



The Global ESG Handbook

A Guide for Practitioners

Consulting Editor **Paul Davies**

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and Business

ESG corporate issues: shareholder activism

Carmen XW Lu

Elina Tetelbaum

Wachtell, Lipton, Rosen & Katz

1. Overview

Shareholder activism, which encompasses a range of actions taken by shareholders to apply pressure to boards and management teams to align corporate actions and company priorities with those of activist shareholders, has become a major feature of the corporate landscape in recent years. Whereas investors previously voted with their feet by selling a company's stock, many more are now leveraging the rights associated with the ownership of company securities, particularly proxy voting rights, rights to nominate directors and the right to bring business before shareholder meetings, to engage privately and publicly with boards and management.

After a brief lull in activist activity during the COVID-19 pandemic, global activism activity soared to record levels in 2022, a trend that has persisted into the first half of the 2023.¹ While market volatility, regulatory changes, rising interest rates and sector weaknesses have all helped to drive the recent resurgence in shareholder activism, ESG issues have also increasingly become a key piece of the activist thesis. The growth of ESG activism reflects the growing recognition that such issues can at times have material financial impacts on businesses. ESG issues can be a powerful coalition building tool that can unite the interests of a range of stakeholders, from institutional investors who are focused on protecting and enhancing the long-term value of their portfolios to proxy advisers who increasingly consider ESG issues when making voting recommendations and retail investors, a growing number of whom expect businesses in which they invest to align with their broader values.

This chapter provides an overview of the key players within the ESG activism landscape, the issues that have driven ESG activism, the range of tactics and strategies deployed by activists, and considerations for boards and management in dealing specifically with ESG concerns within their stakeholder base. Following this chapter are in-depth case studies of two recent activism campaigns (McDonald's Corporation/Carl C Icahn and Activision Blizzard, Inc/SOC Investment Group) where ESG issues formed a key part of the activist agenda.

1 FactSet, as of 16 July 2023.

2. **Key players and the supporting cast**

ESG activism has attracted interest from traditional hedge fund activists as well as smaller impact-oriented investors. These shareholders have been supported in their efforts by investor coalitions, non-profits and, in certain cases, institutional investors and proxy advisers.

Several large activist hedge funds have entered ESG activism in recent years, with some going as far as establishing funds or bringing in senior personnel specifically to examine opportunities in the area. One of the earliest movers was ValueAct which established the ValueAct Spring Fund in 2018 with a focus on ensuring that there is “excess return to be captured in identifying and investing in businesses that are emphasising and addressing environmental and societal problems”.² That same year, JANA Partners launched an Impact Investing Fund, which subsequently teamed up with CalSTRS to issue a letter to the board of Apple Inc, asking the company to examine the adverse health consequences of its devices on children and teenage users.³ More recently, funds such as Inclusive Capital Partners, Engine No.1 and Impactive Capital have come to focus exclusively on creating value from investing in companies based on ESG-related metrics and considerations. Traditional economic hedge fund activists such as Elliott, Third Point, Carl Icahn, Legion and Bluebell Capital have also led ESG-oriented campaigns from time to time.

Changes to the US Securities and Exchange Commission’s guidance on Rule 14a-8 shareholder proposals in 2021⁴ that made it more challenging for companies to exclude certain proposals have also empowered a new wave of smaller, often impact-oriented, shareholder activists in the United States, including As You Sow, Mercy Investment Services, New York State Common Retirement Fund, Arjuna Capital and Green Century Capital Management. Many of these shareholders include state and city pension funds, religious groups, labour unions, private foundations and advocacy organisations, often working as part of, or supported by, broader investor coalitions such as the Interfaith Center on Corporate Responsibility, the Ceres Investor Network and Climate Action 100+. During the 2023 proxy season, over 700 shareholder proposals were submitted concerning ESG issues, including close to 500 shareholder proposals on environmental and social matters, setting a new record.⁵

Institutional investors and proxy advisers also play an important role in determining the outcomes of ESG activism. Neither traditional hedge fund activists nor proponents of shareholder proposals typically command sizeable voting positions and their success will often depend on whether institutional

2 CNBC, “Jeff Ubben’s ValueAct launching fund with social goals, following similar moves by Jana, BlackRock”, 19 January 2018, www.cnbc.com/2018/01/19/jeff-ubbens-valueact-launching-fund-with-social-goal.html.

3 Letter from JANA Partners & CalSTRS to Apple Inc, 19 January 2018.

4 US Securities and Exchange Commission, Shareholder Proposals: Staff Legal Bulletin No 14L (CF).

5 Deal Point Data as of 16 July 2023.

investors and/or proxy advisers align with the dissidents. In particular, among US companies with dispersed ownership, activists will often need the support of key institutional investors and/or Institutional Shareholder Services (ISS) and Glass Lewis, with the latter two able to swing as much as 20% of the overall vote.

3. ESG issues giving rise to shareholder activism

While a wide range of issues and circumstances can give rise to ESG activism, there are a few key issues that draw activist attention time and again. These issues include: climate and sustainability risk management; greenhouse gas emissions targets; matters relating to diversity, equity and inclusion at the board level and in the workplace; political contributions and lobbying; and worker rights and safety. Economic hedge fund activists have sought to leverage ESG-related crises to demand changes to the board and management. Market opportunities created by the influx of capital into sustainable investments have also prompted economic activists to seek the separation of green and brown assets. And when companies are perceived as having gone too far in their pursuit of ESG targets and strategies and underperformed as a result, activists have also sought to lay blame on management.

Among hedge fund activists, ESG-related issues continued to weave their way into economic campaigns throughout 2022 and 2023. In particular, activists looked to capitalise on emerging market opportunities created by regulatory changes and continued investor demand in green investments. For example, in early 2022, Sachem Head acquired a position in Denbury, a company specialising in carbon capture and storage. Following the passage of the Inflation Reduction Act of 2022, Sachem Head deemed the company to be an attractive takeover target for a larger legacy energy company looking to capitalise on the new tax incentives to build out Denbury's capabilities. Third Point, meanwhile, called on Shell to separate its refining and renewables operations to allow for more aggressive investment in decarbonisation and to optimise the company's ability to address the different strategic priorities of its various stakeholders. Similarly, Bluebell urged Glencore to reassess its climate transition plan, separate its thermal coal business and reposition its business as a leading provider of metals required for the energy transition. Bluebell argued that Glencore's exposure to coal was adversely impacting the company's overall valuation and pressure on financial institutions to curb financing of the fossil fuels sectors could threaten the company's long-term access to capital and threaten shareholder value. Meanwhile, Engine No.1 – the once little known activist fund that successfully took on ExxonMobil in 2021 – called on Coca-Cola to commit to a partnership with Republic Services, a plastics recycler and in which Engine No.1 owns a stake, as part of the company's efforts to phase out single-use plastics. Engine No.1 also conducted outreach and engagement with several oil and gas giants including ConocoPhillips, Pioneer Natural

Resources and Devon Energy, urging them to commit to OGMP 2.0, the flagship oil and gas reporting and mitigation programme of the United Nations Environment Programme (UNEP).

Other economic activists capitalised on crises to drive a wedge between the company and its shareholders. Legion, for example, ran a high-profile campaign against Guess, calling for the removal of the company's co-founders in the wake of sexual misconduct allegations. While Legion's "vote no" campaign did not succeed in unseating any Guess directors (in part due to the sizeable stakes held by Guess's co-founders), the campaign attracted significant press attention.⁶ Not all ESG-oriented campaigns have an economic thesis: Carl Icahn's campaigns at Kroger and McDonald's focused on the companies' treatment of pigs (a matter of interest to his daughter).⁷ Icahn's campaign was not an isolated instance where ESG issues were not leveraged solely to drive near-term returns. While neither proxy contest campaign resulted in Icahn gaining any board seats, they drew significant public attention to the issue at hand. Bluebell purchased one share of chemicals maker Solvay and partnered with the World Wildlife Fund to draw opposition to the company's release of waste water onto beaches near Rosignano Solvay in Italy.

Among activists that have relied on shareholder proposals to draw attention to ESG issues, both 2022 and 2023 saw new records being set in the volume of such proposals. Climate and sustainability issues remain the top priority among proposal proponents and have led to a range of proposals that target emissions directly as well as the policies and third-party participants that have continued to support the fossil fuels industry.⁸ Notably, the latest proxy season saw several proposals targeted at financial institutions calling for banks and insurers to align their financing and underwriting activities with emissions reduction targets aligned with a science-based net zero pathway – a proposal which would effectively require these institutions to address value chain emissions arising from their business activities that comprise the bulk of their aggregate carbon footprint. Shareholder proponents have also looked to political lobbying as another avenue to limit the influence of the heaviest GHG emitters and hold companies fully accountable for their commitments to reduce GHG emissions. Proposals focused on disclosure of trade association activities and alignment of lobbying activities with emissions reduction goals aim to catalyse powerful business interests against the influence of the fossil fuels sector. Social issues, including those relating to workers' rights to freedom of association and

6 PR Newswire, "Legion Partners Launches 'Vote No' Campaign Against Guess?, Inc. Directors Paul and Maurice Marciano", 16 March 2022, www.prnewswire.com/news-releases/legion-partners-launches-vote-no-campaign-against-guess-inc-directors-paul-and-maurice-marciano-301503725.html.

7 CNBC, "Carl Icahn launches proxy fight with McDonald's over treatment of pigs", 21 February 2022, www.cnn.com/2022/02/20/carl-icahn-launches-proxy-fight-with-mcdonalds-over-treatment-of-pigs.html.

8 Deal Point Data as of 16 July 2023.

collective bargaining, diversity, equity and inclusion, and reproductive rights, have also drawn increasing attention from shareholder proponents who are looking to businesses to fill the legislative and regulatory gap created by a polarised and frequently paralysed political system in the US.

This is an extract from the chapter 'ESG corporate issues: shareholder activism' by Carmen XW Lu and Elina Tetelbaum in *The Global ESG Handbook: A Guide for Practitioners*, published by Globe Law and Business.

<https://www.globelawandbusiness.com/books/the-esg-handbook>

The Global ESG Handbook

A Guide for Practitioners

The Global ESG Handbook: A Guide for Practitioners

Environmental, social and governance (ESG) issues are increasingly considered as core business priorities for companies, boards and investors, with ESG representing an area of significant opportunity for many. Navigating the broad range of topics that fall under ESG, including regulatory developments, political impacts and stakeholder sentiment, requires multidisciplinary and global expertise from experienced practitioners.

Featuring cross-jurisdictional insight, this important title covers a range of ESG topics in depth, containing contributions from leading legal professionals, industry experts and consultants. The book firstly discusses “what is ESG?” before covering areas including supply chain topics, financial regulatory impacts, ESG disclosure obligations, M&A and private equity, among many other important subjects. Further, the book contains regional specific insights from practitioners on the ground and includes analysis of the diverse themes which underpin the current and future direction of ESG. Specific chapters are also dedicated to the emerging matters of ESG litigation, the evolving nature of technology in ESG, and the incorporation of ESG into enterprise risk management. The final part of the book looks at broader trends and developments in the area.

Despite the large volume of information already available, this is one of the first publications to draw together the various strands of ESG into one book and provides a valuable source of information in this fast-evolving area. It will make essential reading for all legal and other advisers and professionals with an interest in furthering their ESG knowledge.

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