Climate Finance, Spring 2024
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Divestment and Against ESG: Materials for Class on Thursday March 21

In this course we are focusing on the relationship between climate change and financial activity, including the ideas that financial and non-financial businesses need to recognize the risks they face from climate change, and that financial markets can help to fund climate change adaptation and mitigation. If financial institutions and markets can support the development of renewable energy, and technologies to reduce emissions of greenhouse gases, climate change may be slowed. And, whereas public funds may support the development of resilient infrastructure and flood mitigation,[2] private finance, such as green bonds and insurance arrangements which can give credit for work on resilience, can also support the development of resilient construction.[3]

In this class session I want to focus on the larger political context within which regulators are operating, and on two aspects of political activism which relate to climate finance: divestment campaigning and the anti-ESG movement. These two movements do not precisely track each other, because divestment campaigns focus on getting investors, and particularly large investors, to divest from fossil fuel investments, [4]and anti-ESG action covers a range of different measures ostensibly designed to make businesses focus on profits rather than on politics. Much of the pushback against ESG has emphasized protecting fossil fuel companies, but it has also had a more general emphasis on the idea that the focus of business should be profitability rather than social responsibility.[5] For example, the Office of the Comptroller of the Currency's (OCC's) proposal for a Fair Access to Financial Services rule stated:

> Despite the OCC's statements and guidance over the years about the importance of assessing and managing risk on an individual customer basis, some banks continue to employ category-based risk evaluations to deny customers access to financial services. This happens even when an individual customer would qualify for the financial service if evaluated under an objective, quantifiable risk-based analysis. These banks are often reacting to pressure from advocates from across the political spectrum whose policy objectives are served when banks deny certain

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[2] *See*, *e.g.*, https://www.fema.gov/grants/mitigation/building-resilient-infrastructure-communities .

[3] *See*, *e.g.*, Lloyds of London, Innovative Finance for Resilient Infrastructure (2018).

[4] Some groups do advocate other versions of divestment. *See*, *e.g.*, Tufts University Prison Divestment, at https://sites.tufts.edu/prisondivestment/contemporary-divestment-campaigns/ .

[5] *See*, *e.g.*, Office of the Comptroller of the Currency, Fair Access to Financial Services, 85 Fed. Reg. 75261 (Nov. 25, 2020).

> categories of customers access to financial services. The pressure on banks has come from both the for-profit and nonprofit sectors of the economy and targeted a wide and varied range of individuals, companies, organizations, and industries. For example, there have been calls for boycotts of banks that support certain health care and social service providers, including family planning organizations, and some banks have reportedly denied financial services to customers in these industries. Some banks have reportedly ceased to provide financial services to owners of privately owned correctional facilities that operate under contracts with the Federal Government and various state governments. Makers of shotguns and hunting rifles have reportedly been debanked in recent years. Independent, nonbank automated teller machine operators that provide access to cash settlement and other operational accounts, particularly in low-income communities and thinly-populated rural areas, have been affected. Globally, there have been calls to de-bank large farming operations and other agricultural business. And companies that operate in industries important to local economies and the national economy have been cut off from access to financial services, including those that operate in sectors of the nation's infrastructure ''so vital to the United States that their incapacitation or destruction would have a debilitating effect on security, national economic security, national public health or safety, or any combination thereof.''[6]

ESG (environmental, social and governance) as an important component of investment decision-making has been in the news in the last few years. In some ways the ESG movement is the latest version of an idea of corporate social responsibility (CSR) that attracted a lot of attention in the 1970s, although ideas about corporate social responsibility had been discussed for some time before then.[7] CSR was clearly thought of as being about more than mere legal compliance. ESG seems similarly to focus on aspirations rather than legal compliance, although that is not always clear. And it is also the case that regulation has developed since the 1970s, along with the compliance burden for businesses. And regulation continues to evolve to address issues such as climate change. Multinational businesses need to think about compliance with rules in operation wherever they do business. The EU's rules relating to climate finance have implications beyond the EU's territorial limits.

The concept of sustainability does a lot of work here. The UN's sustainable development goals include climate action, protecting life on land and below water and affordable and clean energy, but also reduced inequalities generally and with respect to gender, decent work and

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[6] *Id.* at 75263 (footnotes omitted).

[7] *See*, *e.g.*, https://accp.org/resources/csr-resources/accp-insights-blog/corporate-social-responsibility-brief-history/; Mauricio Andrés Latapí Agudelo, Lára Jóhannsdóttir & Brynhildur Davídsdóttir, *A Literature Review of the History and Evolution of Corporate Social Responsibility*, 4 International Journal of Corporate Social Responsibility (2019).

economic growth, and quality education.[8] The EU defines sustainability for the purposes of its climate related action broadly:

> The Green Deal is the new growth strategy of the Union. It aims to transform the Union into a modern, resource-efficient and competitive economy with no net emissions of greenhouse gases (GHG) by 2050. It also aims to protect, conserve and enhance the Union's natural capital, and protect the health and well-being of Union citizens from environment-related risks and impacts. The Green Deal aims to decouple economic growth from resource use, and ensure that all regions and Union citizens participate in a socially just transition to a sustainable economic system whereby no person and no place is left behind. It will contribute to the objective of building an economy that works for the people, strengthening the Union's social market economy, helping to ensure that it is ready for the future and that it delivers stability, jobs, growth and sustainable investment.[9]

The detailed work of developing a taxonomy of sustainable activities has so far focused on environmental sustainability,[10] although the EU's Platform for Sustainable Finance has published proposals for a social taxonomy, stating:

> Environmental and social aspects have been part of the EU's sustainable finance strategy since the very beginning. It is widely recognised that there is a need for social investments to both: (i) achieve the sustainable development goals (SDGs) of the UN's 2030 agenda; and (ii) create the social internal market set out in the Treaty on European Union (Article 3). It is also widely recognised that businesses must show respect for human rights as envisaged in the UN guiding principles on business and human rights (UNGPs).
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> The high demand for social bonds (to finance social housing, healthcare, and jobs for target groups) is another indicator that investors see social investments as an opportunity. This high demand also shows that private capital can be directed to socially valuable activities. At the same time, investors acknowledge that if they neglect social factors they run the risk of being associated with human-rights abuses like child labour and slave labour. It is therefore crucial to define clearly what constitutes a social investment, as has already been done with environmental investments.
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> Fundamental EU documents provide strong foundations for a social taxonomy.

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[8] https://sdgs.un.org/goals.

[9] Directive (EU) 2022/2464 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as Regards Corporate Sustainability Reporting, OJ L 322/15 (Dec. 16, 2022) (Corporate Sustainability Reporting Directive) at recital 1.

[10] *See*, *e.g.* Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment, OJ L. 198/13 (Jun. 22, 2020) (EU Taxonomy Regulation).

These documents include: the document on the European pillar of social rights and the associated action plan; the European Social Charter; the EU Charter on Fundamental Rights; and the European Convention on Human Rights.[11]

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Some individual investors make a personal choice to prioritize or avoid certain types of investment. Investors may decide to invest in investments that perform well on ESG factors without sacrificing financial performance.[12] Or they may decide that they are prepared to forego investing in profitable businesses because of their values and ethical principles.[13] But implementing these strategies may not be simple. Investors who want to prioritize environmental sustainability need to be aware that funds which are described as ESG funds may not align with their own investment objectives.[14] There are resources that can help investors pick the right products and strategies for their own objectives.[15]

Divestment Campaigns

Divestment campaigns are about encouraging investors—in particular large investors such as asset management firms, pension funds, and universities— to divest from investments that support problematic activity. Groups such as Extinction Rebellion[16] and FridaysForFuture[17] engage in demonstrations and civil disobedience to draw attention to the climate emergency. You

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[11] Platform on Sustainable Finance, Final Report on Social Taxonomy (Feb. 2022), at 6 (footnotes omitted).

[12] *See*, *e.g.* What Is the Difference Between Esg Investing and Socially Responsible Investing?, S&P Global (Feb. 25, 2020) at https://www.spglobal.com/en/research-insights/articles/what-is-the-difference-between-esg-investing-and-socially-responsible-investing ("ESG investing offers a pragmatic approach to addressing financially material issues through a broader information set. ESG-focused investment products record returns on par with or better than those built purely for risk-weighted performance, a trend that runs counter to the notion that taking ESG into account detracts from performance. Accounting for climate risks and environmental challenges, investments in physical and human capital, and good governance characteristics, among other factors, can greatly improve companies; performance through an ESG-minded investment strategy.")

[13] *Id.* ("Socially responsible investors actively avoid investing in companies or organizations whose businesses run counter to their nonfinancial values and ethical principles or those they perceive to have negative effects on society; including businesses across the alcohol, tobacco, fast food, gambling, weapons, fossil fuel, or defense industries.")

[14] In the EU, the SFDR requires financial firms to publish information about their policies on the integration of sustainability risks in their investment decision-making process. Regulation (EU) 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector (SFDR) OJ L 317/1 (Dec. 9, 2019).

[15] *Cf.* https://fossilfreefunds.org/.

[16] https://rebellion.global/ ("Life on Earth is in crisis. Our climate is changing faster than scientists predicted and the stakes are high. Biodiversity loss. Crop failure. Social and ecological collapse. Mass extinction. We are running out of time, and our governments have failed to act. Extinction Rebellion was formed to fix this. ")

[17] https://fridaysforfuture.org/ .

may have seen some of the news stories about protesters who throw substances over famous paintings, or glue themselves to paintings[18] or buildings.[19]

In class we will discuss Julie Ayling & Neil Gunningham, Non-state Governance and Climate Policy: the Fossil Fuel Divestment Movement, Climate Policy (2015). The article raises some questions for a law school class because divestment campaigns are not legal strategies. However, they may have an impact on the development of the law: 1. campaigns may induce legislators or regulators to change the rules; 2. campaigns may produce changes in public opinion that might affect how judges think about particular legal issues; and 3. campaigns may change how investors and financial firms behave (the impact may be significant by changing norms of behavior rather than law).

Some academic commentators and organizations have noted an increasing tendency of governmental authorities to treat the actions of protesters as involving criminal liability.[20]

One important critique of divestment as a strategy to deal with climate change is that when investors who care about mitigating climate change divest from fossil fuel companies this reduces the incentive for fossil fuel companies to change their behavior. Perhaps it would be better if investors who care about climate change tried to work from within? But when shareholders in publicly corporations try to use the shareholder proposal process to discuss issues relating to climate change at shareholder meetings they may face opposition. Exxon Mobil recently filed a complaint in the Northern District of Texas to prevent a shareholder proposal being discussed in the company's shareholder meeting in May.[21] The SEC allows corporations to reject shareholder proposals on various grounds, including that they relate to the company's ordinary business operations, and that they duplicate other proposals or are resubmissions,[22] but this additional step of going to court to challenge a particular proposal is a new development.[23]

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[18] *See*, *e.g.* Talal Ansari, *Why Climate Activists are Still Throwing Food and Paint at Famous Artworks*, Wall Street Journal (Jun. 16, 2023).

[19] Andrew MacAskill, *Extinction Rebellion Protesters Glue Themselves to London Stock Exchange*, Reuters (Apr. 25, 2019).

[20] *See*, *e.g.* https://www.icnl.org/usprotestlawtracker/.

[21] Exxon Sues to Prevent Climate Proposal From Shareholder Vote (Jan. 22, 2024) at https://www.follow-this.org/exxon-sues-to-prevent-climate-proposal-from-shareholder-vote/.

[22] Rule 14a-8, 17 CFR § 240.14a-8. The SEC issues no-action letters to corporations which wish to exclude shareholder proposals from consideration. *See* https://www.sec.gov/corpfin/2022-2023-shareholder-proposals-no-action? .

[23] A case currently before the 5th Circuit, National Center for Public Policy Research v. SEC , 5th Cir., No. 23-60230, involves to a challenge to an SEC decision to allow Kroger to exluding a shareholder anti-discrimination proposal.

Exxon characterizes its lawsuit as being about preventing abuse of the shareholder proposal process on the basis that "activists with minimal or even no shares should not be permitted to re-submit proposals that do not grow long-term shareholder value."[24] The shareholder proposals in this case were arguing that Exxon should adopt targets for the reduction of scope 3 emissions, which Exxon argues is a flawed approach.[25]

Stopping "Woke" Investing

State legislatures have adopted a number of measures to prevent the use of ESG criteria in decision-making, reflecting the sorts of views illustrated in the OCC's Fair Access proposal.

In 2023 the Florida legislature enacted a statute to address Government and Corporate Activism, which requires a financial institution in Florida which seeks to be a qualified public depositary[26] to attest, annually, that they do not "engage in "unsafe and unsound business practices" to include: denying or canceling services based on political opinions, speech, or affiliations, religious beliefs or affiliations, business sector, or any other factor that is not a quantitative, impartial, risk-based standard, or specified actions that consider a "social credit score." " [27] Florida's Chief Financial Officer announced in January 2024 that 117 banks in Florida had signed attestations to become qualified public depositaries.[28] The statute prohibits the issuance by the state or any municipality of any ESG bonds, and also prohibits state and local governments from entering into contracts with rating agencies that might result in an adverse ESG rating.

The statute requires that decisions with respect to the investment of state money should be made based only on "pecuniary factors" which means:

> a factor that the Chief Financial Officer, or other party authorized to invest on his or her behalf, prudently determines is expected to have a material effect on the risk or returns of an investment based on appropriate investment horizons consistent with applicable investment objectives and funding policy. The term does not include the consideration of the furtherance of any social, political, or

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[24] Exxon Mobil, Shareholder Proposal Lawsuit – Our Responsibility to Fight Back (Feb. 29, 2024).

[25] *Id.*

[26] A financial institution that is able to accept Florida public funds for deposit, including state pension assets.

[27] HB 3 Implementation for Financial Services Providers. *See also* Florida Statutes, Chapter 2023-28, Committee Substitute for House Bill No. 3. The reference to social credit scoring reflects copncerns in some areas that banks might adopt approaches similar to the Chinese model. Cf. Daithí Mac Síthigh & Mathias Siems, *The Chinese Social Credit System: A Model for Other Countries?*, 82 Modern L. Rev. 1034-1071 (2019)

[28] CFO Jimmy Patronis: Florida is Prepared to De-Bank Woke Banks (Jan. 19, 2024).

ideological interests.[29]

With respect to the exercise of shareholder rights, the statute provides:

> (1) As used in this section, the term "pecuniary factor" means a factor that the plan administrator, named fiduciary, board, or board of trustees prudently determines is expected to have a material effect on the risk or returns of an investment based on appropriate investment horizons consistent with the investment objectives and funding policy of the retirement system or plan. The term does not include the consideration of the furtherance of any social, political, or ideological interests.
> (2) Notwithstanding any other law, when deciding whether to invest and when investing the assets of any retirement system or plan, only pecuniary factors may be considered and the interests of the participants and beneficiaries of the system or plan may not be subordinated to other objectives, including sacrificing investment return or undertaking additional investment risk to promote any nonpecuniary factor. The weight given to any pecuniary factor must appropriately reflect a prudent assessment of its impact on risk or returns.
> (3) Notwithstanding any other law, when deciding whether to exercise shareholder rights or when exercising such rights on behalf of a retirement system or plan, including the voting of proxies, only pecuniary factors may be considered and the interests of the participants and beneficiaries of the system or plan may not be subordinated to other objectives, including sacrificing investment return or undertaking additional investment risk to promote any nonpecuniary factor.
> (4)(a) By December 15, 2023, and by December 15 of each odd-numbered year thereafter, each retirement system or plan shall file a comprehensive report detailing and reviewing the governance policies concerning decisionmaking in vote decisions and adherence to the fiduciary standards required of such retirement system or plan under this section, including the exercise of shareholder rights.[30]

In class we will think about the idea of investment decision-making being based on only pecuniary factors as defined in the statute, to exclude social, political, or ideological interests. Is the distinction as simple as this makes it seem? What about the impact of reputation on a corporation's business?

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[29] At § 1, amending Subsection (1) of section 17.57, Florida Statutes.

[30] At §5, creating Section 112.662, Florida Statutes.