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**Strategic Perspectives**

# A thoroughly mixed picture for ESG in 2022: Major accomplishments amid significant setbacks, with fierce battles on the horizon

*By Brad Rosen*

For the sustainability and ESG movements, 2022 was the best of times from a legal and regulatory perspective, but also the worst of times with strident opposition from the courts, lawmakers and conservative advocacy groups mounting. Looking to the year ahead, with Republicans taking back the House by virtue of a paper-thin midterm electoral victory, the drumbeat to pushback and squash climate and ESG related measures promises to intensify.

**Significant ESG advances.** On the positive side of the ledger for sustainability and ESG advocates, major progress was made on a number of fronts during the year. This included the passage of the Inflation Reduction Act in September, a game-changer for the economics of clean energy and climate action. Also, the Securities and Exchange Commission (SEC) proposed its historic climate-risk disclosure rule in March. In May, the agency continued moving forward with its sustainability agenda proposing rules for ESG-related disclosure requirements for funds and advisors, and fund names. Additionally, the SEC's Division of Enforcement's Climate and ESG Task Force sprung to life during the year bringing a number of actions to combat greenwashing and other ESG-related violations.

The Biden Administration took steps in the ongoing battle against climate change with the issuance of executive orders, while seeking to bolster resiliency measures and nature-based solutions. Over at the Department of Labor, a final rule was enacted that removed restrictions on ESG considerations in plan investment management thereby permitting plan fiduciaries to consider climate change and ESG factors in selecting investments. Meanwhile, banking regulators also moved forward in addressing the climate related threats to the financial system.

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**Emboldened opponents target ESG and "wokeness".** Notwithstanding these advances, climate and ESG proponents also saw numerous significant setbacks throughout the year. The Supreme Court's decision in *West Virginia v. EPA* led the way as the high Court limited the Environmental Protection Agency's authority to limit carbon dioxide from power plants, a major source of greenhouse gases that is dangerously heating the planet. Moreover, the Court's invocation of the *major question doctrine* in that case has been seen by many observers as a major obstacle to any final climate rule that the SEC might adopt, as well as putting the brakes on actions taken by other federal regulators with respect to addressing climate change.

Additionally in 2022, numerous Republican controlled states introduced legislation that thwarted integrating "woke" ESG principles into investment decision. These measures are an apparent attempt to protect the financial interests and ideological positions of the fossil fuel industry and others threatened by ESG requirement. As a consequence, rapid growth in anti-ESG laws and policies portend ESG becoming a major battlefield in the ongoing culture wars that likely will divide US body politic in the years ahead.

During the year, Republican Florida Governor Ron DeSantis emerged as a leading voice in the anti-ESG movement and a proponent of the state's groundbreaking anti-ESG law, the, Stop W.O.K.E Act. After scoring a decisive reelection victory in November, DeSantis proclaimed, "We fight the woke in the legislature. We fight the woke in the schools. We fight the woke in the corporations. We will never, ever surrender to the woke mob."

The governor concluded, "Florida is where woke goes to die."

DeSantis' anti-ESG words and deeds continue to inspire a vast cadre of ESG opponents as well as officials in other Republican controlled states to press on for their own anti-ESG legislation and policies. Moreover, with the House of Representatives changing hands in January, emboldened Republican members are gearing up to pushback hard on ESG advances.

At the same time, climate and ESG advocates have indicated that they are prepared to stand their ground and fend off the whatever attacks and bluster come their way. Regardless of which side of the ESG debate one finds themselves, buckle up —2023 promises to be a year of bitter disagreement, strive and conflict.

**Biden signs monumental climate legislation into law.** Proclaiming the Inflation Reduction Act of 2022 (IRA) as one of the most significant laws our history and the biggest step forward on climate ever, President Joe Biden signed the sweeping legislation into law on August 16, 2022. The bill invests $370 billion in spending and tax credits in low-emission forms of energy reduce greenhouse gas emissions and fight climate change over ten years. The bill passed both the House and Senate entirely along party lines. A filibuster was avoided in the Senate as the Democrats employed the budget reconciliation process which requires only a majority for passage rather than 60 votes.

The IRA represents U.S.' largest investment to fight climate change. It is aimed at helping the country cut greenhouse gas emissions by an estimated 40 percent below 2005 levels by 2030. The bill's clean energy tax credits and other provisions are geared to increase energy production at home and accelerate energy innovation abroad. Additionally, by investing in disadvantaged communities, and prioritizing projects that reutilize retired fossil fuel infrastructure and employ displaced workers, the IRA attempts to make meaningful progress towards a fair, equitable, and economic clean energy transition. Some of the climate and clean energy provisions of the IRA include:

- **Tax credits that incentivize clean hydrogen production, nuclear power production, renewable electricity production,** clean energy projects to strengthen domestic energy manufacturing and support the production and recycling of clean energy products, and production of clean energy technology components that are produced in the United States or by a U.S. possession.
- **Tax credits that incentivize** low-carbon transportation fuel, the purchase of a qualified new clean vehicle, including electric vehicles, plug-in hybrids, and hydrogen fuel cell vehicle, and the purchase of previously owned clean non-commercial vehicles.
- Support for carbon capture and direct air capture (DAC), and support for low-carbon materials procurement for federal projects, along with multiple efforts to standardize environmental impact disclosure, labeling and verification of low-carbon concrete and construction materials.

While the Biden Administration will move forward with implementing the IRA in 2023, detractors will continue to voice opposition, and efforts by Republican lawmakers to block or undo the legislation are expected. Even though no GOP lawmaker voted for the law, there is hope among sustainability supporters that the law will gain traction nationwide as the legislation's tax credits and clean energy incentives are geared to benefit the red states as well as the blue ones.

**SEC's historic climate-risk disclosure proposal sets off ESG backlash and mobilizes opponents.** Another seismic shakeup in the ESG landscape came in March when the SEC released its historic proposal, *The Enhancement and Standardization of Climate-Related Disclosures for Investors* which would require public companies to disclose extensive and detailed information about their emissions. While climate advocates welcomed the SEC proposal, opponents responded with a fierce and coordinated rebuke, both to the proposed rule and other ESG undertakings more generally.

The SEC's proposed rule passed by a 3-1 vote, with Republican Commissioner Hester Peirce being the lone dissenter. The proposed rule, which amended to SEC Regulations S-K and S-X, would require public companies to formally incorporate climate risk disclosures in their annual and periodic reports. The proposal appeared to leverage at least some of the concepts developed for standards published by the Task Force on Climate-Related Financial Disclosures (TCFD) and the Greenhouse Gas (GHG) Protocol.

In concert with issuing the proposed rule, the SEC stated that many investors were concerned about the potential impacts of climate-related risks to individual businesses, and therefore were seeking more consistent, comparable, and reliable information about the effects of climate-related risks on a company's business to inform their investment decision-making. The agency stated the proposed rules were intended to enhance and standardize climate-related disclosures to address these investor needs, as well as current disclosure practices which it viewed as fragmented and inconsistent. In sum, the agency asserted the proposed rules would help issuers more efficiently and effectively disclose these risks, which would benefit both investors and issuers.

Commissioner Peirce raised a host of objections and sharply criticized the

Commission's proposal at the time of it issuance in a statement titled *We are Not the Securities and Environment Commission – At Least Not Yet*. These comments have served as roadmap of attack for the proposal's opponents. Peirce's main points of contention included:

- the further afield the disclosures are from financial materiality, the more likely it is that they exceed statutory authority;
- SEC rules already require disclosure of material climate risk;
- the disclosure mandates are compelled speech;
- the rules require companies to disclose information that may not be material;
- Congress should speak clearly if it wishes to assign an agency to review decisions of vast economic and political significance.

Many of Commissioner Peirce's assertions were raised and amplified in a April 25, 2022 comment letter to the SEC from a group of 22 law professors led by Lawrence Cunningham of George Washington University. They wrote that the SEC's move to mandate and standardize climate-related disclosures is driven by a "small but powerful cohort of environmental activists and institutional investors."

**SEC steps up scrutiny of ESG funds.** Concerns around exaggerated ESG claims by asset managers and greenwashing continued being a top priority for the SEC during the year. With this in mind, the SEC issued two new rule making proposal May, and also brought a number of enforcement actions involving the recently formed ESG and Climate Enforcement Task Force.

The SEC formally proposed ESG-related disclosure requirements for funds and advisers in a release titled *Disclosures by Certain Investment Advisers and Investment Companies about Environmental Social, and Governance Investment Practices*, as well as requirements for investment company fund names.

With the release of the ESG disclosure proposal, SEC Chair Gary Gensler observed, "it can be very difficult for investors to know what funds mean when they say they're an ESG fund. Different funds might use different terms to describe their strategies or might not be transparent. Funds and advisers might also exaggerate their ESG focus."

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Not surprisingly, the SEC proposals garnered numerous comments that squarely disagreed with the SEC's action but also expressed an overall opposition to ESG investing. That opposition included a coalition of 21 Republican attorneys general led by West Virginia Attorney General Patrick Morrisey who criticized the ESG disclosure proposal as "deeply problematic" and "illegal and misguided." The coalition said the proposal largely ignores the interests of investors and financial interests by proposing disclosures that are "distant from areas of ordinary finance." The attorneys generals, citing the Supreme Court's decision in *West Virginia v. EPA*, also asserted, "The SEC is tackling a major question—but Congress has not given it the clear go-ahead to do so."

**Combatting greenwashing and ESG missteps through enforcement actions.** The growing role the SEC's Climate and ESG Task Force, which was launched in 2021, came into focus during the year with the filing of a number of ESG-related enforcement actions. The DOE's enforcement activities underscored the agency's commitment to lifting the ESG standards and practices among Commission registrants. The report provided, "Environmental, social, and governance (ESG) concerns have grown increasingly important to many investors. As a result, the Division has focused attention on these issues with respect to public companies and investment products and strategies. In doing so, the staff applies time-tested principles concerning materiality, accuracy of disclosures, and fiduciary duty, as codified in federal statutes, regulations, and case law."

Some of the ESG-related enforcement actions brought during year include the following enforcement actions:

- An action charging BNY Mellon Investment Adviser, Inc. for materially misleading statements and omissions about its consideration of ESG principles in making investment decisions for certain mutual funds.
- A litigated matter charging Vale S.A., one of the world's largest iron ore producers, with allegedly making false and misleading claims to local governments, communities, and investors about the safety of its dams prior to the collapse of the Brumadinho dam in Brazil, which killed 270 people, caused serious environmental and social harm, and reduced the company's market capitalization by more than $4 billion.
- Charges against robo-adviser Wahed Invest, LLC, which had marketed itself as providing advisory services

compliant with Islamic, or Shari'ah law, but failed to adopt and implement written policies and procedures addressing how it would assure Shari'ah compliance on an ongoing basis.

- Charges against Goldman Sachs Asset Management, L.P. for policies and procedures failures involving two mutual funds and one separately managed account strategy marketed as Environmental, Social, and Governance (ESG) investments. To settle the charges, Goldman Sachs agreed to pay a $4 million penalty.

**ESG advances throughout government.** While the SEC was the center of many efforts towards moving the sustainability ball forward during the year, ESG advances also occurred throughout the executive branch and other federal agencies. Some developments of note include:

- The Department of Labor's (DOL) enactment of a final rule that removed Trump Administration restrictions on ESG considerations in plan investment management.
- The Federal Reserve Board seeking public comment on climate-related risk proposed principles that would provide a framework for the safe and sound management of exposures to climate-related financial risks for Fed-supervised financial institutions having over $100 billion in assets. The proposed principles are similar to earlier proposals issued by the OCC and FDIC.
- The Biden-Harris Administration announcement of Nature-Based Solutions Roadmap in connection with the United Nations COP 27 climate conference in Egypt, and President Bidens issuance of Executive Order 14072, which recognized the importance of forests and other nature-based solutions to tackle the climate crisis and strengthen communities and local economies.

**ESG opponents take off the gloves.** In a widely cited opinion piece appearing in the Wall Street Journal in May, former Vice President Mike Pence proclaimed that ESG objectives were part of a pernicious strategy set in motion by the "woke left" and part of their campaign to enforce a radical environmental and social agenda on publicly traded corporations. Pence's comments both captured and inspired a well-conceived, well calibrated, and well-executed campaign to derail ESG-oriented policies through the enactment of anti-ESG legislation, court challenges, as well concerted political pressure emanating from conservative Republican controlled states across the country. Some of the anti-ESG measures and developments during the year include:

- Utah's state's treasurer demanding that the credit rating agency, S&P Global, withdraw and cease publishing credit indicators that take ESG factors into account.
- West Virginia State Treasurer denouncing S&P's ESG ratings scheme for states as politically motivated.
- Texas and West Virginia passed laws preventing state entities from investing with firms perceived to boycott the fossil fuel industry;
- Texas passed a law preventing state entities from investing with firms perceived to discriminate against the firearms industry—with potential criminal penalties;
- Conservative legal advocacy group Judicial Watch successfully challenged two California laws requiring corporate board diversity;
- A Texas-based alliance is litigating a Nasdaq rule on board diversity;
- Texas officials have threatened penalties for companies that provide assistance for employees seeking out-of-state abortions.
- Texas state officials sent inquires to 150 companies citing the prohibition of Texan governmental entities from investing in businesses that are looking to restrict their fossil fuel investments.

**Anti-ESG state legislation predominates across the U.S. in 2022.** Lawmakers in 31 US states have recently moved to introduce anti-ESG legislation, with the backlash concentrated in Republican states according to Capital Monitor. The firm mapped out all the US states where ESG-linked bills have been introduced, their status and whether they fit into a broad pro or anti-ESG camp, and it found that out of the 17 Republican states, all introduced bills against integrating ESG principles into investment decision making. Eleven of the 14 Democrat-leaning states have put forward bills in support of ESG measures.

Capital Monitor concludes, "The rapid growth in anti-ESG policies since the start of 2022 alone leaves little room for doubt: ESG investing is a clear target of the ongoing culture wars in the5 US, joining critical race theory, trans rights and Covid masks. It would now appear to be 'woke' for fiduciary managers to take major risks into account.

**Republicans extend ESG battle to antitrust law.** In November, Republicans opened up yet another front in the war against ESG as five prominent GOP Senators warned top law firms and their clients of potential antitrust violation in connection with their ESG undertakings. In a letter to 51 law firms, Senators Chuck Grassley (R-IA), Tom Cotton (R-AK), Marsha Blackburn (R-TN), Mike Lee (R-UT), and Marco Rubio (R-FL) detailed possible antitrust violations the firms' clients may commit if they pursue environmental, social, and governance (ESG) initiatives. The letter advises the firms that they and their clients should preserve documents relevant to the clients' ESG practices to prepare for oversight of antitrust violations for ESG collusion.

In their letter, the senators called the ESG movement a "collusive effort to restrict the supply of coal, oil, and gas, which is driving up energy costs across the globe and empowering America's adversaries abroad." The senators warned that Congress will increasingly use its oversight powers to "scrutinize the institutionalized antitrust violations being committed in the name of ESG" and refer the violations to the Federal Trade Commission and the Department of Justice.

A number of Republican House members have also indicated their enthusiastic readiness to investigate potential ESG-related antitrust violations, even before they assume control in January 2023. House Judiciary Committee Ranking Members Jim Jordan (R-OH) and five other GOP members sent a letter recently to Climate Action 100+ leaders seeking key documents regarding the use of ESG policies to advance their ESG goals.

The letter argues the coordinated effort between banks, money managers, and Climate Action 100+ to restrict investments in coal, oil, and gas is driving up energy costs worldwide, empowering America's adversaries abroad, and may violate U.S. antitrust laws. The letter further asserts, "[w]oke corporations are collectively adopting and imposing progressive policy goals that American consumers do not want or do not need," and that an individual company's use of corporate resources for progressive aims may violate fiduciary duties or other laws, harming the viability of the company and alienating consumers.

**ESG advocates ready to stand their ground.** Not surprisingly, the fierce anti-ESG backlash seen in 2022 has resulted in a backlash of its own among ESG proponents. 19 Republican State Attorneys General sent a letter dated August 4, 2022 to BlackRock, Inc., one of the world's largest asset managers, lambasting the company on numerous ground for its ESG undertakings and advocacy. In response, 17 Democratic Attorneys General issued a letter dated November 4, 2022 to Senators Sherrod Brown (D-OH) and Patrick Toomey (R-PA) as well as Reps. Maxine Waters (D-CA) and Patrick McHenry (R-NC), voicing their support for consideration of ESG factors in investment decision-making. Their letter asserts that public pension funds and their investment managers should be free to make choices that "maximize value for their beneficiaries in a manner that thoroughly evaluates risks and rewards" and "a thorough evaluation of risks and rewards may properly include consideration of ESG factors as part of a sound investment strategy."

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Meanwhile, the **California Public Employees' Retirement System** (CalPERS) has indicated it will not abandon employing an ESG strategy that has reduced the carbon intensity of its global equity portfolio by more than 30% and its global fixed-income portfolio by more than 50% over the past seven years. At a recent board meeting, CEO Marcie Frost decried the politicization of ESG investing at a recent board meeting and highlighted the benefits of the $443.2 billion pension plan's ESG approach observing, "In some cases, the (midterm election) campaign rhetoric not only dismissed the danger of climate change, it went so far as to mischaracterize a strategy we believe in strongly: examining the risk factors of the environment, of social inequality, and of good governance. "

Ms. Frost further observed "that applying the lens of ESG is not a mandate for how to invest. Nor is it an endorsement of a political position or ideology", adding that "those who say otherwise are actually advocating for investors like CalPERS to put on blinders … to ignore information and data that might otherwise help build on the retirement security of our 2 million members."

**Navigating the ESG minefield.** As vicious culture wars and political partisanship persist in the U.S., challenges will abound for companies, funds and their lawyers in 2023 as a growing number of anti-ESG directives clash head on with ESG-related investor and legal demands. On the one hand, federal regulators and Democrat-dominated states are requiring more detailed disclosures about the environmental and social impacts, and show an increased willingness to bring litigation when parties fall short on their obligations. On the other hand, ESG opponents, who believe sustainability efforts and other "woke" undertakings have gone too far, are turning up the dial against asset managers, lawyers and via investigations, boycotts, litigation and other measures. The developments and maneuvers in the ongoing Environmental, Social and Governance saga will be interesting to behold, and time will time will tell which side gains the upper hand in the fierce battles over ESG.

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