreign individuals or entities who pay bribes while in the US or using US mail or interstate commerce.
 - US persons or entities includes US citizens, domestic concerns and publicly-traded companies regulated by the Security and Exchange Commission.
 - Foreign government official is broadly defined to include not only government employees and officials but also foreign political parties, candidates for public office and officials of state-owned or controlled entities.
2. **What is a bribe?** A bribe is defined as “anything of value” including an offer, payment, promise or authorization to pay money, goods or services.
3. **Which US agencies enforce?** The US Department of Justice investigates persons and entities. The SEC investigates publicly-traded companies to determine if their books and records are accurate and fair and if they have suitable internal accounting controls.
4. **What are the penalties for violations of the FCPA?** The Department of Justice can impose both civil penalties and criminal penalties, including jail. The SEC can impose civil penalties. The civil penalties can include large fines, disgorgement of profits obtained as a result of the violations, ongoing oversight and monitoring and debarment from US Government contracts.

Global Magnitsky Act (GloMag)

Background and history

- Originally, the Sergei Magnitsky Rule of Law Accountability Act of 2012, (Magnitsky Act), Pub. L. 112-208, Title IV, 126 Stat. 1502 (Dec. 14, 2012); 22 U.S.C. § 5811 note, targeting Russians involved in detention, abuse or death of Sergei Magnitsky or gross human rights violations against persons in Russia.
- Globalized in 2016 to include foreign human rights abusers and corrupt foreign government officials.
- Expanded further by Executive Order 13818 of December 20, 2017, 82 Fed. Reg. 60,839 (Dec. 26, 2017).

What are the sanctions?

- GloMag allows the President to deny entry and revoke visas of sanctioned individuals, block assets held in the US by individuals and entities and prohibit US persons from entering into transactions with sanctioned individuals.

Who can be sanctioned?

- 1) A foreign entity or person who is responsible for extrajudicial killings, torture, gross violations of internationally recognized human rights against those working to expose the illegal activities of government officials or to defend or promote human rights and freedoms, including the right to a fair trial and democratic elections;
- 2) A foreign government official responsible for acts of significant corruption or a senior associate or facilitator of such an official including using government resources for personal gain, corruption in government contracts or natural resource extraction, bribery of offshore sheltering of ill-gotten gains.

Global Magnitsky Act (GloMag)

In the United States

- EO 13818, signed by President Trump on December 20, 2017 is designed to build upon and implement GloMag.
- This order expanded the scope of GloMag:
 - 1) by changing the standard from gross violations of human rights to serious violations;
 - 2) by changing the range of actors who could be subject to sanctions from those responsible for violations to those complicit in directly and indirectly;
 - 3) by including foreign leaders and officials of entities, not just foreign government officials, as potential targets of sanctions.
- To date, well over 200 individuals and entities have been sanctioned under GloMag, some well-known such as Chinese government officials responsible for human rights abuses against the Uighurs, and others less visible.

California Transparency in Supply Chain Act

- In addition to federal laws on human rights and corruption, some states have additional requirements.
- Noteworthy in California is the Transparency in Supply Chain Act (Act), 2010 Cal. Stat. 93 (SB 657); Cal. Civ. Code § 1714.43.

What is the purpose of the Act?

- To provide consumers with information about each company's efforts to prevent and eliminate human trafficking and slavery in its product supply chains in the US and overseas.

Who is subject to the law?

- Any large retailer or manufacturer doing business in California with annual gross receipts of \$100M or more.

What is required?

- a) Each company subject to the law must disclose on its website the efforts it is taking regarding human trafficking and slavery. These disclosures must be conspicuous, easily understood and located and be specific.
 - The Act does NOT mandate that businesses implement measures to combat trafficking and slavery, just to disclose what, if anything, they are doing.
- b) These disclosures must include cover five topic areas:
 - i. **Verification** that product supply chains are evaluated on a regular basis.
 - ii. **Audit of suppliers** to determine if the supplies comply with the company standards.
 - iii. **Certification.** Does the company require direct suppliers of materials provided to the company comply with the laws of their own countries regarding human trafficking and slavery?
 - iv. **Internal accountability.** Does the company have internal procedures to determining whether employees or contractors are complying with the company standards?
 - v. **Training.** Does the company provide specific training on compliance in its supply chain with human trafficking and slavery?

California Transparency in Supply Chain Act (continued)

Even Companies Taking No Actions Must Comply

- The Act applies even to companies that take no actions related to the five disclosure categories.

Enforcement

- The California Attorney General has exclusive authority to enforce the Transparency in Supply Chains Act.
- Exclusive remedy - civil action for injunctive relief.

California Revenue & Taxation Code section 19547.5

- The Franchise Tax Board shall make available to the Attorney General a list of retail sellers and manufacturers required to disclose efforts to eradicate slavery and human trafficking.
- List based on tax returns.
- List submitted annually to the Attorney General by each November 30, based on original tax returns received by the Franchise Tax Board on or before prior December 31.

What can companies do to comply with these laws?

1. Due diligence on potential business partners and providers in the supply chain.

- a. Many companies already have template due diligence questions for the FCPA. These templates can be expanded to include additional questions for GloMag and the California Transparency Act.
- b. Important to review all major vendors.
- c. May require support from investigation companies and law firm offices on location.

2. Internal compliance

- a. Publicize to all directors, officers, management and employees the company's commitment to the standards set by these laws both on the website, in internal manuals and training materials.
- b. Require all directors, officers, management and employees to sign a prepared document obligating them to comply when they join the company and at least annually to review and re-sign.
- c. Develop in-house training programs for all offices and plants to be held in-person or remotely so that all management and employees have a chance to ask questions.

The “S”ocial Component

ESG as a workforce strategy

- The *social* element looks to how the company treats and values people.
 - What are the company's employment policies?
 - Do its suppliers share the same employment values?
- Studies show that employee satisfaction and attractiveness to talent have a significant effect on employers' ESG scores.
- Millennials/Gen Z, who will soon make up most of the global workforce, place a high value on social issues and will expect their employers to do the same.
- Satisfied employees stay engaged - they work harder, stay longer, and produce better results for the employer.



Diversity, inclusion and equity (DEI) initiatives and its impact on ESG

- Companies find themselves at crossroads when faced with highly visible social movements - they are pressured to state their support of these movements and identify steps they are taking to demonstrate their commitment to them.
- In addition to investors, business partners and consumers, employees are paying more attention and demanding transparency into organizations' diversity programs.
- DEI initiatives can help the company achieve better results, by enhancing business growth and brand reputation.
- Steps to take:
 - Adopt DEI policies.
 - Identify a leader or create a team responsible for the implementation.
 - Review/rely on data.



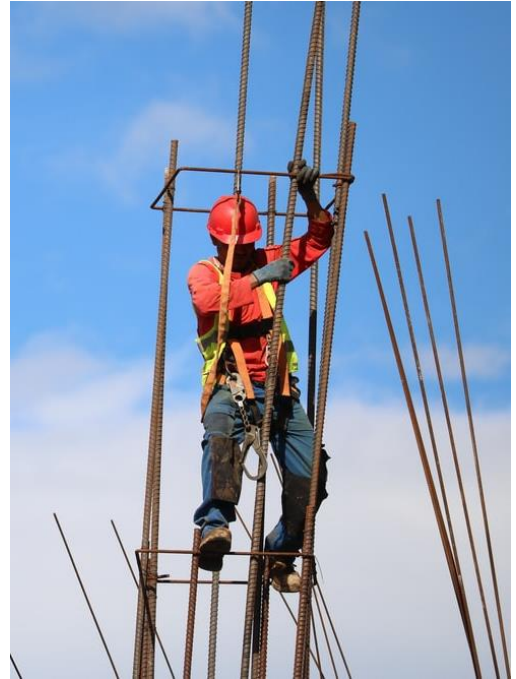
Evolving ESG - supporting the workforce

- Remote work will persist for the foreseeable future so companies will need to determine how to keep their employees engaged virtually.
- Companies need to implement effective work-from-home programs and policies in order to keep employees satisfied and productive while working remotely.
- Creation or development of an infrastructure will help in decreasing remote work stress.



ESG health and safety issues

- Since the start of the COVID-19 pandemic, companies have been evaluated on how they have responded with respect to employee health and work environments.
- A company's behavior on how it has been treating its employees during the pandemic has had significant impact on the company's reputation and brand awareness.
- Going above and beyond already established policies can go a long way towards achieving employee satisfaction.
- Employers need creative solutions to protect their remote and limited workforces while continuing to meet demand.
- This can lead to not only a reduction in health and safety risks but also increased employee satisfaction and enhancement of the company's reputation and brand awareness.



The “E”nvironmental Component

Environmental issues in ESG

Benefits

- Positive environmental impacts
- Savings and investment
- Compliance



Areas of interest

- Climate change
- Carbon emissions
- Air and water pollution
- Deforestation
- Biodiversity
- Water management
- Water scarcity
- Waste
- Land use

Environmental issues audit - sample issues

Carbon

- Carbon footprint
- Product carbon content
- Offset
- Major projects or capital expenditures - impacts

Other emissions

- Measurement
- Approach to reductions

Chemicals

- Use
- Manufacture
- Import
- Packaging/repackaging
- Transportation
- Chemical safety record



Environmental issues audit - sample issues (continued)

Resource efficiency

- Waste minimization
- Waste impact of products / services

Water use, risk and conservation

- Water resource dependency
- Water resource security

Biodiversity

- Impact on protected habitats or species
- Raw materials
- Production of components
- Supply chain



Thank you

