



# 2025 International Client Seminar

## March 6-9, 2025

The Future of ESG and How Companies and People Communicate

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## What is ESG?

Environmental, social, and governance (ESG) is a set of standards for how a company operates in regard to the planet and its people. When used together, they describe the nonfinancial considerations a business makes in its operations. Environmental, social and governance may be a familiar term in investment scenarios, but today's media and culture have elevated the concepts of environs, sustainability, biases, and oversight to a higher level of social consciousness. They have become critical business factors to stakeholders and impact how organizations are managing operations.<sup>1</sup>

## Why is ESG Important?

ESG is important because socially conscious investors use ESG criteria to screen potential investments. Environmental criteria examine how a company performs as a steward of the planet. Social criteria examine how a company manages relationships with employees, suppliers, customers, and the communities where it operates. Governance defines a set of rules and best practices, along with a series of processes that determine how an organization is managed and controlled.

ESG evolved from value-based investing as people sought more systematic ways to describe risks that weren't strictly financial. ESG has become increasingly important as investors, regulators, and customers seek companies that demonstrate sound financial decision-making and business performance while contributing positively to the environment and society.

Companies that effectively implement ESG measures typically show better employee retention and lower involuntary turnover rates. As compared to competitors, sustainable brands often price at a premium and improve margins. Energy efficient investments, logistics optimization, and circular business model innovation can also reduce energy use, emissions, and overall operating costs.

Having strong ESG governance practices go hand in hand with strong business practices. Because corporate governance has been around longer than most environmental and social practices, there's a lot of historical data, evidence, and research that points to the success and long-term value of sound governance. Research suggests companies with robust governance practices have stronger financial performance, lower cost of capital, and more operational efficiency than their peers with weaker governance practices. By comparison, poor ESG governance practices often lead to regulatory and reputational risk, corruption, higher cost of capital, reduced shareholder returns, and ineffective decision-making.<sup>2</sup>

## A Brief History of ESG

In the 1970s, socially responsible investing (SRI) emerged as a way for investors to align their portfolios with their values. This movement gained momentum in the 1980s with the divestment campaigns against companies doing business in South Africa during apartheid.<sup>3</sup> Over time, SRI steadily evolved to

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look much like today's corporate social responsibility (CSR) and was focused primarily on social issues such as human rights and supply chain ethics.<sup>4</sup>

In the 1990s, ESG considerations started to appear in mainstream investment strategies. In 1995, the U.S Social Investment Forum (SIF) Foundation took inventory of all the sustainable investments in North America; the total shed light on how shareholders were starting to invest out of principle versus strictly profit.

Slowly but surely, institutional investors started to recognize that companies could potentially improve financial performance and risk management by focusing on ESG issues like greenhouse gas emissions. In response, asset managers began to develop ESG strategies and metrics to measure the environmental and social impact of their investments. In 1997, the Global Reporting Initiative (GRI) was founded with the aim of addressing environmental concerns, though it soon broadened its scope to also focus on social and governance issues.<sup>5</sup>

In 1998, John Elkington published, *Cannibals with Forks, the Triple Bottom Line of 21st Century Business*, in which he introduced the concept of the triple bottom line, a sustainability framework that revolves around the three p's: people, planet, and profit. Elkington's goal was to highlight a growing body of non-financial considerations that should be included when valuating companies. Moreover, Elkington hoped to persuade businesses to operate in the best interest of people and the planet; a desire that was shared by others around the world.<sup>6</sup>

In 2000, the United Nations hosted world leaders in New York at the Millennium Summit to discuss their evolving role in the new millennia. Over the course of the three-day summit, leaders established guiding principles around topics like human rights, working conditions, the environment, and anti-corruption. Following the summit, the Millennium Development Goals (MDGs) were created, outlining eight (8) international development goals to be achieved by 2015. While meant to spark discussion, the MDGs ultimately set the stage for nations and corporations to discuss ESG factors candidly.<sup>7</sup>

The term ESG was then popularized by a 2004 report titled "*Who Cares Wins*."<sup>8</sup> The report was the result of a joint effort of financial institutions, which were invited by the United Nations (UN) to develop guidelines and recommendations on how to better integrate environmental, social, and governance issues in asset management, securities brokerage services, and associated research functions. Twenty (20) financial institutions from nine (9) countries with \$6 trillion in assets under management participated in and put their names on the report indicating that the endorsing institutions were convinced that a better consideration of environmental, social, and governance factors would ultimately contribute to stronger and more resilient investment markets, and contribute to the sustainable development of societies.

In the decade that followed, more principles and frameworks were created, providing further guidance on how companies can integrate and report on ESG factors.<sup>9</sup> Some prominent examples include the Principles for Responsible Investment (PRI), the Climate Disclosure Standards Board (CDSB), and the Sustainability Accounting Standards Board (SASB). Today, companies and investors still rely on these

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principles and frameworks. By 2023, the ESG movement had grown from a UN corporate social responsibility initiative into a global phenomenon representing more than US\$30 trillion in assets under management.<sup>10</sup>

More recently, key developments include the following:

- 2020. The World Economic Forum and the Big Four accounting firms released a standardized set of stakeholder capitalism metrics to make ESG reporting by companies more consistent and easier to compare.
- 2021. The European Union's Sustainable Finance Disclosure Regulation went into effect, creating new sustainability reporting requirements for financial services and investment firms.
- 2022. The U.S. Securities and Exchange Commission similarly proposed rules amendments with more detailed disclosure and reporting requirements for investment funds that use ESG criteria. The CDSB and the SASB standards were consolidated into the IFRS Foundation, which plans to create a unified set of IFRS Sustainability Disclosure Standards.
- 2023. The EU's Corporate Sustainability Reporting Directive went into force in January. Eventually, it will require 50,000 companies to file annual reports on their business risks and opportunities related to social and environmental issues and how their operations impact people and the environment.
- 2024. Another sustainability-related measure went into force in the EU -- the Corporate Sustainability Due Diligence Directive (CSDDD). Starting in 2027, qualifying companies that operate in the EU will be required to identify and act on adverse human rights and environmental impacts. The CSDDD applies to both internal operations and supply chains. It requires annual reporting on due diligence activities.

### Real World Examples of the Rise of ESG<sup>11</sup>

- *Unilever's Fair & Lovely controversy (2020)*. Unilever sold skin whitening creams under the name of 'Fair and Lovely' in India and other parts of Asia. The branding and advertisements of the product were criticized as discriminatory for promoting negative stereotypes around dark skin tones and instead championing a singular ideal of beauty. The criticism peaked following the death of George Floyd in the US and the subsequent Black Lives Matter movement. As a response to this, the company rebranded the product to 'Glow and Lovely' and removed words such as 'whitening' or 'lightening' from their packaging and marketing materials.
- *Enron scandal (2001)*. Enron was a major US-based energy-trading business. Its 2001 bankruptcy filing was the largest in US history at that time and sparked a huge corporate scandal. The group was manipulating its use of mark-to-market accounting and SPEs to conceal major debts from investors and to create an illusion of higher current profits by logging estimated profits as actual profits. The scandal was so hard-hitting that George Bush signed the Sarbanes-Oxley Act into law

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to heighten the consequences for destroying, altering, or fabricating financial statements and for defrauding shareholders.

- *BBC gender pay gap controversy (2017)*. The BBC published a list of all employees who earned over £150,000, as a condition of their royal charter. Of the 96 employees, 62 were men and 34 were women, and the seven (7) highest earners were all men. This exposed endemic pay inequality at the BBC, and their China Editor, Carrie Gracie, resigned and cited this as her motivation. In the wake of this controversy six (6) leading male BBC presenters agreed to take pay cuts and the BBC pledged to take action by looking into further male pay cuts and increasing pay for some men and women. The corporation conducted a fair paycheck reviewing the salary position of every employee against their relevant job pay range to ensure fair pay, and by 2019 had resolved almost 90% of pay queries, as well as other policy implementation. Notably, the news reports and studies published in response to this controversy accentuated related topics, resulting in government backed inquiries that included “Misogyny in Music.”<sup>12</sup> In 2023, the United Kingdom’s House of Commons (the elected house of its Parliament) took testimony from several individuals, including Annie Macmanus, who worked at BBC Radio 1 for seventeen (17) years as a disc jockey and broadcaster, to better understand the experience of female leaders in the music industry.<sup>13</sup> In January 2024, the House of Commons by way of the Women and Equalities Committee published a 74 page report concluding that “[w]omen working in the music industry face limitations in opportunity, a lack of support, gender discrimination and sexual harassment and assault, as well as the persistent issue of unequal pay in a sector dominated by self-employment and gendered power imbalances.”<sup>14</sup>
- *Google sexual harassment scandal (2018)*. *The New York Times* revealed that Andy Rubin, creator of Android mobile software, was gifted \$90 million in an exit package from Google, following sexual harassment accusations that internally were proved to be credible, and in which the victim was made to sign a non-disclosure agreement. This led to other revelations of senior executives who were protected following credible sexual harassment accusations either with large exit packages or even being permitted to remain in highly compensated posts. In 2019, shareholders filed a lawsuit with the corporation alleging failures to prevent sexual harassment. Subsequently, the company announced its devotion to a new diversity, equality, and inclusion program with a restructure of policy and corporate governance practices, including both an end to forced arbitration and a focus on targeting policy gaps that executives were able to exploit.
- *Volkswagen emissions scandal (2015)*. In September 2015, the Environmental Protection Agency found that many Volkswagen cars being sold in the US had a “defeat device” in diesel engines that would detect when they were being tested and change performance in order to improve emission scores. The company later admitted to cheating on emissions tests and other emissions problems. This led to significant fines and settlements and threw a spotlight on the climate effects of all diesel cars. Consequently, there has been a drive to reduce the number of diesel cars on the road across the industry. Volkswagen has made drastic changes to its management board and leadership. The automotive company has also committed to new competencies.
- *The Facebook - Cambridge Analytica scandal (2018)*. In March 2018, *The Guardian* and *The New York Times* simultaneously published articles, in collaboration with a whistleblower, revealing

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Facebook users' personal data was acquired without individual consent by Cambridge Analytica. This data was used to create psychographic profiles of subjects and tracked their locations, among other concerns. Cambridge Analytica claimed they had harvested 30 million users' data, however Facebook later confirmed that this data breach had possibly affected over 87 million users. The US government imposed further regulations on Facebook, aimed at protecting user data in response to repeated data mismanagement. Facebook announced a new privacy strategy including a pledge to double the number of employees working on cybersecurity and to implement the EU's General Data Protection Regulation in all areas of operation beyond the EU following these events.

## The Three Pillars of ESG<sup>15</sup>

### Environmental Criteria

Environmental factors refer to an organization's environmental impact(s) and risk management practices. Environmental criteria may include a company's energy use, the waste and pollution it creates, how it conserves natural resources, and the way it treats animals.

The criteria are often used in evaluating any environmental risks a company may face and how the company is managing those risks. For example, does it own contaminated land? How does it dispose of hazardous waste? How does it manage toxic emissions, and how does it comply with environmental regulations?

Examples of environmental factors that can be ESG criteria include the following:

- Energy consumption and efficiency.
- Carbon footprint, including greenhouse gas emissions.
- Waste management.
- Air and water pollution.
- Biodiversity loss.
- Deforestation.
- Natural resource depletion.
- Treatment of animals.

### Social Criteria

The social pillar refers to an organization's relationships with stakeholders and includes practices that impact employees and communities. Social criteria examine the company's business relationships. Does the company have a high regard for employee health and safety? Does the company allocate a

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percentage of its profits to its local community? Do company employees engage in volunteer work? Are other stakeholders' interests taken into account?

The criteria used include the following examples:

- Fair pay for employees, including a living wage.
- Diversity, equity, and inclusion programs.
- Employee experience and engagement.
- Workplace health and safety.
- Data protection and privacy policies.
- Fair treatment of customers and suppliers.
- Customer satisfaction levels.
- Community relations, including the organization's connection to and impact on the local communities in which it operates.
- Funding of projects or institutions that help poor and underserved communities.
- Support for human rights and labor standards.
- Prevention of sexual harassment at the workplace.
- Customer relationship management.
- Charitable contributions.
- Managing social vulnerability due to disease, injury, natural disasters, or human-caused disasters.
- Protecting disadvantaged or priority populations (racial and ethnic minorities, low-income, children and adolescents, women, individuals with special healthcare needs, and the elderly).
- Community health and demographic risk due to age or location.
- Community relations.

### Governance

Corporate governance refers to how an organization is led and managed. ESG analysts will seek to understand better how leadership's incentives are aligned with stakeholder expectations, how shareholder rights are viewed and honored, and what types of internal controls exist to promote transparency and accountability on the part of leadership.

Investors looking at a company's ESG will want to see that it is accurate and transparent in its accounting and reporting methods. Investors also will look at how a company treats its shareholders and

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their right to vote on important issues. Investors will seek assurances that the company doesn't engage in illegal practices and avoids conflicts of interest when it chooses its board members.

Examples include the following:

- Company leadership and management.
- Board composition, including its diversity and structure.
- Executive compensation policies.
- Financial transparency and business integrity.
- Regulatory compliance and risk management initiatives.
- Ethical business practices.
- Rules on corruption, bribery, conflicts of interest, and political donations and lobbying.
- Whistleblower programs.
- Accurate and transparent accounting methods.
- Appropriate audit committee structure.
- Lack of bribery and corruption.
- An examination of political contributions and lobbying efforts.

## Pros and cons of ESG

### Advantages

- *Better risk management:* Companies that integrate ESG criteria into their business often better identify and manage risks associated with environmental and social factors. For example, a company that reduces its carbon footprint may be less vulnerable to regulations and fluctuations in energy prices.
- *Attractiveness to investors:* ESG investments are becoming increasingly popular with investors who aim for both financial returns and positive social and environmental outcomes. Companies that score well in ESG assessments often have better access to investment capital.
- *Reputation and brand:* Companies with high ESG ratings can benefit from a better reputation among customers, employees, and business partners. This reputation can lead to higher customer loyalty, reduced employee turnover costs, and better business opportunities.
- *Innovation and efficiency:* ESG initiatives often promote innovation and improve operational efficiency. For example, investing in renewable energy sources can reduce operational costs, while an inclusive work environment can increase employee productivity and creativity.

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- *Long-term sustainability:* Companies focused on ESG factors often are better prepared for future challenges and market changes. This long-term approach can lead to sustainable growth and the long-term success of the business.
- *Investment returns and sustainability can mix:* Sustainability funds can achieve similar or better returns compared to traditional funds. According to global financial services company Morgan Stanley, in 2023, sustainable funds outperformed traditional funds across all major asset classes and regions.
- *ESG can attract new customers for additional growth:* Consumers and business customers, who factor ESG considerations into their buying decisions are likely to seek out products or services provided by companies that are focused on ESG.
- *ESG investing pushes companies to make other positive investment decisions:* Organizations with ESG initiatives tend to focus on a wide range of environmental issues and ethical practices. For example, ESG aligns with the triple bottom line, a sustainability-focused accounting framework that companies use to measure the overall economic value they create, including their social and environmental impact.
- *Helps companies attract and retain high-quality employees:* It can boost employee motivation and increase overall productivity by giving workers a sense of purpose.
- *Reduces costs:* When ESG practices are incorporated into the fabric of an organization, operating expenses, energy bills, and other costs can be reduced over time.

### Disadvantages

- *Implementation costs:* Implementing ESG strategies can be expensive. Companies may face high initial costs to adapt their processes and technologies to meet ESG standards.
- *Complexity of measurement:* Evaluating ESG performance is not always straightforward and can be complex. There is no universal methodology that clearly determines how to measure and compare ESG performance across different companies and sectors. This complexity can lead to inconsistent and misleading assessments.
- *Greenwashing:* Some companies may use ESG as a marketing tool without genuinely integrating these principles into their business. This phenomenon, known as greenwashing, can lead to distrust among investors and the public in ESG ratings and reports.
- *Short-term vs. long-term goals:* Focusing on ESG sometimes leads to conflicts between short-term financial goals and long-term sustainable objectives. Companies may be under pressure from shareholders to achieve immediate profits, which can limit their ability to invest in long-term ESG initiatives.
- *Regulatory uncertainty:* ESG regulations are rapidly evolving and vary by region. This uncertainty can be challenging for companies, as they continually monitor and adapt to new legal requirements, increasing operational costs, and complexity.

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- *Doesn't follow a one-size-fits-all approach:* One company's approach to ESG might not work for another, which complicates both management of ESG initiatives and ESG investing. The need to weave ESG efforts into both day-to-day business practices and long-term strategies adds more complications.
- *Strong stock market performance isn't guaranteed:* While there are success stories, focusing on ESG doesn't guarantee strong performance by a company's stock. In addition to other internal factors, changes in market conditions, business trends, and the overall economy can negatively affect the performance of companies and ESG funds alike.
- *Creating a diverse investment portfolio can be difficult:* For investors focused on an ESG-led investment strategy, it might be harder to create a balanced portfolio that aligns with long-term goals.
- *Detailed performance reporting across different ESG criteria can be challenging:* Most ESG factors aren't tied directly to financial data, which requires additional effort to provide tangible performance results. Further, knowledge gaps reside between ESG information and the supply chain as reporting standards and frameworks aren't consistently applied.

## Why is ESG Becoming Controversial?

Despite growing in popularity, ESG policies and practices have attracted criticism from many. Profit and appetite for risk are no longer the sole factor considered in investment decisions. Amid rising temperatures, global climate disasters, and increasing social and environmental activism, the perception of how a business conducts itself has become as important as its financial forecasts and bottom line.

ESG standards are at the core of this shift in strategy. Since their inception at the turn of the century, the market and demand for ESG expertise and practices has skyrocketed. Research suggests that the vast majority of consumers and employers care, too; and think companies should be shaping ESG best practices. In the eyes of many, ESG isn't just a box-ticking exercise – it's a strategic imperative for any organization that wants to remain competitive and retain customers and employees. However, ESG isn't without its critics. Many have decried these initiatives as another example of corporate greenwashing, while others have questioned the merit and legitimacy of these practices altogether.

## Criticisms of ESG

So, what are some of the biggest criticisms and concerns around ESG? Are they valid? And how do they stack up against the benefits it could offer organizations, business leaders, and investors?<sup>16</sup>

### It's a Public Relations Move

One of the biggest criticisms of ESG is that it perpetuates what it was partly designed to stop – greenwashing. While there are plenty of benefits of implementing these initiatives, the concern is that organizations will be encouraged to adopt ESG to improve their reputation and standing among

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investors, employees, and customers, only to treat it as a 'nice-to-have' – secondary to their *real* priorities.

Skepticism towards ESG is growing, and in some instances declining in popularity among investors. So, while there are many parties celebrating the benefits of ESG, it seems that cases of greenwashing are diluting its popularity and, potentially, its actual impact.

### Overcomplicated and Too Difficult to Achieve

ESG covers three very broad topics – the Environment, Society, and Governance. However, while each of these topics have relationships and dependencies with one another, many are questioning the merit of applying a single ESG score when it is such a difficult, broad, and complex field to define.

For some organizations (and investment strategies), the biggest priorities that require the most attention will differ, and ESG measures that benefit one area, e.g. society, could potentially have a negative impact on another. This makes satisfying multiple stakeholders a significant challenge.

### Lack of Standardized Measurement

There's no standardized measurement for ESG success. With agencies like Bloomberg and Dow Jones among others offering their own bespoke rating systems (with results that can vary significantly depending on the provider), this has opened ESG claims up to scrutiny and skepticism. Criticism also has been raised at the lack of transparency surrounding the procedures that agencies use to establish ratings and rankings.

However, while there have been calls to standardize ESG scores, this itself has sparked concerns that it would leave the measurements prone to manipulation, meaning a universal ESG rating system may not be the solution.

### No Apparent Meaningful Impact on Society or the Environment

The evidence of ESG's benefits has been called into question. Some argue that, while there are statistics that illustrate a positive correlation with performance, it's not possible for these to be directly attributed to ESG – especially when the ratings organizations receive (and the criteria used to produce them) vary so significantly.

### Nominal Evidence of Returns

In contrast to much of the positive reception ESG has received, some evidence suggests that it isn't even offering financial benefit for investors and businesses. A study conducted by researchers at the University of Chicago found that high sustainability funds hadn't outperformed any of the lowest rated funds. Another study by the European Corporate Institute found that businesses with investment from

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'responsible investors' didn't observe an improvement in ESG scores and instead experienced reduced financial returns.

## ESG Today and Tomorrow

### Today

ESG is no longer a fringe concept, but a household initialism for both companies and investors. ESG data is used to evaluate a company's performance on specific ESG issues.

Asset managers continue to develop a range of ESG strategies and metrics to measure the environmental and social impact of today's companies. Some strategies focus on excluding industries or organizations that do not meet certain ESG criteria. Others focus on actively selecting companies that have strong ESG profiles.

New regulations have been established, like the European Union's Corporate Sustainability Reporting Directive (CSRD) which requires businesses to report on the environmental and social impact of their business activities, and on the business impact of their ESG efforts. In North America, the Securities and Exchange Commission (SEC) is considering mandatory ESG reporting for public companies, as is the case in Canada, Brazil, India, Australia, and Japan. As the world faces increasing challenges related to climate change and social issues, ESG considerations will continue to play a critical role in the way companies and investors operate and measure their performance.<sup>17</sup>

ESG ratings and indices have also become more prevalent in recent years. Morgan Stanley Capital International (MSCI), for example, offers a range of ESG indices that allow investors to track companies based on their ESG performance. These indices have become popular with investors looking to integrate ESG factors into their portfolios.

### Tomorrow

Political backlash against ESG in the US, the relabeling of ESG products, and the underperformance of sustainable funds have contributed to a shift in ESG analysis and considerations. Consequently, ESG has begun a quiet rebranding.<sup>18</sup> It now is at an inflection point; it has come to represent a broad and inchoate aspiration for what business should be doing beyond maximizing shareholder value. These ideals have sometimes been pitched as win-wins that will increase profits, and at other times as advocating that companies engage in tradeoffs to generate positive, but below-market returns in order to improve their social impact.<sup>19</sup>

Corporate leaders should: (1) identify the sustainability issues that have the most potential impact on the bottom line — analogous to the concept of financial materiality — and solve for them, which requires scanning for the biggest opportunities and threats that environmental and social issues pose to a company's short- and long-term competitiveness; and (2) identify the most material negative impacts the company is having on society, and invest serious resources to developing practical solutions.<sup>20</sup>

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For many ESG is all about politics, but ESG goes much deeper than politics. The real decisions are made on quieter levels, where investing patterns continue, and corporate strategies align with investor priorities.

Complications have arisen over time for various reasons, including that ESG is an ill-defined term that captures many different topics, such as: worker safety; workplace conditions; diversity, equity, and inclusion (“DEI”); climate change; waste; and product safety. The term also captures governance topics like shareholder rights, board composition, and executive compensation. As such, ESG came to mean nearly everything and therefore also almost nothing.

In addition to ESG being too broad a tent, it has also become highly politicized. The term has been misused to imply that those considering ESG issues are engaged in corporate advocacy on social issues, impact investing, or other progressive or “woke” agenda outcomes — or attempting to penalize industries such as energy or defense. Many critics also argued that ESG proponents were promoting “stakeholder capitalism” — that is, prioritizing the interests of constituencies such as a company’s employees, vendors, or surrounding communities over the financial interests of the company’s shareholders.<sup>21</sup>

### The Future of 2025 and Beyond

The future of ESG is uncertain. Publicly, the battle over ESG principles is heating up, and 2025 is shaping up to be a make-or-break year. While some parts of the world are doubling down on anti-ESG sentiment, others—like Europe and Asia—are charging ahead with ambitious sustainability plans—unfazed, so far, by angry rhetoric elsewhere.<sup>22</sup>

- *Litigation:* In the investment context, the demand for better ESG disclosure has been driven by the world’s largest institutional investors. These shareholders have pressed corporate issuers to enhance their ESG-related governance practices and to disclose key environmental and social risks and information, thereby mitigating risk or addressing the needs of a company’s stakeholders.

In response to these demands, as well as other complex drivers like consumer perceptions and younger generations making retirement investment decisions premised on value-driven investing, many companies and asset managers made ambitious ESG-related statements and marketed investment products as ESG-aligned. However, these statements and products — even when made in good faith — have faced harsh criticism from pro- and anti-ESG quarters as being mere virtue-signaling puffery, or antithetical to a corporation’s purpose to pursue profit maximization, respectively.

As legislative and regulatory avenues are expected to be foreclosed under the second Trump administration, ESG-related litigation risk for public companies likely will increase as various parties seek to pursue pro- or anti-ESG agendas via the courts. Given that federal legislation and

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regulation is unlikely for the next four (4) years, lawsuits will likely fill some of the resulting vacuum.

- *The Anti-ESG Movement.* At the state level, numerous states passed laws targeting ESG initiatives in recent years. These laws included a mandate that state treasurers compile a “blacklist” of investment advisors deemed to have “boycotted” the energy industry, banning such advisors from managing state pensions or other assets unless and until removed from the list.

Private actors also launched highly effective attacks on ESG — particularly in the area of DEI, which accelerated after the U.S. Supreme Court ruled that race-based affirmative action programs in college admissions violated the Constitution. While that ruling did not directly implicate corporate DEI initiatives, it emboldened opponents of corporate DEI initiatives to bring claims against companies based on reverse discrimination theories, with success lawsuits against private actors on similar reverse discrimination grounds.

Threats of negative publicity and reputational harm for companies that set DEI commitments or other ESG goals have led to rapid change and spurred major companies to walk back their commitments on DEI-related initiatives.

Companies should be cautious about how they navigate the pro- and anti-ESG forces at play. For the moment, gun-shy institutional investors will be far less likely to push an ESG agenda out of concern for their own legal and reputational risks, which almost certainly means that companies will face less pressure from their investors to pursue ESG-related initiatives. Companies that turn away from these initiatives might mitigate risks of finding themselves in the crosshairs of anti-ESG elected officials.

- *Shareholder Proposals:* Shareholder proposals have been a key tool for ESG activists to attempt to influence corporate behavior and policies. In recent years, Environmental and Social (“E&S”) proposals (covering topics such as climate change, board diversity, human rights, and political spending) and Governance proposals (director tenure, board composition, and shareholder rights) have increased in number and scope.

Anti-ESG proposals also have faced a similar significant surge of submissions in the last couple of years. But despite the high levels of media coverage these proposals often receive, they have historically won low levels of support at the ballot box. This is, in part, due to institutional investors and proxy advisors; while under pressure themselves from anti-ESG activists, these voters have not swung around to *active opposition* of ESG either.

ESG shareholder proposals likely will continue to be submitted at a high rate over the next few proxy seasons, as ESG activists seek to maintain their pressure and visibility on corporate issues. However, under a new SEC chair appointed by President Trump, SEC staff priorities almost certainly will change, making ESG proposals far more likely to be excluded by companies from proxy materials. It is expected that the SEC’s more restrictive approach to shareholder proposals

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will likely lead to exclusions of proposals starting in the latter half of 2025 and into proxy season 2026 and beyond.

- *Walk Back of ESG Commitments:* When companies began racing to announce ESG-related targets in goals at the beginning of the decade, society was in a different mood. Many companies were jumping on the ESG bandwagon, interest rates were historically low, and pursuing profits and purpose seemed something that could be done without debilitating trade-offs. And because of incomplete data, technological advancement assumptions, overconfident consumer behavior predictions, and the horizons to achieve stated goals, it is unclear whether companies had a reasonable basis to believe the stated goals could be achieved in the time frame established, even if the goal was set in good faith. For many companies, their ability to achieve stated goals remains uncertain and a work in progress.
- Today, the operating environment is becoming much more complex, there are real threats to companies for pursuing polarizing goals that may be at odds with their businesses. Many companies likely may walk back ESG goals by adjusting or abandoning targets. While companies likely will adjust ESG targets, they should do so with caution. Abandoning a previously disclosed goal may allow a company to focus on near-term operational performance without ESG distractions, but doing so comes with risk.

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<sup>1</sup> Madeline Parisi, *What is ESG and Why is it Important?*, Legal Management The Magazine of ALA (2024), <https://www.alanet.org/legal-management/2022/march/columns/what-is-esg-and-why-it-is-important>

<sup>2</sup> Leslie Norton and Charity Blue, *ESG Turns 20: A Brief History, and Why It's Not Going Away*, Morningstar Indexes (Jun. 21, 2024), <https://indexes.morningstar.com/insights/perspective/bltb86a91912cf03c3f/esg-turns-20-a-brief-history-and-why-its-not-going-away>

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