

CORPORATE
ESG

ESG stakeholder activism is transforming corporate governance

The continued focus on the sustainability agenda is forcing general counsel into becoming ESG experts and serving as a bridge between executive management and a diverse range of stakeholders

ESG targets have created a dynamic in which corporate governance is less dictated by the board of directors and more by a range of stakeholders from varying backgrounds with wider interests and goals, according to a report by Lex Mundi, a global network of independent law firms.

This wider pool of stakeholders has resulted in an expanding number of KPIs coming to the forefront, including social and sustainable targets, which need to be balanced carefully with financial targets and regulatory compliance.

In response to this situation, Lex Mundi notes that general counsel are stepping further out of a behind-the-scenes role of providing legal guidance and support to boards and management, and more into the fray of supporting relations with four types of constituencies: boards and shareholders, government authorities, business partners, and public groups.

“The pre-eminence of the sustainability agenda is setting in motion an overhaul of the rules of global capitalism,” said Eric Staal, vice president of global markets at Lex Mundi. “As part of the new economic paradigm, corporate governance is giving way to a new model of stakeholder governance.”

According to the Lex Mundi report, the evolution of ESG targets in corporate governance has quickly gone from being a voluntary internal standard to full legal requirement. During the Lex Mundi 2022 Summit, general counsels also noted the importance of recognising the infinite nature of ESG. Since ESG has no set end, it is important that general counsel can look ahead of the curve for the next big flashpoint, the report argues.

“Much of the responsibility for managing this transition will lie with the general counsel, who will help corporate leadership teams balance this pressure with other business

imperatives such as meeting financial targets and basic compliance,” Staal continued. “The real-world trade-offs involved will naturally presuppose a heightened awareness of, and strategy to proactively manage the competing priorities of diverse stakeholders.”

Helena Samaha, president and CEO at Lex Mundi stressed the impact of an exponential rise in stakeholder expectations around how to manage the climate crisis. “Targets are rising, and new regulations are being introduced or updated across most major jurisdictions,” she said. “General counsel are always expected to be fleet of foot but increasingly need the guile to manage a more diverse range of stakeholders, to balance these pressures with traditional business imperatives.”

Her comments correlate with a key finding of the report: that traditional corporate compliance could not handle the increasing pressure of ensuring supply chain integrity, which is at the “heart of the ESG agenda”. On the operational level, this means that diligence in acquisitions and business partners has become more demanding. In addition, contracts will need to be terminated or redrawn to account for new regulations, and employee guidelines and policies will need to be updated under general counsel guidance.

“The sustainability agenda is the number one item that general counsels talk about,” said ESG-focused M&A partner Nicola Evans at Hogan Lovells. “Clients often ask us about what the ESG landscape looks like and what they need to do to stay on top of it. That means we all have to become ESG lawyers in some shape or form.”

According to Evans, ESG concerns go into “everything general counsel are doing”. For example, if a corporate wishes to take out finance, the banks are now likely to provide interest rate payments that vary depending on certain aspects of ESG performance. Then, in the M&A world, there is an increasing focus on ESG-related diligence around supply chains and climate disclosures.

Shareholder Activism

ESG-related shareholder activism is becoming an increasingly powerful tool with which stakeholders can hold companies to account – and this is having an enormous spillover into the role of general counsel.

“Blackrock CEO Lawrence Fink’s 2018 letter to shareholders was a watershed moment in harnessing the financial services sector to the climate change and social agenda,” said Staal.

Nowadays, Staal added, an impressive 60-80% of investments made by the world’s top institutional funds are dedicated to ESG principles, even before “Gordon Brown’s COP26 announcement that \$130 trillion in assets had been committed by banks, funds, insurances to achieving net zero targets”.

“The power of money has thus become the driving force of the sustainability and social agenda with banks and asset managers now the primary tool to achieve change by imposing higher costs of capital on corporate borrowers who do not comply,” Staal said.

Catherine Howarth, chief executive at ShareAction, said asset managers are now targeting individual directors of companies that are deemed to be breaking emissions pledges. “It is just not good enough to be sitting on the sidelines, supporting management over and over again,” she said.

According to the Lex Mundi report, before the end of 2021, there were already more than 800 shareholder resolutions proposed for US-listed companies with the majority of these focused on diversity and climate change as opposed to traditional areas like governance, financial performance, and strategy. Furthermore, there was a 50% increase in the number of resolutions approved in 2021, which does not count the increase in pre-emptive actions adopted by companies.

“Shareholders may be growing increasingly intolerant of costly corporate compliance and accounting lapses,” said Michael Perergine, partner at McDermott Will & Emery, and Charles Elson, professor of corporate governance at the University of Delaware Alfred Lerner College of Business and Economics in a joint paper. “There is a renewed emphasis on the role of the whistleblower, and the board’s role in assuring the support and protection of that role.”

All of this means that general counsel are caught “between a traditional governance model of supporting the direction of corporate leadership with timely guidance for the board and a new model of proactively navigating diverse

stakeholders with varying interests”, according to the report.

“UK PLC is likely to follow the EU’s example and see more shareholder activism around climate,” said Evans.

For example, the Children’s Investment Fund (TCI) pushed Spanish airport operator Aena to seek approval for an advisory climate vote, the proposal becoming the first of its type in the world to pass on October 29 2020. Thanks to the resolution, each year shareholders now have to vote on the company’s transition plan to net zero. If shareholders don’t like the transition plan, or how quickly the managers are moving with the plan, they have the power to overrule management by not approving it. It is a good example of shareholders taking control of an agenda that would normally be run by the executive management team.

“We’re beginning to see similar things happen in the UK,” Evans added. “The trend is likely to continue.” Historically, shareholders who wanted more climate action from companies in which they were invested were having conversation behind closed doors to try and move the agenda. Now some investors “are much more vocal, and prepared to go public and have the debate in the public sphere”.

“The rise of shareholder activism could change corporate governance and ultimately the way firms work,” Evans said. “This is even true for hard-to-abate industries, like aviation or oil and gas.”

Many firms in hard-to-abate industries are still struggling to deliver credible transition plans.

For example, in 2021, Britain’s biggest fund manager, Legal & General Investment Management (LGIM), was among investors behind a significant shareholder vote against Shell’s climate transition targets at the company’s annual meeting.

The asset manager, which is part of the insurer Legal & General and manages more than £1.2 trillion of assets, told the Guardian activists demanding faster progress because it did not believe the Anglo-Dutch company’s plan was credible.



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