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On the Debate Regarding ESG, Stakeholder Governance, and Corporate Purpose

We previously described (most recently here, here, and here) the growing politicization of the consideration of environmental, social, and governance (ESG) factors in decision-making by asset managers, financial institutions and public companies, among others. In particular, a key target of political attention has been investment managers' and pension fund fiduciaries' consideration of ESG factors in their investment-related decisions. A prime example is a recent paper arguing that public pension trustees are prohibited by law from considering ESG factors in their investment decisions (or allocating capital to asset managers who engage in such practices) and, separately, that registered investment advisers may place client capital in investments promoting ESG objectives only after obtaining informed, express client consent. Notably, the paper defines ESG as a set of "loosely-defined but highly influential non-pecuniary criteria that purport to assess the extent to which companies are achieving certain social and political objectives with which many citizens disagree." This critique, which regards ESG as a matter of ideology rather than economics, has also found voice among conservative state treasurers and attorneys general and among certain presidential aspirants who are building anti-"woke" campaigns targeting ESG.

We write to make clear that this critique of the legality of ESG-related investment decisions is entirely separate from — and has no bearing on — the ability, and responsibility, of directors and officers of corporations to consider ESG issues to the extent such issues may materially impact the sustainable long-term value of the business. Companies and boards must address ESG factors and other risks (and opportunities) to fulfill the company's fundamental purpose of growing value over the long term, considering the stakeholders that are critical to the company's success (shareholders, employees, customers, suppliers, and communities) as determined in their business judgment and with regular engagement with shareholders. As we have stated, the complex stakeholder issues that companies face today are integral to corporate sustainability, responsible risk management and value creation; indeed, addressing these risks is consistent with directors' fiduciary duty of care and the board's legal obligation under *Caremark* to implement and monitor systems to identify material risks and to address risks once identified.

Although the legal debate on the propriety of ESG investing is distinct from directors' and managers' consideration of ESG risks in the context of corporate

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decision-making, it is important to recognize that major asset managers undeniably play an important role in supporting corporations in their pursuit of long-term, sustainable value creation. A key principle of The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth (issued by the World Economic Forum in 2016) is that institutional investors should engage actively and openly with corporations in the context of developed, long-term relationships, and make voting decisions on an informed basis in a manner consistent with the best interests of the asset manager's long-term beneficiaries. This ongoing, reciprocal dialogue — supported in numerous jurisdictions around the world, including by the UK Financial Reporting Council — is a critical component of the stakeholder governance model and ensures that the views of leading institutional investors and asset managers will be taken into account in company decision-making and risk management assessment.

Vigorous debate about the ability of pension plan fiduciaries and investment advisers to consider ESG factors likely will continue, as evidenced by the lawsuits seeking to reverse the Department of Labor's ESG rule. However, there should be no doubt about the responsibility of boards to consider and address ESG-related risks and opportunities when assessing and balancing all other issues that are material to the long-term value and sustainability of the company.

Martin Lipton
Adam O. Emmerich
Kevin S. Schwartz
Sabastian V. Niles
Carmen X.W. Lu
Anna M. D'Ginto