

Session 18 – Law Lab

Environmental, Social & Governance Factors (ESG)
Does the General Counsel have a role to play?

Steve Leroy & Ford Shanahan

27 May 2021

Today's agenda

- Focus on a crucial business concept – ESG
- Discuss & analyse the General Counsel's role
- Disclaimers:
 - Mainly *Anglo-Saxon, global* perspective
 - *Introductory* big picture
 - *Subjective*, perhaps controversial views
 - *Non-exhaustive* overview

Content

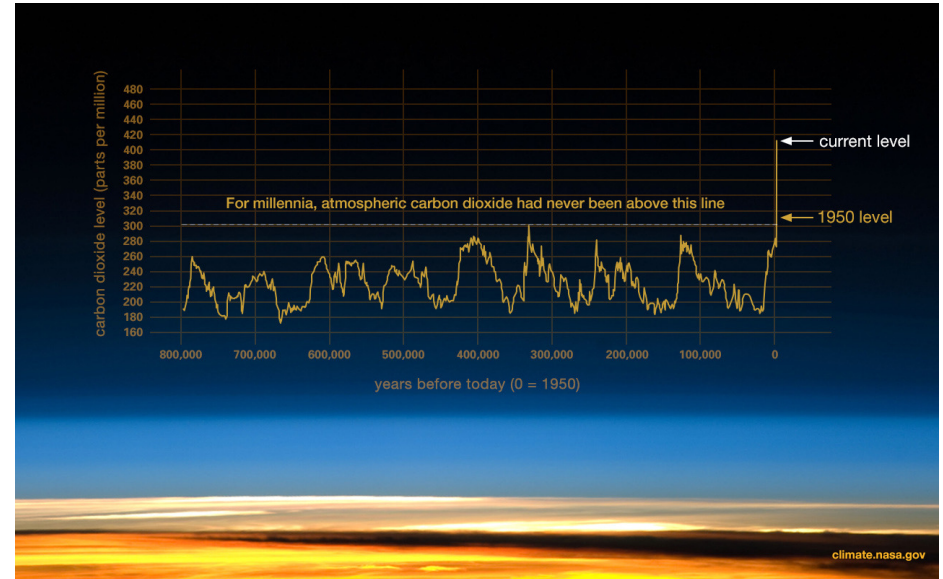
1. What are the issues? Does business have an obligation?
 - *Short group discussion*
2. How did we get here? A historical look
3. A role for the General Counsel?
 - *Breakout discussion*
4. Conclusion

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Climate Change

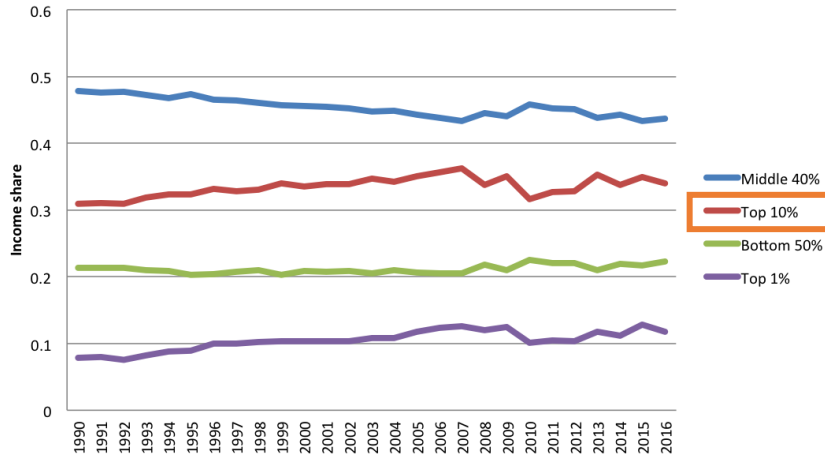
- Global temperature rise: + 1.14°C since late 1800s
- Warming ocean: +0.33°C in top 100m since 1969
- Shrinking ice sheets: ice sheets average annual decrease in mass since 1993:
 - Greenland -279B tonnes
 - Arctic -148B tonnes
- Glacial retreat
- Decreased snow cover
- Sea level rise:
 - 20cm in last century
 - Doubling rate in last two decades & growing
- Declining Arctic sea ice
- Extreme events (heat, rain, storms)
- Ocean acidification: +30% since Industrial Revolution



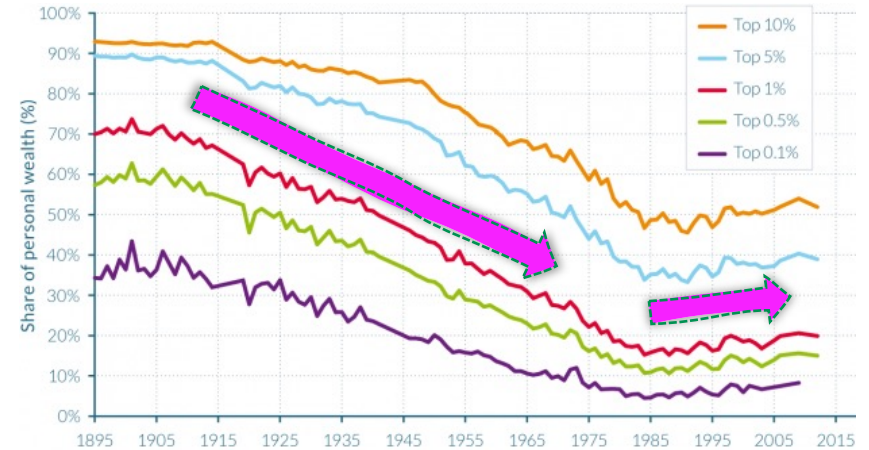
Source: climate.nasa.gov

Income Inequality – UK as Example

Income Share Over Time



Share of Personal Wealth



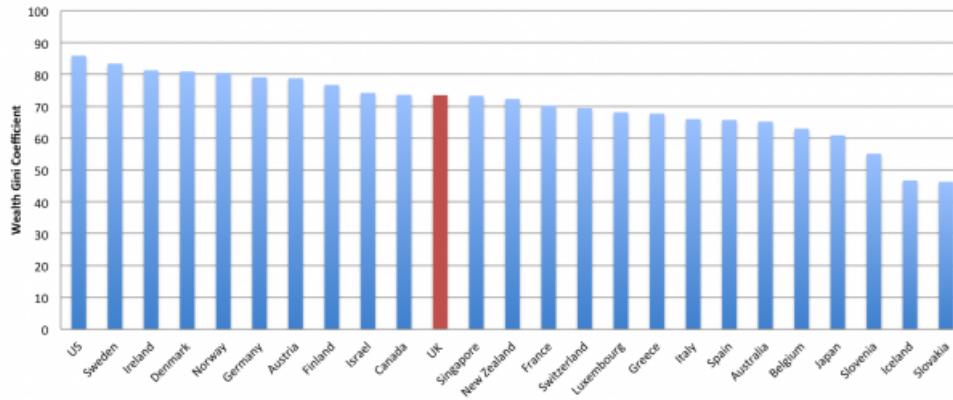
Source: Alvaredo, Atkinson and Morelli (2017). See wir2018.wid.world/methodology.html for data series and notes.
In 2013, the Top 10% owned 47% of personal wealth.

Source: equalitytrust.org.uk

Wealth Inequality – Selected Countries

Gini coefficient: 0% is perfect equality / 100% is perfect inequality

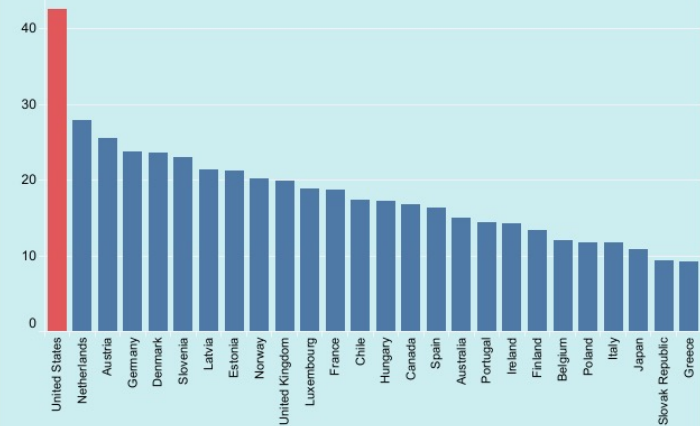
How unequal is wealth in different countries?



Source: World Economic Forum: The Inclusive Development Index 2018

The U.S. is Much More Top-Heavy Than Any Other OECD Country

Richest 1% share of national wealth, 2015 or most recent



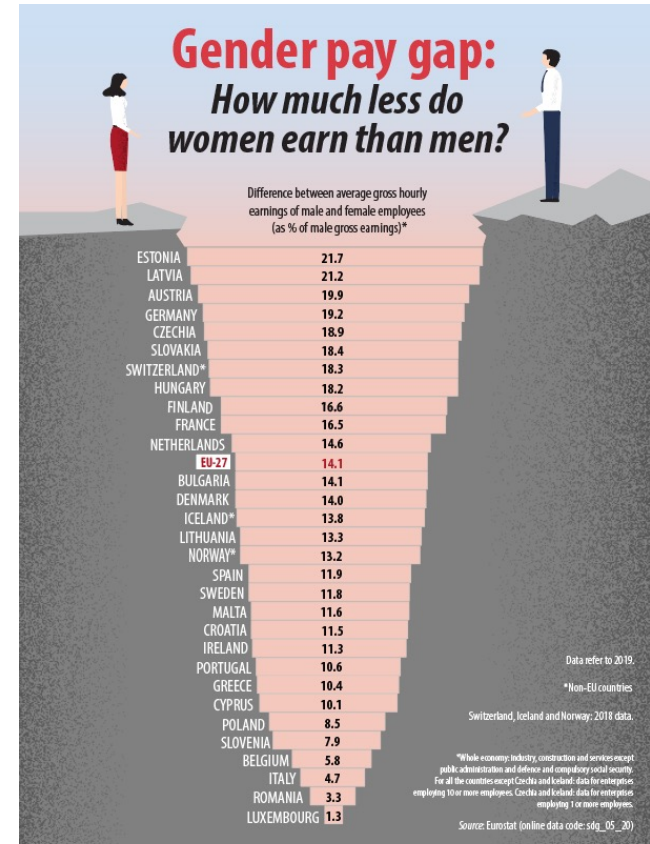
Source: OECD

Overall data source: inequality.org

Race & Gender Inequities



Photo credit: Lindsey Wasson/Reuters, Washington DC, 1 June 2020, via Business Insider

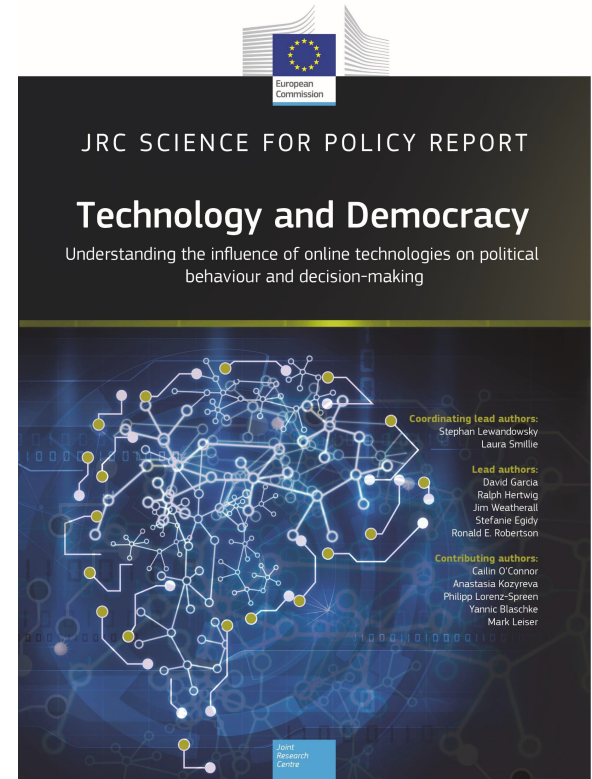


ec.europa.eu/eurostat

Source: ec.europa.eu/eurostat – 2019 data

Digital Technology

- Incomplete *regulation*
- Policymakers focus on *actors & content*, but should also focus on behaviour
- Pressure points for *behaviour*:
 - Human attention is the online commodity;
 - Choice architectures that guide choice online have a big behavioural impact (e.g. default opt-in or opt-out);
 - With algorithms, private actors curate content to maximise user attention for commercial interest, including typically attractive polarising & negative content that puts people in echo chambers.
 - Certain demographics are particularly susceptible to misinformation & disinformation, such as fake news.



Covid-19 – Health & Economy

“We are really not in this together. It is far, far worse for some than for others.” – Gertjan Vlieghe, Bank of England policymaker (FT, 17 November 2020)

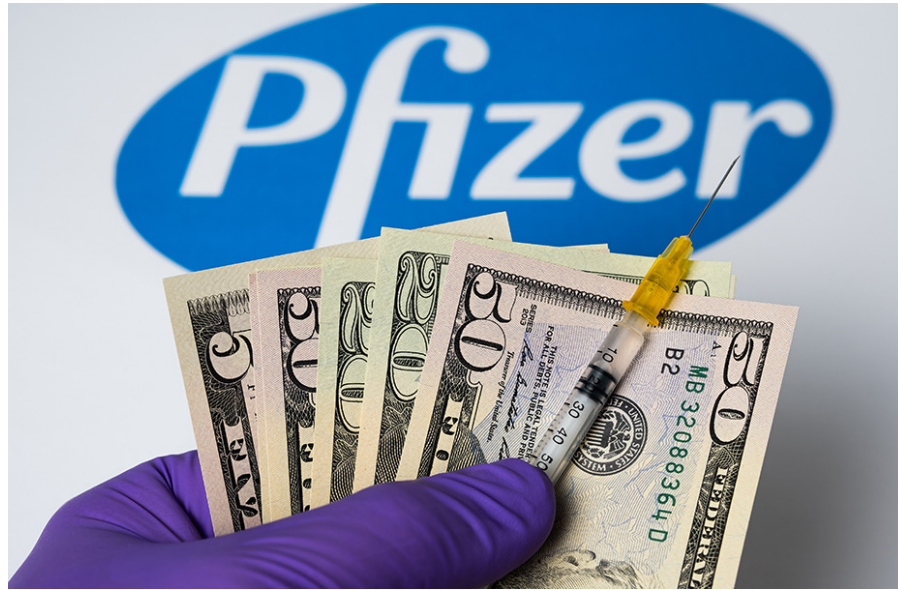


Photo credit: globaljustice.org.uk

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Group Discussion

Does business have an obligation to take into account environmental and societal issues, and to help solve them?

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Selected Historical References 1/2

- 1862:
 - Joint stock company
 - 1950s-60s:
 - Multinational corporation
 - Separation of ownership & control, with the latter exercised by professional management (Berle & Means, 1932; Chandler, 1977)
 - Responsibility of business (Bowen, 1953; Heald, 1970)
 - 1960-70s:
 - “Business exists to maximize shareholders’ profit” (Friedman, 1962 & 1970)
 - Agency theory and agency costs (Jensen & Meckling, 1976)
 - OECD publishes first guidelines for multinationals (1976; current version: 2011)
 - 1980s-90s:
 - Stock options to align management & shareholder interests and consequently reduce or eliminate agency costs
 - Hedge funds, venture capital, private equity, leveraged buy-outs
 - Stakeholder theory (Freeman, 1984)
 - Brundtland Report “Our Common Future” (1987)
 - CSR Europe business network launches (1996)
 - Global Reporting Initiative (GRI) launched after Exxon Valdez oil spill (Alaska) (1997)
- Colour legend:*
- Narrowly business-focused
 - Societally relevant for business

Selected Historical References 2/2

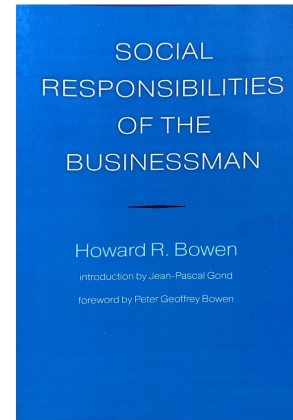
- 2000s:
 - UN Global Compact (2000)
 - Dot-com bubble burst (2002)
 - Financial Sector Initiative & UN Global Compact: “Who cares, wins” (2004): Environmental, Social & Governance factors
 - UN Principles for Responsible Investment (2006)
 - Certified B Corp (2006) and Economics of Mutuality (2007)
 - Subprime mortgage issues triggered global financial crisis (2007-2008)
 - 2010s:
 - Climate change (Paris, COP 2015), inequality (Piketty, 2014) and digital issues become clear
 - International institutions adopt further strategies, rules, guidance & principles: e.g. UN: Sustainable Development Goals, Business & Human Rights; ISO 26000; EU
 - Business focuses more on sustainability, CSR, Environmental, Social & Governance (ESG) topics, augmented by regulation (e.g. reporting)
 - Increase in privately held (family- and PE-owned) companies – under less scrutiny – versus publicly held companies (Schneider & Valenti, 2010)
 - Institutional investors and PE adopt ESG principles
 - “We are on the edge of a fundamental reshaping of finance” (Fink, BlackRock, 2019)
 - 2020s:
 - European Green Deal (2020)
 - US Climate Goals (2021)
- Colour legend:*
- Narrowly business-focused
 - Societally relevant for business

Corporate Social Responsibility (1953)

- Philanthropy by individual businessmen since mid 1800s
- Howard R. Bowen, (1953):

“Obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society”

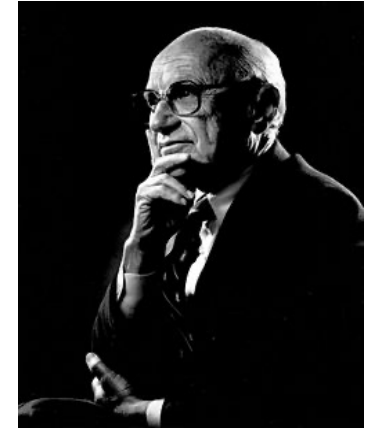
- Business & society interface
- Shift from societal to corporate perspective
- Economic justification:
 - Business case
 - Strategy (Porter)
 - Marketing, reputation
- Corporate citizenship



Howard R. Bowen – Photo credit: Unknown / The University of British Columbia

Milton Friedman (1970)

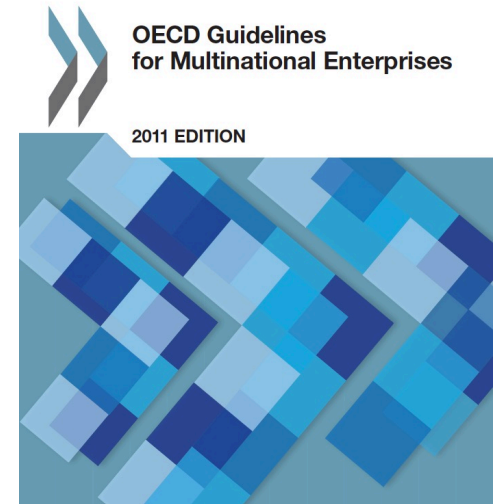
- *“The social responsibility of business is to increase profits”*
- *“The businessmen believe that they are defending free enterprise when they declaim that business is not concerned ‘merely’ with profit but also with promoting desirable ‘social’ ends; that business has a ‘social conscience’ and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are – or would be if they or anybody else took them seriously – preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades.”*



Milton Friedman – Photo credit: Wikipedia

OECD Guidelines for Multinationals (1976-2011)

- *Responsible Business Conduct principles and standards* set out the expectation that businesses – regardless of their legal status, size, ownership or sector – *contribute to sustainable development*, while avoiding and addressing adverse impacts of their operations including throughout their supply chains and business relationships.
- Areas:
 - Digitalisation
 - Climate change
 - Child labour
 - Sustainable Development Goals
 - Gender
 - Criminal exploitation of resources
 - Sports & corruption
 - Artisanal & small-scale gold mining
 - Public procurement



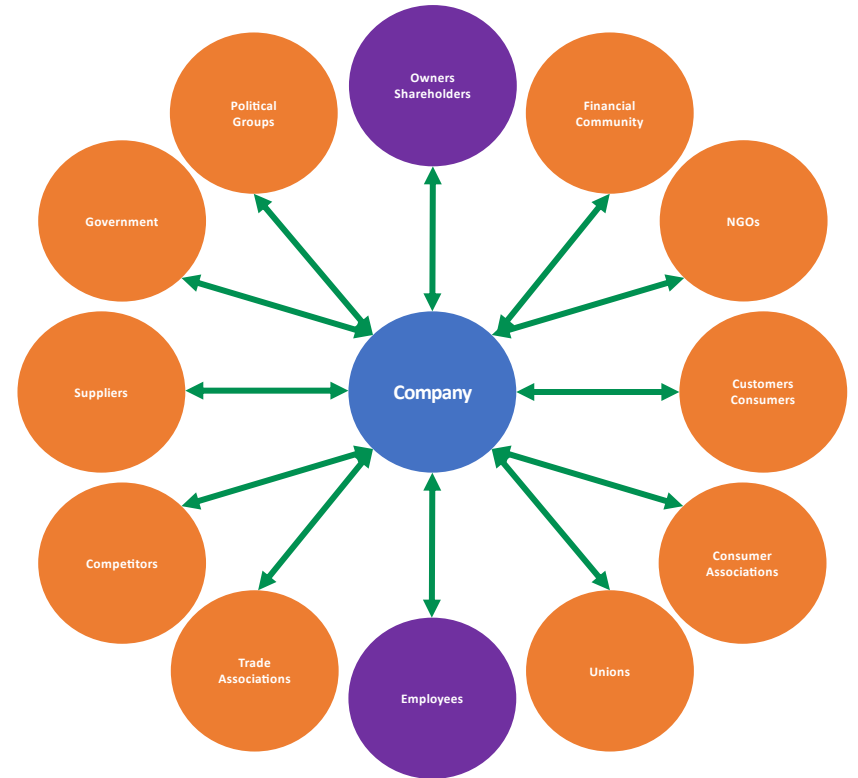
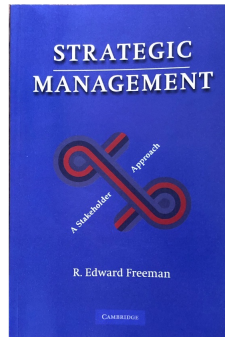
Stakeholders (1984)

- Stanford Research Institute (1963):
“Those groups without whose support the organisation would cease to exist.”
- R. Edward Freeman (1984):

“Any group or individual who can affect or is affected by the achievement of the firm’s objectives.”



R. Edward Freeman – Photo credit: University of Virginia Darden School of Business



Sustainable Development (1987)

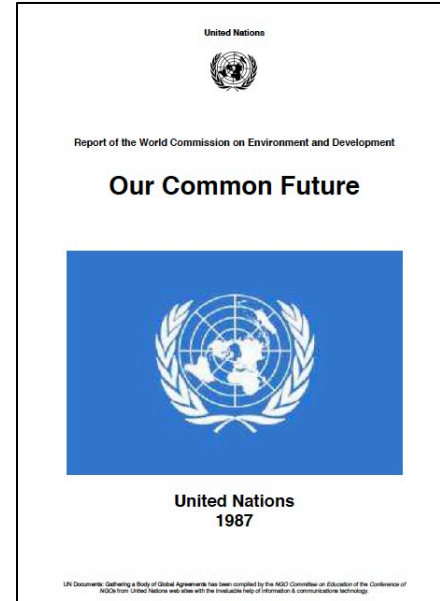
- Brundtland Commission report, “Our Common Future”, 1987:

“Sustainable development is the kind of development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

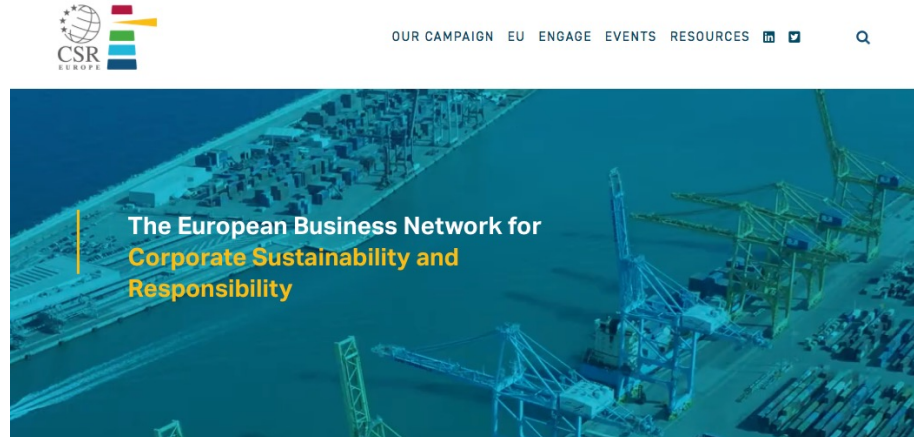
- Environment and more:
 - Economic growth
 - Social inclusion
 - Environmental protection
- Intergenerational equity
- Humanity
- Time – long-term perspective
- Sustainability



Gro Harlem Brundtlandt – Photo credit: GAD - CC BY-SA 3.0, <https://commons.wikimedia.org/w/index.php?curid=6581424>



CSR Europe (1996)



The European SDG Summit 2021

Save the date: The EuropeanSDG Summit will be back on **11th, 12th, and 14th October** for a new virtual and fully open edition.

[CONCEPT](#) [BECOME A SPONSOR](#) [PREVIOUS EDITION](#)

Global Reporting Initiative (GRI) (1997)

- Private initiative, founded in Boston, MA, USA, after Exxon Valdez oil spill
- Global standard setter for impact reporting
- Since 2017 guidance for corporate reporting on the UN Sustainable Development Goals with UN Global Compact



CONSOLIDATED SET OF GRI
SUSTAINABILITY REPORTING STANDARDS
2020



UN Global Compact (2000)

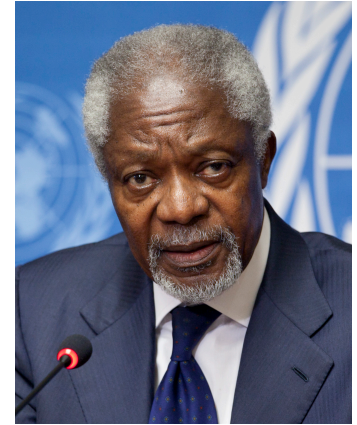
- *The world's largest corporate sustainability initiative*
- Ten Principles:
 1. Business should support and respect the protection of internationally proclaimed human rights; and
 2. Make sure that they are not complicit in human rights abuses.
 3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
 4. The elimination of all forms of forced and compulsory labour;
 5. The effective abolition of child labour; and
 6. The elimination of discrimination in respect of employment and occupation.
 7. Businesses should support a precautionary approach to environmental challenges;
 8. Undertake initiatives to promote greater environmental responsibility; and
 9. Encourage the development and diffusion of environmentally friendly technologies.
 10. Businesses should work against corruption in all its forms, including extortion and bribery.
- Lots of management guidance for sustainability



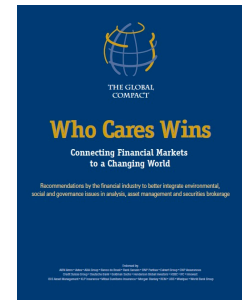
Environmental, Social, Governance Factors (2004)

Financial Industry & UN Global Compact, Who Cares Wins, 2004:

- “... we have refrained from using terms such as sustainability, corporate citizenship, etc., in order to avoid misunderstandings deriving from different interpretations of these terms. We have preferred to spell out the **environmental, social and governance issues**, which are the topic of this report.”
- “This report focuses on issues which have or could have a material impact on investment value.”
- “Ultimately, successful investment depends on a vibrant economy, which depends on a healthy civil society, which is ultimately dependent on a sustainable planet.”
- Long-term materiality: 10 years + and intangible aspects (e.g. *reputation*) impacting company value.



Kofi Annan – Photo credit: UN Mission, Geneva



UN Principles for Responsible Investment (2006)

- World's leading proponent of responsible investment
- *By investors, for investors*
- *Six principles:*
 1. We will incorporate ESG issues into investment analysis and decision-making processes.
 2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
 3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
 4. We will promote acceptance and implementation of the Principles within the investment industry.
 5. We will work together to enhance our effectiveness in implementing the Principles.
 6. We will each report on our activities and progress towards implementing the Principles.



Certified B Corporation (2006)

- Business that meets “*highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose*”
- Has an SDG Action Manager tool, in association with UN Global Compact



Image credit: bcorporation.uk

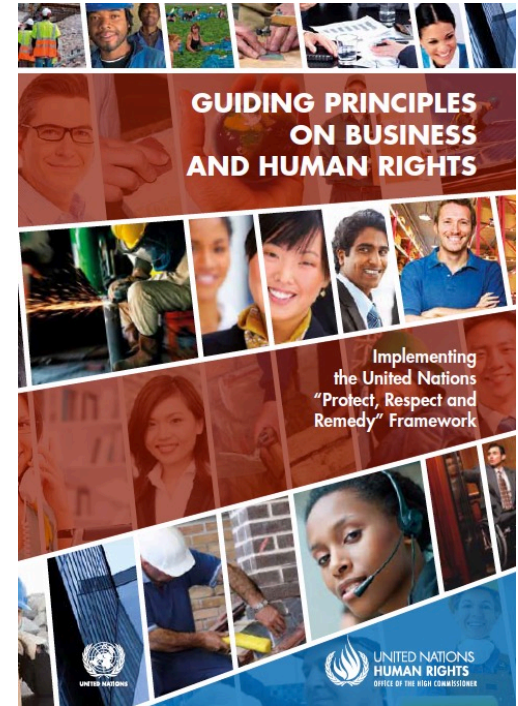
ISO 26000 (2010) – Guidance

- *Guidance for implementing sustainability*
- Not for certification as a management standard
- Complements ISO 14000 for environment



UN Business & Human Rights (2011)

- *UN Guiding Principles on Business & Human Rights*
- Guidelines for States and companies to prevent, address and remedy human rights abuses committed in business operations
- *Three pillars:*
 1. Protect: State duty to protect human rights
 2. Respect: the corporate responsibility to respect human rights
 3. Remedy: access to remedy for victims of business-related abuses



UN Sustainable Development Goals (2015)

SUSTAINABLE DEVELOPMENT GOALS

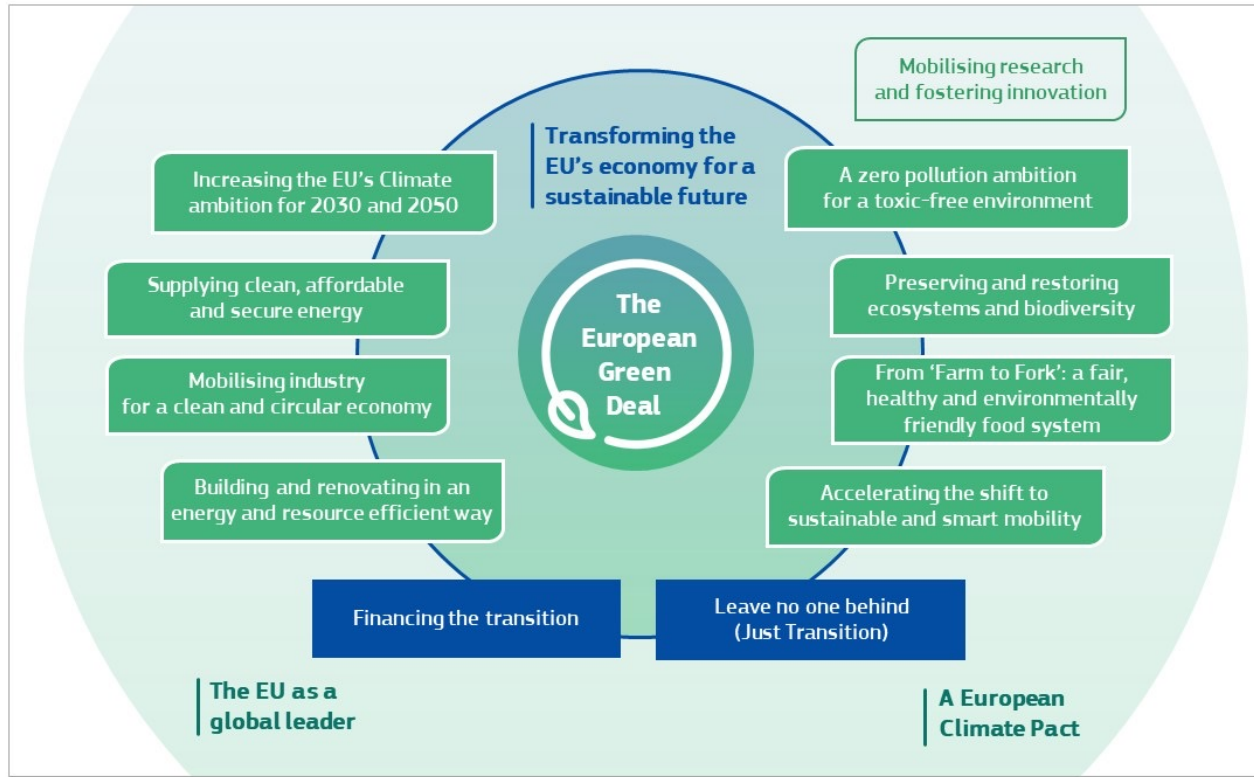


EU Non-Financial Reporting Directive (2018)

- Directive 2014/95/EU
- Around 6000 large companies must include non-financial statements in annual reports from 2018
- Applies for entities of 500+ employees
- Reports on the policies they implement in relation to
 - environmental protection
 - social responsibility and treatment of employees
 - respect for human rights
 - anti-corruption and bribery
 - diversity on company boards (in terms of age, gender, educational and professional background)
- Standards: e.g. ISO 26000, UN Global Compact/GRI, OECD Guidelines
- Now under review



EU Green Deal (2020): Climate Neutral by 2050



EU Taxonomy – Green Classification System (2020)



To qualify as green, an investment would need to contribute to at least one of these **six objectives**:



CLIMATE CHANGE
MITIGATION



CLIMATE CHANGE
ADAPTATION



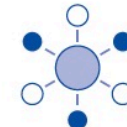
SUSTAINABLE USE OF WATER AND
MARINE RESOURCES



CIRCULAR
ECONOMY



POLLUTION
PREVENTION



HEALTHY
ECOSYSTEM

Source: Fact sheet “Financing sustainable growth, 18 June 2019, available on https://ec.europa.eu/info/files/190618-sustainable-finance-factsheet_en

USA (2021): Net Zero Emissions by 2050



Photo credit:
© Bloomberg

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Role for General Counsel & Legal Department

- Conscious of the organization
 - Personal beliefs and ethics
 - Ethics and beliefs of the Board, CEO and senior managers
- Understand and manage risk
 - Rarely a black & white scenario, non legal considerations
 - The legal mind-set and framing of options
- Decisions form a part of our corporate character / corporate ethos
- Corporations in a social context

Interaction & Collaboration with Stakeholders



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Breakout Discussion

- Discuss five important stakeholders for your companies
- Consider the expectations these stakeholders have towards your companies

	Stakeholder	Stakeholder	Stakeholder	Stakeholder	Stakeholder
Sustainability					
Diversity & inclusion					
Fair business practices					

Breakout Discussion (10')

Tip: take screenshot with your phone

- Discuss five important stakeholders for your companies
- Consider the expectations these stakeholders have towards your companies

	Stakeholder	Stakeholder	Stakeholder	Stakeholder	Stakeholder
Sustainability					
Diversity & inclusion					
Fair business practices					

- For each stakeholder, name:
 - Two benefits when meeting their expectations
 - Two disadvantages when you don't meet their expectations

	Stakeholder	Stakeholder	Stakeholder	Stakeholder	Stakeholder
Meet expectations					
Fail expectations					

Corporate Reputation

- Benefits of a good reputation
 - Higher pricing, increased sales, customers purchase broader spectrum of goods, qualified employees, lower cost of capital, sustainable growth
- Corporations often have more than just one reputation
- Value of reputation
 - Up to 70% of a corporation's market capitalization may stem from intangible assets such as reputation, brand and intellectual capital (Eccles et al., 2007; Neufeld, 2007; Weber and Shandwick, 2007)
 - *"It takes **20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently.**" (Warren Buffett, Berkshire Hathaway)*
- Management of reputation risk
 - Reputation risk is based on the notion that risk exists where a corporation's reputation exceeds its character (Eccles et al., 2007)
 - Many firms take their first steps in managing risk associated with reputation only after a crisis begins and with a particular emphasis on the immediate needs of protecting the reputation through public relations (Sims, 2009)

ESG and the Legal Department

Shareholder/investor questionnaires

- Policies and procedures in place
- Collecting information

Law department management

- Profile of in-house team and opportunities
- Questionnaires of retained firms

Strategic input and advice

- Discussing important issues with the executive team
- Consideration of various stakeholders
- Reputation risk

ESG Pillars

Environmental

- Production:
 - Carbon emissions
 - Energy use
 - Water use
 - Waste management
- Logistics:
 - Carbon emissions
 - Waste management
- Suppliers/upstream:
 - Carbon emissions
 - Energy use
 - Water use
 - Waste management
 - Deforestation
- Consumers/downstream:
 - Carbon emissions
 - Energy use
 - Water use
 - Waste management

Social

- Employees:
 - Health & safety
 - Diversity
 - Employee engagement
 - Human rights
 - Employee representation
- Suppliers/upstream:
 - Health & safety
 - Diversity
 - Employee engagement
 - Human rights
 - Employee representation
- Society/outside stakeholders:
 - Community relations
 - Government relations
 - Product quality
 - Customer satisfaction

Governance

- Company mission statement
- Board & shareholders:
 - Board composition
 - Shareholder rights
 - Board committees (e.g. audit, compensation)
- Executive compensation:
 - Ratio highest/lowest employee
 - Targets & incentives
- Enterprise Risk Management
- Data privacy & data protection
- Cybersecurity approach
- Crisis management procedures
- Ethics policies & codes:
 - Business conduct
 - Anti-bribery/corruption
 - Human rights
 - Diversity
- Whistleblowing hotline
- Internal audit process
- Transparency & reporting
- Tax policy

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- ESG:

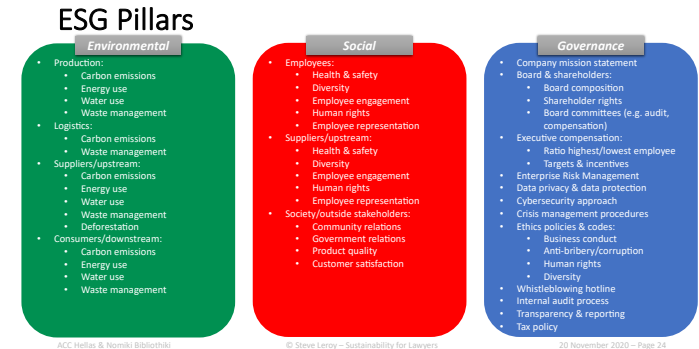
- From “financial capitalism” to “stakeholder capitalism”
- Fast moving area – learn as we go – be tolerant of change & speed
- Areas of soft law and hard law

- Collaboration:

- Enormous challenges cannot be tackled alone
- Work with internal & external stakeholders

- Role of the General Counsel:

- Lead on many Governance aspects
- Support on Environmental & Social
- Strategic transversal roles: General Management, Legal, Corporate Affairs & HR



Thank You

Steve Leroy & Ford Shanahan

27 May 2021

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