

## ESG Essentials: What You Need To Know Now

### Inaugural Podcast

Welcome to “ESG Essentials: What You Need to Know Now,” which is a new podcast from Fox Rothschild. I’m your host, David Colvin, co-chair of the firm’s Environmental Social and Governance Practice Group.

Our series of short bite-sized and snackable podcasts will cover core ESG concepts and explore important issues for businesses that are concerned with developing and deploying an ESG profile, responding to increased scrutiny from regulators, investors and consumers regarding their environmental and social impact, and minimizing the potential legal and business risks that can be associated with ESG.

In this inaugural episode of the podcast, I will be providing a primer on ESG – just call it ESG 101 – and we’ll be discussing ESG and why it matters.

**Q:** *So, David, for those who are unaware or new to the concept of ESG, what exactly is ESG?*

**A:** So, it’s a great question, because ESG definitely means different things to different people. From my perspective, and the way I think about it, ESG, at its most basic level, is a way of judging a company by factors other than its financial performance and those factors seek to identify and uncover material risks and opportunities to a company by asking: (1) What are the environmental, social and governance risks to your company? (2) What’s the company doing to address and minimize those risks? And (3) What’s the company doing to maximize the chances that it will be sustainable over the long term?

The answer to those questions, whether they’re published in a company’s regulatory filings and disclosures, or in public statements, or on its website, through social media, on its labeling and packaging, wherever those statements may be found – the answers can really provide valuable insight into a company’s long-term prospects for success. The concepts of the corporate social responsibility and socially responsible investing have been around for decades. ESG really builds on those concepts by providing a framework and data points that are both measurable and reportable. So when you ask what is ESG, at its core, ESG really is an investment strategy, where investors take into account nonfinancial factors in the areas of environmental, social and corporate governance, and we’ll talk about some of those factors in a minute. But it’s the strategy where those factors are taken into account, evaluated and considered by investors, as a supplement to traditional bottom line financial metrics when making investment decisions.

And I have to tell you, the results are pretty clear. Research shows that companies that proactively identify and assess environmental, social and governance risks and opportunities,

they tend to be less risky investments than companies that do not. Not always the case for sure, but things are definitely trending in that direction.

**Q:** *In addition to investors, can you talk a little bit about other key stakeholders when it comes to ESG?*

**A:** Absolutely. As you might expect, who the key stakeholders are can depend upon your perspective. We just talked about investors and the importance of ESG to the investment community, but ESG is much more than just an investment strategy. Consumers, for example, are another key stakeholder group that need to be considered from an ESG perspective. Consumers are increasingly focused on purchasing goods and services from companies that have an ESG profile that aligns with their own values on the environmental and social issues. People want to feel good about what they buy, and where they buy it.

So, if climate change and protecting the environment is your thing, the chances are you're going to prioritize buying goods and services from a company that has a solid plan in place to address its impact on the environment. In addition to consumers, employees are another really important stakeholder group the companies need to be thinking about, when they're thinking about their ESG profile. Employees are increasingly focused on working for companies that align with their own values. They want to feel good about where they work, and they want to know that their employer is committed to making a positive impact on the communities in which they live and the communities in which they operate. Other stakeholder groups include a company's board of directors, upstream and downstream companies in a company's supply chain and organizations that provide ESG ratings and frameworks against which companies can benchmark their ESG efforts. In future podcasts, we will talk more in-depth about all of those key stakeholder groups. I've talked about the so-called ESG factors – which the investors and the other key stakeholders consider under each of the E, S and G pillars – and I want to briefly touch on a few of those.

When we talk about the factors that fall within the environmental pillar, for example, we're talking about things like carbon emissions and carbon footprints, bio diversity and land use, sourcing of raw materials, packaging material and waste and of course, climate impact. Climate impact – for example, how does the company impact the environment, and what is the company doing to reduce that impact? It's a really simple concept. It's really complex in terms of how to address it. But it's more than just how the company impacts the environment, It's also about evaluating how does the environment impact the company and its operations? Does the company have manufacturing facilities in areas that are susceptible to wildfires or hurricanes? And if so, what's the company doing? What plans does it have in place to minimize and mitigate the threat that the environment poses to its business? Has the company made a net zero carbon pledge? If so, that's terrific. That's great. That's what we want companies to do. We want companies to take affirmative steps to reduce their impact on the environment. But what matters as much as the pledge is whether the company has a plan and protocol in place to measure and report its progress on how it's getting to that net zero place. It isn't enough anymore to just make the aspirational statement. Companies need

to be able to demonstrate, to whichever key stakeholder group is looking at them, that they can measure, validate and report on these issues.

So when it comes to the social pillar, the social pillar really asks: How do companies manage their employee relationships, their customer relationships and their relationships in the communities in which they operate? Does the company have a demonstrated track record of respecting human rights? Does the company have a demonstrated respect for labor rights, which, of course, can reduce potentially disruptive strikes, which can then reduce potential disruptions to the operations of the company. Does the company have zero tolerance for harassment and discrimination of any kind? Of course, every company has a zero tolerance policy, but what matters is, does the company actually follow it? Does it actually enforce it, and does it do the right thing when presented with people who are inevitably going to behave badly? Zero tolerance in terms of harassment and discrimination can reduce the risk of costly lawsuits and reputational harm. Does the company treat its employee well? Does it compensate its employees fairly? Does it provide them with a safe working environment? Does it measure employee happiness? Because simply measuring employee happiness can demonstrate that happiness of its employees is a priority to the company.

From the governance pillar perspective, the governance pillar really asks: Does the company have a solid track record of good corporate governance and decision making? The pillar looks at things like business ethics. Does the company abide by all the laws and rules and regulations in the jurisdictions in which it operates? We certainly hope so. In terms of executive compensation, are executives paid fairly but not excessively? Are executive bonuses tied to factors other than just the company's financial performance? So, will executives get bonused more when employees are happier or when customers are more satisfied? Are executive compensation and bonuses suspended when employee salaries have to be frozen? Board diversity is another incredibly important topic and an incredibly important factor under the governance pillar. Does the diversity of the board reflect the company's commitment to diversity? So, for example, the NASDAQ, just last month, announced a new rule that will require reporting, of board demographic data going forward. It will require, going forward, at least two diverse board members on every company listed on the NASDAQ, if the company has five or more board members. Of those two diverse board members, one will need to self-identify as female and one will need to self-identify as an underrepresented minority or self-identify as LGBTQ. Going forward in 2023, those companies must have at least one diverse board member, and by 2025, they need to have the full complement of two. So these are just a few of the issues and risk factors that companies need to be thinking about and taking into account now, from an ESG perspective.

**Q:** *Can you talk a little about the risks related to ESG?*

**A:** Sure. So companies are under a tremendous amount of pressure to say something about the environmental and social impact of their products and services. With the explosion of publicly available information, ESG-related litigation is definitely on the rise.

Enterprising lawyers are using the increase in disclosures – whether that's through a regulatory filing or a statement on the website, or on social media or on labeling and

packaging – to manufacture and file costly lawsuits. The cases that are being filed typically fall into one of three buckets: (1) consumer claims are filed under one or more state consumer protection laws (2) shareholder derivative claims are filed under federal and state securities laws; and (3) government and regulatory actions are a third bucket.

In terms of, for example, consumer claims: the consumer protection claims we're seeing typically arise from an ESG-related statement on product labels or packaging. So, for example, you say on your product that the product is 100% recyclable and it isn't. Or you said on your product label that the product is biodegradable and it isn't.

So that's one flavor of consumer protection claim and the consumer claims they relied on those statements, and they were allegedly untrue. Another flavor of consumer protection claim can be an omission from a product label or package. So you didn't disclose on your label that your product was produced in violation of child labor laws. Or, you didn't disclose on the label that animals were mistreated in the production of your product and, had I known those facts, and had you disclosed them on your label, I never would have purchased your product. That's the theory of the claim.

Consumer claims can also arise from ESG statements on the company's website, in sustainability reports and marketing materials that might somehow be inconsistent with reported performance. So what companies can do to minimize the risk of potentially costly and time consuming litigation, because there's no way to eliminate the risk, right? But what can companies do to minimize the risk?

First and foremost be truthful. Don't say something about your product or service if it's not true. If your product is only 95% recyclable, don't say that it's 100% because that extra 5% puffing that you're doing is going to get you in trouble. Be concise. Be very direct about the statements that you're making so you're not embellishing in any way. Avoid over disclosing. Don't say more than you need to when it comes to your environmental impact, for example, or what it is you're doing when it comes to social and governance issues.

I would say that the most important thing the companies should be thinking about, when it comes to ESG and minimizing risk, is be prepared to back up your ESG statements with evidence that substantiates what it is you're saying. Companies can't get away with just saying the right thing anymore. They need to be prepared to demonstrate that they're doing the right thing. They need to demonstrate that they have a plan in place to measure, validate and ultimately report to various stakeholders what it is they're doing from an ESG perspective.

So, that concludes this installment of "ESG Essentials, What You Need To Know Now." Please check back regularly for new episodes and feel free to reach out to me with any questions. I can be reached at [dcolvin@foxrothschild.com](mailto:dcolvin@foxrothschild.com). Thanks.