

Navigating the Board Director's Role in Environmental, Social and Governance (ESG)

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Questions and Topics We Will Cover Today

1. What are the top ESG issues that companies face today?
2. What keeps executives and directors up at night when it comes to ESG?
3. Examples of ESG backlash & how to respond to highly politicized social issues
4. What is the role of the Board when it comes to ESG?
5. Management of ESG risk and liability
 - i. Board committees
 - ii. ESG disclosure
6. Recognizing and managing competing stakeholders
7. What are some ESG opportunities?

What are the Top ESG Issues that Companies Face Today?

Types of ESG Risks

- Litigation risks
- Regulatory risks
- Disclosure risk
- Human capital risk
- Climate-related physical risks
- Climate-related transition risks
- Reputational risks/brand value
- Data privacy/data security risks
- Risks based on lobbying
- Risks associated with lost opportunity



What Keeps Executives and Directors Up at Night?

- Influence of world events
 - Cost increases due to inflation
 - War in Ukraine
 - Politicization
 - Supply-chain disruption
 - High cost of energy
 - Threat of Climate Change
- Evolving regulatory and legal landscape
 - Increased risk of litigation and regulatory enforcement
- Balancing needs of multiple stakeholders
 - Social media has amplified community and stakeholder voice
- Timing
 - Sometimes need to make decisions in real-time
 - Can be a competitive advantage or disadvantage

What Keeps Executives and Directors Up at Night?

ESG Backlash/Politicization of ESG

- Politicians attack ESG
 - AG Letters vs. Blackrock
 - Boycott rules
 - Anti-ESG in investing
 - State of Florida
- Institutional opposition
 - Vivek Ramaswamy
- Fear of retaliation
 - Disney vs. State of Florida (LGBT Rights)
 - Sidley Austin + Reproductive Rights

Taking a Step Back: What is the Role of the Board in ESG?



What is the Role of the Board?

TITLE 8

Corporations

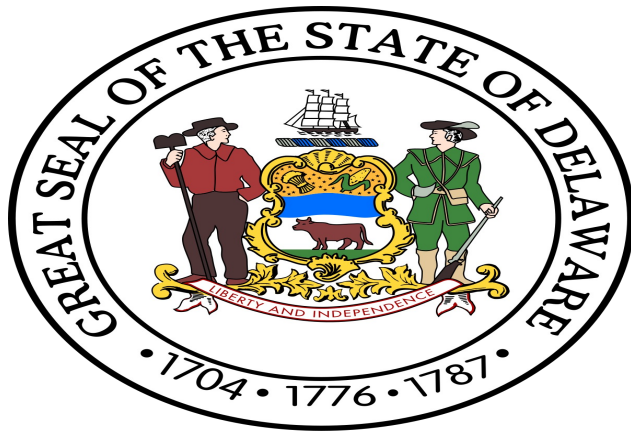
CHAPTER 1. General Corporation Law

Subchapter IV. Directors and Officers

§ 141. Board of directors; powers; number, qualifications, terms and quorum; committees; classes of directors; nonstock corporations; reliance upon books; action without meeting; removal.

(a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

[Link to Delaware Code](#)



Board Fiduciary Duties

- Duty of Care
- Duty of Loyalty
- Duty of Oversight

What is the Role of the Board?

- Duty of Care
 - Requires directors to inform themselves prior to making a business decision, of all material information reasonably available to them
 - Factors courts consider
 - Information about relevant internal and external developments
 - Engaged in discussion with relevant advisors
 - Due diligence/document review
 - Reasonable inquiry about relevant issues
 - It is not “no stone unturned”
- Duty of Loyalty
 - Directors should act and make decisions in the best interest of the corporation and its stockholders
 - Avoid personal interests
 - Refrain from conduct that would injure the corporation and its stockholders

What is the Role of the Board?

- Fiduciary Duties

- Interpreted Fiduciary Duties → Duty of Oversight

- Caremark decision

- board of a Delaware corporation has a fiduciary obligation to adopt internal information and reporting systems that are ‘reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation’s compliance with law and its business performance.’

- [In re Caremark International Inc. Derivative Litigation](#), 698 A.2d 959 (Del. Ch. 1996)

- Basis for Director Liability under Caremark

- (a) the directors utterly failed to implement any reporting or information system or controls; or

- (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

- In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.*

Management of ESG Risk and Liability



Management of ESG Risk and Liability

- Factors Courts Look to As Lack of Good Faith Implementation of Risk Monitoring Systems
 - The lack of any board committee assigned responsibility for overseeing the applicable safety issue;
 - Where a committee has been assigned to oversee the risk, the committee having completely failed to perform the role assigned to it;
 - The lack of any whistleblower system that would permit whistleblowers to report concerns directly to the board;
 - The lack of any regularly scheduled board discussions of the risk at issue;
 - The lack of any regular process or protocols requiring management to keep the board apprised of the risks at issue;
 - The fact that management received information that could be described as yellow flag or red flag, but failed to pass it on to the board;
 - Management having given the board selective information that was intended to minimize the significance of the risk; and
 - The lack of any mention in board minutes of a discussion regarding the risk at issue.

Management of ESG Risk and Liability

Business Judgment Rule→ Presumption that Directors acted on an informed basis, in good faith and in the honest belief that an action was taken in the best interest of the company

Several Resources Available to Assist with Board Oversight

- Outside Counsel
- Trade Associations
- Frameworks to assist with Enterprise Risk Management (ERM)
 - [Committee of Sponsoring Organizations of the Treadway Commission \(COSO\)](#)
 - [Task Force on Climate-related Financial Disclosures](#)



Management of ESG Risk and Liability – Board Committees

- An effective ESG governance program will typically involve one or more board committees
- Under Delaware Law, a duly appointed board holds all powers delegated to it by the full board (or as otherwise provided in the COI or by-laws)
- Various approaches to Board committee oversight of ESG risk/liabilities
 - Audit Committee – ensure ESG risks identified, process and assessed, properly disclosed, consider risks in ERM process
 - Risk Committee – ESG oversight but Audit Committee limited to financial risk oversight
 - Sustainability/CSR Committee
 - Nominating and Governance Committee - oversight of ESG matters; integrate ESG within board training and board performance evaluations, consideration of ESG or sustainability experience in director qualifications and board composition.
 - Compensation/ HR Committee – tie executive compensation to ESG performance; DEI; Recruiting/Retention of diverse talent

Management of ESG Risk and Liability – ESG Disclosure

- Voluntary Disclosure of Sustainability/ESG Information
 - Contains both qualitative and quantitative information
 - Metrics support goals or initiatives
 - Qualitative information reinforces purpose statement
 - Publicly Available
 - Websites
 - CSR reports
 - Annual Reports
 - Proxy Statements
 - Consider Stakeholder Preferences
 - Legal and Regulatory Risks
 - Avoid misstating or misrepresenting information
 - FTC Green Guides
 - Private Litigation-Green Marketing
 - Consider Interplay between SEC filings and other Public ESG disclosure and information

Management of ESG Risk and Liability – ESG Disclosure

- Securities Exchange Act of 1934

- [Rule 10b-5](#)

- "Rule 10b-5: Employment of Manipulative and Deceptive Practices":

- It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,

- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

- Board Oversight of SEC Filings

- Board is ultimately responsible for ensuring compliance

- Important for management to identify "material" issues, including ESG issues

- Board oversight should properly identify and evaluate risks that may require disclosure

How to Recognize and Manage Competing Stakeholders



How to Recognize and Manage Competing Stakeholders

- Importance of Stakeholder Analysis
- Types of Stakeholders
 - Employees
 - Customers
 - Community
 - Regulators
 - Shareholders
 - Supply Chain
- Steps for Stakeholder Analysis
 - Identify key stakeholders
 - Figure out preferences, positions and viewpoints
 - Engage with stakeholders
 - Utilize external resources or industry groups
 - Review competitors with developed ESG programs

How to Recognize and Manage Competing Stakeholders

- How to manage competing stakeholders
 - Employees vs. Shareholders or Shareholders vs. Community
- Ramifications of not conducting a stakeholder analysis
 - Negative press attention
 - Poor workplace culture
 - Employee retention issues
 - Strained relationship with regulators (permits, expansions, community opposition)
 - Shareholder Actions



How to Respond to ESG Backlash & Highly Politicized Social Issues



How to Respond to ESG Backlash & Highly Politicized Social Issues?



- Influence of Social Media
 - Given voice to minority voices
 - Given power to companies and other stakeholders
 - Influence the community (sometimes negatively)
- News Media
- Politics inform personal and societal viewpoints
- ESG Backlash from state governments
 - Other Stakeholders in the Investment Community

How to Respond to ESG Backlash (cont.)

- Risks of a Rushed Response
 - Reputation damage/boycotts
 - Negative media attention
 - Shareholder suits/pressure
 - Strained relationships with regulators
 - Loss of revenue
 - Lack of financing opportunities
 - Having to deal with uncertainty
 - Competitors have advantage

How to Respond to ESG Backlash (cont.)

- When to Speak
 - Timing is difficult→ Speaking too early or too light
 - Competitive Advantage or Disadvantage
 - When is it too late?
 - Goal is a long-term solution
- How to Speak
 - Difficulty of Speaking via Social Media
 - News Media
 - Public statements
 - Policy Changes
 - Promises/Goals/Initiatives
- Who gets to decide?
 - Board or Executives?
- Silence = Speaking
 - Many stakeholders view neutrality or silence as action vs. inaction

ESG Opportunities



ESG Opportunities – Environmental

- Resource efficiency
- Reduction in energy costs/access to incentives
- Improving competitive advantage
- Reduction in legal and regulatory risks
- Resiliency
- Positive reputation
- New market opportunities



ESG Opportunities – Social

- Productive workforce
- Positive workplace culture
- Meaningful impact on pressing social issues
- Positive reputation
- Reduced risk of litigation
- Stronger community connection
- Positive relationship with regulators



ESG Opportunities – Governance

- Benefits of being proactive vs. reactive
- Decreased risk of litigation
- Transparency/Insight
- Reduction of waste
- Reduced risk of business interruption
- Stronger more resilient supply chains
- Positive relationships with stakeholders, including shareholders



Conclusion: Key Takeaways

- Moving to a new phase of ESG regulation and oversight, companies must carefully think through decisions when it comes to ESG
- Beyond climate change, companies are facing a multitude of ESG issues which must be balanced against one another
- Companies must anticipate and respond to ESG backlash and may face retaliation
- Boards must account for ESG in oversight and ensure appropriate channels to keep apprised of potential ESG risks



Conclusion: Key Takeaways (cont.)

- Heightened review of ESG disclosure, including interplay between voluntary disclosure and periodic filings
 - Board must ensure adequate and transparent disclosure in light of securities regulations but also stakeholder expectations
- Each company faces a different set of stakeholders--important to identify and manage competing stakeholder needs
- Companies should carefully evaluate risks when responding to highly politicized social issues, including how and when to respond



Questions?



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