ESG & SUSTAINABILITY ADVISORY PRACTICE

How To Build an ESG Practice Amid Backlash

Thoughtful and comprehensive. When Morgan Lewis partners Erin Martin, Carl Valenstein, and Jason Frank held a discussion with Aspen Aerogel's chief legal officer, general counsel, and corporate secretary Ginny Johnson and NetScout Systems' senior vice president, general counsel, and secretary Jeff Levinson about how to create an environmental, social, and governance (ESG) program amid increasing state, federal, and private backlash, those were the overarching themes. That is, they discussed the importance of being thoughtful in what to share about environmental and social goals and being thorough in governance practices and reporting—while addressing stakeholder concerns and aligning with the corporate mission. Below is an excerpted version of select points of their conversations.

Where is the resistance to ESG coming from and how is that affecting companies?

Erin: We are seeing anti-ESG movements from all levels: state, federal, and private. On the state side, certain governors are attacking prominent companies over ESG issues, specifically calling into question investment strategies that prioritize ESG and disclosures around their diversity data. On the federal level, a group of Republican senators sent a letter targeting major law firms that have an ESG practice advising them to tell clients about antitrust concerns around ESG. And private investors are attacking the time it takes to find and vet ESG-related investments.

Carl: ESG started as an organic, dynamic movement led by companies that were focused on socially responsible investing practices and focus on the interests of stakeholders beyond just stockholders. The current environment has politicized ESG and has pitted so-called red states against blue states with respect to the consideration of non-financial factors in investment, as well as companies speaking out on social issues. To the extent the anti-ESG movement results in the reduction in greenwashing and the standardization of ESG metrics then it will have had a positive effect. But companies and their investors are not going to retreat from consideration of

various stakeholders and interests beyond profit maximization that result in perceived long-term strategic value.

What is the impact of that resistance on in-house lawyers?

Jeff: There are three overarching themes that many in-house counsel balance when entertaining an ESG program:

1. Understand what your stakeholders are asking. While there may be a lot of noise out there against ESG principles, in-house counsel need to listen to their stakeholders and the communities where they operate. There is a lot of demand from employees to prioritize diversity, equity, and inclusion (DEI) and sustainability. Same from investors who are asking companies to publicly address their stewardship policies and their key community engagement issues, and also from customers who are requesting and expecting substantial information about a company's ESG strategy and practices, including governance and oversight.
2. Make sure you have a good understanding of your corporate mission, strategies, and goals. You need to know what you are trying to achieve.
3. Try to align and integrate your corporate ESG strategies with stakeholder requirements and corporate goals. Sometimes you may not be able to integrate it, but in most cases, you can align what your stakeholders are asking for and what you as a company want to do anyway (or are already doing) to build a program that integrates those demands, is effective, and implements a risk-based practice approach. As long as you can integrate with your company's mission, listen to stakeholders, and demonstrate long-term value, you will have an easier time building out ESG programs at your company.

Ginny: Identifying your key stakeholders and what their respective priorities are is crucial. That sounds fundamental, but ESG is a difficult beast to wrestle because it means different things to different people. So understanding which of those goals/objectives matter most to your stakeholders—your Board, your executive team, your employees, your investors, your customers, your suppliers, your communities—is a crucial step to building an effective ESG program.

Long before ESG became the in-vogue topic it is currently, the underpinnings of ESG have been important to companies for years. Sound corporate governance practices, employee engagement, diversity, and inclusion are the pillars of many businesses that prioritize being a good corporate citizen, and will continue as such regardless of real or perceived backlash. But for those companies that didn't necessarily have those priorities built into their corporate culture, the recent political backlash has made it easier for CEOs and boards at all companies to look at their ESG programs and priorities and ask if they should scale back spend and resources; it simply adds fuel to the fire for those companies that don't want to more heavily invest in these areas yet.

How is the SEC scrutinizing ESG?

Erin: In 2010, the Securities and Exchange Commission (SEC) released guidance addressing how the current business disclosure rules could be used to discuss climate-related concerns, depending on the materiality to the company. As a baseline, the disclosure required by public

companies should be tailored to that company and represent the material information necessary to make an informed investment decision.

In 2021, the SEC formed an enforcement task force and the Division of Corporation Finance published a sample comment letter addressing climate change disclosures, which tied back to 2010 interpretive guidance. In March 2022, the SEC proposed new climate-related disclosure rules that, if adopted, would represent a complete shift in how public companies are expected to report climate-related information. Instead of a principles-based and company-specific approach to disclosure, the SEC has essentially declared climate-related disclosures to be material to every type of company, in every industry and of every size. Full stop. The SEC did open up that proposed rulemaking for an additional comment period, which just closed November 1. That, in addition to recent public statements by the SEC's chair, could signal that the SEC is open to reevaluating the benefit versus effort around those disclosures. In addition to the climate-related disclosure rulemaking, the SEC has indicated it may require more details on human capital disclosures and may revisit the prior rulemaking on the topic.

Outside of climate-related disclosures, the SEC continues to focus on disclosure concerns for companies that tout ESG commitments but show little specifics on how they will meet those commitments. As a former regulator, one of the first things I often did when reviewing a company's filing was to look at its website and determine whether there was material disclosure on the public website that was not being provided in registration statements or periodic reports.

Ensuring that website and other public disclosures are accurate and balanced is just as important as your financial statements. Investors and the SEC are looking at everything you are providing externally. Being overly broad or lofty in public statements can give rise to SEC civil actions and also open companies up to private action. To help protect themselves, companies should be intentional and cautious when sharing ESG-related information and goals. As a rule, avoid the "everything but the kitchen sink mentality" when sharing ESG goals.

Carl: We are getting more requests as outside counsel to review ESG statements being made by companies before they are publicly disseminated. With the SEC looking at everything a company is putting out—websites, blog posts, diversity statements, and documents companies don't traditionally think of as SEC reporting—it is important for companies to take a holistic look at what they've been saying, and in some cases dial it back to ensure that any statements can be supported by real data. If companies don't have the data to back up their claims, especially as companies feel pressure to declare a target date to reach net-zero carbon emissions before they are ready, that's where they enter a danger zone. Companies will get called on that by both the regulators and private litigants. We are seeing an increase in not only SEC enforcement but also private class action lawsuits on sustainability claims.

What are the drivers of ESG at your company?

Ginny: There are lots of different drivers. I see it coming from all over the C-suite—investor relations, human resources, finance, operations, IT, product development, etc.—and all of these stakeholders bring different vantage points. The "G" in ESG tends to be overlooked in these conversations, as the climate/environmental and DEI/human capital issues may be somewhat easier—or at least more enticing—to discuss. But we can't underestimate the importance of having a comprehensive governance structure and best practices that will allow you to build a

quality narrative based on facts, metrics, and data in your public filings as well as voluntary disclosures around sustainability.

At the management level, ensuring appropriate governance varies wildly depending on the industry and company you are in, but it is imperative within any organization to prioritize and right-size the appropriate governance frameworks that will help you to achieve transparent reporting of measurable progress against ESG goals.

Jeff: This is an opportunity for in-house counsel to get involved in ESG. We do "G" all the time; that's not hard for us, but there is more attention on it. We have to get the right people in the room to talk about the other pieces that may not directly be in our charter in order to plan for what is coming next. Luckily, a lot of elements in ESG are not that different than what many companies are already doing. But the focus on ESG provides a spotlight on the areas you may not have focused as much on in the past. So it is more about bringing together existing practices into an integrated strategy with oversight from a holistic level.

How do you build an ESG program, especially in the current environment?

Ginny: Having a centralized, formal ESG program is something relatively new. Figuring out how to orchestrate which stakeholders need to be involved, how to build an effective governance structure, how to understand materiality and what your carbon emissions footprint is, are all important first steps when building a program. For me, I put the governance program in place and then went on a learning quest to see where we are now to plan for how to improve.

Determine and then share the key themes that are important to your stakeholders and figure out where you are today so you can build a story of improvement to tell in a year, three years, five years. I think it's important to be able to demonstrate progress over time and not set unrealistic or unreachable goals. New challenges will inevitably crop up and we need the flexibility to react and respond while moving forward the most mission-critical projects in the near term, while still keeping in mind the long-term goals.

For companies that are feeling the backlash a bit more strongly, the conversation is less about creating long-term value and more about answering the question, "Do we have to do this right now?" When you have a business to run and capital to raise, adding in additional ESG focus to the legal department mission might not be feasible on a large scale. I handle these competing demands by being practical and candid with my teams about what we can and should set out to achieve over the short- and long-term time horizons. I don't question whether most people see the value in ESG-driven objectives, but rather they might question "Do we need to do this right now?" especially given the absence of a final SEC mandate at the moment. We may see an evolving attitude about ESG being a necessary expense—if not a value driver—once the SEC mandates disclosures around it. Time will tell where the rules will land, and there will no doubt be litigation and ultimately enforcement actions well down the road.

Jeff: You need to start with a few key things:

1. What is the right internal governance?
2. Conduct a materiality assessment and understand as a company which of the ESG factors are material to your company. We are not going to chase everything; we have to

focus our time and attention on what is most important to your company and your corporate culture.

3. Bring together key leaders from different levels in the companies to both advise and liaison with different leaders in your company that have to do the work to accomplish these goals.
4. Create a disclosure committee to validate the numbers through a robust process to ensure good, complete, and accurate disclosures. This requires a solid process on how to validate your numbers. It's not hard to do the qualitative disclosures, but if you are setting goals and targets that is much harder. It is the next step in the evolution, how do you measure yourself, how do you report that, and what are reasonable goals.

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