Legal Teams Lead on ESG but Have Room to Grow

By Suz Mac Cormac

We will start with the good news. There are certainly many encouraging results from Morrison Foerster's sponsored survey by *Corporate Counsel*, headlined by the general awareness of the importance of Environmental, Social, and Governance (ESG) issues by in-house counsel and by the 90% of those surveyed who confirmed that either their GCs or in-house teams are leading their company's ESG strategy. But the results also leave open the question of whether in-house lawyers still view ESG and their role in its adoption and promotion too narrowly.

First, among the encouraging results was the focus on reporting and compliance. For example, more than half of the respondents said their legal departments lead ESG compliance. Leadership in this area will become more critical as the demands increase for more meaningful action and transparency—not just from regulators, but also from employees, partners, customers, and investors.

Take diversity, equity, and inclusion (DEI) as just one example. A commitment to DEI has meant, at minimum, collecting and reporting data on workforce diversity. But many companies, in response to their employees and other stakeholders, have taken that commitment to a new level. They have hired human resources experts to design programs to measure how effectively companies attract and retain diverse talent. These market leaders will force others to follow them regardless of what regulatory action is required.

Greater Focus Needed on the "E" in ESG

Legal departments will also need to increase their time spent on the "E" in ESG. In our survey, more respondents listed social and governance issues as high priorities than environmental issues. That's not surprising, given that our respondents were not significantly represented by the three industries responsible for nearly approximately 95% of greenhouse-gas emissions: energy, agriculture, and transportation.

But the "E" will become increasingly urgent for all companies. In March, shortly after respondents completed our survey, the U.S. Securities and Exchange Commission proposed new regulations that would require registered companies to make extensive disclosures about climate-related risks. Those disclosures will include not just a company's carbon dioxide emissions and the energy it uses in the form of electricity, heat, and cooling—known as Scope 1 and Scope 2 emissions—for the fast majority of public companies, but also Scope 3 emissions coming from a company's upstream and downstream operations and customers, a monumental reporting task. Almost all public and private companies will be within the Scope 3 emissions of public companies required to report, and will, therefore, need to be able to measure, verify, and benchmark emissions and effectively assess climate risk.

Executive Compensation, ESG Disclosures, and Third-Party Verification

On another positive note from our survey, most respondents said their executive compensation includes incentives/mandates for ESG achievements. Left unanswered by our survey, however, is whether that compensation is purely subjective or whether it is tied to the same kind of qualitative metrics used to capture financial performance. Over the long run, I expect compensation to be dictated by the latter.

It was no surprise that about half of the respondents said their companies make voluntary ESG disclosures, while 38% said they include ESG factors in required disclosures and 11% include ESG in both voluntary and required disclosures. Curiously, however, 14% said their company makes no ESG disclosures. Frankly, we believe that those respondents do not understand what is included under the ESG umbrella. The fact is, every company is legally required to monitor and disclose risks around anti-money laundering, anti-bribery, privacy, cybersecurity, and governance (to name a few)—and all those issues fit squarely within ESG.

In other good news, more than two-thirds of respondents noted that their company employs a third party to provide assurance or verification on their ESG reporting. That number was surprisingly high, but I am unclear as to whether those third parties were independent or paid consultants. Today, there only a handful of well-regarded independent third-party verification providers. But I believe that, like accounting firms that audit a company's financial reporting, independent verifiers will play an essential role in undergirding the credibility of ESG reporting.

Looking Ahead: ESG in the Future

Ultimately, while there is much to cheer in these results, many legal departments will need to take further steps along their ESG journeys. In my view, there are (at least) four lenses through which to view ESG: driving value, enterprise risk management, compliance, and reporting.

These survey results suggest that many legal departments focus too narrowly on the latter two. A few years ago, that limited view may have been acceptable, provided that compliance was strong in areas where there was already regulation. However, the job of in-house legal leaders today requires more focus on using ESG to drive value and manage risk for the entire enterprise.

We are living through an era of rapid change. Over the last decade, we've seen the risks and regulations dramatically increase around cybersecurity, privacy, climate change, and human rights. A company's legal team is perfectly positioned to help not just to comply with existing laws and regulations, but to see around corners to identify company-wide risks and opportunities to drive value.

What does that look like? Say your company is opening a new office or new plant. Are you analyzing the physical threats posed by climate change to that building? And what about threats indirectly caused by climate change, like civil unrest? Will those risks threaten your company's ability to service contracts?

That level of analysis is more than just checking boxes. It requires a new way of thinking about ESG. But, ultimately, it's the thinking that companies and boards of directors need most.