JS | HELD

PERSPECTIVES

Crosscurrents: J.S. Held's Environmental, Social & Governance Observations (ESG Issues at the State Level)

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

INTRODUCTION

Right now, one big question for companies is, "How do you balance the demands of investors and consumers against the political backdrop both nationally and at the state level?"

In one example at the national level, the U.S. Department of Labor, Employee Benefits Security Administration (DOL) published a Notice of Proposed Rulemaking in October 2021; it received 895 comments within the public comment period and may issue in December 2022. Not only does the proposed rule allow consideration of ESG factors in investment decisions for Employee Retirement Income Security Act (ERISA) plans, "a fiduciary's duty of prudence may often require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action."[i] Examples from the Fact Sheet include:

- Climate-change related factors, such as a corporation's exposure to the physical and transitional risks of climate change and the positive or negative effect of government regulations and policies to mitigate climate change;
- Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and
- Workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

ISSUES AT THE STATE LEVEL

At the state level, interstate conflicts abound. Florida Governor Ron DeSantis passed a resolution eliminating ESG considerations from state pension investments. Governor DeSantis has also proposed legislation for the 2023 Legislative Session that will include amending Florida's Deceptive Trade Practices statute to effectively eliminate ESG scoring as a factor in financial institution decision-making. Conversely, New York has taken the opposite approach. New York's State Common Retirement Fund must transition its portfolio to net zero emissions, apply minimum standards for climate action, develop evaluation tools for ESG, and formally integrate climate risk assessment into the investment process.

Conflicts also exist internally within states. The Teacher Retirement System of Texas, for example, has announced the following policy:

> *"Environmental, social, and governance (ESG) factors influence the performance of TRS's investments. In making investment decisions, the Investment Division will consider ESG factors that are material to long-term returns and levels of risk. Materiality of specific ESG factors vary across strategies, companies, sectors, geographies and asset classes."*

However, the Texas Legislature also passed the Oil and Gas Investment Protection Act last year, which prohibits state entities, including pension funds, from investing in companies that boycott the oil and gas industry. The Public Accounts Comptroller maintains a list of such companies and those companies are excluded from working with the state of Texas.

In addition to the high variability of guidance companies are receiving, there is now an ever-increasing trend in commentary and investigation by states into corporate ESG activities. On August 16, 2022 New York, California, Delaware, Illinois, Maryland, Minnesota and New Jersey, through their respective State Attorney Generals, filed comments in support of the SEC-proposed ESG rulemaking. That same day, West Virginia Attorney General Patrick Morrisey, joined by 20 other State Attorneys General, filed comments in opposition to the SEC-ESG rulemaking. The next day, Missouri Attorney General Eric Schmitt, joined by 18 additional State Attorney Generals, announced an investigation into Morningstar and Sustainalytics. Attorney General Schmitt's focus includes both ESG and the Boycott, Divestment and Sections (BDS) movement against Israel.

CONCLUSION

These conflicts are problematic for companies who are trying to navigate the tumultuous ESG waters. A good corporate citizen in one locale may well be identified as "undesirable" in another. These conflicts raise the overall risk profile for companies and investors and open windows, not only for governmental action but also for litigation, as changes such as those to the Florida Deceptive Trade Practices Act present a previously nonexistent risk.

We at J.S. Held will continue to watch ESG development at the DOL, in the legislatures, and elsewhere.

ACKNOWLEDGMENTS

We would like to thank John Peiserich for providing insight and expertise that greatly assisted this research.

John F. Peiserich is an Executive Vice President and Practice Lead in J.S. Held's Environmental, Health & Safety practice. With over 30 years of experience, John provides consulting and expert services for heavy industry and law firms throughout the country with a focus on Oil & Gas, Energy, and Public Utilities. He has extensive experience evaluating risk associated with potential and ongoing compliance obligations, developing strategies around those obligations, and working to implement a client-focused compliance strategy. Mr. Peiserich has appointments as an Independent Monitor through EPA's Suspension and Debarment Program. John routinely supports clients in a forward-facing role for rulemaking and legislative issues involving energy, environmental, Oil & Gas, and related issues.

Contact John at john.peiserich@jsheld.com or +1 504 360 8373.

REFERENCES

i. https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/notice-of-proposed-rulemaking-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.pdf

ii. https://www.osc.state.ny.us/files/reports/special-topics/pdf/climate-action-plan-2019.pdf