ARTICLE

CAREMARK AND ESG, PERFECT TOGETHER: A PRACTICAL APPROACH TO IMPLEMENTING AN INTEGRATED, EFFICIENT, AND EFFECTIVE *CAREMARK* AND EESG STRATEGY

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I. Introduction

With concerns about climate change, growing economic insecurity and inequality, and the resiliency of critical supply chains has come renewed concern about whether business entities conduct themselves in a manner that is consistent with society's best interests. This concern manifests in a demand that corporations respect the best interests of society and all corporate stakeholders, not solely stockholders.[1] The buzz abbreviation for this is "environmental, social, and governance" (ESG), or as one of us has called it, "EESG."[2]

Many corporate fiduciaries believe that companies are most likely to create sustainable profits if they act fairly toward their employees, customers, creditors, the environment, and the communities the company's operations affect.[3] However, boards and management teams struggle to situate EESG within existing reporting and committee frameworks and figure out how to meet the demand for greater accountability to society while not falling short in other areas.

Here, we propose a way of thinking about EESG that promotes ethical, fair, and sustainable behavior without heaping additional work on already-stretched employees and directors. To develop the framework for this proposal, we relate the concept of EESG to the preexisting compliance duty of corporations. This long-standing duty, associated with the Delaware Court of Chancery's landmark decision in *In re Caremark International Inc. Derivative Litigation*[4] but rooted in the much older requirement that corporations conduct only lawful business by lawful means,[5] overlaps with and should be integrated into companies' decisions to hold themselves to even higher levels of responsibility.

This Article proceeds in three parts. Part II observes that corporate law's first principle is that a corporation must

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1. *See infra* Part III.
2. The extra "E" is for employees—a crucial but oftentimes missing component in the ESG discussion. *See* Leo E. Strine Jr., *Toward Fair and Sustainable Capitalism* 6 (Roosevelt Inst., Working Paper No. 202008, 2020), https://rooseveltinstitute.org/wp-content/uploads//08/RI_TowardFairand SustainableCapitalism_WorkingPaper_202008.pdf [https://perma.cc/69BL-P6MD].
3. *See, e.g.*, John D. Morley, *Too Big to Be Activist*, 92 S. Cal. L. Rev. 1407, 1409 (2019); Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, BlackRock, https://www.BlackRock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/NT9H-PKKZ] ("To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society.").
4. In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).
5. Leo E. Strine Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 Geo. L. Rev. 629, 649-51 (2010).

conduct lawful business by lawful means. From this, the Article explains that if a company strives to be an above-average corporate citizen, then it will also be much more likely to simultaneously meet its minimum legal and regulatory duties. In this way, EESG and ordinary compliance should be seen as interconnected and be accomplished in an integrated one-step process. Part III then sketches a high-level framework that allows directors and managers to situate EESG initiatives within their existing compliance and regulatory program. Finally, Part IV advises corporate leaders to update and integrate existing regulatory reporting and compliance processes and EESG standards, share results with stakeholders, and simultaneously fulfill their duty to monitor the corporate enterprise.

II. The Origins of Today's Intense Focus on EESG

For generations, the prevailing view among many business leaders, institutional investors, and law and economics academics was that corporate law should primarily serve the interests of companies' stockholders, an ideology known as "shareholder primacy."[6]

However, as a response to societal concerns regarding shareholder primacy, many business leaders, institutional investors, and policymakers have gravitated toward the view that corporations should serve the interests of all their stakeholders, not just those who own the company's stock.

Additionally, the economic and human crisis caused by COVID-19 will only boost calls for greater corporate regard for stakeholders like workers, ordinary-course suppliers, and the communities in which companies operate.

The demand for increased attention to stakeholders is clear. But too often lost in this conversation is the first principle of corporate law: corporations may only conduct lawful business by lawful means.[7]

Precisely because of this statutory mandate, corporate fiduciaries are imbued with substantial discretion to manage their corporations in an "other-regarding" manner.[8] Like a human citizen, corporations can consciously choose to avoid ambiguous grey areas of conduct that risk violating the law.[9]

This first principle also helps illustrate our central point: a corporation's plan to fulfill its legal compliance obligations should not be viewed as separate and distinct from the corporation's plan to operate in a sustainable, ethical manner with fair regard for all the corporation's stakeholders.

In the landmark *Caremark* decision, Chancellor William Allen articulated the fiduciary duty that corporate directors owed to honor this first principle of statutory corporate law[10]:

> [C]orporate boards may [not] satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.[11]

Caremark and other developments stimulated focus on corporations adopting sound procedures to ensure lawful business conduct. Although liability under *Caremark* is hard to prove,[12] scholars have viewed the case as having enormous value in encouraging more intensive diligence in compliance,[13] amplified by substantial government penalties on corporations that run afoul of the law with weak compliance programs. And recent *Caremark* decisions denying the defendants' motions to dismiss have resulted in renewed attention to directors' oversight obligations.[14]

In response to major accounting scandals and a market-shaking financial crisis within a decade, federal law also substantially enhanced the requirements for corporations to address financial risk and seat independent board members as the exclusive members of committees relevant to compliance.[15]

This period coincided with predominance of institutional investors over human stockholders, which facilitated collective action to change corporate management and strategy. Many investor initiatives have focused on making companies more, rather than less, responsive to immediate market pressures and paid little to no attention to issues like risk management.[16] And some investors have pushed

6. Shareholder primacy dictates that corporations should, within the limits of law and ethics, focus on the best interests of their stockholders. *See* Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. Times, Sept. 13, 1970, at 32; William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 Cardozo L. Rev. 261, 268-70 (1992).
7. Del. Code Ann. tit. 8, §101(b) (2020) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes. . . ."); Model Bus. Corp. Act §3.01(a) (Am. Bar Ass'n 2016) ("Every corporation incorporated under this Act has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation.").
8. *See* Lynn Stout, The Shareholder Value Myth (2012); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. Rev. 733, 738, 761 (2005).
9. *See* Elizabeth Pollman, *Corporate Disobedience*, 68 Duke L.J. 709, 710-11 (2019).
10. In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).
11. *Id.* at 970.
12. *See, e.g.*, Guttman v. Huang, 823 A.2d 492, 505-06 (Del. Ch. 2003).
13. Donald C. Langevoort, Commentary, Caremark *and Compliance: A Twenty-Year Lookback*, 90 Temp. L. Rev. 727, 728 (2018); Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. Rev. 949, 967 (2009).
14. *See* Marchand v. Barnhill, 212 A.3d 805, 807-09 (Del. 2019); In re Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019); Hughes v. Xiaoming Hu, No. 2019-0112, 2020 WL 1987029, at *1 (Del. Ch. Apr. 27, 2020).
15. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §301, 116 Stat. 745, 775-76 (codified as 15 U.S.C. §78j-1 (2018).
16. *See* Kosmas Papadopoulos et al., U.S. Board Study: Board Accountability Practices Review 5 (2018), https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf [https://perma.cc/E374-BC8V] (documenting the changes in governance at S&P Composite 1500 companies from 2009 to 2017).

companies to deliver immediate returns or risk being ousted from office or otherwise publicly embarrassed.[17]

This new dynamic has led naturally to an intense corporate focus on pleasing stockholders, even if doing so harms other key stakeholders such as creditors and, most importantly, employees. During this period, the traditional gainsharing from increased corporate profitability and productivity between employees and stockholders has markedly tilted toward stockholders and top corporate management.[18] This tilt has contributed to greater inequality and growing economic insecurity and dissatisfaction.[19] Likewise, some observers have expressed concern that the avid pursuit of stock market gains has led corporations to be insensitive (or worse) to the long-term consequences of their conduct for the planet's health and the health and welfare of their consumers.[20]

One consequence of inequality and economic insecurity has been an increasing sense that corporations need to do more than the legal minimum and that the so-called stockholder wealth maximization principle is legally erroneous and socially harmful. Even mainstream institutional investors recognize that most investors whose money the institutions manage are human beings who invest for long-term objectives like retirement.[21]

The increased salience of so-called ESG, today's word for yesterday's corporate social responsibility, is one manifestation of this. Recognizing developments that highlight employees as well as environmental and social concerns, we will use the term "EESG" to incorporate the interests of employees into the ESG framework instead of just "burying them in the S."[22]

In reaction to this EESG movement, corporations have taken action to adopt policies and practices reflecting their commitment to sustainable governance and ethical treatment of stakeholders.[23] However, managers and directors are struggling with how to implement a commitment to good EESG practices, along with all their preexisting legal obligations and business requirements. If EESG just becomes another add-on to a list of already difficult-to-accomplish checklist items, the proponents of greater corporate social responsibility, i.e., EESG, will fail to achieve their worthy purpose. We next turn to the task of avoiding this wasteful and harmful outcome.

III. Toward an Integrated, Efficient, and Effective Approach to Corporate Compliance and EESG

We are optimistic about EESG for two reasons. First, the demand that corporations treat stakeholders and society with respect is a fundamentally critical function of social institutions.[24] Second, because EESG is intrinsic to good corporate management, there is good news: there is an effective method for corporations to embrace quality EESG standards that does not simply pile EESG responsibilities on top of existing duties of managers and the board. This method involves the recognition that the company's compliance and EESG plans should be identical, and that the work of implementing that singular plan should be allocated across company management and across the board's committee structure itself. That is, if a corporation already maintains a thorough and thoughtful compliance policy, the corporation has a strong start toward a solid EESG policy.

To grasp why, focus on the traditional "E" in ESG: the environment. Without minimizing the importance of carbon emissions, let's not lose sight of the fact that there are other sorts of dangerous emissions (e.g., particulate matter), there are other sorts of harmful excess (think plastic), and there will be evolving standards as new innovations result in unanticipated consequences. Since before *Caremark*, environmental concerns have been a core focus of corporate compliance programs.[25] The growing focus on climate change and other negative effects of intensive economic activity on the environment has manifested itself in litigation under *Caremark*.[26] Corporate compliance programs that effectively addressed these environmental risks have thus better-positioned their companies to confront

17. *See* Lyman Johnson, *A Fresh Look at Director "Independence": Mutual Fund Fee Litigation and Gartenberg at Twenty-Five*, 61 Vand. L. Rev. 497, 534 n.228 (2008).

18. We are not arguing in this Article that this reduction in gainsharing can be causally attributed to the interaction of greater company responsiveness to stockholders and a simultaneous weakening of worker leverage.

19. *See generally* Thomas Piketty, Capital in the Twenty-First Century (Arthur Goldhammer, trans., 2014) (documenting growing inequality throughout the United States and other OECD countries). Growing inequality has resulted, in part, in increased economic instability. *See generally* Austin Nichols & Philipp Rehm, *Income Risk in 30 Countries*, 60 Rev. Income & Wealth S98 (2014) (documenting the rise of economic insecurity in America). research.org/global/2017/06/05/2-public-divided-on-prospects-for-the-next-generation [https://perma.cc/7XE4-TJR7].

20. *See, e.g.*, Henry M. Paulson Jr., *Short-Termism and the Threat From Climate Change*, McKinsey & Co. (Apr. 1, 2015), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/short-termism-and-the-threat-from-climate-change [https://perma.cc/J8A4-GJF3]; *see* Jamie Dimon & Warren E. Buffett, *Short-Termism Is Harming the Economy*, Wall St. J.: Opinion (June 6, 2018, 10:00 PM), https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801 [https://perma.cc/Z2SM-QP64].

21. BlackRock, BlackRock Investment Stewardship: 2018 Annual Report 1 (2018), https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2018.pdf [https://perma.cc/G4YJ-R3KZ].

22. Some commentators and market participants have lumped employees into the "social" prong of ESG. *See, e.g.*, *What Is the "S" in ESG?*, S&P Glob. (Feb. 24, 2020), https://www.spglobal.com/en/research-insights/articles/what-is-the-s-in-esg [https://perma.cc/64SE-LTXF].

23. *See, e.g.*, Brad Smith, *Microsoft Will Be Carbon Negative by 2030*, Microsoft: Off. Microsoft Blog (Jan. 16, 2020), https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030 [https://perma.cc/PD7X-632V] (announcing that Microsoft will decrease its carbon emission to below zero by 2030).

24. *See generally* Colin Mayer, Prosperity: Better Business Makes the Greater Good (2018) (laying out a stakeholder vision of business, with a focus on the corporate commitment to both customers and communities).

25. *See* Michael P. Vandenbergh, *Private Environmental Governance*, 99 Cornell L. Rev. 129, 140-61 (2013).

26. *See* City of Birmingham Ret. & Relief Sys. v. Good, 177 A.3d 47, 50 (Del. 2017); Inter-Mktg. Grp. USA, Inc. ex rel. Plains All Am. Pipeline, L.P. v. Armstrong, No. 2017-0030, 2020 WL 756965, at **10-15 (Del. Ch. Jan. 31, 2020).

emerging demands to meet the "environmental" prong of EESG for action going beyond the legal minimum.

The environmental example is not isolated. For instance, to the extent that EESG embraces a responsibility toward company customers, it overlaps with compliance. Many *Caremark* cases and regulatory actions have focused on corporations that allegedly exposed consumers to undue harm, financial or otherwise.[27] Similarly, the responsibility to provide employees with safe working conditions,[28] an environment that is tolerant toward diverse beliefs and backgrounds,[29] and fair wages and benefits,[30] overlaps with important compliance duties. As with other EESG factors, the employee factor has also been a focus of *Caremark* cases and actions by regulators.[31]

Finally, to the extent that good EESG could be thought to involve yet another E, ethics and the overall commitment to conducting business with high integrity and an other-regarding spirit, EESG also overlaps with compliance. And as with the previous EESG factors, perceived ethical lapses have often prompted *Caremark* suits.[32]

The overlap between compliance and EESG is understandable and unremarkable when considered from this perspective. Perhaps the most important foundational question corporate directors and managers need to be able to answer to be an effective fiduciary is: "How does the company make money?"[33]

This simple question is powerful because it forces directors to examine closely what the company does that results in the ultimate profitable sale of a product or service. What will naturally flow from asking this core question is an understanding that the legal regimes likely to be most salient for the company are identical to the EESG issues that have the most salience. Why? Because society learns from experience, and the law is likely to have the most relevance to the company in those areas where the company has the most impact on the lives of its stakeholders, be they the company's workers, its consumers, or the communities in which its operations have a material impact. So too will the pressures on particular companies to implement more ambitious EESG standards and practices likely coincide with the areas of company operations that have the most impact on particular stakeholders and society.

Therefore, by analyzing in a rigorous way how a company makes money, and the impact that has on others, directors will be well-positioned to best shape an effective compliance system and an effective EESG plan. If directors seek to go beyond the legal minimum and treat all the corporation's stakeholders and communities of impact in an ethical and considerate manner, the corporation minimizes the risk of breaking the law. By trying to engage in EESG best practices, the corporation will have a margin of error that keeps it largely out of the legal grey and create a reputation that will serve the company well with its stakeholders and regulators when there is a situational lapse.

Unfortunately, for too many companies, their existing board compliance structures are not well thought-out. This may result in an imbalanced approach to legal compliance and risk management that hazards failing to identify and address key areas where the company could negatively affect stakeholders and society—and run afoul of the law.

IV. A Practical Way to Think About Organizing and Implementing an Integrative Compliance/EESG Strategy

For a public company seeking to reorganize its compliance and EESG functions, the most rational starting point involves building on the thought process discussed. The company's board, management, and advisors should identify how the company makes money and the affected stakeholders.

As to material business lines, top management must address the relevant regulatory regimes that constrain the company's conduct, consider the reasons why that is so, and identify the stakeholders whose interests the law protects. Relatedly, managers and boards should undertake the same inquiry in addressing reputable EESG criteria and their application. The results of these inquiries should then be integrated. The concerns addressed by law and EESG standards will tend to track.

This is an important point in the ongoing discussion about EESG reporting. Regulatory systems already require disclosure that is essential to a quality EESG monitoring and reporting system. And in the instances in which governments do not formally mandate reporting but still set metes and bounds for appropriate conduct, trade and industry groups often coalesce around best practices for monitoring and reporting.

However, the proliferation of different approaches to EESG reporting cannot be ignored.[34] It is inefficient, encourages greenwashing[35] and gamesmanship, and threatens to engage companies more in the rhetoric of EESG

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27. *See, e.g.*, Marchand v. Barnhill, 212 A.3d 805, 807 (Del. 2019).
28. *See generally* Occupational Safety and Health Act of 1970, Pub. L. No. 91-596, 84 Stat. 1590 (ensuring safe working conditions).
29. *See generally* Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241 (prohibiting discrimination on the basis of race, color, religion, sex, or national origin).
30. *See generally* Fair Labor Standards Act of 1938, 29 U.S.C. §§201-262 (2018) (establishing fair labor standards).
31. *See* In re Am. Apparel, Inc. 2014 Derivative S'holder Litig., No. CV-14-05230, 2015 WL 12724070, at **2-4, 16-17 (C.D. Cal. Apr. 28, 2015); In re FedEx Corp. S'holder Derivative Litig., No. 08-2284, 2009 WL 10700362, at *11 (W.D. Tenn. July 30, 2009).
32. *See, e.g.*, In re McKesson Corp. Derivative Litig., No. 17-cv-01850, 2018 WL 2197548, at **1, 7-12 (N.D. Cal. May 14, 2018) (*Caremark* claim based on alleged maximization of "short-term profits over safety with respect to sales and distribution of prescription opioids and fail[ure] . . . to [properly] implement a Controlled Substance Monitoring Program").
33. Leo E. Strine Jr., *Warning—Potential Danger Ahead!*, Dirs. & Bds., Third Quarter 2004, at 25, 29.
34. *See* Jill Fisch, *The Uncertain Stewardship Potential of Index Funds*, *in* Global Shareholder Stewardship: Complexities, Challenges and Possibilities (Dionysia Katelouzou & Dan W. Puchniak eds., Cambridge Univ. Press, forthcoming), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3141&context=faculty_scholarship [https://perma.cc/T8TS-269H].
35. Richard Dahl, *Green Washing: Do You Know What You're Buying?*, 118 Env't Health Persps. A246, A247 (2010).

than the logistics.[36] Until this proliferation is alleviated, however, the only rational way to proceed is for the company to exercise judgment and to carefully select the most relevant and credible EESG standard. Management should also be prepared to explain the selection to its stakeholders.

The critical next step is determining what expertise is needed to implement the company's compliance and EESG plan, the allocation of responsibility among the company's management team, and the organization of the board to oversee management's implementation of the adopted plan.

Diversity is rightly a salient topic in the conversation about corporate citizenship. To be clear, we are not referring to the idea that having a board and management team with diverse socioeconomic, racial, ethnic, national, and gender backgrounds might enhance the company's ability to look at key issues from multiple perspectives. That very well may be the case.[37]

But for present purposes, we are referring to the more mundane idea that the world is complex and diverse expertise is essential. In corporations whose products involve complex science and safety considerations, it is vital to have employees with the skill set and experience to enable the company not only to develop and market new products, but to do so in a manner that is safe and compliant with regulatory regimes.

The problem, however, is that the same kind of sensible deployment of expertise has not characterized how American corporations have addressed EESG. It remains the case that, for a large percentage of American public companies, the audit committee is the corporate committee singularly charged with approving and monitoring the corporation's compliance.[38] This is problematic for two reasons: (1) audit committees' core responsibilities in accounting and financial compliance, prudence, and integrity have grown even more challenging, complex, and time-consuming; and (2) corporations rarely face risk and compliance issues only in the financial arena, and often have issues in areas where specialized expertise of a non-financial nature is essential to effective management.

The interactive effect is easy to explain. With increased complexity in accounting and finance has come requirements that audit committees be comprised solely of directors who consider themselves financially expert.[39] Directors whose background is not in finance, but who have other relevant talents, may be excluded from qualifying for those committees.

The core duties of an audit committee mean that the CFO, the head of internal audit, and other top finance officers will not just want, but need, a lot of time with the audit committee. There is an obvious danger that the audit committee will not have enough time to responsibly consider and address non-financial risks.

And the reality is that it is exceedingly unlikely that the skill set necessary to address the company's other non-financial risks and compliance issues is identical to that sought in audit committee members. More likely, corporations would want directors with substantial industry expertise in other relevant subjects.

The time crunch imposed by core financial and accounting duties means that the access that non-financial officers will get to the audit committee will be carefully rationed. It is natural to expect that the CFO and auditors will have an agenda of items to accomplish at each audit committee meeting. Other officers will have to fight for time.

The resulting allocation of talent and time is suboptimal. By putting a critical function in a committee that cannot perform it effectively, the board risks missing issues, limits communication between the directors and a more diverse set of company officers, and is likely to be spreading its work across its members in a highly inequitable way.

It is also unlikely that the corporation organizes its management-level approach to risk and compliance by giving its accountants responsibility for compliance with non-financial regulatory requirements, such as environmental rules. Much more likely, the corporation has developed methods to balance the competing values in specialization and generalization and has developed some industry-specific structures to address non-financial risk.

For these reasons, it seems much more effective and efficient to make sure that committee-level responsibility for risk management and compliance is thoughtfully allocated among the board's committees, rather than solely vested in the audit committee. With such a thoughtful allocation should come an alignment of officer-to-board-level reporting relationships.

Specifically, this allocation facilitates management-to-director communication on a regular basis on all the industry-relevant areas of compliance. Such a structure also maximizes the ability of a company to comprise a board with directors having the full range of talents the company's business needs, because directors can be seated and given roles that make sense for them.

This topic is an urgent one to date, as there has been a noticeable trend toward entrusting the nominating and corporate governance committee with responsibility for approving and overseeing the implementation of the company's EESG policies.[40] Rather than integrate EESG into the corporation's compliance oversight process,

36. *See* Sanjai Bhagat et al., *The Promise and Peril of Corporate Governance Indices*, 108 Colum. L. Rev. 1803, 1826-27 (2008); Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. Pa. L. Rev. 1263, 1268-69 (2009). *See* Sustainability Acct. Standards Bd., The State of Disclosure 21 (2017), https://www.sasb.org/wp-content/uploads/2019/08/StateofDisclosure-Report-web11271.pdf?__hstc=105637852.135a89045bd6ea85f685914 78e99eb09.1553809423920.1570492048390.1570494269935.17&__hssc=105637852.1.1570494269935 [https://perma.cc/4TPC-SAAF].

37. *See, e.g.*, David A. Carter et al., *Corporate Governance, Board Diversity, and Firm Value*, 38 Fin. Rev. 33, 51 (2003).

38. *See* Nat'l Ass'n of Corp. Dirs., 2019-2020 NACD Public Company Governance Survey 18 (2020), https://corpgov.law.harvard.edu/wp-content/uploads/2020/01/2019-2020-Public-Company-Survey.pdf [https://perma.cc/7QFF-4B36].

39. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §407, 116 Stat. 745, 790 (codified as 15 U.S.C. §7265 (2018)); *see also* NYSE Listed Company Manual §303A.07(a) cmt. (2021); Nasdaq Stock Market Rulebook §5605(c)(2)(A) (2021).

40. Nat'l Ass'n of Corp. Dirs., *supra* note 38, at 27.

most companies seem to be keeping primary responsibility for compliance in the audit committee, while putting EESG in another committee or on the whole board, splitting up what ought to be one integrated approach to inextricably linked goals. This is wasteful, risks missing key issues, and will be less effective in creating an ethical corporate culture.

To organize the EESG function of the corporation, the board should allocate responsibility to committees in a sensible way. This allocation of responsibility should track the skills needed to do the task well and mirror the way it is allocated at the management level.

The board's committee structure should be informed by the process outlined above, and when the fundamental compliance and EESG concerns are lined up, committees should be formed correspondingly based on board member expertise and functional purpose. For most companies,[41] this will necessitate creating at least one committee that has risk management, compliance, and EESG functions.

Generally, it is important not to proliferate committees. Rather, in addition to considering whether to establish an EESG committee, what also needs to be revisited is the function of some of the mandated committees, such as the compensation committee. Compensation committees have focused obsessively on the compensation of top management. They have not been focused on the company's overall human capital strategy, or whether it would create more value to focus more on good pay for the many rather than the few at the top. But, there is an increased demand for corporations to give greater consideration to these areas.[42]

Skeptics might contend that it is essential that the entire board be involved in compliance, risk management, and EESG. Yes, we agree, but there is an advantage to specialization. Specialization allows boards to use their management's diverse talents and limited time effectively to make sure that they identify all key issues. The result is a board that is better able to develop and implement an overall approach that is most effective.

V. Conclusion

With careful thought, corporate leaders can position their companies to better identify and address known and emerging risks; adopt goals for responsible corporate behavior toward workers, other stakeholders, and society; and establish standards and policies designed to promote and measure the attainment of both EESG goals and legal compliance. This will not be easy, but it is an exercise that is long overdue for most companies and will have long-lasting value if it becomes a regular process of serious thought about how the company makes money and how it affects the world in doing so.

41. *See, e.g.*, Ashland Glob. Holdings Inc., Proxy Statement (Schedule 14A) 33 (Dec. 9, 2019).

42. Fin. Reporting Council, The UK Corporate Governance Code 5 (2018), https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf [https://perma.cc/P4HG-BNMJ].

C O M M E N T

BOARD OVERSIGHT IN ESG—EVOLVING TRENDS IN THE ERA OF INCREASING DISCLOSURE REQUIREMENTS

by Margaret E. Peloso and Chloe E. Schmergel

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In Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *EESG Strategy*, Leo Strine and co-authors frame a board's duty of oversight for environmental, social, and governance (ESG) issues in light of the common-law duties articulated under *Caremark*.[1] The landmark *Caremark* decision articulated that corporations and their directors have a duty to implement and monitor compliance programs to ensure that the company honors its legal obligations.[2] However, a number of recent proposed rules from the U.S. Securities and Exchange Commission (SEC) signal that ESG in the United States has reached an inflection point—moving from discretionary actions to regulatory ones. This Comment uses the SEC's recent proposal, The Enhancement and Standardization of Climate Related Disclosures for Investors (the SEC Climate Proposal),[3] to examine how the shift to regulatory ESG may impact the board's oversight of ESG issues, potentially rendering Strine et al.'s *Caremark* framework obsolete.

I. What Is ESG and Why Does It Matter for Corporate Boards?

ESG is a widely used acronym that stands for the phrase "environmental, social, and governance." Over the last few years, the term has been broadly used to refer to a range of factors that have traditionally been considered noneconomic risks, but are increasingly recognized to present potentially material risks to public companies.

Increasingly, large investors and proxy advisory services have promoted heightened ESG-related oversight by corporate boards. In recent years, major institutional investors and both proxy advisory services (ISS and Glass Lewis) announced policies articulating their prioritization of certain ESG matters.[4] Such policies often lead investors to vote in favor of shareholder proposals or against key directors where the proxy advisor or institutional investor feels that a company and its board have not been sufficiently attentive to ESG matters. For example, in articulating its belief that "robust disclosure is essential for investors to effectively gauge the impact of companies' business practices and strategic planning related to [environmental and social] risks and opportunities," BlackRock asks companies to, among other things, demonstrate their approach to human capital management and disclose their business plans related to the transition to global net zero.[5] According to BlackRock's proxy voting guidelines, if shareholders propose climate plans aligned with BlackRock's expectations, it may then vote in favor of such proposals.[6]

Companies have faced growing pressure from their shareholders regarding ESG matters in the form of shareholder proposals, as well. Shareholder proposals regarding ESG issues have become much more prevalent in recent years, with 530 environmental and social-related proposals being filed at U.S. companies in 2021, a record amount,

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1. Leo E. Strine, Jr. et al., Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *EESG Strategy*, 106 Iowa L. Rev. 1885 (2021).
2. In re Caremark, 698 A.2d 959, 970 (Del. Ch. Sept. 25, 1996).
3. Release No. 33-11042, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (Apr. 11, 2022) [hereinafter Proposal].
4. *See generally* BlackRock, *BlackRock Investment Stewardship: Proxy Voting Guidelines for U.S. Securities* (Dec. 2021), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf; Cyrus Taraporevala, President & CEO of State Street Global Advisors, *CEO's Letter on Our 2022 Voting Agenda* (Jan. 2022), https://www.ssga.com/us/en/intermediary/ic/insights/ceo-letter-2022-proxy-voting-agenda; Vanguard Funds, *Global Investment Stewardship Principles* (Jan. 2022), https://global.vanguard.com/documents/global-investment-stewardship-principles.pdf; Glass Lewis, *2022 Policy Guidelines* (Jan. 2022), https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf.
5. BlackRock, *supra* note 3, at 16-18.
6. *Id.*

and 530 being filed by just March 2022.[7] Voting support has also increased for these proposals, with social and environmental proposals receiving average support of 31.4% and 39 proposals receiving majority support in 2021, up from 21 majority-supported proposals in 2020.[8]

Corporate boards are increasingly[9] choosing to focus on ESG for three reasons: (1) to capture ESG-focused investors and to appease the aforementioned shareholder demands; (2) to implement risk management/avoidance of adverse ESG events (i.e., to protect shareholder value); and (3) to pursue ESG-related opportunities (i.e., to create value). However, as ESG has grown in popularity, it has also arguably grown past usefulness as a concept due to the ever-expanding category of risks swept under the ESG umbrella[10] and inconsistent methods of measuring and evaluating ESG performance.[11]

Though the literature on ESG and value creation is somewhat limited, it tends to show that the ESG-value creation link only exists when companies pursue specific elements of ESG that are aligned to their core strategy.[12] However, the ability to generate empirical evidence clearly linking ESG writ-large to corporate value creation is limited because of inconsistencies and lack of precision in how ESG data are measured and reported. For example, in a report to the SEC Asset Management Advisory Committee by its ESG Subcommittee in May 2020, the Subcommittee stated that there was no consistent framework to determine how managers integrate ESG into their investment processes, and as a consequence, they could not compare corporate performance as it relates to ESG.[13]

Capital flows into sustainable funds have grown from 30 billion U.S. dollars in 2016 to 360 billion U.S. dollars in 2020, rising every year.[14] Much of this ESG investing is guided, at least in part, by reliance on external ESG rating systems, including the MSCI, Sustainalytics, and Bloomberg ESG. However, differences between these rating systems and the vast array of measures that can be used in constructing an ESG score lead to significant differences in their scoring of individual companies. Research investigating the divergence of ESG ratings based on data from six prominent ESG rating agencies found that the correlation between ESG ratings ranged from 38% to 71%, with an average of 54%.[15] Credit agency ratings, on the other hand, were correlated at 99%.[16]

Corporate boards have largely attempted to address their ESG-related concerns and the vast array of shareholders' ESG demands in broad strokes. However, it is clear that if companies wish to create value in taking up the ESG mantle, the approach to ESG must be more nuanced and strategically focused on company-specific risks.

II. The Pivot to Regulatory ESG and Its Impact on Board Oversight

As ESG issues have risen on the investor agenda in the last few years, corporate boards have addressed them using a variety of practices. As noted by Strine et al., some corporate boards have entrusted ESG duties to their nominating and corporate governance committees, some to their audit committees, and others have delegated the issues to the whole board, "bifurcating, trifurcating, or otherwise splitting up" these duties.[17] Indeed, a recent survey of global corporate leaders found that 43% of companies house primary oversight of ESG with the full board, 30% with their nominating and corporate governance committees, and 15% with ESG or sustainability committees.[18] By and large, ESG governance to date has been shaped by specific investor pressures in certain industries, and is far from uniform. However, 2022 marks a potentially pivotal year for ESG governance in the United States, as a suite of proposals from the SEC requires such granular detail on an issuer's specific management and governance of climate change that issuers may feel compelled to develop robust governance and oversight of such matters regardless of whether climate risks are significant to generating value or managing risks for a particular company.

For example, the SEC's Climate Proposal, proposed in March 2022, contains a set of specific disclosure requirements related to a board's oversight of climate change risks.

7. ISS, 2022 Proxy Season Review: United States—Environmental & Social Issues 4 (2022).
8. *Id.*
9. A survey of 590 corporate directors conducted in 2022 on how boards are addressing ESG found that only 4% of respondents rarely or never discuss ESG in the boardroom, which is up from 20% pre-pandemic. Diligent Institute & Spencer Stuart, Sustainability in the Spotlight: Board ESG Oversight and Strategy 12 (2022).
10. ESG has been construed to include a wide and diverse array of topics including, but not limited to, climate change, diversity, privacy, workplace relationships, cybersecurity, supply chain concerns, and human rights. *See* Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 Wash. U. L. Rev. 1821 (2021); *see also* Stavros Gadinis & Amelia Miazad, *Corporate Law & Social Risk*, 73 Vand. L. Rev. 1401, 1414-15 (2020).
11. *See* Rose, *supra* note 9, at 1825 (stating that ESG performance ratings are inconsistent and difficult to decipher because the variety of ESG issues are factored into a rating, how performance on those issues is measured, and the weight each issue is given are subjective, usually non-transparent determinations that vary across ratings providers.) *See also* James Mackintosh, *Is Tesla or Exxon More Sustainable? It Depends Whom You Ask*, Wall St. J., Sept. 17, 2018, at https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931 (arguing that ESG scores are "no more than a series of judgments by the scoring companies about what matters").
12. *See* Michael E. Porter et al., *Where ESG Fails*, Institutional Investor, Oct. 16, 2019, at https://www.institutionalinvestor.com/article/b1hm5ghqtxj9s7/Where-ESG-Fails (stating that there has never been conclusive evidence that socially responsible screens or company positions on lists such as the Dow Jones Sustainability Index deliver value, but arguing that there is compelling evidence that superiority in identifying and harnessing selected social and environmental issues relevant to the business can, over time, have a substantial economic impact on companies and even entire industries).
13. ESG Subcommittee Update: Report to the SEC Asset Management Advisory Committee (May 27, 2020), https://www.sec.gov/files/ESGSubcommitteeUpdate_0.pdf (powerpoint slide 10).
14. *The Tectonic Shift to Sustainable Investing*, BlackRock, https://www.blackrock.com/institutions/en-us/insights/investment-actions/sustainable-investing-shift (last visited July 7, 2022).
15. Florian Berg et al., *Aggregate Confusion: The Divergence of ESG Ratings*, Rev. Fin. 8 (forthcoming 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533.
16. *Id.* at 7.
17. Strine et al., *supra* note 1, at 1918.
18. Diligent Institute & Spencer Stuart, Sustainability in the Spotlight: Board ESG Oversight and Strategy 4-5 (2022).

Proposed Item 1501(a) of the climate disclosure rule would require all U.S.-listed public companies to disclose:

- The identity of any board members or committees responsible for the oversight of climate-related risks;
- Whether any member of the board has expertise in climate-related risks, including a description of that expertise;
- How the board is informed about and discusses climate risks, including the frequency of those conversations;
- Whether and how the board considers climate-related risks as part of business strategy, risk management, and financial oversight; and
- Whether and how the board sets climate-related targets and how it oversees progress toward those targets.[19]

There are a number of features of the SEC's proposed Item 1501 that merit further discussion. First, the proposed rule requires disclosures rather than particular substantive approaches—for example, it does not explicitly require that every board have a climate change expert or committee specifically charged with climate oversight. Nevertheless, numerous commenters have requested clarification that the SEC is not intending to dictate *how* board governance of climate risks is structured.[20] Even if such clarification were to be provided in any final rule, as a practical matter, many companies will likely feel the need to develop new board roles and competencies mapping onto these disclosure topics in order to avoid disclosing that they have no such expertise, discussions, targets, etc. regarding climte-related risks. Particularly when viewed in combination with the requirement to describe any climate-related expertise on the board, these disclosure requirements could be read as a suggestion that boards should have a climate expert. Second, the SEC's Climate Proposal does not specify what kind of climate expertise a board should seek to acquire. Instead, the proposed rule simply notes that companies must disclose "such detail as necessary to fully describe the nature of the expertise."[21] Still, even an implication that all boards should have climate expertise is a significant departure from the Commission's existing rules simply requiring information about the business experience of a company's board members and their qualifications for serving on the board.[22]

19. Proposed 17 C.F.R. §229.1501(a).
20. *See* Microsoft Corporation, Comment Letter on the Proposed Rule (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131614-301990.pdf (recommending that the SEC revise proposed Item 1501 to encourage issuers to tailor processes and disclosure to their circumstances with a focus on materiality).
21. Proposed 17 C.F.R. §229.1501(a)(1)(ii).
22. 17 C.F.R. §229.401(e)(1).

Third, proposed Item 1501 seeks granular disclosures of *how* the board is overseeing climate risks, including in the areas of strategy, risk management, and target-setting. In discussing the proposed requirement that issuers disclose whether and how the board of directors considers climate-related risks as part of its business strategy, risk management, and financial oversight, the Commission champions that such information would enable investors to understand how the board considers climate-related risks when reviewing and guiding business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, when reviewing and approving annual budgets, and when overseeing major expenditures, acquisitions, and divestitures.[23] The Commission argues that this disclosure requirement could help investors assess the degree to which a board's consideration of climate-related risks has been integrated into a registrant's strategic business and financial planning and its overall level of preparation to maintain its shareholder value.[24] As many commenters have noted, the level of disclosure into the board's oversight and decisionmaking sought here is far more detailed than the disclosures companies are required to make regarding fundamental economic issues that relate to the overall financial performance of the company.[25]

While an approach such as that set forth in proposed Item 1501 has the potential to lead to a set of standard practices for climate change governance, it also has the potential to put a thumb on the scales toward board focus on climate change without consideration of whether it is the most significant ESG issue that would align with generating value or managing risks for a particular company. The SEC's proposed rule regarding disclosure of cybersecurity, Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure (the Cybersecurity Proposal),[26] would similarly require companies to make granular disclosure regarding the board's oversight of cybersecurity risk, including the processes by which the board is informed about cybersecurity risk and the frequency of such discussions, whether and how the board considers cybersecurity risks as part of its business strategy, risk management, and financial oversight, and whether any

23. Proposal, *supra* note 2, at 95.
24. *Id.*
25. *See* Business Roundtable, Comment Letter on the Proposed Rule (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132191-302705.pdf (arguing that the extent of disclosure required under proposed Item 1501 far exceeds required governance disclosures about any other topics and is disproportionate to a board's overall responsibilities); Bank Policy Institute, Comment Letter on the Proposed Rule (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131389-301543.pdf ("The proposal's [governance] requirements are more prescriptive than the requirements for audit committee financial experts, defined in Regulation S-K."); *see also* State Street Global Advisors, Comment Letter on the Proposed Rule (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131965-302424.pdf ("The Commission should only require high-level, qualitative disclosure of the process by which climate-related financial risks are incorporated into governance arrangements and risk management").
26. Release No. 33-11038, Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, 87 Fed. Reg. 16590 (Mar. 9, 2022).

members of the board have expertise in cybersecurity.[27] Again, such a level of detailed disclosure could pressure boards to rethink their composition and priorities when doing so may not be in the best interests of the company and creating shareholder value.

Turning to the question of *how* boards should implement climate oversight in light of the SEC Climate Proposal, it is important to note the breadth of quantitative and qualitative disclosures that are called for under the Proposal. The SEC Climate Proposal would amend Regulation S-K to require every public company to disclose its own greenhouse gas emissions and adopt a series of qualitative disclosures on climate change strategy and risk management modeled after the Task Force on Climate Related Financial Disclosures. It would also amend Regulation S-X to require the incorporation of climate risks into a company's financial reporting. This means that simply to provide oversight of the disclosures that would be required under the SEC Climate Proposal (let alone the actual climate risks that a company may face), a board will have to develop some capacity for oversight of greenhouse gas emissions calculations, the identification and management of climate risks, and the integration of measures to address or respond to climate impacts into the company's financials. Even the proposed disclosure requirements that hew more closely to some of the traditional oversight of specific board committees may require that boards develop new areas of expertise. For example, audit committees are charged with reviewing a company's annual financial reporting and typically include among their members former corporate auditors or Chief Financial Officers. These board members are selected for their important qualifications in financial accounting that are necessary to carrying out the board's oversight function. However, they may not have experience with issues such as the accounting for and auditing of greenhouse gas emissions inventories. When assessing the breadth of the SEC's Climate Proposal, it appears that boards may need to assess how the individual disclosure requirements would overlap with responsibilities of board committees or the board as a whole to determine how to best situate these responsibilities within their board structures. In so doing, boards will need to respond to any requirements in the SEC's final rule, with the regulatory requirements for disclosure being a primary factor in driving future organization of oversight efforts.

However, this does not mean that the board itself must have expertise regarding climate risks, or be granularly involved in the relevant measurments or management of those risks, to meet its oversight duties under *Caremark*. It is well established under Delaware law that directors are not required "to possess detailed informatiion about all aspects of the operation of the enterprise," as "[s]uch a requirement would simpl[y] be inconsistent with the scale and scope of an efficient organization size in this technological age."[28] Rather, the board is entitled to rely on the work and technical expertise of officers and others within the organization—so long as the board (i) implements a reporting system to monitor the key risks facing the company, and (ii) ensures that the company responds to problems that are flagged by that reporting system. But regardless of what *Caremark* independently requires, to the extent that a company discloses pursuant to proposed Item 1501(a) that the board is involved in climate-related issues, it is important under *Caremark* (and the federal securities law) that the board in fact diligently fulfills the roles it has undertaken.

Strine et al. argue that an efficient and effective method for corporations to embrace quality ESG standards that does not simply pile ESG responsibilities on top of existing duties of managers and the board would be to build ESG responsibility into thorough and thoughtful compliance policies that corporations already maintain via satisfying their *Caremark* duties. The rigid and detailed requirements of the SEC's proposed ESG-related rules, however, seem to mandate the sacrifice of efficiency and strategy in favor of satisfying prescriptive disclosure requirements. While Strine et al. make a compelling argument for corporations to embrace ESG while still building shareholder value, the rise of regulatory ESG begs the question of whether this approach is still feasible.

27. Proposed 17 C.F.R. §229.106(c)(1); §229.407(j).

28. *In re Caremark*, 698 A.2d 959. 971 (Del. Ch. Sept. 25, 1996).

C O M M E N T

DIRECTOR ENGAGEMENT: NECESSARY FOR ESG SUCCESS

by Todd Phillips

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Leo Strine, Kirby Smith, and Reilly Steel make an important contribution to the corporate governance literature. In their article, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*,[1] they make the compelling case that *Caremark*'s obligation that directors "be reasonably informed concerning" the activities of their corporations—and be subject to legal liability if they are not—provides a foundation upon which directors can and should inform themselves as to whether their companies are acting in ESG-forward or otherwise ethical manners.[2]

While Strine, Smith, and Steel include discussions of *Caremark* liability and associated legal gloss, the practical "takeaway" from their article is that directors must be engaged with their companies' ESG (or, as the authors write, EESG)[3] efforts, addressing those matters that pose moral risk to their firms as well as those that only pose legal ones. And importantly, director engagement on ESG should not just be something that corporate boards implement, but that shareholders should be demanding.

I. Informed Corporate Directors

Both primary theories of corporate governance today—whether to be operated in the interest of stakeholders or shareholders—require directors to be informed as to their corporations' activities. Under "stakeholder capitalism," a company should operate in manners that benefit all it affects. For example, a 2019 letter from the Business Roundtable and signed by the CEOs of some of America's largest corporations made "a fundamental commitment to all of our stakeholders," including customers, employees, suppliers, communities, and shareholders.[4] However, the perhaps most significant criticism of stakeholder capitalism is that it "means reducing CEOs' responsibility to shareholders, not increasing their responsibility to workers or society or anyone else."[5] Accordingly, for stakeholder capitalism to be effective, chief executives must not be given carte blanche and directors must provide appropriate oversight that ESG commitments are being fulfilled.

The other theory of corporate governance is "shareholder primacy," meaning that a company should operate solely to benefit its investors. Although this has traditionally meant a focus on profits (Milton Friedman famously wrote, "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits")[6] this is not necessarily the case as shareholders increasingly care about investing in corporations that are stewards for ESG values. Today, investments in ESG funds total roughly $8 trillion worldwide with inflows only growing[7] and the largest shareholder of public companies, BlackRock's Larry Fink, annually writes to corporate executives encouraging them to "act as a powerful catalyst for change."[8] Clearly, whether because they believe companies that have ESG focuses will be more profitable than those who do not,[9] or because they generally want their companies to act more ethically without regard for profit,[10]

Editors' Note: All opinions are the author's own and not of any affiliate or employer.

1. Leo Strine et al., Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 Iowa L. Rev. 1885 (2021).
2. In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).
3. EESG stands for "employee, environmental, social, and governance." Strine et al., *supra* note 1, at 1885.
4. Business Roundtable, *Statement on the Purpose of a Corporation* (last updated July 2021), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf (emphasis removed).
5. Matt Levine, *Money Stuff: When Can Bond Investors Lie to Banks?*, Bloomberg (Apr. 13, 2020), https://www.bloomberg.com/news/newsletters/2020-04-13/money-stuff-when-can-bond-investors-lie-to-banks (emphasis removed).
6. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. Times Mag. (Sept. 13, 1970).
7. Evie Liu, *ESG Investing Could Quadruple by 2030*, Barron's (Dec. 3, 2021), https://www.barrons.com/articles/esg-investing-outlook-2030-51638493803.
8. Larry Fink, *Larry Fink's 2022 Letter to CEOs: The Power of Capitalism*, BlackRock (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.
9. *See* Jon Hale, *Sustainable Equity Funds Outperform Traditional Peers in 2020*, Morningstar (Jan. 8, 2021), https://www.morningstar.com/articles/1017056/sustainable-equity-funds-outperform-traditional-peers-in-2020.
10. *See* Lauren Migaki & Andee Tagle, *Understanding the Promises and Limits of Ethical Investing*, NPR (Jan. 22, 2022), https://www.npr.org/2022/01/11/1072207126/ethical-investing-with-esg-funds.

shareholders are taking ESG investing seriously. As shareholders' representatives, directors should ensure their companies are taking ESG seriously as well.

Directors owe a fiduciary duty to their corporations,[11] and a failure to provide oversight of their firms' activities can have catastrophic consequences.[12]

And whether because it is right by stakeholders (as Strine, Smith, and Steel argue) or right by shareholders, directors—especially independent directors—must provide oversight of their firms' ESG efforts.

II. Effective Board Oversight of ESG

Once a board has determined it has a role to play in supervising and directing its firm's ESG activities, the next question is how to effectively make that oversight a reality. Although most companies and all publicly traded companies maintain board audit committees,[13] and although "most companies seem to be keeping primary responsibility for compliance in the audit committee," Strine, Smith, and Steel recognize that "audit committees' core responsibilities [are, currently, largely] in accounting and financial compliance, prudence, and integrity" and that audit committees are "already the most burdened board committee."[14] Left unsaid is also that placing ESG oversight in the audit committee seemingly absolves directors who do not serve on that committee from ESG responsibilities.

Strine, Smith, and Steel articulate a better way. "[R]ather than solely vest[ing] in the audit committee" responsibility for oversight of a company's entire risk, compliance, and associated ESG efforts, that function should be "thoughtfully allocated among the board's committees" with that allocation "track[ing] the skills needed to do the task well and mirror the way the task is allocated at the management level."[15] The audit committee should likely focus on matters of accounting while other committees take on risk, compliance, and ESG oversight.

Strine, Smith, and Steel are quick to note that there should not just be a risk committee, a compliance committee, and an ESG committee. Those committees should be focused on business lines. Directors must "identify how the company makes money" and use that as a basis to set up board committees.[16] Strine, Smith, and Steel note that important committees could include an environment or a food safety committee, with responsibility for the "risk management, compliance, and EESG functions addressing" that business line, in addition to traditional nominating and governance committees and compensation committees.[17]

With that responsibility allocated, directors then need to get to the business of overseeing their company's ESG efforts. Strine, Smith, and Steel recommend that directors "consider the company's material sources of business and their impact."[18] Each board committee "must carefully address the relevant regulatory regimes that constrain the company's conduct, consider the reasons why that is so, and identify the stakeholders whose interests the law seeks to protect."[19] They should also take into consideration third-party criteria, protocols, or frameworks,[20] as well as their company's own ESG policies and values. In light of proliferating ESG standards, Strine, Smith, and Steel explain that it is ultimately up to a "company's management and board to exercise judgment and to carefully select the EESG standards it believes are the most relevant, informative, and credible."[21]

Next, board committees must determine how they are going to measure their firms' performance in meeting its ESG goals and how they will obtain that data. As the adage goes, you get what you measure, and directors must use their business judgment—with reliance on third-party standards and frameworks if applicable—to determine what their goals are and how to adequately measure whether those goals are being met. Fortunately, as Strine, Smith, and Steel note, "[a] substantial amount of the relevant data required for robust EESG reporting [and evaluation] is already required to be collected by government regulation or as part of the company's legal compliance monitoring program."[22]

Finally, directors and boards as a whole must "determin[e] what expertise is needed to implement the company's compliance and EESG plan," including at the management and board levels.[23] Strine, Smith, and Steel note that legal requirements have effectively ensured that audit committees are "comprised solely of directors who consider themselves financially expert,"[24] and there is no reason that the members of other committees should not similarly have expertise, such as in "environmental, food safety, data security, drug efficacy, plant and production safety measures, [and] privacy protections," among oth-

11. Principles of Corp. Governance §4.01(c) (Am. Law Inst. 2008).
12. *See, e.g.*, Ron Leuty, *"Ultimately, Elizabeth Made the Decisions": A Look Inside Theranos' Ineffective Board*, S.F. Bus. Times (Aug. 7, 2018), https://www.bizjournals.com/sanfrancisco/news/2018/08/07/theranos-elizabeth-holmes-board-kovacevich-shultz.html (describing how the board of Theranos Inc. considered themselves "to be a collection of advisers, not one with traditional fiduciary duties" who did not understand the company's technology, and how that contributed to the company's downfall).
13. *See* Strine et al., *supra* note 1, at 1897-98.
14. *Id*. at 1915-16, 18.
15. *Id*. at 1917-18.
16. *Id*. at 1909.
17. *Id*. at 1918.
18. *Id*. at 1910.
19. *Id*.
20. *See, e.g.*, The Greenhouse Gas Protocol, https://ghgprotocol.org/; Principles for Responsible Investment, https://www.unpri.org/.
21. Strine et al., *supra* note 1, at 1913.
22. *Id*. at 1910. Part of this is a result of *Caremark*. Because directors have the ultimate responsibility for stewarding their corporations, *Caremark* held that directors must "assur[e] themselves that information and reporting systems exist in the organization that are reasonably designed to provide to . . . the board itself timely, accurate information sufficient . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance." In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996). Resultingly, many firms maintain data reporting requirements to ensure that directors fulfill this responsibility.
23. *Id*. at 1913.
24. *Id*. at 1915. *See also id*. at n.87 (noting that the Sarbanes-Oxley Act of 2002 and the NYSE and NASDAQ listing rules generally require audit committees to be financially literate and at least one member to be an accountant).

ers.[25] Only with directors (and managers) with varied expertise will companies be able to adequately assess and effect change in their ESG efforts.

III. Conclusion

ESG has traditionally been the province of divisions dedicated to diversity, sustainability, ESG generally, or even investor relations, making companies' ESG efforts somewhat of "a 'check the box' exercise or an inconsequential appendage to core business concerns."[26] Although no effort to implement ethical decisionmaking should be discounted, all employees, managers, directors, and shareholders must be involved in ensuring ESG is fully considered and realized. Strine, Smith, and Steel make a compelling argument not only for why corporate directors especially must be engaged and why *Caremark* provides the foundation for board oversight of ESG, but also for how directors can oversee ESG effectively. Directors and shareholders must begin pushing to implement their recommendations in companies large and small.

25. *Id*. at 1916.
26. David A. Katz & Laura A. McIntosh, *Integrating ESG Into Corporate Culture: Not Elsewhere, but Everywhere*, Harv. L. Sch. F. on Corp. Governance (Mar. 29, 2021), https://corpgov.law.harvard.edu/2021/03/29/integrating-esg-into-corporate-culture-not-elsewhere-but-everywhere/.