ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) ISSUES IN COURT

In March 2022, ClientEarth, a shareholder in Shell plc. (Shell), announced it will bring an action against the company for failure to diligently act to comply with the Paris Agreement goal of net zero. The ClientEarth claim follows an order by the Hague District Court in 2021, which ordered the company to reduce emissions by 45% by the end of 2030. ClientEarth's claims, personally against the directors, must be approved by the court to proceed, but directors should take note.

Matt Caples, Francesca Berry, and Elaina Bailes of Stewarts Litigate write, "Assuming this hurdle can be overcome and the claim proceeds, Shell will be one of the first companies to have its ESG credentials tested in the English courts."

While ESG is often spoken about as one thing, it has multiple, overlapping components, some of which directors must address when they meet their duty to deliver shareholder value in the short and long term. The case of Shell and ClientEarth, highlighted by Caples, Berry, and Bailes, is of interest, but directors can't afford to wait for the outcome of this case to decide what they must do.

IS ESG DIFFERENT?

When directors think about all the issues demanding their attention, the list is long and evolving. Cybersecurity has been on boards' radar for years, yet the specifics change daily, perhaps hourly. Technology has revolutionized work in many positive ways, but companies aren't simply raking in money due to advances in engineering. Every advance creates new risks, whether from autonomous cars, tracking devices, crypto-currency, electronic payment systems, etc.

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Directors must continuously take in information about opportunities and risks that were difficult to imagine even ten years ago. The rising costs to secure a company's infrastructure are staggering and necessary, and require teams of people with the skill and character to do the work well. Yet directors cannot dive into tactics or dictate specific methods, even if tempted to do so to get their arms around particular issues.

Boards must remain at the right level in their thinking and decision-making, lest they become meddlesome and create a distracting and unhealthy relationship with management. While written with management in mind, my article in Harvard Business Review can be a helpful reminder for directors whose interference is often unwitting.

THE BOARD MINDSET™

The vital attribute of exceptional boards

ESG, like other issues pertinent to the board, can be managed by using good governance processes which are strategic, valid, and transparent. While

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the specific focus of all board matters will vary over time, the processes by which a board fulfills its duties are evergreen. We offer three ideas that, while simple to understand, take time to implement when new(er) matters must come under board oversight.

First, a robust definition of "what" needs oversight. Measuring what matters isn't as obvious as it may seem. For example, many companies focus on quantifying financial and operational risks when strategic risk is associated with more significant losses (James Lam).

When considering what needs oversight, they can ask "why" for each idea. But, again, financial measures are often an easy place to start. Traditionally, many metrics are linked to directors' duties—revenue, margin, exposure, future obligations, etc.

Second, "how" will the board know, and who says so? Our work with boards indicates that many boards accept the metrics offered by management, but this is backward. For example, in a recent discussion with a chief marketing officer, a board chair rejected all but one of the proposed measures because they were inputs, not outcomes. The executive was, not so politely, informed that the board will determine what information they need, not the other way around.

In the crush of matters a board must oversee, defining metrics may seem too tactical, and sometimes it is. However, directors must ensure that measures presented for their review are valid progress indicators toward strategic goals. Even intelligent directors may need help to develop the proper measures, lest they collectively stand on a scale to find out how tall they are.

Third, clarity. Sometimes, directors tell us that they receive mountains of detail that are more confusing than clarifying. When emerging issues are the topic, "experts" often come before the board with massive amounts of detail, sometimes peppered with unfamiliar jargon. We have seen competent boards sometimes sit politely through such nonsense because it can be temporarily disorienting. Great boards may be unsettled by avalanches of information that confuse and obscure, but they quickly find their footing and call a halt.

When directors are either too passive or overly aggressive, they get performances when what they need is factual information. Instead, boards should insist that management and advisors speak in their language, connect the information presented to the company's well-being, and admit what is yet unknown. As new issues emerge, so too will acronyms and jargon. Directors should expect some education to help them feel more comfortable, but not so they can adopt a new language and the accompanying mindset.

We will be watching as Shell's legal issues make their way through the courts, but we can be confident that the actions taken by ClientEarth are not the last of their kind. On the contrary, these actions can help prompt a board to increase the quality of its oversight or in reassuring shareholders that the directors are fully meeting their responsibilities.

If your board is grappling with the issues within ESG, it's understandable. Of course, the legal issues are important, yet as we see in this case, the central theme is whether the directors fulfilled their duties.

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