PERSPECTIVES

Crosscurrents: J.S. Held's Environmental, Social & Governance Observations (Fiduciary Duties Become Political)

Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

INTRODUCTION

The Attorneys General for both Indiana and Louisiana have issued opinions that environmental, social, and governance (ESG) criteria violate the fiduciary duty owed to corporate investors absent full disclosure of the use of ESG criteria. Both opinions rely on fiduciary duties arising from state and federal law regulating securities. Risk managers, attorneys and investors will be interested in the politicization of ESG investments as discussed below.

INDIANA'S DEEP DIVE

Indiana Attorney General Todd Rokita issued an 18-page opinion answering three questions:

1. Does Indiana law prohibit the Indiana Public Retirement System's (INPRS) board (Board) from choosing investments or investment strategies based on ESG considerations?

2. Does Indiana law prohibit the Board from exercising voting rights appurtenant to its investments based on ESG considerations?

3. Does Indiana law prohibit the Board from retaining investment advisors that make investments, set investment strategies, engage with portfolio companies, or exercise voting rights appurtenant to investments based on ESG considerations?

Rokita's answer to all three questions was a resounding "yes."

1. Yes. As trustees of various pension funds, the Board owes fiduciary duties to beneficiaries to "invest its assets with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims," Ind. Code § 5-10.3-5-3, while also investing and managing trust assets "solely in the interest of the beneficiaries." Ind. Code § 30-4-3.5-5. **Investing for other purposes, such as to further general environmental, social, or governance goals, violates these duties.**

2. Yes. For the same reasons that the Board may not invest for reasons other than the financial interests of the fund beneficiaries, it may not exercise rights appurtenant to those investments based on extraneous considerations.

3. Yes. The Board is statutorily authorized to use Investment Managers, but those managers are required to act in the same manner as a trustee would owing a fiduciary duty to its beneficiaries.

These answers result in three clear takeaways for Indiana corporations:

1. Investment strategies that include ESG are now at risk in Indiana for breach of fiduciary duty claims by both the Attorney General and plaintiff-beneficiaries.

2. The INPRS Board is prohibited from doing business with firms that have committed to any climate initiative.

3. The INPRS Board cannot consider ESG in its investing.

There is a lot more to unpack in the 18-page opinion, but Attorney General Rokita has laid out a roadmap for potentially successful litigation against any investment manager who either is committed to any climate initiative or considers ESG data in the investment decision-making process.

LOUISIANA'S INVESTMENT GUIDANCE

Louisiana Attorney General Jeff Landry does not need as much ink to get to the same point. Louisiana securities laws control any registered dealer, a fiduciary under Louisiana law, who sells or offers to sell securities.

According to Attorney General Landry, Louisiana Revised Statute Title 51, Part X, Section 712 A(2), "unambiguously imposes a fiduciary duty to disclose (or to tell the whole truth) all material facts regarding the sale or attempted sale of any security." He opines:

> *"[T]herefore, investment firms which operate as a registered investment advisor in Louisiana, and which utilize ESG factors or criteria without full disclosure to their investor-clients, are likely in violation of their fiduciary duties imposed by Louisiana law."*

In other words, the use of ESG is likely a violation of the duty of loyalty in that the ESG agenda has supplanted the investment manager's duty to the client to obtain the best monetary result.

However, in the last paragraph of his opinion, Attorney General Landry attempts to moderate what would appear to be a harsh interpretation:

> "I must note that this legal guidance should not be construed as concluding that the ESG agenda or the use of ESG criteria when selecting investments is inherently unlawful in any context [emphasis added]. Instead, it explains that where investment firms, such as the Big Three, utilize ESG without full disclosure, they are likely in violation of a Louisiana registered investment advisor's fiduciary duties owed to investor-clients. It also illustrates how ESG has been exploited by the largest wealth management funds in our country at the expense of investors. As Attorney General, I encourage each of you to consider the aforementioned legal guidance when selecting investment firms to do business in the State of Louisiana."

CONCLUSION

Landry's commentary may contain the ultimate takeaway for states currently tackling the issue. Notably, several states have mandated various ESG criteria in investment decisions for state-related retirement funds. Investment decisions related to ESG are a political hot topic that will continue to draw attention from all levels of government, which may unintentionally create conflicts and litigation risk for investment managers.

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