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ESG: Why Boards Are Getting on Board

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As the importance of—and attention to—environmental, social and governance (ESG) issues continue to increase societally, corporations must decide how they will proceed.

With no uniform requirements in place, there is no single, easy answer to the ESG question (although, this recent publication offers potential approaches to, and illustrative examples of, corporate oversight structure over ESG issues and disclosure methods). Therefore, this article does not discuss how boards should consider addressing ESG issues—but, rather, only *why* they should.

The growing ESG-related pressures facing boards come not only from a strengthening legal and policy framework surrounding ESG issues, but from a variety of other stakeholder and strategic business considerations.

Growing legal and regulatory pressures

Increased regulatory rulemaking is on the horizon, and not only in the United States but abroad. Consider, for example, the U.S. Securities and Exchange Commission's (SEC) recent emphasis—and proposed rulemaking expected by year end or in early 2022—on climate and ESG oversight and disclosures, including the formation (in March 2021) of a Climate and ESG Task Force on in the Division of Enforcement, followed by the released of a blueprint for reinvigorating climate and ESG-related disclosures, among other publicly released statements.

The Biden administration is focusing on ESG issues; rating agencies are proliferating; and litigation, quite predictably, has already begun—with an expected future focus on operations, governance and reporting; what is being disclosed, and how (or what has *not* been disclosed, and why); and whether any of this could potentially be alleged to be a breach of fiduciary duty.

Of course, directors are broadly protected by the business judgment rule, which requires them to duly consider their decisions, but gives them considerable discretion in doing so. However, recent cases in Delaware suggest that greater engagement and proactivity might be prudent, at least when it comes to considering the risks that ESG issues could potentially present.

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Pressures from various stakeholders

Beyond growing legal and regulatory pressures, boards are also facing scrutiny from all sides, and from various stakeholders.

Large (and no so large) investors are making increasingly clear their expectations that corporate CEOs and boards pay attention to and address ESG issues—or face decreased investment. And investor pressure is also coming from "activist" investors, such as hedge funds—either via dedicated PR efforts or by exercising their voting or proposal rights as shareholders (or both) and, in some cases, successfully incorporating ESG strategies into proxy contests for board control or representation.

On social media and elsewhere, customers have shown a willingness to put their dollars where their values are—and, even more impactfully, to withhold those dollars from corporations that do not adequately reflect those values.

Employees care greatly about such issues as diversity, climate change and sustainability as well—and can "vote" powerfully with their resumes, if not their shares. As the ability to attract and retain top talent is key to a company's long-term viability and success, employee satisfaction is not something boards can afford to take lightly.

Finally, media attention and public perception will continue to play a powerful role in determining a company's success—and can be significantly impacted by a company's handling of ESG issues.

Other strategic considerations

Boards are not only tasked with oversight responsibilities when it comes to preventing and addressing risks—they are also expected to see and take advantage of opportunities.

Beyond the potential for increased investment and/or corporate performance in portfolios and other opportunities mentioned above, if handled correctly, attention to ESG issues—such as investigating and implementing greater resource efficiencies as a corporate policy—could also potentially reduce a company's operating costs.

Conclusion

Boards will deservedly always have great discretion, and it is important that they undertake any ESG initiatives thoughtfully and carefully—and not merely in response to any external pressures or as part of a societal trend. It is also their responsibility to ensure that any ESG strategy ultimately undertaken aligns with and advances the company's mission and broader long-term business goals and strategy.

But, for the numerous reasons outlined in this article—both to avoid risks and take advantage of potential opportunities—if they have not already done so or done so seriously, boards would be wise to start carefully considering ESG issues.

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