Reuters Legal News

ESG trends: improving and standardizing disclosure

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OCTOBER 20, 2021

The millennial generation is undeniably shaping and influencing investment decisions across the economy. Millennials are demanding a heightened focus on equity, racial justice and the environment. With this trend, the focus on valuation of social, environmental and governance (ESG) impacts is increasingly taking center stage while rapidly evolving in the process. Key institutional investors have embraced this trend as good business sense by making sustainability their new standard for investment.

According to Blackrock (https://bit.ly/3DW3w61), part of a company's commitment to long-term sustainable growth involves better data and disclosures to help investors understand "the deep interdependence between environmental and social issues," especially given that "climate change is already having a disproportionate impact on low-income communities around the world."

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Heeding the call, corporate directors are actively looking beyond short-term profit and loss and demanding to see that their companies are effectively grappling with the realities of social change, the challenges of operational environmental impacts, and opportunities to engage with community stakeholders. This leads to hard questions at shareholder meetings and the push for more information and data in these areas.

While directors may be driven in some instances by personal commitments to the global corporate good, their actions are also rooted in business judgment, as market demands for corporate social accountability are changing the expectations of corporate fiduciary duty. Indeed, ample evidence reveals that poor environmental performance and undesirable corporate impacts may negatively impact operations, limit access to capital, and cause adverse reputational effects.

The Biden administration's "whole of government" (https://bit.ly/3lToITK) focus on environmental justice, and particularly its Justice40 (https://bit.ly/3n7mShw) movement, which strives to drive 40 percent of federal financial investments to vulnerable communities and communities of color, leverages this evolving ESG movement.

In fact, the government is looking at these "environmental justice" or "EJ" communities in every aspect of its decision-making across industries and sectors, particularly in connection with climate change and emissions impacts, which are a critical focus of voluntary ESG reporting. As the U.S. Securities and Exchange Commission (SEC) works to craft a potential new rule aimed at standardizing ESG reporting among registered companies, climate risk and impacts will likely be a focus.

The increased public, federal, and corporate focus around social, economic and environmental equity presents an incredible opportunity to corporate leaders that lean into this moment. Not only the public, but companies and their shareholders are craving more standardization and improved reporting and disclosure for environmental and social impacts, including around community engagement and commitments. Companies not only have a chance to develop and refine their own disclosures, but also to shape the very rules that will be applied.

Under the evolving principles of ESG, companies are continuously refining approaches to corporate disclosures in the areas of energy use, human rights protection and environmental stewardship. Increasingly, corporate websites, shareholder reports and reports to regulatory bodies are including more than just a passing reference to company performance in the environmental and human capital space. These disclosures now often include data and details such as graphs on air emissions, including greenhouse gas calculations, and energy use trends; inventories of environmental releases; results of employee quality of life surveys; summaries of charitable and educational investments, and even case studies on partnerships and collaborations with neighboring fenceline communities.

There is certainly a business case for ESG and EJ, as investors are now viewing the impacts of climate change as the existential crisis of our time. Over time, it is certainly possible that access to public and private capital may be prioritized for companies that help mitigate environmental stressors rather than exacerbate them. The SEC has emphasized that ESG risks, such as those related to diversity, are important predictors for organizational resilience and maximizing risk-adjusted returns on investments.

In many ways, the crux of ESG involves identifying risks and opportunities that are not readily apparent in the traditional corporate financial disclosures. Evolving ESG expectations reflect the notion that anything perceived by the market as materially affecting a company's long-term value should be measured, managed and reported on — including non-financial, social and environmental information.

Companies at the leading edge of both ESG and the public focus on equity are holding related discussions not just in the Boardroom or C-Suite but are engaging employees at all levels of the company and seeking to understand and evaluate direct or indirect impacts, whether local, national, or global. Internally, employees are assessing sustainability, developing measurable goals, and helping to integrate ESG and other equity considerations, such as environmental justice, in both corporate values and individual performance evaluations — even executive performance bonuses are being tied to performance against social and environmental values.

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At this point, however, there are few metrics or rules for companies to directly quantify, for comparison, traditionally subjective impacts. In fact, public reports indicate that board and corporate executives are desperate for more guidance on "how to do" consistent ESG disclosures, and they are troubled by the current variability across industry sectors. Many companies just include these burgeoning ESG metrics in their financial reporting while others are releasing standalone ESG reports.

Two of the most widely used ESG voluntary disclosure frameworks, Global Reporting Initiative (GRI) (https://bit.ly/3G0EjJh) and the Sustainability Accounting Standards Board (SASB) (https://bit.ly/3lPKmZa) take different approaches to "quantifying" impacts for the marketplace.

Many of the SASB industry sector frameworks require specific disclosure of the number of facilities located in or near dense areas of population. GRI, on the hand, requires reporting on topics that are "material." It is up to the company to decide what is "material," but these include reporting on local community engagement, monitoring, grievance processes, vulnerable groups, and health and safety impacts of products and services.

The wait for a required ESG disclosure framework may not be too far off, as SEC's proposed rule on climate disclosures is expected soon. As a precursor to a potential rule, the SEC launched a new Climate and ESG Task Force (https://bit.ly/30t7OTO) earlier this year and appointed its first policy advisory for climate and ESG. Although climate change is the current focus of the SEC, the Biden administration has closely linked climate impacts to environmental justice. The SEC could soon propose new rules regarding disclosures about other ESG concepts, such as environmental justice, racial equity in human capital, and political contributions.

As the SEC explores how to place parameters around ESG reporting, companies should consider how best to describe their organization's strategy around climate and environmental justice, racial and economic equity, and human rights, as well as stewardship of land, natural resources and local economies. Even more challenging will be any consideration (required or voluntary) of cumulative environmental or social impacts, actions taken to address environmental, climate and social inequity, and the results of those actions.

Another federal agency in the environmental disclosure game is the U.S. Federal Trade Commission (FTC), which issued the Green Guides (https://bit.ly/3vpFP2F) to prevent companies from making environmental claims that mislead consumers. The guides include general principles that apply to all environmental marketing claims and have historically been used to protect consumers from products with misleading environmental claims — like "made with renewable energy" or "fully biodegradable."

Citizen groups, however, are pushing the FTC to expand the application of the Green Guides to marketing claims around general business operations and human impacts. A current petition asks the FTC to find that a multinational energy company is misleading the public with any green claims because its core products are fossil fuel derived and its operations disproportionally impact minority communities. As companies trumpet their environmental or social justice accomplishments through ESG reporting, such disclosures and claims are well-served by appropriate and ongoing due diligence to support credibility and avoid challenges.

As the environmental and social justice movements continue to unfold, companies are well served to think ahead and be nimble. ESG disclosures can offer opportunity to reflect the value, and realize the benefit, of corporate actions that implicate both social and environmental impacts. Environmental justice is a prime example of an evolving area of ESG that the market and regulators may likely embrace for increased disclosure.

The companies that will benefit most from increased ESG disclosure are those that have an internal and external strategy for identifying, assessing, addressing and quantifying these risks in their operations. The time is now to seize this moment to meet the expectations of investors, employees, the public, and frankly the world — going forward.

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This article was first published on Reuters Legal News and Westlaw Today on October 20, 2021.