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STARTUP & ACCELERATE

**MAKING AN IMPACT – LEGAL CONSIDERATIONS
FOR ESG AND EQUALITY INVESTING**

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What is ESG?

E is for "Environment"	S is for "Social"	G is for "Governance"
<ul style="list-style-type: none">• Climate change• Greenhouse gas emissions (GHG)• Energy use• Water use• Pollution• Hazardous waste• Recycling• Sustainability	<ul style="list-style-type: none">• Diversity and inclusion• Corporate giving and philanthropy• Working conditions• Workplace health and safety• Compensation and benefits• Internal pay equity• Employee opportunity• Labor and human rights• Child and forced labor• Supplier practices	<ul style="list-style-type: none">• Board structure and composition (including tenure and diversity)• Executive compensation• Shareholder rights• Enterprise risk management• Audit oversight• Disclosure and reporting• Ethics and compliance• Privacy and cybersecurity

Breadth of Current ESG Issues

CORPORATE, INVESTMENT & FINANCE

Fund Formation, Investment, Transactional and Public and Private Company Issues

ENERGY & CLIMATE CHANGE

Clean Energy Technologies, Emissions Reduction and Energy Efficiency, and Regulations Related to the Same

DISCLOSURE & ENFORCEMENT

Regulatory and Disclosure Rules for Investment Advisers, Asset Managers, and Public and Private Companies

ERISA & RETIREMENT PLANS

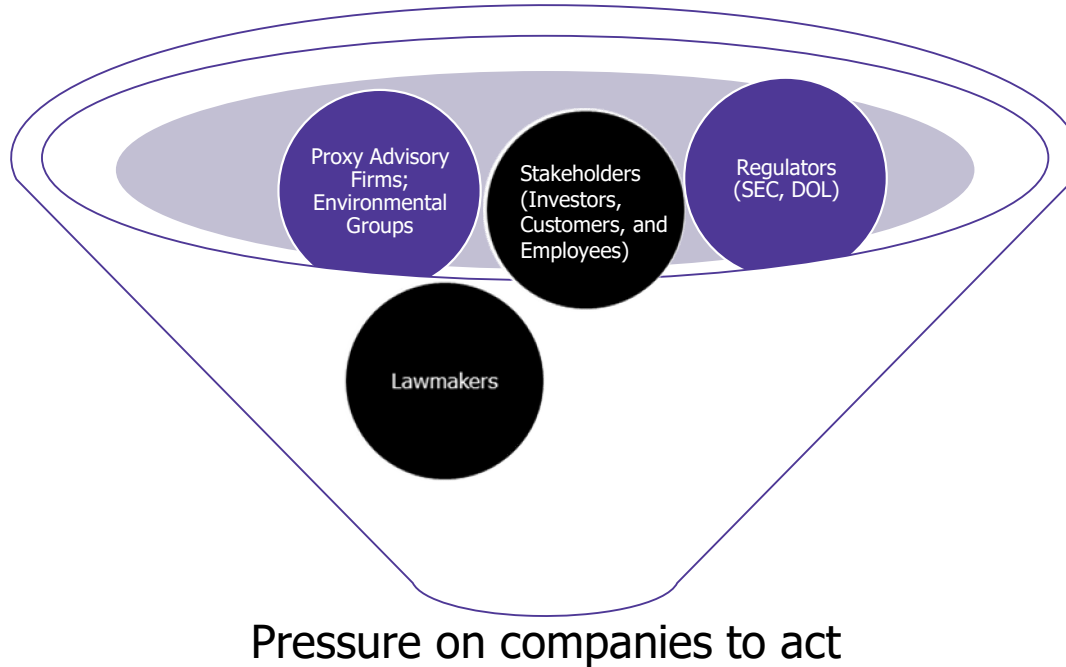
SOCIAL ISSUES

Advancing Diverse, Inclusive, and Harassment-free Workplaces and Ethical Supply Chains

SECURING ESG-RELATED TAX ADVANTAGES

Optimizing Tax Advantages in Transactions Achieving ESG, Sustainable Investing, and Impact Investing Goals

Who Is Paying Attention to ESG



US ESG Regulatory Landscape

SEC – Issuers

- What is “material” and does it even have to be? What data is available and possible?
- Immediate focus on climate risk and carbon sensitivities
- **SEC Proposal (3/21/22): Proposes to require enhanced and standardized disclosures regarding GHG emissions and climate change risks, management and impacts. Unclear when final rule will be published and may be reduced in scope; litigation threatened by certain business groups**

SEC – Funds/Advisers

- Disclosures regarding investments and investment strategies; funds and advisers
- Fund names, compliance issues, reliance on third parties; funds as consumers of issuer data
- **Prediction: Enhanced “names rule” for US registered funds; ESG disclosure requirements in registration statements; investment adviser disclosures (Form ADV)**

DOL

- ERISA creates challenges for ESG investing – “solely in the interests of the [plan] ... and for the exclusive purpose of ... providing benefits ... and defraying reasonable expenses”
- New proposed rule intended to smooth these challenges
- **New DOL Final Rule issued on November 11/22/22, reframing how ERISA-regulated fiduciaries can consider environmental, social, and governance factors in retirement plan investment decision making.**

SEC – Examinations/ Enforcement

- Issuers and managers asked to “show their work”; scrutiny of ESG-branded funds and strategies
- Even generic statements can be a trigger for inquiries – many access points to start an examination or investigation that can become an enforcement
- **Prediction: More inquiries; more examinations; more enforcement**

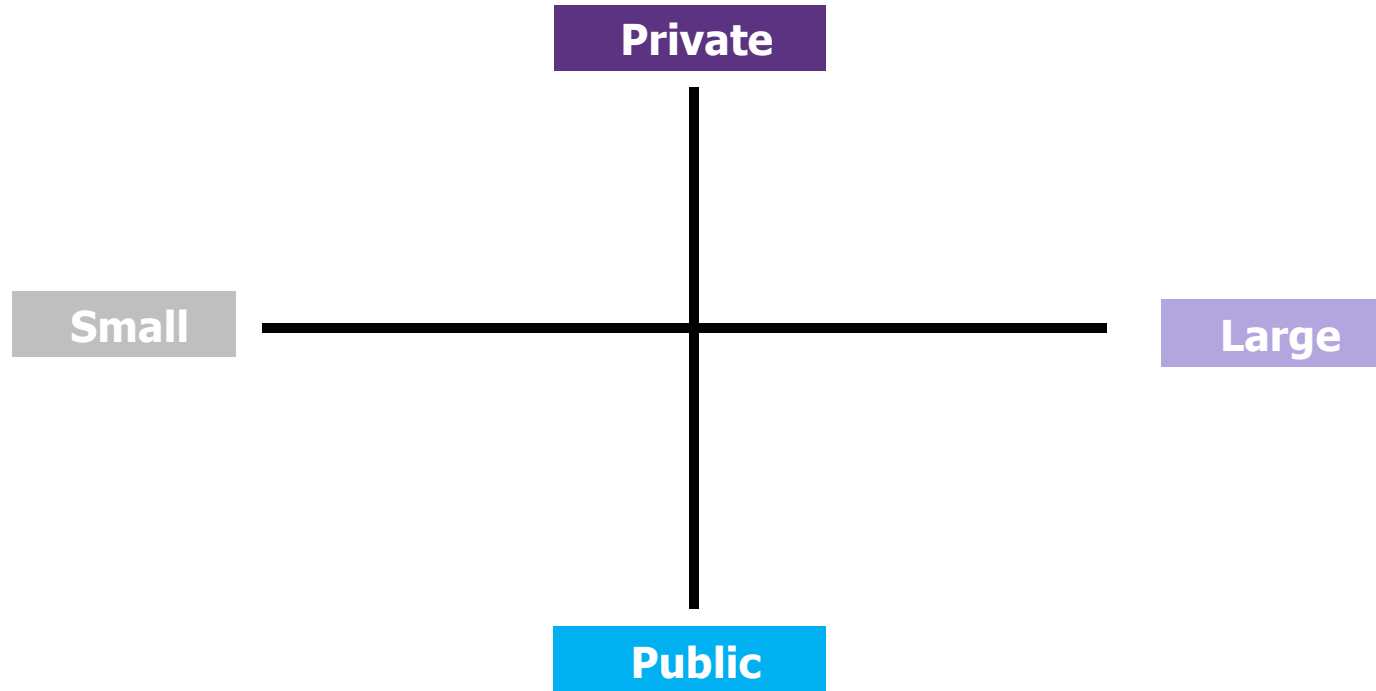
What is the ESG Backlash?

- Red states versus blue states on non-financial considerations in pension investments
- Attacks on corporate DE&I initiatives, including affirmative action and diversity/LBGTQ rights
- Attacks on greenwashing and lack of uniform ESG metrics
- Attacks on proposed mandatory SEC disclosures on climate change



ESG- Not One Size Fits All

Larger Cap Public Companies Lead the Way Because of Greater Resources and Reporting Obligations –BUT- Smaller Private Companies Should Still Keep ESG in Mind



Emerging Growth Companies

Practical Realities

- Maximizing and prioritizing current resources
- Focus on funding and growth
- Limited time
- Focused Personnel
- Upfront costs
- Green versus Gold
- No national / global standardization
- Need to measure and track related metrics to avoid claims of “greenwashing”

Why ESG Deserves Consideration

- Expanding funding and profit opportunities; access to growing investment capital earmarked for ESG
- Differentiation from, or keeping up with, peers
- Drawing unique talent
- Aligning with stakeholders (customers, investors and employees)
- Proxy for preparedness
- Future positioning for enhanced global regulations and policy

Benefitting Stakeholders and Stockholders

Examples of actions that benefit other stakeholders but promote long-term stockholder value:



**Increasing
employee wages**



**Allocating
resources to
diversity and
inclusion
initiatives**



**Offering fair terms
to small, local
suppliers and
ensuring supply
chain integrity**



**Giving back to,
and
conscientiously
engaging with,
local communities**

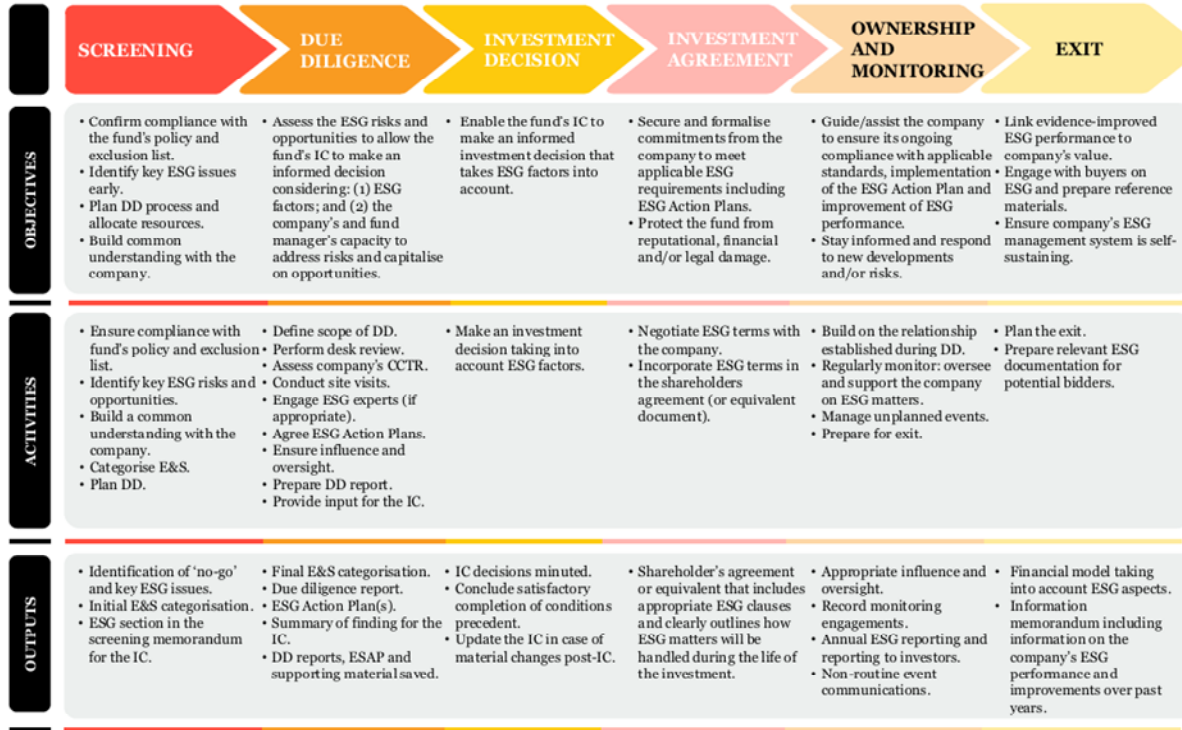


**Adopting
environmentally
sustainable
measures**

Impact Investors

- While there are a growing number of impact venture capital firms that focus on ESG/impact issues (see membership of Impact Capital Managers, a trade association of impact venture capital firms), we are beginning to see more concern over ESG issues from traditional venture capital firms, as well as certain private equity firms.
- ESG due diligence is becoming more commonplace, importing some of the due diligence concepts and checklists from Europe that has traditionally had a greater focus on ESG issues.
- ESG/impact investors often require reporting on ESG issues using key third-party or proprietary key performance indicators (KPIs). In some cases, third-party validation is required.
- Only a minority of impact investors are “baking” ESG/impact into their documentation, which still tends to be standard documentation based on the NVCA forms. Examples include redemption rights if KPIs are not being met or there is fundamental mission drift from the ESG thesis underlying the investment decision.

Integrating ESG into the investment process

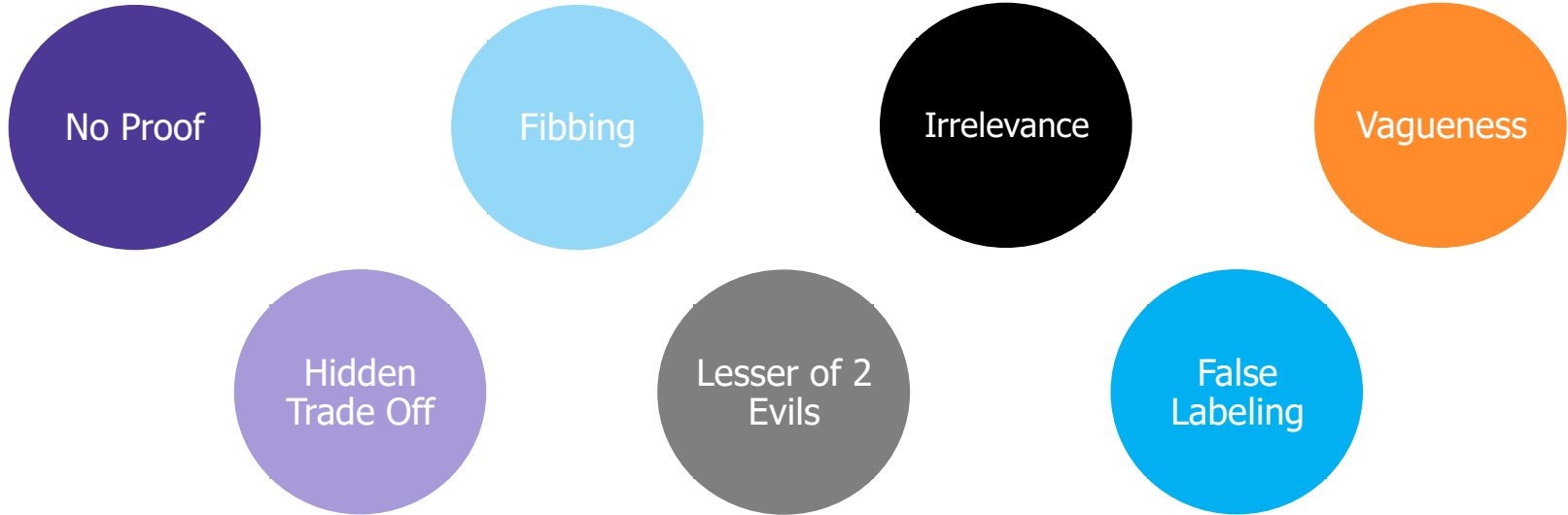


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Abbreviations: CCTR, commitment, capacity and track record; DD, due diligence; ESG, environmental, social and governance; E&S, environmental and social; IC, Investment Committee.

Greenwashing

Creating false or misleading information to persuade the public that an organization's policies, goals, products, supply chain, etc. are environmentally friendly



Greenwashing Cont.

- The SEC is focused on companies that tout ESG commitments but provide limited (or no) information as to how they plan to accomplish such commitments
- March 30, 2022, European Commission proposed a series of changes to existing EU consumer rules aiming to address greenwashing of consumer products
- Consequences
 - Significant erosion of stakeholder trust, high turnover rate and loss of profits
 - Damage to brand
 - SEC enforcement and private lawsuits

Best Practices for Implementing an ESG Program



Define ESG goals, KPIs and rating systems/metrics (including measurement and tracking), looking at peers/competitors



Identify key areas for impact.

Examples: Responsible supply chain management; Diversity commitments; Transparency in corporate governance



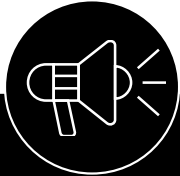
Engage with C-Suite/Board on ESG goals



Prioritize the time and resources needed to support ESG goals



Engage with other internal stakeholders, along with third-parties, advisors, shareholders and other stakeholders, on achieving ESG goals



Communicate strategic importance of ESG goals with disclosure team



Develop disclosure and reporting policies and procedures



Consider forming ESG reporting and disclosure committee



Adjust regularly

Board of Directors and ESG

Why should Boards care about ESG issues:

- Stockholders, stockholder advisory firms and other stakeholders (e.g. customers and employees) are increasingly holding boards and corporations more accountable for addressing ESG issues- COVID-19 catalytic effect
- Increase in ESG stockholder proposals for inclusion in proxies and ESG activist campaigns
- Buyers/investors increasingly conducting ESG due diligence
- Potential for increase in federal and state regulation on climate change and other areas, although overly prescriptive regulation could be met with challenges in court.
- Potential for increase in federal and state legislation on ESG reporting, although it is unclear in the divided US Congress that the votes are there at the federal level.
- Keeping up with peers and competitors - according to the [Governance & Accountability Institute](#), 90% of the companies in the S&P 500 Index published sustainability reports in 2019. Further, 65% of the Russell 1000 Index companies published sustainability reports in 2019, up from 60% in 2018. These numbers are expected to increase.

Advising Boards on ESG

ESG risk areas:



Lack of measurability and reporting standards – no equivalent of GAAP for ESG measurement and reporting



Proxy contests over ESG issues



Litigation/activist campaigns from shareholders over alleged breach or fiduciary duties for failing to maximize profits (anti ESG backlash) or litigation/activist campaigns from other stakeholders (e.g. consumers/advocacy groups) over allegedly false or misleading statements concerning ESG commitments



Increase in SEC investigations and enforcement over climate disclosures (letters to select companies) and cybersecurity/protection on confidential information. New SEC Enforcement Task Force-primary focus is on alleged “greenwashing” by ESG investment funds.

Advising Boards on ESG

- Current Delaware law mandates that “stockholders’ best interest must always, within legal limits, be the end” of business decisions made by directors of a Delaware corporation. Stockholder primacy does not prohibit directors from considering the interests of constituencies other than stockholders, but those “[o]ther constituencies may be considered only instrumentally to advance [stockholders’ best interests]” (*In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 37 (Del. Ch. 2013))
- Therefore, it is crucial for the Board to begin any discussion of corporate purpose by asking not only **why** the interests of the Company’s various stakeholders should be considered, but also **how** benefitting a non-stockholder constituency ultimately impacts shareholder value

Advising Boards on ESG

- In the context of a sale of the business, the so-called *Revlon* duties **do** require profit maximization
 - Unlike 44 other states, Delaware does not have a constituency statute
 - Delaware has adopted a Public Benefit Corporation Statute that allows for stakeholder capitalism to be baked in the charter and override traditional fiduciary duties requiring profit maximization, including *Revlon* duties
- While there are a growing number of publicly-traded Benefit Corporations, this trend should not be exaggerated and they still represent a very small percentage of publicly-traded corporations and this alternate form does not appeal to the majority of stockholders who place return/share price before impact.

Key Takeaways



Takeaway #1

It's not too early for smaller, private companies to think about an ESG strategy, but care should be taken in selecting which areas to focus on given your stage of development.



Takeaway #2

It's important to consult with stakeholders about what's important on ESG and to organize oneself internally to address ESG issues.

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Karen A. Abesamis focuses her practice on mergers and acquisitions, strategic and venture capital investments, and technology transactions. She advises on general corporate matters, including securities compliance and corporate governance. Karen also advises social impact investors and private foundations on a range of impact investments and environmental, social, and governance (ESG) matters. Her clients include public and private companies, financial institutions, venture capital funds and corporate investors.

Having practiced in the Bay Area for more than a decade, Karen has significant experience working with technology companies and non-technology companies that are finding opportunities to grow through the use of technology.

Prior to joining Morgan Lewis, Karen interned with the Securities and Exchange Commission's Enforcement Division, and worked in-house at Sun Microsystems, Dodge & Cox Mutual Fund, and Visa International. She has also worked in-house through secondment with a Fortune 100 public company.

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Carl Valenstein focuses his practice on domestic and international corporate and securities matters, mergers and acquisitions, project development, and transactional finance. He counsels extensively in the life science, telecom/electronics, and maritime industries, and has worked broadly in Latin America, the Caribbean, Europe, Africa, Asia, and the Middle East. He previously served as co-chair of the International Section of the Boston Bar Association and co-chairs the firm's environmental, social, and governance (ESG) and sustainable business initiative. He is also an active member of the Ukraine Conflicts Task Force, CFIUS Working Group, Renewable Energy Working Group and Cuba Initiative. Carl is the leader of the Boston office corporate and business transactions practice.

In addition to his transactional practice, Carl advises clients on international risk management, including compliance with the foreign investment review process (Exon-Florio/CFIUS), export control and sanctions, anti-money laundering, antiboycott, and anticorruption (Foreign Corrupt Practices Act (FCPA)) laws and regulations. He also advises on internal investigations, enforcement cases, and dispute resolution proceedings relating to his transactional and regulatory practice.

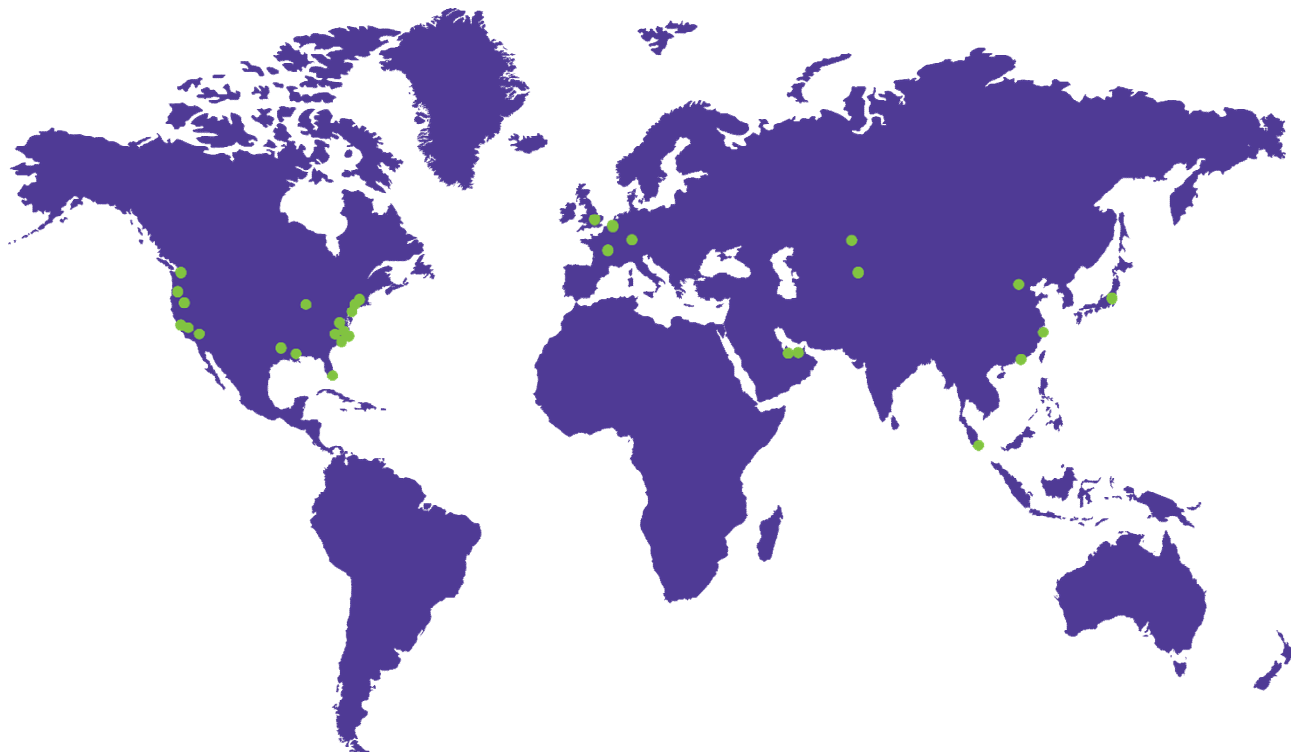
Carl has worked over 30 years in the field of socially responsible and impact investing. He is an adjunct professor at the University of Michigan and New York University Law Schools' International Transactions Clinics, focusing on impact investing. He also serves on the board of advisors of the Michigan Social Venture Fund, the first student-led impact investment fund, and the NU Impact fund. He is a founding member of the Impact Investing Legal Work Group.

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