The ESG Backlash: Politics and Shareholder Primacy

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In the late 2010s and early 2020s, ESG – a wide-capturing acronym standing for "environmental, social and governance" – roared into action, emerging both domestically and abroad as one of the defining trends in investing, regulation, finance, and corporate governance.

ESG's proponents have long sought a unified framework through which to describe interrelated standards of environmental sustainability and human rights, and bring them into greater alignment with the private sector's traditional profit-seeking goals. This change in approach gained in prominence as a result of the Business Roundtable's 2019 declaration on the purpose of the corporation, endorsing a vision of corporations being led for the benefit of all stakeholders, not just shareholders. The ESG movement was super-charged and achieved mainstream ubiquity during the 2020 protests for racial justice which integrated new goals for diversity, equity, inclusion, and racial justice into their broader ESG policies.

In the past two years, however, a reaction against ESG has become more concerted and prominent, led by detractors who are ambivalent, skeptical, or outright hostile to ESG investing and the social agenda undergirding it.

Some of the more salient examples, of many, include:

- In 2022, at least 44 bills or new laws in 17 conservative-led states targeted company policies taking stances on gun control, climate change, diversity and other social issues, compared with roughly a dozen such measures in 2021, according to a Reuters analysis of state legislative agendas, public documents and statements.

- On November 3, 2022, five US senators, including Senators Tom Cotton and Charles Grassley, sent a letter to dozens of top law firms warning them to "fully inform clients of the risks they incur by participating in climate cartels and other ill-advised ESG schemes." The Senators suggested that there would be upcoming investigations into allegedly collusive agreements aimed at curtailing the use of coal, oil, and gas as unlawfully anticompetitive.

- In January 2023, Republican attorneys general from 21 states challenged leading proxy advisors ISS and Glass Lewis over the firms' ESG-related policies and practices.

- The Biden Administration published a labor rule permitting retirement plan managers to incorporate ESG factors into their investment decisions, prompting litigation by Republican attorneys general. In the latest development, Congress passed legislation that would repeal the rule. Although Biden will issue his first-ever veto to keep the regulation intact, a few centrist Democrats facing tough reelection prospects voted in favor based on the argument that ESG standards could jeopardize the retirement returns of middle class workers.

- Democrats have also provided Republicans with support in constraining other ESG-related actions, with dozens of House and Senate lawmakers voting to block the local Washington DC government's overhaul of its criminal code. Bipartisan opposition to major criminal law reform could place companies that strongly promoted such reform and other racial justice objectives in uncomfortable policy positions.

- At the more local level, a number of state governments have passed rules barring their public pension funds from considering ESG factors, while also seeking to divest from large asset managers perceived to be in favor of ESG.

- Rules proposed by the Securities and Exchange Commission that would require greater disclosures related to climate change by public companies received extensive comment and attention, and when the rules are adopted, litigation challenging them is inevitable.

- Vivek Ramaswamy centered opposition to ESG both as the centerpiece of his hedge fund Strive Asset Management as well as nascent presidential campaign.

The dispute as to the appropriateness of ESG factors in board and management decision-making in academic and legal circles significantly precedes the current political tension over ESG, generally informed by the long-running academic debate over "shareholder primacy" versus "stakeholder primacy" understandings of the role of the corporation. In recent years, the significant concentration in voting power in so-called universal owners such as index fund providers has provided a new real-world relevance to this debate, while recent criticism of ESG has often made use of the language of shareholder primacy.

This program will explore the ESG backlash on several different dimensions.

First, the program will consider the ESG backlash and its relationship to evolving domestic and international legislation requiring, among other things, public disclosure of diversity, equity and inclusion goals; greenhouse gas emissions and reduction targets; and efforts to by companies to respect internationally recognized human rights principles – including the steps they take to remediate or mitigate harms to rights-holders affected by their operations.

The speakers will also explore how the backlash to ESG is both related to and also transcends partisan clashes over the modern corporation's responsibilities. In addition, the panelists will discuss how the ESG backlash may or may not affect the long-term efforts of companies to implement ESG-related programs, such as the commitments companies have already been making for years to credible human rights due diligence and meaningful engagement with vulnerable communities and other rights-holders as part of the human rights due diligence process.

Second, the program will consider how the ESG backlash relates to board fiduciary duties and other litigation topics. A recent complaint against Meta (formerly, Facebook) directors and officers alleged the breach of fiduciary duties for decisions ignoring national and international ESG risks. The suit was predicated on the evolving role of the corporate directors given the rise of index funds seeking to manage risk across their portfolios. The panelists will discuss how competing theories of shareholder primacy and stakeholder governance may contribute both to the rise of the ESG movement and the backlash against it, and will also give thought to key challenges corporate boards are likely to face in balancing their traditional business interests with the conflicting demands being pushed by both movements.

Finally, the panel will give attention to the role of ESG and its backlash in shaping the corporate disclosure landscape and proxy process. In this vein, the panelists will consider the SEC's rulemaking in the area of climate change-related disclosure; potential rule proposals related to corporate board diversity and human capital management; California laws related to board diversity; and related efforts by Nasdaq and in the private sector. The panelists also plan on discussing other ESG topics related to SEC disclosure (such as the definition of materiality) and the evolving shareholder proposal space (including "anti-ESG" shareholder proposals and pending Commission rulemaking on standards for the exclusion of shareholder proposals).

The panelists' remarks will be followed by a Q&A session, focused on addressing challenges from corporate counsel, risk managers, and compliance managers, as they consider ways to effectively manage the evolving ESG framework and its emerging discontents.