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THE SPOTLIGHT

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WEALTH PLANNING, ADMINISTRATION, AND DISPUTES GROUP

CONSIDERATIONS REGARDING THE F(IDUCIARY) IN ESG

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The Spotlight is the result of ongoing collaboration between our national trial practice and estate planning groups, with the goal of providing a forum to discuss the latest news and other issues impacting the trusts and estates community. Whether you are a trustee, beneficiary, trust officer, attorney, financial advisor, or other professional in this area, we hope that you will find this newsletter interesting, informative, and perhaps at times even a bit entertaining.

As leaders and teachers in the field of wealth planning and administration, our attorneys have built a reputation for excellence in meeting the needs of individuals and organizations from basic to complex testamentary planning. We counsel individuals and business owners in all aspects of estate planning and business succession, providing them with peace of mind and reassurance that their legacy is in the best of hands.

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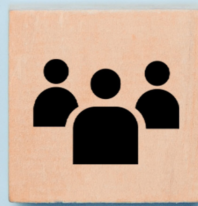
Is there a topic affecting your practice that you would like us to discuss in an upcoming issue of The Spotlight? Let us know at all_marketing@robinskaplan.com.

– Denise S. Rahne and Steven K. Orloff



CONSTITUENCY STATUTES:

THE OVERLOOKED PREDECESSOR TO THE ESG MOVEMENT

BY ANNE M. LOCKNER

ESG—environmental, social, and governance—has been the new hot topic for the last several years. Yet companies are still trying to come to grips with what it means and how they can address these varying and often competing interests of shareholders and other stakeholders.

Some have questioned how the idea of ESG can be reconciled with the traditional "maximizing value for the shareholder" or "shareholder primacy" theory. But many might be surprised to learn that, long before "ESG" became the acronym du jour, most states had enacted some flavor of a "constituency statute" that allows a board of directors to consider various other constituencies when making decisions on behalf of the corporation.

For instance, Minnesota's statute provides that directors may consider a broad array of interests, including:

... the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.

Minn. Stat. § 302A.251, Subd. 5

Statutes like this appear to give directors wide latitude and cover for decisions that may not fit the "primacy of the shareholder" model. And indeed, these statutes were enacted at the behest of directors of boards during the 1980s heyday of hostile takeovers—when the barbarians were at the gates, so to speak. Some directors believed that takeovers were not in a corporation's long-term best interest but feared fiduciary-duty claims if they resisted a hostile takeover that would have provided short-term financial gain to the shareholders.

As a result, directors turned to state legislatures and sometimes threatened to incorporate elsewhere if a constituency statute was not passed in the current state of incorporation. Wanting to keep employers in the state, many state legislators passed these laws—sometimes rather expeditiously. For example, Pennsylvania was the first state to enact such a statute, in 1983, after Scott Paper Company and Gulf Oil Corporation, both facing potential hostile takeovers, threatened to leave the state if the statute was not passed.

That constituency statutes were meant to benefit directors is perhaps best reflected by the fact that none provide an enforcement mechanism for any of the non-shareholder constituencies. Are you an employee or supplier that believes a company's board is not giving due consideration to how a given decision will affect you? Too bad. Not only are the statutes permissive (the board is not required to give thought to other constituencies), but the statutes have no private right of action and cannot help you. It will only help the director defend against a shareholder who believes its interests must prevail over all others. But some would argue that these laws have done little to benefit directors, either.

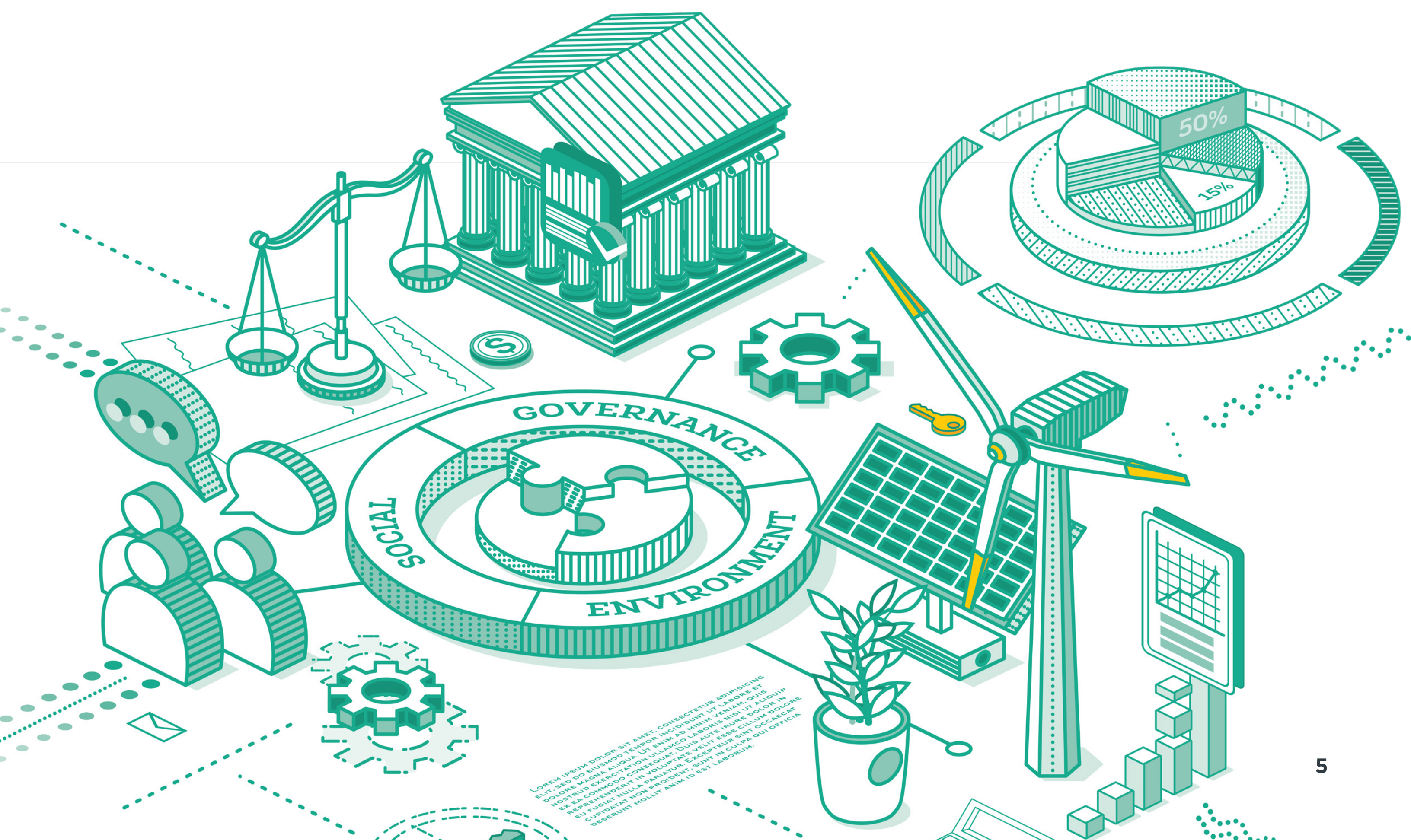
And that is because, notwithstanding a majority of states that codified constituency statutes, one state has not: Delaware, the state where the majority of corporations are incorporated. Indeed, Delaware law has established the Revlon standard, which requires that, when a company goes up for sale, the board must maximize the value for the shareholder.

Some have suggested that Delaware has a "quasi-constituency statute" in the post-*Revlon* case, *Paramount Communications v. Time, Inc.*, where the Supreme Court of Delaware upheld Time's rejection of a highly profitable tender offer from Paramount to instead merge with Warner Brothers in what the board believed would provide better long-term benefits to the corporation. But, even that case did not address the interests of stakeholders other than shareholders. In sum, Delaware is known for its "primacy of the shareholder" model.

Because of Delaware's overwhelming influence in corporate jurisprudence, constituency statutes from other states often are overshadowed—or overpowered—by the traditional focus on the interests of the shareholder. Indeed, directors remain reluctant to choose a path financially detrimental to shareholders, even if there may be countervailing benefits to non-shareholder stakeholders. For example, if a company were to put itself up for sale and the highest bidder was an entity with a history of polluting and the next highest bidder promised more environmentally favorable practices, directors in recent years have still been likely to go with the polluting entity, because shareholders can easily quantify their losses and bring a breach-of-fiduciary claim. And directors have been reluctant to rely on constituency statutes when defending fiduciary-duty claims for fear that doing so would result in a lower stock price by suggesting that the company's shareholders are not paramount. Therefore, despite their prolific presence in statute books throughout the country, constituency laws have rarely been litigated and have done little to bolster the interests of non-shareholder stakeholders.

Somewhat surprisingly, it's the shareholders who've succeeded in getting companies to consider other constituencies. While the term "ESG" first appeared in 2004, it was BlackRock CEO Laurence Fink's 2016 annual letter to corporate CEOs that catapulted "ESG" into the corporate zeitgeist, where it remains today. Fink argued that boards needed to be more strategic in creating long-term value for their shareholders and less focused on near-term profits. He stated: "Generating sustainable returns over time requires a sharper focus not only on governance, but also on environmental and social factors facing companies today." And further: "At companies where ESG issues are handled well, they are often a signal of operational excellence. BlackRock has been undertaking a multi-year effort to integrate ESG considerations into our investment processes, and we expect companies to have strategies to manage these issues."

Going forward, it will be interesting to see if constituency statutes see any revival in light of ESG efforts. Or, as is more likely, will directors instead argue that considering other stakeholders is just another way of providing long-term value to their shareholders?



LEGAL STRATEGIES FOR ESG INITIATIVES

BY PETER N. FOUNDAS AND MANLEEN SINGH

Environmental, social and governance ("ESG") factors now play a major role in business decision-making. The ESG Global Study 2022 published by the Capital Group reveals that 26% of global investors say that ESG concerns are "central" to their investment approach.[1] Regulators also have taken notice, with the Securities and Exchange Commission announcing last year that it is studying ways to develop and implement standardized disclosure rules for reporting environmental metrics.[2]

The question now for many business leaders is not whether they should commit to ESG causes, but how to do so effectively. This article discusses legal strategies that business owners, directors, officers, and management should consider when implementing ESG initiatives.

THE QUESTION NOW FOR MANY BUSINESS LEADERS IS NOT WHETHER THEY SHOULD COMMIT TO ESG CAUSES, BUT HOW TO DO SO EFFECTIVELY.

CORPORATE STRUCTURE

ESG considerations may cut at the heart of what your business does. If so, one way to place your ESG efforts at the center of your business is to incorporate or convert to a public benefit corporation ("PBC"). Available in most states, a PBC is a distinct corporate form that requires a company to state in its charter document what benefit it will pursue and how it will do so. Incorporating as a PBC has the benefit of placing your ESG goal at the heart of your business model and can help in recruiting and retention. This structure also makes clear that directors and officers can make the public benefit a central focus of decision-making without fear of facing fiduciary claims. However, this corporate form may come at a cost; PBC statutes typically have mandatory reporting requirements and subject the company to potential shareholder challenges regarding progress toward the stated public benefit. While this is a significant step that may require additional start-up capital to implement proper reporting structures, incorporating as a PBC clearly signals that your ESG goal is just as important as pursuing profits.

ORGANIZATIONAL DOCUMENTS AND POLICY STATEMENTS

A less drastic but still impactful way to focus on ESG issues is to meaningfully discuss your ESG goals in your company's organizational documents. There are many options here, ranging from setting forth specific directives to the directors and officers, establishing director or officer positions to monitor for progress, or, more broadly — if your jurisdiction allows it, simply make it clear that considering ESG factors will not violate fiduciary obligations. Keep in mind that governance documents may not be easy to amend, especially if your business has many owners, thus it may be difficult to adopt language that is acceptable to a requisite number of equity holders. However, the benefits of discussing ESG goals in your charter documents are twofold: (1) the company will have demonstrated a focus on and clear commitment to ESG issues at the highest levels; and (2) the company will have a structure and road map to implement the initiative.

If amending organizational documents is not feasible (or even if you have already done so), consider developing an ESG policy statement that identifies the main goals you hope to accomplish. This statement should detail in plain language the specific ESG goal or goals you are seeking to achieve and should include specific metrics you will use going forward to measure progress, such as tracking diversity in hiring, greenhouse gas emissions, philanthropic contributions or gender pay equity.

SUPPLIER AND VENDOR RELATIONSHIPS

A key part of the success of many businesses is strong relationships with external vendors, suppliers, and service providers. These relationships also provide a critical opportunity for a business to further its ESG goal by strategically choosing to partner with others that share similar values. Practically speaking, it may be difficult to find much information on a third party's ESG initiatives relying solely on publicly available information. Opening a dialogue on these issues may lead to a surprising realization that your vendor or supplier already has ESG programs or metrics in place. If they do not, give thought to what key performance indicators your business may want them to incorporate in the next contract renewal and have open discussions about the costs of compliance. One thing is certain here – if you do not discuss ESG concerns with your vendors, service providers or suppliers, they will never know that these issues matter to your company.

CAREFULLY VET ACQUISITION TARGETS

If your business grows through mergers and acquisitions, then strategically selecting your next target can further your ESG goals. Consider developing an ESG section in your diligence questionnaire to potential targets or incorporating ESG topics in interviews with key personnel. Placing a focus on ESG concerns in the due diligence process can help to uncover hidden risks in areas such as energy usage, supply chain management, diversity and inclusion efforts, and cyber security.

CONFRONTING BACKLASH

Directors and officers may be surprised to find that implementing an ESG strategy can cause backlash among investors, employees, or other important stakeholders. ESG factors are now in the political crosshairs, as Texas recently passed legislation barring the state's retirement and investment funds from doing business with companies that are boycotting fossil fuel companies and Florida recently announced it will consider legislation banning its state pension fund from selecting investments based on ESG criteria.

At the business level, if the message is not resonating on a moral level, one way to deal with any backlash is to focus the conversation on the positive financial impacts of ESG initiatives. One recent meta-analysis of over 1,000 ESG studies showed that 58% found a positive relationship between ESG and financial performance.[3] Another study from 2020 states, "Companies with high ESG scores, on average, experienced lower costs of capital compared to companies with poor ESG scores."[4] Additionally, framing ESG initiatives as improving corporate decision-making, ensuring equity in compensation, and fostering a culture of thoughtful leadership can minimize dissent and showcase how management is adhering to its fiduciary responsibilities.

KEY TAKEAWAYS

ESG initiatives can cover a range of topics and involve various segments of your business. The key is to start with a clear plan at the highest levels of your organization to properly scope the issues and define how you will measure success. Beyond a good policy statement, think critically about how your strategic partners and alliances can advance your ESG goals, and be prepared to deal with pushback from unexpected sources.

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[1] https://www.capitalgroup.com/content/dam/cgc/tenants/eacg/esg/global-study/esg-global-study-2022-full-report(en).pdf (Accessed September 2, 2022) at p. 9.

[2] See SEC Statement, dated March 12, 2021, https://www.sec.gov/news/public-statement/lee-climate-change-disclosures

[3] https://www.stern.nyu.edu/sites/default/files/assets/documents/ESG%20Paper%20Aug%202021.pdf (accessed September 1, 2022) at p. 4-5.

[4] https://www.msci.com/www/blog-posts/esg-and-the-cost-of-capital/01726513589 (accessed September 2, 2022).

GREENWASHING LITIGATION IS INCREASING

BUSINESSES SHOULD BE ADVISED ON HOW TO DEFEAT THEM

BY GABRIEL BERG AND WALEED ABBASI

Newspapers often expose famous actors who publicly profess to be ardent climate change activists committed to reducing their carbon footprint while traipsing across the world aboard private jets. The World Economic Forum, for example, pledges to limit "global warming to 1.5 degrees Celsius to avoid catastrophe," while the private plane tarmac at the annual conference in Davos, Switzerland, resembles the FDR Drive at rush hour.[1] Yet, the headlines criticizing actors or businesspeople for flying privately to Davos are flash-in-the-pan stories. The reason these famous actors retain their images in the face of these articles is because they are beloved or despised no matter what they do.

Business leaders tend to emerge mostly unscathed, too, but for very different reasons. For businesses, an opportunity to increase market share across virtually all industries by promoting socially responsible business policies and practices has become an unstoppable force, invading boardrooms across the world. Though too often politicized, industries such as oil and gas, media, farming, airlines, cosmetics, apparel, and investment firms have received the message — and many businesses are delivering.

Promoting environmental, social, and governance ("ESG") investment and business practices has led businesses to publicly declare their products and services to be "eco-friendly," "sustainable," and "carbon-neutral," among other socially conscious descriptors. According to Morningstar's "proxy database," 43 anti-ESG proposals considered by businesses in 2022 received only 7% shareholder support, compared with 30% support for all other shareholder proposals.[2] Pressured by a new generation of consumers, many businesses are finding that being a good corporate citizen has become much easier — and empirical evidence shows bottom lines have been rewarded for it.

In instances where the bottom line clashes with ESG initiatives, directors, officers, and management must take caution not to fall into the trap of "greenwashing," the practice of conveying false, misleading, incomplete, or unsubstantiated information to consumers about a business's environmental credentials. Or, more practically, saying one thing and doing the opposite. And companies lured by the temptation find that greenwashing appears to work. According to U.K. consulting firm Behavioural Insights Team, 57% of consumers in a recent study "believed that greenwashed claims were a reliable source of information about a company's eco-practices."[3] Further, the Morningstar proxy report asserts that the most successful anti-ESG shareholder proposals, which often pass, involve lobbying practices.[4] These proposals support lobbying efforts to defeat specific

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"eco-friendly," "sustainable," and "carbon-neutral" legislation, in direct contrast to many companies' affirmative, public statements to the contrary.

Consequently, a cottage industry of greenwashing litigation has been spawned. Typically, greenwashing claims include false advertising, deceptive trade practices, and fraud, and many of the greenwashing cases have been filed as class action lawsuits, targeting the most general of environmental claims. Shareholders, trustees, or others with beneficial interests in companies should think hard about whether their chosen ESG-focused investment lives up to the rhetoric. Likewise, directors, officers, and management overseeing ESG publicity campaigns should take care to ensure those words are not hollow.

Greenwashing cases, however, are in their infancy, and proving these claims is extremely difficult. By their nature, plaintiffs have the difficulty of discovering proof that a business is greenwashing. That burden has led many plaintiffs to rely on general studies or media reports — fodder for withering cross-examination. This evidentiary difficulty compounds the problem of defining the specific greenwashing claims on the merits. The New Climate Institute studied the plans of 25 multinational companies and found in its February 2022 "Corporate Climate Responsibility Monitor," that it is "more difficult than ever to distinguish between real climate leadership and unsubstantiated greenwashing."[5]

Missing or inconsistent regulatory standards make discerning greenwashing from model corporate behavior hard to discern. How are "sustainability," "low emissions," and "carbon neutrality" defined and measured? Neither the Federal Trade Commission ("FTC") nor the Securities Exchange Commission ("SEC") has passed or amended any regulations with the requisite specificity to create up-to-date standards and norms. Though, to be fair, the regulations are inevitable. In March of this year, the SEC proposed sweeping new rules on climate disclosures and have since conducted some "ESG quality reviews" of banks' and investment firms' marketing materials. This year, the FTC also is due to update its 2012 "Green Guides," applicable to publicly promoting "the environmental attributes of a product."[6]

In short, more ESG claims regulation is almost certain, though long overdue and sputtering. The SEC's proposed new climate disclosures, for example, were expected to pass earlier this year, but they are facing critical comments from some business sectors.[7] On August 5, 2022, the FTC announced it "intends to" seek comments on the updates to the Green Guides, suggesting its update is already tardy.

In the interim, law firms run leagues ahead of the regulators. Sophisticated defenses and risk mitigation strategies have been developed to counter greenwashing litigation and accusations. Even so, and critically, corporate clients should be advised only to make environmental responsibility claims that are specific — and supportable by scientifically reliable data. Proving the scientific veracity of a public assertion before anyone can credibly accuse a business of greenwashing can increase market share and blunt any greenwashing lawsuit. Armed with industry-specific methods to track and measure ESG quantitative data, even now, many businesses voluntarily publicize the data on their websites and exceed even the SEC-proposed rules. This information often is compared with historical statistics and may include forward-looking targets. The data systematically should be updated to be current.

Rewards for ESG initiatives are too important to be jeopardized by making hyperbolic or unsupportable public statements. Businesses should seek counsel before stating their environmentally friendly credentials, because the comprehensive data is available to guide the statement prior to release. Trustees and other active shareholders concerned about ESG factors should consult with legal professionals to determine if litigation is warranted if a particular company is not living up to expectations.

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[1] https://www.weforum.org/topics/climate-change/
[2] https://www.morningstar.ca/ca/news/225811/anti-esg-proxy-explosion-ends-with-a-whimper-not-a-bang.aspx
[3] https://www.bi.team/blogs/there-is-a-growing-epidemic-of-climate-anxiety/
[4] *Id.*
[5] https://newclimate.org/sites/default/files/2022/02/CorporateClimateResponsibilityMonitor2022.pdf at 4
[6] https://www.ftc.gov/news-events/news/press-releases/2012/10/ftc-issues-revised-green-guides
[7] https://www.sec.gov/comments/s7-17-22/s71722.htm

MEET OUR ISSUE EDITOR:

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Peter N. Foundas is a senior associate in the firm's business litigation and transactions group. Peter has extensive experience litigating fiduciary breaches, financial fraud, unfair trade practices and freeze outs in courts across the country. Additionally, Peter advises business owners, boards, and other fiduciaries on commercial transactions, real estate deals, and mergers and acquisitions. Peter draws from his prior work as an auditor with a big four accounting firm to integrate practical business advice as part of his legal advocacy on behalf of his clients. Peter can be reached at **PFoundas@robinskaplan.com**.

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REMINDER: WEALTH PLANNING, ADMINISTRATION, AND FIDUCIARY DISPUTES GROUP ANNUAL CLE EVENT

Thursday, October 13, 12:30 p.m. – 5:00 p.m. (with networking reception to follow).

The seminar will take place live in our Minneapolis office with simulcast to other cities. This year's program will include presentations and panel discussions on ethical issues and dilemmas in fiduciary disputes, as well as our regular roundup of current issues in wealth planning, administration, and fiduciary disputes.

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