

## ESG Essentials: What You Need To Know Now

### Episode 11 – Is the Future of ESG in Peril as Backlash Mounts?

**Colvin:** Welcome back to "ESG Essentials: What You Need to Know Now," a podcast from Fox Rothschild. I'm your host, [David Colvin](#), co-chair of the firm's ESG Practice Group. For any of our new listeners out there, Fox's series of short, bite-sized podcasts 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 or consumers regarding their environmental and social impact; and minimizing the potential legal business and reputational risk that can be associated with ESG. In today's episode, we'll be talking about the perceived anti-ESG backlash which has been in the news.

And for that conversation, I'm very pleased to be joined by my partner and friend and co-chair of the ESG Practice Group, [Karen Davis](#). Karen, welcome back to the podcast.

**Davis:** Thanks, David. I'm excited to be here.

**Colvin:** That makes two of us. So, as I mentioned, there has been some pushback recently on ESG initiatives, particularly at the state level.

And so what I have in mind on that is, for example, over the summer we know that the state of West Virginia issued a ban on five major investment banks from doing business in the state of West Virginia based upon the view-- or the understanding --by the state that those banks had taken positions that were antagonistic to fossil fuels and to coal industry products.

We know that, for example, at the end of the summer the state of Texas banned 10 companies and 348 investment funds from doing business with the state of Texas based upon alleged, perceived antagonistic views towards energy companies. And then just more recently in the state of Louisiana in October, the state pulled approximately \$800 million of investment out of BlackRock. Again, for the same reasons, the perceived view that BlackRock was quote "anti-fossil fuel or anti-energy."

And all of those banks -- quick disclaimer, all of those banks and companies and investment funds have responded to those criticisms and denied those allegations -- but nonetheless, the states have taken these positions and so it's created the perception of a potential backlash related to ESG. And so that's what we're here to talk about, not to take a position on either side of the argument.

So, let me ask you just briefly, do you think that these anti-ESG actions at the state level are going to have an impact on the development of ESG programs, both with public and private companies?

**Davis:** I really don't see that happening, David. I think it's possible we might see a decrease in the rate of the increase in the amount of money that's being directed to ESG funds. And if that does happen, I think that would happen for a number of reasons. As we've previously reported, the SEC has proposed rules that would impose certain transparency requirements on ESG funds.

So, there is some pressure on ESG funds, but money has been pouring into ESG funds. For example, in 2021, over \$500 billion in the U.S. alone flowed into ESG funds, and that was an increase of 55%. And the demand for sustainable investing is coming from the bottom up. It's coming from individual savers, to large institutions. So, I don't see that going away. I think ESG investing is around for the long term, but more importantly for the companies that those funds are investing in, I think we're going to continue to see increases in the attention and resources that those companies are devoting to ESG initiatives.

I think there's a number of reasons, if we just look at it from a legal perspective, there's both the carrot and the stick approach. From the perspective of legal requirements, large global companies may currently be subject to rules that impose climate risk disclosures on them. For example, in the UK there is the TCFD reporting requirement that is currently in place and requires companies that are subject to that to compile and report on their climate risk. And as we have previously reported, the SEC in the U.S. has proposed a Climate Risk Disclosure Rule.

Companies recognize that complying with the SEC proposed rule is going to take time. They can't just flip a switch. They will need to develop mechanisms to collect and verify the data that will be required to be disclosed under the proposal. So, many companies have already begun to implement their programs. And while it's uncertain what exactly will be included in the SEC final rule, whether or not it'll include Scope 3 emissions, which is the entire value chain, and when they'll go final, I think the general thinking and understanding is that there'll be some form of climate risk disclosure from the SEC in the not-too-distant future, and companies are getting ready for that.

**Colvin:** Let me stop you there and if I can, just ask-- no one really knows what's going to happen with the SEC proposed rule on climate. It was expected when the rule was first announced that it would be implemented in some form or fashion by the end of this calendar year. There's been no forward movement towards implementation since the close of comment period --and in fact there have been some revisions due to some technical glitches with respect to the comments that have just further extended the process-- it seems unlikely that the rule is going to be implemented in whatever final form it takes by the end of this calendar year.

But in terms of support for the rule, I think at least in the literature I've been reading and in the conversations I've been having, it seems that folks are sort of a mixed mind when it comes to the rule, particularly those who work at companies that would be subject to it. Meaning that, many support what the rule is attempting to accomplish by way of providing additional information to investors, material information, when making investment decisions along the lines of climate and climate risk. But also concerned about the impact and the burden of not only the data gathering and putting in the infrastructure to identify, gather and then verify data, but just the cost of doing it.

And so, do you have any thoughts along those lines in terms of how companies that may share the values of, "Hey, we want to do the right thing and provide as much information as we can to our stakeholders?" But at the same time are concerned about, is this going to be worth it? A and B, how we going to pay for it? Do you have any thoughts to share with people who are of mixed mind?

**Davis:** I think, as I mentioned earlier, for large, publicly traded, international companies, they may already be required in other jurisdictions to compile and report on that information.

So, for them it's not as much of a heavy lift. And because the SEC rule, as proposed, and the proposals or existing rules and other jurisdictions are looking at the entire value chain, these large companies are pushing out the requirements to other companies, smaller private companies.

I think it'll be an evolution. I think it will take time. But I think it's coming. I think that this is not something where we're going to lose momentum and sort of retreat. I think that what we'll find is just moving forward --and there will be certain companies that are leading the way-- but I think we're going to find more and more companies are tracking their climate-related emissions, putting programs in place to verify the data. And of course, these are all just disclosure rules. These are not rules that are limiting the amount of emissions or requiring companies to reduce their emissions. These are just rules related to tracking and reporting those emissions.

**Colvin:** Right, and as we sit here again, as I mentioned on Election Eve if there's a new Congress and if the balance of power changes, perhaps that will also change the landscape from a regulatory perspective as we move into the years to come.

But, we've spent a little bit of time talking about the quote unquote "stick aspect" of incentivizing companies or motivating companies, perhaps the better word, to make certain disclosures and certain information available to their stakeholders. Can you talk a little bit about what's out there from a legal requirement perspective when it comes to the "carrots" that might otherwise incentivize companies to be making the types of disclosures that many stakeholders are demanding when it comes to ESG.

**Davis:** Sure. So, under the recent Inflation Reduction Act, there are a number of significant financial incentives for companies and individuals to pursue renewable energy. So, the Act extends the renewable energy investment credit, and it provides additional incentives under a number of circumstances, including investments in low-income communities and investments in communities that have been impacted by the closure of coal mines and coal power plants. And a variety of other circumstances, too. Princeton University did a study to model the impact. They concluded that the Inflation Reduction Act would drive nearly \$3.5 trillion in capital investment in energy supply infrastructure over the next decade. So, I think there's just a lot of momentum in terms of climate risk disclosure and capital investment in renewable energy. And I think that we'll see the trend continuing in that direction.

**Colvin:** For sure. So, we've spent some time now talking about climate, both the carrot and the proverbial stick. Can you talk a little bit, Karen, about legal requirements that fall under the S pillar of ESG and how the general anti-ESG movement, if it's even the right word, movement, may have an impact on that aspect of ESG?

**Davis:** Sure. So again, there are existing legal requirements that apply to companies.

For example, under the Uyghur Forced Labor Prevention Act, which is a current law, companies importing goods into the United States are required to demonstrate that products from a certain region of China were not made with forced labor. Also, many states have environmental justice considerations that must be considered in both environmental enforcement matters and environmental permitting processes.

So, those are existing legal requirements and we're seeing more and more states-- and on the federal government --more and more laws and requirements that are being put into place. And so, these are things that companies have to comply with.

**Colvin:** Yeah, and I think that We've spent a little bit of time on the legal reasons and requirements that may support the idea that companies -- whether those requirements, by the way, are proposed or existing -- that those requirements won't necessarily require or cause any scaling back in the ESG initiatives that the companies are either prioritizing or investing in. Can you talk a little bit from a stakeholder demand perspective, why it is that -- at least in the conversations you're having and what you're reading -- why it is that stakeholder demand probably suggests as well that there won't be any scaling back in what companies are doing from an ESG perspective?

**Davis:** From what I see, stakeholder demand has not diminished at all. In fact, it's ever increasing. Surveys have consistently found that customers are willing to pay more for ESG friendly goods. A recent study found that 88% of customers check the sustainability of a product before at least some purchases. And many customers are requiring suppliers to provide information on ESG metrics. And our law firm is among them. We have clients that require the firm to report on our DEI initiative and metrics each year.

Investor demand, we talked about, according to SEC Chairman Gensler, the impetus behind the SEC proposed Climate Disclosure Rule is that investors were demanding it. And so, with or without that rule, I think there is investor demand for additional disclosure on ESG metrics.

And employees, particularly younger employees, they want to work for companies that have a strong ESG program. They want to feel good about where they work. And so, ESG is a factor in a company's ability to attract and retain qualified employees.

Last but not least, are proposals for proxy statements. Last year was a new record in the 2022 U.S. proxy season. There were 247 ESG proposals. So, stakeholder demand from a wide range of stakeholders continues to increase.

**Colvin:** And on that last point, am I right --and feel free to correct me if I'm wrong-- am I right that the majority of those proxies failed? And while they may have failed, they're going to continue to be made. And at some point, it's anticipated that there will be a breakthrough.

Do you agree with that or do I have that wrong?

**Davis:** So, it's my understanding that most of the ESG proxy proposals failed because they were too specific, with the general thinking that management of company should determine how the company is run. But the proposals that were more goal-oriented and gave the company the ability to determine how those goals will be achieved, those were more likely to be successful.

But the overall goals of ESG are still being endorsed by shareholders.

**Colvin:** Understood, and I appreciate that clarification.

No ESG podcast would be complete without some discussion of risk and risk avoidance. And whether we're talking about climate risk, or whether we're talking about risk that stakeholders will pull up their stakes and move elsewhere, or really just the risk to the enterprise itself, climate impact directed at the enterprise and the areas in which it operates, or areas in which its supply chain operate. So, can you just talk a little bit with the idea of this quote unquote "anti-ESG backlash" in mind, talk just a little bit about the impact that may or may not have when it comes to risk and risk avoidance from an ESG perspective?

**Davis:** Many large companies have realized that sustainability is an integral part of the company's long-term success. And they recognize that in order to stay competitive, they need to have a strong ESG program. So, I think as part of the company's overall enterprise risk management system, ESG will be integrated.

I mean, we see that happening already in a number of large companies, that they identify ESG risks as entity-level risks and are developing programs to mitigate those risks over the long term. I think, to stay ahead of the curve, they're going to continue to grow their ESG programs, notwithstanding these actions that may have been taken by certain states that are labeled as anti-ESG.

**Colvin:** Understood, understood. Well, Karen, I guess the one thing we both know and the one thing we can say with certainty is that it's uncertain as to whether or not any of this anti-ESG action will take hold and continue and grow, or whether it will be muted, or whether it will just continue alongside with pushing forward with these types of initiatives at companies that make a priority addressing their climate impact, making it a priority to have a diverse and inclusive workforce. And who make it a priority to operate with a transparent governance structure among many other of the various factors that fall under ESG. I appreciate very much your time today and your valuable insight into these issues.

It's always good to talk to you and for those of you listening, please stay tuned for our next podcast, which should be dropping in about two weeks. Until then, everyone, be well, stay safe and we'll talk to you soon.