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Navigating the Current ESG Landscape: Recommendations for the Board and Management

In recent months, ESG has emerged as a domestic political battleground with businesses and their leadership increasingly caught in the crossfire. Opponents of ESG have coalesced at the state level, enacting legislation targeting the consideration of ESG factors in the investment decisions of state pension fiduciaries and proxy advisors. Such legislation has been buttressed by letters and opinions from state attorneys general and treasurers questioning the legality of investment decisions that consider ESG factors. Meanwhile, companies continue to be inundated with shareholder proposals that overwhelmingly seek the expansion of ESG commitments. Such proposals have been supplemented by growing regulatory demands on companies to identify, disclose and mitigate ESG risks. And when companies have ventured to take a public stance on ESG issues, several have attracted national controversy and exposed deep rifts among their different stakeholders.

Today's boards and management teams face a challenging balancing act as stakeholders grow more divided on ESG. While each company's circumstances vary, we believe there are two guiding principles that boards and management should keep in mind: (1) approach important ESG issues as one would approach other important business decisions or risks and (2) recognize that political pressure on ESG is a risk that needs to be managed (rather than a missive to be obeyed).

ESG is an acronym for environmental, social and governance. Each of these three elements has several components. Not every shareholder and not every other stakeholder (including local, state and national governments) has the same interest in each element or in each component of an element. Not every person, organization, politician or government official has the same interest in the separate components. Corporate law, which varies by jurisdiction of incorporation, fundamentally imposes fiduciary duties on management and the board of directors to take into account and balance the interests of all the stakeholders and use their informed business judgment to address the risks and profit opportunities of the business to achieve the highest sustainable long-term growth in the value of the corporation.

Boards and management, as corporate fiduciaries, continue to have an obligation to assess which ESG factors may have a material impact on their business and actively seek to address them in strategic and operational decision making. As we have discussed previously, recent Delaware *Caremark* decisions are a reminder that ESG-related issues can and do rise to the enterprise risk level. In those cases, corporate law afforded protections to directors and management that sought to identify, monitor and mitigate those risks.

The politicization of ESG not only serves to underscore the importance of remaining attuned to the perspectives of different stakeholders but also recognizing that such perspectives, however forceful, are not substitutes for the informed judgment of the board and management. Today, a successful ESG strategy requires companies to navigate the competing demands and expectations of investors who have largely continued to advocate for the consideration of ESG factors and groups who view ESG as a political opportunity. The act of addressing ESG issues in and of itself is now a political risk that requires its own preparedness and response strategy. Boards and management should assess their potential risk exposure, calibrate and align on how and when it may be appropriate to take a public stance on ESG issues (and when to stand down) and be ready to respond if the spotlight falls onto their company. While staying silent on these issues can often be a prudent course of action, it can also be seen as a form of speech by other stakeholders such as employees and customers, whose perspectives, too, must be taken into consideration.

The current ESG landscape requires companies to carefully juggle a variety of competing interests and priorities. In this environment, having market conviction in one's ESG strategy may not be enough; one may also need to be prepared to face the court of political opinion. Dealing with this balance is difficult. Nowhere is that better illustrated than in the now two-year dispute between Disney and the governor of Florida. Managing conflicting political views requires a business judgment decision that satisfies the objective of furthering the long-term increase in the sustainable value of the corporation.

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