August 2023

ESG Challenges for Corporations—Recent SEC Developments

The Securities and Exchange Commission (SEC) has taken several ESG-related actions in recent years that have changed the landscape for corporate disclosures and actions. Investors depend on many corporate disclosures—including those related to ESG policies and procedures—to make their investment decisions. The SEC has taken action to ensure that corporations are transparent and fully and accurately disclose their ESG policies, procedures, and actions so investors have the information they need to make these decisions.

Corporations also face pressure from state regulators and shareholders as they try to incorporate ESG principles. In some states, regulators seek to limit ESG efforts, claiming they violate antitrust rules or create discrimination in the workplace. Shareholder actions challenge corporations that fail to comply with their own ESG policies and procedures. Some shareholder actions challenge corporate efforts as 'greenwashing.' Other shareholder actions seek to force corporations to divulge the information that will help their ESG-based lawsuits survive motions to dismiss. There is also litigation that challenges, under the federal Employee Retirement Income Security Act, a U.S. Dept. of Labor rule that permits retirement plan managers to consider companies' ESG efforts in choosing which stocks to include in portfolios.

Recent SEC Action

In 2021, the SEC created the Climate and ESG Task Force within its Division of Enforcement[1] to investigate corporate misconduct and violations related to ESG disclosures and activities. The SEC conducts enforcement on, among other things, issuer misstatements and gaps in disclosures concerning ESG strategies.[2]

[1] "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues." *U.S. Securities and Exchange Commission* (March 4, 2021). <https://www.sec.gov/news/press-release/2021-42> (accessed July 29, 2023).
[2] *Id.*

SEC Enforcement Actions

Vega previously discussed key actions the SEC brought against BNY Mellon Investment Adviser, Inc. (BNYMIA) and Vale S.A., a Brazilian iron-ore mining company.[3] The agency charged BNY Mellon for misstatements and omissions it made regarding ESG factors it considered in making investment decisions for mutual funds it managed.[4] The SEC charged Vale S.A., a Brazilian iron-ore mining company, for deliberately misleading the public regarding the safety of a dam that collapsed, killing 270 people, damaging the environment, and causing the company to lose more than $4 billion in market capitalization.[5]

In November 2022, the SEC charged Goldman Sachs Asset Management, L.P. (GSAM) in connection with ESG investments. GSAM had no ESG research policies and procedures early on and, after promulgating them, failed to follow them consistently. Employees were supposed to research each company that was to be included in a particular product's investment portfolio. This research was supposed to occur before being included but, in some cases, was not performed until after the fact. In addition, some research was not performed in accordance with the guidelines.[6]

The SEC noted that GSAM and others were increasingly branding and marketing funds as "ESG." To safeguard investors, the agency requires companies to "establish reasonable policies and procedures governing how the ESG factors will be evaluated as part of the investment process, and then follow those policies and procedures, to avoid providing investors with information about these products that differs from their practices."[7]

GSAM agreed to a cease-and-desist order and a censure. It also agreed to pay a $4 million penalty to settle the matter.[8]

In January 2023, in a case focusing on governance and social concerns, the SEC charged the former CEO of McDonald's Corporation, Stephen J. Easterbrook, with providing false and misleading statements relating to his termination in 2019. The agency also charged McDonald's for

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[3] See "Vega Economics." *Government ESG-Related Enforcement Actions Are on the Rise.* <https://vegaeconomics.com/government-esg-related-enforcement-actions-are-on-the-rise> (accessed July 29, 2023).

[4] "SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations." *U.S. Securities and Exchange Commission* (May 23, 2022). <https://www.sec.gov/news/press-release/2022-86> (accessed July 29, 2023).

[5] "SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse." *U.S. Securities and Exchange Commission* (April 28, 2022). <https://www.sec.gov/news/press-release/2022-72> (accessed July 29, 2023).

[6] "SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments." *U.S. Securities and Exchange Commission* (November 22, 2022). <https://www.sec.gov/news/press-release/2022-209> (accessed July 29, 2023).

[7] *Id.*

[8] *Id.*

failing to provide adequate disclosures regarding the separation agreement between the company and Easterbrook.[9]

McDonald's terminated Easterbrook for having an inappropriate relationship with an employee. In the separation agreement, the company stated that the former CEO had been terminated 'without cause.' This allowed Easterbrook to save face and retain about $40 million in equity compensation that he otherwise would have forfeited. McDonald's failed to disclose to its investors its exercise of discretion to arrive at this result.[10] Many investors want to invest in corporations that emphasize the equitable treatment of employees.

McDonald's later discovered that Easterbrook had withheld information about additional inappropriate relationships with other employees. The SEC order concluded that these facts would have influenced the corporation's disclosures had its leadership been aware of them when they terminated Easterbrook.[11] The company was required to "disclose and explain all material elements of their CEO's compensation, including factors regarding any separation agreements."[12] Gurbir S. Grewal, the Director of the Division of Enforcement, said, "When corporate officers corrupt internal processes to manage their personal reputations or line their own pockets, they breach their fundamental duties to shareholders, who are entitled to transparency and fair dealing from executives.[13]

Easterbrook consented to the SEC's cease-and-desist order barring him for five years from officer and director positions. He also agreed to a $400,000 civil penalty. McDonald's also agreed to the cease-and-desist order but faced no monetary penalty because it cooperated with the SEC and recovered the compensation it had agreed to in the original separation agreement.[14]

<u>NASDAQ Board Diversity Rules</u>

In another ESG-related matter, the SEC has weighed in on boardroom diversity rules. In 2021, the NASDAQ exchange implemented a new rule regarding corporate board diversity[15] that the agency subsequently approved.[16] These rules require NASDAQ-listed companies to disclose annually their board-level diversity statistics and further requires these companies to have diverse directors or explain why they do not have them.[17] Smaller companies and foreign issuers have some flexibility.

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[9] "SEC Charges McDonald's Former CEO for Misrepresentations About His Termination." *U.S. Securities and Exchange Commission* (January 9, 2023). <https://www.sec.gov/news/press-release/2023-4> (accessed July 29, 2023).
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *See* "NASDAQ." *"NASDAQ's Board Diversity Rule: What Companies Should Know."* <https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf> (accessed July 29, 2023).
[16] "Statement on the Commission's Order Approving Exchange Rules Relating to Board Diversity." *U.S. Securities and Exchange Commission* (August 6, 2021). <https://www.sec.gov/news/public-statement/roisman-board-diversity> (accessed July 29, 2023).
[17] *Id.*

The NASDAQ has also provided a transition period.[18] Challenges to these rule changes are currently in litigation.

Vega Economics Offers Expertise in ESG Litigation

Vega Economics, an economic consulting firm, offers expertise in ESG litigation and expert support in various areas, such as deceptive business practices, human rights violations in the supply chain, climate change litigation, and shareholder claims against companies for misstatements and omissions.

For additional inquiries, please contact info@vegaeconomics.com.

[18] *Id.*