JS HELD

PERSPECTIVES

Crosscurrents: J.S. Held's Environmental, Social & Governance Observations (Impacts of ESG Enforcement)

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

INTRODUCTION

Former Securities and Exchange Commission (SEC) Commissioner Allison Herren Lee gave an incredibly insightful keynote address at the 2021 Society for Corporate Governance National Conference and spoke to the expanding responsibilities of boards with respect to risk oversight and disclosures involving ESG issues. Commissioner Lee, who focused on Environmental, Social & Governance (ESG) issues during her time at the SEC, provided focus to board members about the obligations they have. It is worth highlighting her thoughts:

> *"Boards also play an important role in the oversight of other types of disclosures made outside of financial statements. These disclosures may also implicate ESG considerations. For example, the SEC's 2010 climate guidance identifies multiple existing disclosure requirements, most prominently Management's Discussion & Analysis, that may give rise to climate disclosure obligations. The SEC's recent update to Regulation S-K's Item 101 specifically identifies human capital as a potentially material disclosure topic. And there is a requirement under item 407(h) of Regulation S-K for disclosure of the board's role in the risk oversight of a company, which in many instances could include climate change risks. These are just a few of the currently existing federal requirements that implicate board involvement and engagement on climate and ESG."*

As Commissioner Lee pointed out, these are only some of a board's obligations. The S-K Item 101 update mentioned above is an excellent example of just how broad ESG obligations can be. These broad ESG obligations can lead to novel liabilities.

LIABILITY FOR DIRECTORS

In addition, novel litigation around directors' liabilities for failing to follow their statutory ESG duties is just starting to appear. Just this year ClientEarth, a non-governmental organization (NGO) and shareholder in Royal Dutch Shell, PLC, gave notice of a derivative claim—one on behalf of the corporation—against the board members for failing to act in accordance with their general duties found in Sections 170 through 177 of the UK's Companies Act 2006.

ESG KEYWORD FREQUENCY IN S&P 500 COMPANY FILINGS

HSBC Holdings published an interesting analysis of the references to certain ESG keywords in the annual filings of S&P 500 companies and the changes between 2014 and 2020.[i] Two graphs from the HSBC analysis are reproduced below. As expected, references to ESG keywords have gone up. The "E" references are substantial, "G" references are less so, and "S" references are only a fraction of the overall keyword references. The keyword search in the annual filings reveals that the "E" references are more substantial but companies and their boards may need some additional focus around social and governance issues. Commissioner Lee's comments around human capital reminds the industry that "S" and "G" deserve the same treatment as "E". These issues may just have harder-to-define metrics that the accountants and engineers have more difficulty qualifying and quantifying.

Count of Keywords	2014	2020	% Change
E	21,343	22,654	6%
S	1,282	1,502	16%
G	,3,600	4,067	12%
Total	26,225	28,223	7%

Figure 1 *– HSBC analysis of ESG keyword frequency in S&P 500 company filings (2014-2020).*

% of Keywords	2014	2020
E	81.4%	80.3%
S	4.9%	5.3%
G	13.7%	14.4%

Figure 2 *– HSBC analysis of ESG keyword frequency in S&P 500 company filings (2014-2020).*

HISTORY OF ESG ENFORCEMENT

Although the SEC founded its Climate and ESG Task Force in the Division of Enforcement in March 2001, examples of SEC's enforcement around ESG goes back almost 15 years[ii]. SEC's enforcement was traditionally focused on fraud[iii], more recent charging papers relate to omissions and misstatements concerning ESG issues. While many SEC enforcement actions involve less sophisticated broker-dealers, some of the largest companies have also found themselves subject to charges for ESG issues[iv].

SOCIAL MEDIA & FURTHER DISCUSSION

The examples above are certainly not the only ESG areas that the SEC finds interesting. The Nikola rolling truck video and its CEO Trevor Milton's social media activities drew the ire of the SEC. Interest in how a company interacts with the public on social media has resulted in the SEC providing guidance for both the companies[v] themselves and the registered investment advisors[vi] that routinely interact with the public. Ultimately, the SEC's focus on ESG enforcement and the related board obligations will be sure to keep ESG issues at the forefront of high-level corporate discussions. We at J.S. Held will continue to watch ESG development at the SEC and elsewhere.

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REFERENCES

i https://www.gbm.hsbc.com/insights/markets/trends-in-esg-disclosure-in-10-ks

ii SEC Administrative Proceeding No. IA-2761. Pax World Management Corp. settled SEC charges alleging it purchased at least 10 securities prohibited by the socially responsible investing restrictions contrary to representations to investors and the boards of the Funds in question.

iii E.g., Securities and Exchange Commission v. Ronald Van Den Heuvel, et al., No. 17-cv-1261. It's bad to purchase Green Bay Packers tickets using investor funds, but adding in lying about your process attracts the SEC.

iv BP was charged in 2012 related to the Deepwater Horizon oil spill, Fiat/Chysler was subject in 2020 to a cease-and-desist order related to emissions representations, and Vale S.A was charged in April 2022 for false and misleading claims related to dam safety.

v https://www.sec.gov/news/press-release/2013-2013-51htm

vi https://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf

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