BEPI PEZZULLI*

ESG: From Hype to Scrutiny— Legal Challenges to Fiduciary Duties and Shareholder Value

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* Bepi Pezzulli is a Solicitor of the Senior Courts of England and Wales. He also qualified as an Attorney at Law in New York and an Avvocato in Italy. His research interests include financial services policy; global risk governance; and economic statecraft. He carries out analyses about the impact of legislation on financial markets, financial regulation, financial architecture, financial stability, governance, and risk management.

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ABSTRACT

Environmental, Social, and Governance (ESG) investing has transitioned from a dimension of fervent hype to one under intense scrutiny. This Article examines the shifting landscape of ESG investment, tracing its trajectory from being a self-proclaimed beacon of socially responsible capitalism to becoming a subject of contentious legal proceedings. As investors increasingly withdraw capital from ESG funds and legal challenges emerge, the Eighth Circuit now faces a pivotal moment in the form of consolidated petitions against the Securities and Exchange Commission's (SEC) mandate for extensive climate-related disclosures. This Article posits two primary critiques of ESG investing. Firstly, it argues that by delegating public policy pursuits to private entities, ESG frameworks allow companies to

obscure political militancy and political motivations behind compliance measures. Secondly, it asserts that ESG metrics can serve as a convenient veil for underperforming companies seeking refuge from accountability for poor financial results. Additionally, this Article makes two other secondary contentions. First, the economic ramifications of ESG mandates, encompassing compliance expenditures and operational encumbrances, disproportionately affect small and medium-sized enterprises (SMEs). By limiting the discretion of these businesses to prioritize ESG imperatives, such mandates may undermine market efficiency and disrupt the natural mechanisms of capital allocation. This asymmetry of impact fragments the market, segmenting large corporations on one side and SMEs on the other, thereby exacerbating disparities within the business landscape. Second, while the intentions behind ESG regulations may be worthy, the piecemeal approach taken by policymakers has resulted in ambiguity and a lack of clarity, causing unwarranted disruptions in corporate business operations. By exploring these themes, this Article delves into the multifaceted dynamics of ESG investing, highlighting the complexities that underlie its purported benefits. It concludes that in the mercurial world of finance, trends rise and fall with the swiftness of market fluctuations. ESG, once hailed as the herald of a new era in responsible capitalism, now finds itself navigating treacherous waters of skepticism and critique. As the winds of change continue to blow, one thing remains certain: in the ever-shifting landscape of investment, what rises swiftly may fall just as quickly. ESG's meteoric rise may indeed prove to be matched only by a precipitous fall from favor.

INTRODUCTION

The rise of Environmental, Social, and Governance (ESG) principles has reshaped the landscape of corporate governance and economic policy. Proponents argue that integrating ESG considerations into business practices can lead to more sustainable and ethically responsible outcomes. Yet, this Article critiques ESG principles from the perspectives of both corporate governance and economic efficiency. Section I provides a historical overview of the development of ESG law, explaining that its incremental evolution has led to significant inconsistencies and ambiguities. Sections II and III compare the European legislative model, characterized by detailed prescriptions, with the U.S. regulatory framework, which relies on mandatory disclosures. Section IV summarizes the legal and economic arguments

against the SEC's mandatory disclosure rules on ESG requirements. Section V examines the legal challenges faced by investment managers balancing ESG mandates with their fiduciary duties. Section VI illustrates how ESG mandates can influence investor rights and financial maximization, while Section VII highlights the economic inefficiencies introduced by integrating ESG considerations into the investment process.

The Article draws four conclusions. Firstly, it argues that ESG frameworks delegate public policy objectives to private companies, allowing them to obscure political agendas behind their compliance measures. Secondly, it contends that ESG metrics can serve as a convenient shield for underperforming companies to evade accountability for their poor financial results. Thirdly, it demonstrates that ESG principles disproportionately affect small businesses, often burdening them with compliance costs and complexities that larger corporations can more easily absorb. Hence, this Article asserts that asymmetry of impact fragments the market, segmenting large corporations on one side and SMEs on the other, thereby exacerbating disparities within the business landscape. Finally, it posits that the disjointed and inconsistent approach to ESG legislation has resulted in regulatory chaos, undermining the coherence and effectiveness of governance frameworks.

Ultimately, regulating ESG by statute executes an ideological agenda that threatens the common law principle of judicial discretion, as it imposes rigid legal standards rather than allowing courts to interpret evolving societal norms through case law. This shift erodes the adaptability central to common law's dynamic nature. Hence, this Article advocates for a return to a libertarian approach to financial law grounded in economic freedom, individual liberty, and common law.

I
BACKGROUND

A. Explanation of ESG Principles

ESG stands for Environmental, Social, and Governance. It represents a set of criteria that investors use to evaluate a company's operations and how they influence society and the environment.[1]

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[1] The Investopedia Team, *What Is ESG Investing?*, INVESTOPEDIA, https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp [https://perma.cc/P45Z-QE2Y] (last updated Jul. 30, 2024).

The "Environmental" aspect refers to how a company manages its impact on the environment and includes factors such as carbon emissions, energy efficiency, waste management, pollution control, and natural resource conservation.[2] Hence, ESG investors consider a company's commitment to sustainability, renewable energy use, and efforts to mitigate environmental risks.

The "Social" component focuses on how a company interacts and manages its relationships with society, and comprises aspects such as labor practices, human rights, community relations, product safety, diversity and inclusion, employee well-being, and involvement in controversial industries.[3] Thus, ESG investors evaluate a company's social responsibility initiatives, employee relations, and involvement in socially beneficial activities.

The "Governance" dimension refers to the structure and practices that guide a company's decision-making processes and accountability mechanisms and encompasses factors such as board diversity, executive compensation, shareholder rights, transparency, anti-corruption measures, and ethical business practices.[4] Finally, ESG investors assess the quality of a company's governance framework to ensure accountability, integrity, and alignment of interests with stakeholders.

ESG criteria are increasingly considered alongside financial metrics when making investment decisions.[5] Companies that demonstrate strong performance across ESG factors claim to be better positioned for long-term sustainability and may attract capital from socially conscious investors.[6] Integrating ESG considerations into investment strategies is generally seen as a way to promote responsible investing

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2 *Understanding the "E" in ESG*, S&P GLOBAL (Oct. 23, 2019), https://www.spglobal.com/en/research-insights/market-insights/understanding-the-e-in-esg [https://perma.cc/3GXD-87YC].

3 *What Is the "S" in ESG?*, S&P GLOBAL (Feb. 24, 2020), https://www.spglobal.com/en/research-insights/market-insights/what-is-the-s-in-esg [https://perma.cc/5XVL-743H].

4 *What Is the "G" in ESG?*, S&P GLOBAL (Feb. 24, 2020), https://www.spglobal.com/en/research-insights/market-insights/what-is-the-g-in-esg [https://perma.cc/72AR-LENQ].

5 Hadiqa Ahmad et al., *Environmental-, Social-, and Governance-Related Factors for Business Investment and Sustainability: A Scientometric Review of Global Trends*, 26 ENV'T DEV. & SUSTAINABILITY 2965 (2023), https://doi.org/10.1007/s10668-023-02921-x [https://perma.cc/H8XR-RD9C].

6 RICCARDO BOFFO & ROBERT PATALANO, OECD, ESG INVESTING: PRACTICES, PROGRESS AND CHALLENGES 6 (2020), https://doi.org/10.1787/b4f71091-en [https://perma.cc/L97S-P5T7].

and drive positive societal and environmental impacts alongside financial returns.[7]

B. Growing Adoption of ESG Criteria in Financial Law

The incorporation of ESG considerations into law and regulation has evolved over several decades in response to changing societal attitudes, investor preferences, and global challenges related to sustainability, corporate responsibility, and governance practices.[8] Therefore, the law of ESG has been a nonlinear process, shaped by fluctuating public sentiment, stakeholder pressures, and political ideologies.[9] Regulatory fragmentation and corporate lobbying have further complicated this evolution, resulting in a convoluted legislative landscape.[10] Public demand for accountability and sustainability, coupled with investor preferences, has driven policymakers to hastily address ESG concerns: 1,255 different ESG policy interventions have been introduced worldwide since 2011.[11] However, ideological divides and competing interests have led to compromises and inconsistencies in regulatory standards.[12] This complex interplay continues to influence the direction and effectiveness of ESG legislation, making regulation an ongoing and intricate endeavor.

C. A Brief Historical Overview

The historical evolution of ESG law demonstrates the persistent issues and inconsistencies that plague ESG reporting. Despite efforts to shift from voluntary to mandatory reporting, the regulatory frameworks remain fragmented, leading to a lack of transparency and accountability. ESG considerations, although now more prominent, are

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7 *Id.* at 17.

8 *See* Hao Liang & Luc Renneboog, *Corporate Social Responsibility and Sustainable Finance: A Review of the Literature* (Eur. Corp. Governance Inst., Finance Working Paper No. 701/2020, 2020), https://ssrn.com/abstract=3698631 [https://perma.cc/KR2U-PGZP].

9 Michael Barzuza et al., *The Millennial Corporation: Strong Stakeholders, Weak Managers* (Stan. J. L., Bus. & Fin., Working Paper No. 687/2023, 2021), https://ssrn.com/abstract=3918443 [https://perma.cc/Z7RY-Y7FG].

10 Adam Sulkowski & Ruth Jebe, *Evolving ESG Reporting Governance, Regime Theory, and Proactive Law: Predictions and Strategies*, 59 AM. BUS. L.J. 449 (2022), https://doi.org/10.1111/ablj.12210 [https://perma.cc/CJ6D-A66J].

11 *Global ESG Regulation Increases by 155% Over the Past Decade*, ESG NEWS (Jun. 20, 2023), https://esgnews.com/global-esg-regulation-increases-by-155-over-the-past-decade/ [https://perma.cc/U279-U9GT].

12 Gabriela De Sousa E Figueiredo Soares, *ESG Is in the Eye of the Beholder: The Ambiguities Within Concept, Culture and Evaluation* (2022) (J.D. Dissertation, Universidade Nova de Lisboa).

often superficially integrated into mainstream investing, resulting in perfunctory compliance rather than genuine commitment. Attempts at standardization and harmonization, such as those by the International Financial Reporting Standards Foundation (IFRS Foundation), have struggled to achieve true comparability and consistency. The broadened scope of ESG, from environmental to social and governance issues, has only added to the complexity and confusion, lacking a unified understanding of sustainability. Government and regulatory interventions, exemplified by the European Union's (EU) Sustainable Finance Disclosure Regulations (SFDR) and Task Force on Climate-related Financial Disclosure (TCFD) recommendations, have created a patchwork of requirements that are difficult to navigate and enforce effectively. Stakeholder influence, while growing, has led to conflicting demands and pressures, further complicating ESG accountability. Technological advancements and data analytics, intended to improve ESG reporting, often result in data overload and inconsistent interpretations. ESG factors, although recognized in risk management, are frequently treated as secondary concerns, leading to inadequate mitigation of financial, operational, and reputational risks. This evolution underscores the ongoing challenges and disarray within ESG practices, highlighting the difficulties in achieving coherent and effective sustainable business practices.

1. Early Recognition of Social and Environmental Issues

Concerns about environmental degradation, social inequality, and corporate accountability began to gain traction in the mid- to late 20th century.[13] Events such as environmental disasters, labor strikes, and human rights abuses prompted calls for greater corporate responsibility and transparency.[14]

2. Emergence of Socially Responsible Investing (SRI)

In the 1960s and 1970s, the concept of socially responsible investing gained momentum, with investors seeking to align their investment

13 *See* Mauricio Andrés Latapí Agudelo et al., *A Literature Review of the History and Evolution of Corporate Social Responsibility*, 4 INT'L J. CORP. SOC. RESP. 1 (2019), https://doi.org/10.1186/s40991-018-0039-y [https://perma.cc/52E4-EUW9].

14 U.N. GLOB. COMPACT, IMPACT: TRANSFORMING BUSINESS, CHANGING THE WORLD 44 (2015).

decisions with their values and ethical beliefs.[15] SRI funds began excluding companies involved in controversial industries or practices, such as tobacco, weapons, and apartheid-era South Africa.[16]

3. Institutionalization of ESG Principles

As awareness of sustainability issues grew, institutional investors, including pension funds, endowments, and asset managers, started incorporating ESG factors into their investment strategies.[17] They recognized that ESG considerations could hamper long-term financial performance and allegedly mitigate investment risks.[18]

4. Regulatory Responses

Governments and regulatory bodies around the world began to undertake initiatives to include ESG considerations in financial markets and corporate governance.[19] They introduced various regulations, guidelines, and reporting requirements to encourage greater transparency and accountability on ESG issues. Examples include disclosure requirements that force companies to include information on ESG risks, opportunities, and performance metrics in their financial reports and filings. This includes requirements related to climate change disclosure, human rights reporting, and diversity and inclusion metrics. Regulators also developed stewardship codes to promote active engagement and responsible ownership practices among institutional investors.[20] These codes encourage investors to integrate ESG considerations into their investment decision-making and to engage with companies on ESG-related issues. Finally, some

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15 Tom Krantz, *The History of ESG: A Journey Towards Sustainable Investing*, IBM (Feb. 8, 2024), https://www.ibm.com/blog/environmental-social-and-governance-history/ [https://perma.cc/UEW2-AHWA].

16 Blaine Townsend, *From SRI to ESG: The Origins of Socially Responsible and Sustainable Investing*, 1 J. IMPACT & ESG INV. 1 (2020), https://www.bailard.com/wp-content/uploads/2020/09/History-Socially-Responsible-Investing-and-ESG-Investing.pdf [https://perma.cc/ZLE6-QWSR].

17 LAUREN CAPLAN ET AL., COMMONFUND INST., FROM SRI TO ESG: THE CHANGING WORLD OF RESPONSIBLE INVESTING (2013).

18 Krantz, *supra* note 15.

19 *See, e.g.*, *Institutional Investors' and Asset Managers' Duties Regarding Sustainability*, EUR. COMMISSION, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/1185-Institutional-investors-and-asset-managers-duties-regarding-sustainability_en [https://perma.cc/9W9J-DL5K] (last visited May 18, 2025).

20 Guido Ferrarini & Michele Siri, *Stewardship and ESG in Europe* (Euro. Corp. Governance Inst., Law Working Paper No. 743/2023, 2023), https://ssrn.com/abstract=4651834 [https://perma.cc/RPE7-L9JK].

jurisdictions clarified that fiduciary duties require institutional investors and asset managers to consider ESG factors when making investment decisions.[21] This helped legitimize the integration of ESG considerations into mainstream investment practices.

5. International Standards and Initiatives

International initiatives, such as the United Nations Principles for Responsible Investment (UN PRI), the Global Reporting Initiative (GRI), and the Task Force on Climate-related Financial Disclosures (TCFD), developed standards, frameworks, and guidelines to promote ESG integration, reporting, and disclosure globally.

a. The United Nations Principles for Responsible Investment

The UN PRI is a global initiative that aims to promote responsible investment practices among institutional investors, asset managers, and other financial market participants.[22] It was launched in 2006 with support from the United Nations Environment Programme Finance Initiative (UNEP FI) and the United Nations Global Compact.[23] The UN PRI consists of six voluntary principles that guide signatories in integrating ESG factors into their investment decision-making and ownership practices.[24] The principles cover areas such as incorporating ESG issues into investment analysis and decision-making, engaging in active ownership and incorporating ESG issues into ownership policies and practices, and seeking appropriate disclosure on ESG issues by the entities in which they invest.[25] The UN PRI has thousands of signatories worldwide, including asset owners, investment managers,

21 *See Institutional Investors' and Asset Managers' Duties Regarding Sustainability*, *supra* note 19.

22 *About the PRI*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/about-us/about-the-pri [https://perma.cc/XXK6-MVDE] (last visited May 18, 2025).

23 *Integrate the Principles for Responsible Investment*, U.N. GLOB. COMPACT, https://unglobalcompact.org/take-action/action/responsible-investment [https://perma.cc/WC5P-BTM2] (last visited May 18, 2025).

24 *What Are the Principles for Responsible Investment?*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment#:~:text=Principle%201%3A%20We%20will%20incorporate,entities%20in%20which%20we%20invest [https://perma.cc/48GH-R5QB] (last visited May 18, 2025).

25 *Id.*

and service providers.[26] Signatories commit to implementing the principles and reporting on their progress annually.[27]

b. The Global Reporting Initiative

The GRI is an independent international organization that develops and promotes sustainability reporting standards and guidelines for organizations to report their economic, environmental, social, and governance performance.[28] It was established in 1997 with the goal of advancing sustainability reporting as a means to drive transparency, accountability, and sustainable development.[29] The GRI has developed a comprehensive set of sustainability reporting standards known as the GRI Standards.[30] These standards provide a framework for organizations to measure and report their sustainability impacts, risks, and opportunities across various aspects of their operations, including governance, human rights, labor practices, environmental performance, and community engagement.[31] The GRI Standards are widely used by companies, governments, and other organizations around the world to prepare sustainability reports and disclose their nonfinancial performance. They are considered one of the leading frameworks for sustainability reporting and are aligned with international reporting best practices.[32]

c. The Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD is a task force established by the Financial Stability Board (FSB), an international body that monitors and makes

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26 PRINCIPLES FOR RESPONSIBLE INV., 2022–23 ANNUAL REPORT (2023), https://dwtyzx6upklss.cloudfront.net/Uploads/z/s/n/pri_ar2023_smaller_file_8875.pdf [https://perma.cc/L6K6-ZC88].

27 *Become a Signatory*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/signatories/signatory-resources/become-a-signatory [https://perma.cc/S428-4P7D] (last visited May 18, 2025).

28 *About GRI*, GRI, https://www.globalreporting.org/about-gri/ [https://perma.cc/W5E6-4YQ9] (last visited May 18, 2025).

29 *Our Mission and History*, GRI, https://www.globalreporting.org/about-gri/mission-history/ [https://perma.cc/Y39M-2HF6] (last visited May 18, 2025).

30 *GRI Standards by Language*, GRI, https://www.globalreporting.org/standards/download-the-standards/ [https://perma.cc/3JRN-R3NV] (last visited May 18, 2025).

31 *Id.*

32 Cedric Thompson et al., *Global Reporting Initiative (GRI): Purpose, Standards, and Importance*, INVESTOPEDIA, https://www.investopedia.com/global-reporting-initiative-7483127 [https://perma.cc/B6FL-QMRS] (last updated May 17, 2023).

recommendations about the global financial system.[33] The TCFD was launched in 2015 with the aim of developing voluntary, consistent climate-related financial risk disclosures for companies to enable investors, lenders, insurers, and other stakeholders to make informed decisions.[34] The TCFD developed a set of recommendations for disclosing climate-related financial risks and opportunities across four thematic areas: governance, strategy, risk management, and metrics and targets.[35] TCFD structured the recommendations to apply to organizations across sectors and industries and to encourage transparency, consistency, and comparability in climate-related disclosures.[36] Since its inception, the TCFD recommendations have gained widespread support from businesses, investors, regulators, and other stakeholders globally. Many organizations have started to align their climate-related disclosures with the TCFD recommendations as part of their broader efforts to enhance climate risk management and transparency.[37]

D. ESG Legal Evolution: Piecemeal Progress or Regulatory Chaos?

The implementation of ESG policies by policymakers has been criticized for its piecemeal approach, which often leads to ambiguity and forced interventions in corporate business operations.[38] Policymakers have often adopted a fragmented approach to ESG regulations, with different jurisdictions implementing varying standards and guidelines.[39] This lack of coherence creates confusion among businesses, as they struggle to navigate a complex landscape of

33 *About*, TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, https://www.fsb-tcfd.org/about/ [https://perma.cc/CS78-RR2L] (last visited May 18, 2025).

34 *History*, TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, https://www.fsb-tcfd.org/about/#history [https://perma.cc/Q6ZC-SQBN] (last visited May 18, 2025).

35 *Id.*

36 *TCFD Recommendations*, TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, https://www.fsb-tcfd.org/recommendations/ [https://perma.cc/K8UB-XSAJ] (last visited May 18, 2025).

37 Nathan Reiff et al., *Task Force on Climate-Related Financial Disclosures (TCFD)*, INVESTOPEDIA, https://www.investopedia.com/what-is-the-tcfd-task-force-on-climate-related-financial-disclosures-4771379 [https://perma.cc/5B9B-THQV] (last updated Aug. 30, 2022).

38 *See* PAULO CAMARA & FILIPE MORAIS, THE PALGRAVE HANDBOOK OF ESG AND CORPORATE GOVERNANCE (2022), https://doi.org/10.1007/978-3-030-99468-6 [https://perma.cc/XD6J-YWXM].

39 *See* PETER YEOH, ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) LAWS, REGULATIONS AND PRACTICES IN THE DIGITAL ERA (2022).

regulations.[40] For multinational corporations operating across borders, this inconsistency only exacerbates the challenge of compliance.[41] The lack of standardized metrics and reporting frameworks for ESG factors contributes to ambiguity in compliance requirements.[42] Without clear guidelines on what constitutes acceptable environmental practices, social responsibility, or governance standards, companies may find it difficult to align their operations with regulatory expectations.[43] This ambiguity opens the door to interpretation and potentially exposes businesses to regulatory scrutiny and legal risks.[44] In some cases, policymakers may impose ESG mandates on businesses without adequately considering their unique circumstances or market dynamics.[45] This top-down approach can lead to forced interferences that disrupt established business models or impose undue financial burdens on companies. Instead of fostering genuine sustainability initiatives, these interventions may result in token gestures or superficial compliance measures aimed at appeasing regulators rather than driving meaningful change.[46]

Barney Reynolds, cohead of Financial Institutions at the global law firm A&O Shearman, makes the very relevant point that certain policymakers have used ESG regulations as a vehicle to advance an activist agenda, imposing ideological preferences on corporate behavior.[47] While promoting sustainability and social responsibility may have its merits, mandating specific ESG practices without

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40 *Proposal for a Regulation of the European Parliament and of the Council on the Transparency and Integrity of Environmental, Social and Governance (ESG) Rating Activities*, COM (2023) 314 final (June 13, 2023), https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX%3A52023SC0204 [https://perma.cc/29DR-CNBW].

41 Krista Bondy & Ken Starkey, *The Dilemmas of Internationalization: Corporate Social Responsibility in the Multinational Corporation*, 25 BRIT. J. MGMT. 4 (2012), https://doi.org/10.1111/j.1467-8551.2012.00840.x [https://perma.cc/3QR9-W5XC].

42 Sulkowski & Jebe, *supra* note 10.

43 Timothy M. Devinney, *Is the Socially Responsible Corporation a Myth? The Good, the Bad, and the Ugly of Corporate Social Responsibility*, 23 ACAD. MGMT. PERSPS. 6 (2009), https://doi.org/10.5465/amp.2009.39985540 [https://perma.cc/669L-S7RV].

44 *See* Elizabeth Pollman, *The Making and Meaning of ESG Law*, 14 HARV. BUS. L. REV. 403 (2024), http://ssrn.com/abstract_id=4219857 [https://perma.cc/DFP4-2YX3].

45 *See generally* Allen Mendenhall & Daniel Sutter, *ESG Investing: Government Push or Market Pull?*, 22 SANTA CLARA J. INT'L L. 75 (2024).

46 Sebastião Vieira de Freitas Netto et al., *Concepts and Forms of Greenwashing: A Systematic Review*, 32 ENV'T SCIS. EUR. Article 19 (2020), https://doi.org/10.1186/s12302-020-0300-3 [https://perma.cc/5M36-2PHY].

47 Barnabas Reynolds, *Woke Banks Rejected Farage – But It Was Brussels That Let Them*, THE TELEGRAPH (Sept. 5, 2023), https://www.telegraph.co.uk/business/2023/09/05/woke-banks-farage-brussels-let-them/ [https://perma.cc/7QDL-3UW7].

considering their practical implications can be counterproductive. Businesses should be encouraged to embrace ESG principles voluntarily, rather than being coerced into compliance through regulatory fiat.[48] Piecemeal ESG regulations may also have unintended consequences, such as diverting resources away from productive investments or stifling innovation.[49] By imposing rigid compliance requirements, policymakers risk discouraging risk-taking and entrepreneurial activity, thereby hampering economic growth and competitiveness.[50] Moreover, excessive regulatory burdens may disproportionately affect small and medium-sized enterprises, limiting their ability to compete in the marketplace.[51] While the intentions behind ESG regulations may be noble, the piecemeal approach adopted by policymakers has led to a lack of clarity, ambiguity, and forced interferences in corporate business operations.

II
THE LAW OF ESG IN THE EUROPEAN UNION

The European Union (EU) has been at the forefront of developing comprehensive regulations and directives aimed at promoting sustainability, responsible investing, and corporate governance. Below are some key aspects of ESG law and regulation in the EU.

A. Non-Financial Reporting Directive (NFRD)

The NFRD requires large public interest entities (such as listed companies, banks, and insurance companies) with over 500 employees to disclose nonfinancial information. This includes information on environmental, social, and employee matters, as well as respect for

48 Jeremy Bertomeu et al., *Voluntary Versus Mandatory Disclosure*, 26 REV. ACCT. STUD. 658 (2021), https://doi.org/10.1007/s11142-020-09579-0 [https://perma.cc/9RHE-RSX8].

49 Delilah Rothenberg et al., *ESG 2.0: Measuring & Managing Investor Risks Beyond the Enterprise-Level* (Apr. 6, 2021), https://ssrn.com/abstract=3820316 [https://perma.cc/W6GX-6WNE].

50 Rolf Nebel, *Regulations as a Source of Systemic Risk: The Need for Economic Impact Analysis*, 29 GENEVA PAPERS ON RISK & INS. ISSUES & PRAC. 273 (2004), http://www.jstor.org/stable/41953115 [https://perma.cc/Q5V8-MR2L].

51 John Kitching et al., *Burden or Benefit? Regulation as a Dynamic Influence on Small Business Performance*, 33 INT'L SMALL BUS. J.: RESEARCHING ENTREPRENEURSHIP 130 (2015), https://doi.org/10.1177/0266242613493454 [https://perma.cc/U5AX-GQ2R].

human rights, anti-corruption, and diversity.[52] The directive aims to enhance transparency and accountability by requiring companies to report on their ESG performance and impacts, enabling stakeholders to assess their sustainability practices.[53]

B. Sustainable Finance Disclosure Regulation (SFDR)

The SFDR is a regulation that aims to harmonize sustainability-related disclosures in the financial services sector.[54] It requires financial market participants, including asset managers, investment firms, and financial advisers, to disclose information on how they integrate sustainability risks into their investment decision-making processes and the impact of sustainability factors on the returns of financial products. SFDR also introduces requirements for asset managers to categorize their funds into different sustainability categories.[55]

C. EU Taxonomy Regulation

The EU Taxonomy Regulation establishes a classification system for sustainable economic activities by establishing a set of criteria companies can use to determine whether an economic activity is environmentally sustainable.[56] This classification system aims to reduce greenwashing and facilitate sustainable investment by providing a common language for investors and companies to identify sustainable activities.[57] The taxonomy covers six environmental objectives: climate change mitigation, climate change adaptation,

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52 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups, 2014 O.J. (L 330) 1.

53 NORA HAHNKAMPER-VANDENBULCKE, EUR. PARLIAMENTARY RSCH. SERV., PE 654.213, BRIEFING, IMPLEMENTATION APPRAISAL: NON-FINANCIAL REPORTING DIRECTIVE (2021), https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/654213/EPRS_BRI(2021)654213_EN.pdf [https://perma.cc/S4FR-6F7V].

54 *EU SFDR Explained: A Guide to the EU Sustainable Finance Disclosure Regulation for Investors*, J.P. MORGAN ASSET MGMT., https://am.jpmorgan.com/ch/en/asset-management/institutional/investment-strategies/sustainable-investing/understanding-SFDR/ [https://perma.cc/6CCB-T2V5] (last updated Jan. 1, 2023).

55 Regulation 2019/2088, of the European Parliament and of the Council of 27 November 2019 on the Sustainability-Related Disclosures in the Financial Services Sector, 2019 O.J. (L 317) 1 (EU).

56 David H. Doyle, *A Short Guide to the EU's Taxonomy Regulation*, S&P GLOB. (May 12, 2021), https://www.spglobal.com/esg/insights/a-short-guide-to-the-eu-s-taxonomy-regulation [https://perma.cc/BF7P-R6TX].

57 *EU Taxonomy for Sustainable Activities*, EU COMM'N, https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en [https://perma.cc/2VQB-GZ6F] (last visited May 18, 2025).

water and marine resource sustainability and protection, circular economy transition, pollution control and prevention, and biodiversity and ecosystems.[58]

D. EU Action Plan on Sustainable Finance

The EU Action Plan on Sustainable Finance sets out a comprehensive strategy to integrate sustainability considerations into the financial system and mobilize capital toward sustainable investments.[59] The action plan includes initiatives such as the development of EU green bond standards, the establishment of a sustainable finance taxonomy, the integration of sustainability factors into prudential requirements for banks and insurers, and the promotion of sustainable investment and transparency.[60]

E. EU Corporate Governance Initiative

The EU Corporate Governance Initiative aims at establishing requirements for the corporate governance of listed companies, including rules on board composition, transparency, and shareholder rights.[61] While not specific to ESG, the directive promotes good governance practices that are aligned with ESG principles, such as board diversity, transparency, and accountability. The Corporate Governance Initiative, which consists of both regulations and directives, represents a comprehensive framework for promoting sustainability, responsible investing, and corporate governance practices across the EU. It wants to drive systemic change in the

58 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088, 2020 O.J. (L 198) 13 (EU).

59 Directorate-General for Financial Stability, Financial Services and Capital Markets Union, *Renewed Sustainable Finance Strategy and Implementation of the Action Plan on Financing Sustainable Growth*, EU COMM'N, https://finance.ec.europa.eu/publications/renewed-sustainable-finance-strategy-and-implementation-action-plan-financing-sustainable-growth_en [https://perma.cc/XDD4-2ZLZ] (last updated Aug. 5, 2020).

60 *Id.*

61 *See* Wolf-Georg Ringe & Alperen A. Gözlügöl, *The EU Sustainable Corporate Governance Initiative: Where Are We and Where Are We Headed?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 18, 2022), https://corpgov.law.harvard.edu/2022/03/18/the-eu-sustainable-corporate-governance-initiative-where-are-we-and-where-are-we-headed/ [https://perma.cc/6MND-5BHF].

financial sector and corporate landscape toward a more sustainable and inclusive economy.[62]

F. The Hidden Costs and Inefficiencies of EU ESG Regulations

Understanding the law of ESG in the EU reveals several concerning aspects. These regulations impose excessive bureaucratic burdens on businesses, stifling innovation and competitiveness. Companies face significant compliance costs, which can disproportionately affect smaller enterprises, potentially leading to market consolidation and reduced competition. Moreover, these laws appear ineffective; they create loopholes for greenwashing rather than fostering genuine sustainable practices. These regulations also lead to increased operational complexities and legal uncertainties, hindering economic growth and job creation within the EU. Ultimately, such stringent regulatory frameworks may do more harm than good, restricting business dynamism and economic progress.

III
THE LAW OF ESG IN THE UNITED STATES

The U.S. Securities and Exchange Commission (SEC) oversees and enforces federal securities laws to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.[63] In the context of ESG criteria, the SEC's role includes ensuring that publicly traded companies provide accurate and comprehensive disclosures about their ESG practices and impacts. This helps investors make informed decisions by understanding the sustainability and ethical dimensions of their investments. The SEC's involvement in ESG regulation aims to enhance transparency, accountability, and comparability among companies to align financial markets with broader societal goals.[64]

After initially limiting its action to issuing guidance and interpretive releases within the broader context of existing securities laws and regulations, the SEC shifted toward formal ESG regulations due to

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62 *Sustainable Corporate Governance*, EU COMM'N, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en [https://perma.cc/9AB7-SLQY] (last visited May 18, 2025).

63 *Mission*, SEC, https://www.sec.gov/about/mission [https://perma.cc/99AA-W2YX] (last updated Aug. 9, 2023).

64 *See generally* Mahna Behbin et al., *ESG Investing: The US Regulatory Perspective*, MORGAN LEWIS (Mar. 12, 2024), https://www.morganlewis.com/pubs/2024/03/esg-investing-the-us-regulatory-perspective [https://perma.cc/2QZP-ER2H].

increasing investor demand for transparency and pressure from stakeholders concerned about inconsistent disclosures. The change in position aimed to standardize reporting and address risks tied to climate and sustainability.

A. SEC Guidance on Climate Change Disclosure (2010)

In 2010, the SEC issued interpretive guidance on climate change disclosure requirements. This guidance clarifies that existing disclosure requirements under Regulation S-K may require companies to disclose material, climate-related risks and opportunities in their filings, such as annual reports (Form 10-K) and registration statements.[65] According to the SEC, companies were encouraged to consider the potential impacts of climate change on their business operations, financial condition, and results of operations, and to disclose relevant information to investors when such impacts are material.[66]

B. Regulation S-K (Item 303—Management's Discussion and Analysis of Financial Condition and Results of Operations)

Regulation S-K requires companies to disclose in their annual reports any known trends, events, or uncertainties that are reasonably likely to have a material effect on their financial condition or results of operations.[67] This includes material ESG-related risks and opportunities that may affect the company's performance.[68]

C. Proxy Statement Disclosure

The SEC's proxy rules require companies to disclose certain ESG-related information in their proxy statements when such information is material to understanding the matters to be voted on by shareholders. This may include information related to executive compensation, board diversity, corporate social responsibility initiatives, and sustainability practices.[69]

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65 Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61,469, 75 Fed. Reg. 6289 (Feb. 2, 2010).

66 *Id.*

67 Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 43 SEC Docket 1330 (May 18, 1989).

68 *Id.*

69 17 C.F.R. § 240.14a-101.

D. Investment Advisers Act of 1940

Under the Investment Advisers Act of 1940, investment advisers are required to act in the best interests of their clients,[70] which may include considering ESG factors when providing investment advice.[71] The SEC has indicated that investment advisers should disclose to clients how they consider ESG factors in their investment decision-making process and portfolio management strategies.[72]

E. Regulation Best Interest (Reg BI)

Reg BI, which became effective in 2020, establishes a standard of conduct for broker-dealers when making recommendations to retail customers.[73] While not specific to ESG, Reg BI requires broker-dealers to act in the best interest of their customers, which may include considering ESG factors when recommending investments.[74]

IV
FROM GAVEL TO GRIT: FINAL RULES MARK THE STARTING LINE FOR LEGAL JOUSTS

The SEC's recent split decision approving new climate-related disclosure rules marks a significant shift in reporting requirements that has generated concerns about increased compliance burdens and legal risks. On March 6, 2024, the SEC finalized its climate-related disclosure rules, with a 3-to-2 vote.[75] These rules, known as the "Final Rules," will require U.S. reporting companies and foreign private issuers to disclose expanded climate-related information in their

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70 *See, e.g.*, Transamerica Mortg. Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979); SEC v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 191 (1963).

71 *See* Mark T. Uyeda, Commissioner, SEC, Remarks at the California '40 Acts Group (Jan. 27, 2023), https://www.sec.gov/news/speech/uyeda-remarks-california-40-acts-group [https://perma.cc/J8EM-J7A9].

72 *See* BNY Mellon Inv. Adviser, Inc., Investment Company Act Release No. 34591 (May 23, 2022) (settled order), https://www.sec.gov/litigation/admin/2022/ia-6032.pdf [https://perma.cc/5WCJ-5T4B].

73 Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86,031, 84 Fed. Reg. 39178 (June 5, 2019).

74 *Regulation Best Interest and ESG Investing: Confluence for the SEC or Consternation Under ERISA?*, JONES DAY (Sept. 2020), https://www.jonesday.com/en/insights/2020/09/regulation-best-interest-and-esg-investing-confluence-for-the-sec-or-consternation-under-erisa [https://perma.cc/2PC6-6W8V].

75 Press Release, SEC, SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 6, 2024), https://www.sec.gov/news/press-release/2024-31 [https://perma.cc/MY3S-W8ES].

periodic filings, reports, and registration statements.[76] Following a substantial response of 24,000 comment letters, including 4,500 unique letters, to its proposed rulemaking in 2022, the SEC refined its requirements.[77] This included making many disclosure requirements, such as disclosures of Scope 1 and 2 greenhouse gas emissions, contingent on materiality. Additionally, the proposed Scope 3 emissions reporting requirements were eliminated, and the financial statement disclosures were narrowed, by dropping the financial metrics disclosure.[78] Under the Final Rules, companies are required to disclose in the footnotes capitalized costs, expenditures, charges, and losses as a result of severe weather events, such as hurricanes, flooding, drought, wildfires, and rise in sea level, subject to applicable one percent and de minimis disclosure thresholds.[79] Holland & Knight note that despite these adjustments, however, the Final Rules still mandate extensive climate-related disclosures, which will elevate the costs, compliance burdens, and legal risks associated with public reporting.[80] Commissioners Hester M. Peirce and Mark T. Uyeda voted against the rule release.[81] The dissenting commissioners said, "The SEC failed to justify why prescriptive and granular climate disclosure rules are necessary."[82] "Peirce said that a flood of new disclosures will overwhelm investors while increasing compliance burdens for public companies."[83] Uyeda noted that the "SEC is acceding to the pressure of political activists who 'seek to transform the agency's authority to achieve policy objectives that are outside its statutory mandate.'"[84]

The adoption of the Final Rules has been met with a string of legal challenges that have delayed their implementation. Various petitioners,

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76 *Id.*

77 Soyoung Ho, *SEC Scales Back Requirements in Final Climate Disclosure Rule*, THOMSON REUTERS (Mar. 7, 2024), https://tax.thomsonreuters.com/news/sec-scales-back-requirements-in-final-climate-disclosure-rule/ [https://perma.cc/ZJ4S-JWL6].

78 *Id.*

79 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668 (Mar. 28, 2024).

80 Jessica B. Magee et al., *SEC Adopts Landmark Climate Disclosure Rules*, HOLLAND & KNIGHT (Mar. 11, 2024), https://www.hklaw.com/en/insights/publications/2024/03/sec-adopts-landmark-climate-disclosure-rules [https://perma.cc/5MLG-USMN].

81 *Id.*

82 Ho, *supra* note 77.

83 *Id.*

84 Cydney Posner, *Commissioner Uyeda Warns: The SEC "Has Gone Astray,"* COOLEY (Apr. 4, 2024), https://cooleypubco.com/2024/04/04/uyeda-sec-gone-astray/#page=1 [https://perma.cc/DMH9-JMWJ].

including energy companies, energy trade associations, a group of state attorneys general, the Ohio Bureau of Workers' Compensation, the U.S. Chamber of Commerce, and climate advocacy groups in six different circuit courts filed a total of nine petitions contesting the rules.[85] The Judicial Panel on Multidistrict Litigation consolidated these challenges in the Eighth Circuit, which was randomly selected for review.[86] On April 4, the SEC issued an order to stay the Final Rules until the consolidated Eighth Circuit petitions undergo judicial review.[87] The lawsuit marks the first major obstacle for the new rules, mere hours after their adoption by the SEC, with several lawmakers and the U.S. Chamber of Commerce expressing opposition to the Commission's new climate disclosure requirements.

In the lawsuit, the petitioners argued that the new rule exceeded the SEC's authority, describing it as "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law,"[88] and have asked the court to overturn the ruling.

The case poses four key challenges to the SEC's Final Rules.

1. Ultra Vires: Petitioners argue the SEC exceeded its authority by mandating climate disclosures beyond what's necessary for investor protection.[89] The issue centers on whether climate-related information falls under the SEC's jurisdiction.

At common law, the ultra vires doctrine refers to the principle that describes actions taken by a corporation or an agent that exceed the powers granted to them by law, by the corporate charters, or by the

85 *See* Liberty Energy Inc. v. SEC, No. 24-60109 (5th Cir. filed Mar. 6, 2024); West Virginia v. SEC, No. 24-10679 (11th Cir. filed Mar. 6, 2024); Louisiana v. SEC, No. 24-60109 (5th Cir. filed Mar. 7, 2024); Tex. All. of Energy Producers v. SEC, No. 24-60109 (5th Cir. filed Mar. 11, 2024); Nat. Res. Def. Council, Inc. v. SEC, No. 24-707 (2d Cir. filed Mar. 12, 2024); Iowa v. SEC, No. 24-1522 (8th Cir. filed Mar. 12, 2024); Sierra Club v. SEC, No. 24-1067 (D.C. Cir. filed Mar. 13, 2024); Ohio Bureau of Workers' Comp. v. SEC, No. 24-3220 (6th Cir. filed Mar. 13, 2024); and Chamber of Com. of U.S. v. SEC, No. 24-60109 (5th Cir. filed Mar. 14, 2024).

86 *In re* SEC, The Enhancement and Standardization of Climate-Related Disclosures for Investors, Issued on Mar. 6, 2024, Consolidation Order Issued Mar. 21, 2024, MCP No. 180 (J.P.M.L. 2024).

87 The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11,280, Exchange Act Release No. 99,908, 89 Fed. Reg. 25804 (Apr. 4, 2024).

88 Cynthia Hanawalt & Chloe Field, *The SEC's Final Climate Disclosure Rule Must Respond to Emerging Legal Risks*, CLIMATE L. BLOG (Dec. 11, 2023), https://blogs.law.columbia.edu/climatechange/2023/12/11/the-secs-final-climate-disclosure-rule-must-respond-to-emerging-legal-risks/ [https://perma.cc/HD9T-PVET].

89 *See* 15 U.S.C. § 78m(a).

principal.[90] In the context of a federal agency in American law, the ultra vires doctrine applies similarly to its application in corporate law. Federal agencies derive their powers and authority from statutes enacted by Congress. The ultra vires doctrine holds that federal agencies cannot take actions or make decisions that exceed the authority granted to them by law.[91] If a federal agency were to act beyond its statutory authority, its actions may be deemed ultra vires and subject to challenge. Courts have the authority to review agency actions to ensure they are within the scope of the agency's statutory mandate. If a court determines that an agency has acted ultra vires, it may invalidate the action or decision. The ultra vires doctrine serves as a check on the power of federal agencies, ensuring that they operate within the bounds set by Congress and adhere to the rule of law.

2. Major Questions Doctrine: Petitioners claim that this legal principle suggests that because climate disclosure is a significant issue, Congress should provide clear direction.[92] Critics claim the SEC's rules deviate from its historical focus on financially material information, raising doubts about its authority.

The major questions doctrine is a legal principle that addresses the interpretation of statutes and regulations. It essentially deals with determining whether Congress intended to delegate certain significant questions to administrative agencies or whether the courts should resolve those questions. Under this doctrine, when a statute is ambiguous or silent on a major policy issue, courts will presume that Congress did not intend to delegate authority to the administrative agency to make decisions on that issue.[93] Instead, courts will assume that Congress intended to keep such decisions within its own purview. The U.S. Supreme Court case *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* elaborated upon the major questions doctrine.[94] In this case, the court established a two-step process for reviewing agency interpretations of statutes:

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90 Stephen J. Leacock, *Rise and Fall of the Ultra Vires Doctrine in United States, United Kingdom, and Commonwealth Caribbean Corporate Common Law: A Triumph of Experience Over Logic*, 5 DEPAUL BUS. & COM. L.J. 67 (2006).

91 Alexandra Nickerson, *Ultra-APA Ultra Vires Review: Implied Equitable Actions for Statutory Violations by Federal Officials*, 121 COLUM. L. REV. 2521 (2021), https://www.jstor.org/stable/27093856 [https://perma.cc/8X6A-DTN7].

92 *See* West Virginia v. EPA, 597 U.S. 697 (2022).

93 *See generally* Jonas J. Monast, *Major Questions About the Major Questions Doctrine*, 68 ADMIN. L. REV. 445 (2016).

94 Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984).

> Step one: The court must determine whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, then that intent must be followed by both the agency and the courts.
>
> Step two: If the statute is silent or ambiguous, the court must defer to the agency's interpretation of the statute as long as it is reasonable and not arbitrary or capricious.

However, the major questions doctrine can be seen as an exception to Chevron deference. When an issue is deemed to be a "major question," meaning one of significant economic or political importance, the courts may not defer to the agency's interpretation and may instead interpret the statute themselves.

Kristy Balsanek et al. note that the major questions doctrine may prove pivotal.[95] This year, the Supreme Court has overruled Chevron deference.[96] The 6–3 decision in *Loper Bright Enterprises v. Raimondo*, together with its companion case, *Relentless, Inc. v. Department of Commerce*, is a significant limitation on federal regulatory power, and has been seen as a setback for President Biden's administration.[97] The case involved fishing companies challenging a program to monitor herring overfishing off New England's coast, funded partly by the industry.[98] Chief Justice John Roberts, writing for the majority, stated that courts must now independently judge if agencies act within their statutory authority.[99] This ruling empowers judges to second-guess regulatory actions, benefiting business, conservative, and libertarian groups who argue it removes a pro-government bias in regulatory challenges.[100] The litigation is part of a broader effort to weaken federal agency power in law interpretation,

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95 Kristy Balsanek et al., *SEC Stays Climate Rules: An Overview of Ongoing Legal Challenges*, DLA PIPER (Apr. 9, 2024), https://www.dlapiper.com/en/insights/publications/2024/04/sec-stays-climate-rules-an-overview-of-ongoing-legal-challenges [https://perma.cc/DY25-2N2V].

96 Amy Howe, *Supreme Court Strikes Down Chevron, Curtailing Power of Federal Agencies*, SCOTUSBLOG (June 28, 2024), https://www.scotusblog.com/2024/06/supreme-court-strikes-down-chevron-curtailing-power-of-federal-agencies/ [https://perma.cc/4MTX-L8GD].

97 John Kruzel & Andrew Chung, *US Supreme Court Curbs Federal Agency Powers, Overturning 1984 Precedent*, REUTERS (June 29, 2024), https://www.reuters.com/legal/us-supreme-court-curbs-federal-agency-powers-overturning-1984-precedent-2024-06-28/ [https://perma.cc/UF96-U5NG].

98 Loper Bright Enters. v. Raimondo, Sec'y of Com., 603 U.S. 369 (2024).

99 *Id.* at 374.

100 Kruzel & Chung, *supra* note 97.

rulemaking, and execution.[101] The importance of this decision cannot be overstated. Given Congressional gridlock, Democratic presidents have increasingly relied on agency-issued rules for regulatory goals. The Biden administration defended the regulation and Chevron doctrine, emphasizing its creation under President Trump.[102] Liberal Justice Elena Kagan's dissent warned that the ruling enhances Supreme Court power and undermines agency expertise crucial for public safety and health.[103] Critics, including Democrats and environmental groups, argue the decision hinders agencies' ability to ensure safe food, clean air and water, and stable financial markets.[104] Supported by conservative groups like Charles Koch's network, the fishing companies contended that the monitoring program imposed excessive costs and exceeded agency authority.[105] The ruling reflects the Court's ongoing trend of curbing perceived regulatory overreach. With Chevron deference now overturned, the Eight Circuit can conduct a more rigorous review of the SEC's final rules, likely invoking the major questions doctrine.

3. First Amendment Violation: Petitioners hold that requiring climate disclosures amounts to compelled speech, violating the First Amendment.[106] The SEC counters by asserting that such disclosures are factual and relevant for investors, thus falling within permissible limits.[107]

4. APA Challenge: Petitioners allege that the SEC's rulemaking lacks a proper basis and thorough explanation, violating the Administrative Procedure Act (APA).[108] The APA is a foundational statute in American administrative law that governs the process by which federal administrative agencies develop and issue regulations, as

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101 *Id.*

102 *Id.*

103 Loper Bright Enters. v. Raimondo, Sec'y of Com., 603 U.S. 369 (2024) (Kagan, J., dissenting).

104 Stuart Shapiro, *With Chevron Overturned, Americans' Faith in Government Will Sink Even Further*, THE HILL (July 1, 2024, 12:00 PM), https://thehill.com/opinion/energy-environment/4749143-with-chevron-overturned-americans-faith-in-government-will-sink-even-further/ [https://perma.cc/9HXF-VEYH].

105 Kruzel & Chung, *supra* note 97.

106 *See* Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518, 524 (D.C. Cir. 2015).

107 *See* David Lopez et al., *The Materiality Debate and ESG Disclosure: Investors May Have the Last Word*, CLEARY GOTTLIEB (Jan. 11, 2022), https://www.clearygottlieb.com/news-and-insights/publication-listing/materiality-and-esg [https://perma.cc/GYS9-WXKF].

108 *See* Chamber of Com. of the U.S. v. SEC, 88 F.4th 1115, 1118 (5th Cir. 2023).

well as how they conduct adjudicatory proceedings.[109] Enacted in 1946, the APA aims to ensure fairness and transparency in the rulemaking and adjudication processes of federal agencies. The APA provides a framework for judicial review of agency actions. It allows individuals and entities adversely affected by agency decisions to seek judicial review in federal courts. Courts may set aside agency actions that are found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.[110]

The SEC argues its rules are consistent with its historical authority and supported by evidence linking climate risks to firm performance.[111]

These challenges underscore legal and conceptual debates surrounding the SEC's authority and the necessity of climate disclosures.

The legal action is no surprise. As early as February 2023, Republican leaders in Congress had published a letter to SEC Chairman Gary Gensler, arguing that the rule exceeded the SEC's authority, accusing the SEC under Gensler of pursuing a "progressive social agenda," and arguing that a climate disclosure rule "in any form," would "harm consumers, workers, and the U.S. economy."[112]

Sullivan & Cromwell has noted that the timing and procedures for the Eighth Circuit's actions regarding the consolidated petitions are currently uncertain.[113] The SEC's stay order does not modify the compliance dates outlined in the Final Rules. Consequently, if upheld, it remains unclear whether and how the phase in and compliance schedules would be adjusted. Furthermore, other climate-related reporting requirements, such as the SEC's 2010 guidance on climate-related disclosures, and jurisdiction-specific regulations, like California's climate disclosure laws and the EU's Corporate Sustainability Reporting Directive, continue to be in effect.

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109 5 U.S.C. § 551 et seq.

110 Summary of the Administrative Procedure Act, EPA, https://www.epa.gov/laws-regulations/summary-administrative-procedure-act#:~:text=The%20Administrative%20Procedure%20Act%20(APA,on%20notices%20of%20proposed%20rulemaking [https://perma.cc/DX8B-VFJT] (last updated July 22, 2024).

111 *See* Balsanek et al., *supra* note 95.

112 Press Release, House Comm. on Fin. Servs, McHenry, Scott, Huizenga Demand Info. from Gensler on Disastrous Climate Disclosure Proposal (Feb. 22, 2023), https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408573 [https://perma.cc/AF9J-KGV7].

113 *SEC Stays Climate-Related Disclosure Rules for Public Companies Pending Judicial Review*, SULLIVAN & CROMWELL (Apr. 5, 2024), https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/SEC-Stays-Climate-Related-Disclosure-Rules.pdf [https://perma.cc/3BMY-YBMY].

Additionally, it is not evident what actions the SEC will take concerning other rulemaking proposals related to ESG topics, including its proposed ESG disclosure requirements for investment advisers and investment companies.[114]

V
OVERVIEW OF THE LEGAL CHALLENGES FACED BY MANAGERS INCORPORATING ESG PRINCIPLES

The case against mandatory adoption of ESG principles by private issuers has been in the cards for some time. On August 4, 2022, nineteen attorneys general, led by Mark Brnovich, the attorney general of Arizona, sent a letter to BlackRock's CEO, Laurence D. Fink, expressing their intent to defend their respective states' pension funds from what they perceived was a breach of fiduciary duty.[115] The attorneys general each represented states that were clients of BlackRock. The nineteen states (Alabama, Arizona, Arkansas, Kansas, Kentucky, Georgia, Idaho, Indiana, Louisiana, Mississippi, Missouri, Montana, Nebraska, Ohio, South Carolina, Tennessee, Texas, Utah, and West Virginia) argued that BlackRock's commitment to financial returns for state pensions should be undivided, as fiduciaries are obligated to act solely in the interest of participants and beneficiaries, and acting on motives other than pursuing the best economic outcome for the client "triggers an irrebuttable presumption of wrongdoing."[116] Furthermore, they criticized BlackRock's campaign to achieve net-zero emissions by 2050, citing that none of their states or the federal government of the United States has endorsed such an agreement.[117] They assert that focusing investments solely on reaching zero emissions rather than maximizing returns for clients undermines the duty of care.[118]

Shortly thereafter, on August 30, the state of Louisiana formed a taskforce to issue recommendations regarding the regulation of ESG

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114 *Id.*

115 Amy Resnick, *19 GOP Attorneys General Slam BlackRock Over ESG Investments*, CHIEF INV. OFFICER (Aug. 9, 2022), https://www.ai-cio.com/news/19-gop-attorneys-general-slam-blackrock-over-esg-investments/ [https://perma.cc/A7FW-CV82].

116 Letter from Mark Brnovich, Ariz. Att'y Gen., to BlackRock, Inc. (Aug. 4, 2022), https://www.azag.gov/sites/default/files/2022-08/BlackRock%20Letter.pdf [https://perma.cc/H8KH-F4AP].

117 *Id.*

118 *Id.*

factors in lending and investment practices,[119] subsequent to which the state removed $794 million in funds from BlackRock on the basis of ESG investing strategies it employed.[120] The attorney general of Louisiana, Jeffrey M. Landry, emphasized the duty of transparency of funds toward their clients, particularly in disclosing conflicts of interest.[121] The reference is specific, concerning BlackRock's extensive investment portfolio, which includes both ESG-compliant products and investments in companies like PetroChina,[122] without full disclosure to clients. An example highlighted is BlackRock's activism influencing Exxon's production cuts, leading to the sale of several oil fields to PetroChina.[123] The attorney general questioned why BlackRock imposes its ESG agenda on Exxon but not on PetroChina, suggesting that funds advising clients to invest in ESG-compliant products without full disclosure may violate their fiduciary duties.[124] This underscores the importance of transparency, accountability, and the duty of loyalty in financial management, particularly in navigating the complexities of ESG considerations within fiduciary responsibilities.

BlackRock's response to the letter from the attorneys general was delivered by Dalia Blass, the investment manager's head of external relations.[125] BlackRock asserted itself as a fiduciary managing capital on behalf of retail and institutional clients, emphasizing that being a

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119 Leah Malone et al., *ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S.*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 11, 2023), https://corpgov.law.harvard.edu/2023/03/11/esg-battlegrounds-how-the-states-are-shaping-the-regulatory-landscape-in-the-u-s/ [https://perma.cc/BTQ7-MS7A].

120 *Louisiana to Remove $794 Mln from BlackRock Funds Over ESG Drive*, REUTERS (Oct. 5, 2022), https://www.reuters.com/business/sustainable-business/louisiana-remove-794-mln-blackrock-funds-over-esg-drive-2022-10-05/ [https://perma.cc/39GK-GJ6V].

121 *See Treasurer Follows Attorney General's Lead, Louisiana Divests from BlackRock*, L'OBSERVATEUR (Oct. 6, 2022, 10:34 AM), https://www.lobservateur.com/2022/10/06/treasurer-follows-attorney-generals-lead-louisiana-divests-from-blackrock/ [https://perma.cc/8YUJ-G53T].

122 *BlackRock Inc. Ownership in PTR / PetroChina Co. Ltd. – ADR*, FINTEL, https://fintel.io/so/us/ptr/blackrock [https://perma.cc/7JG5-LHDH] (last updated Sept. 8, 2022).

123 *ExxonMobil (XOM) Hands Over West Qurna 1 Oilfield to PetroChina*, NASDAQ: ZACKS EQUITY RSCH. (Jan. 3, 2024, (9:10 AM), https://www.nasdaq.com/articles/exxonmobil-xom-hands-over-west-qurna-1-oilfield-to-petrochina [https://perma.cc/G33Z-HUA6].

124 Gabriella Hoffman, *BlackRock Is Forcing ESG Behavior on Companies*, INDEP. WOMEN'S F. (Oct. 5, 2022), https://www.iwf.org/2022/10/05/blackrock-is-forcing-esg-behavior-on-companies/ [https://perma.cc/8QQL-8JX9].

125 Rob Kozlowski, *BlackRock Responds to Anti-ESG Movement, 'Disturbed' by Trend*, PENSIONS & INVS. (Sept. 7, 2022, 4:22 PM), https://www.pionline.com/esg/blackrock-responds-anti-esg-movement-disturbed-trend [https://perma.cc/D9F2-34JM].

fiduciary is a foundational principle.[126] The attorneys general also characterized BlackRock's role thus. However, the attorneys general failed to address a key aspect in their letter: Institutional clients, such as pension funds, establish and communicate their investment policies to managers, which managers must adhere to.[127] Additionally, BlackRock stated that it has implemented a system allowing institutional clients to vote in company meetings, reflecting a new development likely to spark discussion.[128]

According to an analysis by Alberto Lupoi, in summary, BlackRock's response highlights three significant points: First, amidst an energy transition, investors need to manage risks and opportunities, which can explain seemingly inconsistent investments as risk mitigation tools.[129] Second, clients drive long-term and sustainable investment policies, although this does not encompass the full spectrum of ESG objectives.[130] Third, BlackRock does not impose policies on companies; institutional funds could decide how to vote in company meetings if they wish.[131]

Blackrock's commitment to ESG principles and the resulting backlash have had a significant financial impact on the company and increased wariness from Blackrock's leadership. According to official figures, as of March 2024, state pension funds have withdrawn $13.3 billion from BlackRock.[132] Will Schmitt observed that skepticism over the climate change issues "have coincided with new caution by BlackRock and other asset managers over participating in industry alliances that seek to tackle climate change. BlackRock has scaled back its commitment to Climate Action 100+ while State Street, JPMorgan Asset Management, Pimco and Invesco have withdrawn entirely."[133]

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126 Press Release, BlackRock, Response to Attorneys General (Sept. 6, 2022), https://www.blackrock.com/us/individual/literature/press-release/blackrock-response-attorneys-general.pdf [https://perma.cc/T7HD-5U7N].

127 *Id.*

128 *Id.*

129 Alberto Lupoi, *Doveri Fiduciari e ESG* [Fiduciary Duties and ESG], 6 TRUSTS 1090 (2022).

130 *Id.*

131 *Id.*

132 Will Schmitt, *US Investment Funds Pull $13.3bn from BlackRock in Anti-ESG Campaign*, FIN. TIMES (Mar. 23, 2024), https://www.ft.com/content/9306c8f2-530d-45ca-a830-4d26e5a90509 [https://perma.cc/7LVN-6PS5].

133 *Id.*

VI
ANALYSIS OF LEGAL ARGUMENTS

A. Examination of Breach of Fiduciary Duties Claims

Delaware law governs the majority of U.S.-based corporations, making it a benchmark for corporate governance. Due to its comprehensive and well-established body of corporate law, Delaware is often regarded as exemplary, providing clear and reliable guidelines that influence corporate practices nationwide. Under Delaware law, directors owe fiduciary duties to the corporation and its shareholders.[134] The two primary fiduciary duties are the duty of care and the duty of loyalty.[135]

1. Duty of Care

Under the duty of care, directors have a duty to act with the care that an ordinarily prudent person in a similar position would exercise under similar circumstances.[136] This duty requires directors to make informed decisions,[137] exercise reasonable diligence,[138] and act in the best interests of the corporation.[139] Key aspects of the duty of care include informed decision-making, exercise of reasonable business judgment, reliance on information and experts, and oversight responsibility. Therefore, directors must adequately inform themselves before making decisions on behalf of the corporation. This typically involves reviewing relevant information, seeking advice from experts when necessary, and actively participating in board meetings and deliberations. Directors are also expected to exercise their business judgment in a manner that promotes the best interests of the corporation and its shareholders. While they have discretion in decision-making, they must do so in a rational and well-informed manner. However, directors may rely on information, reports, opinions, or statements prepared or presented by officers, employees, legal counsel, accountants, or other experts whom the director reasonably believes to be reliable and competent within their respective areas of expertise.[140]

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134 *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

135 William M. Lafferty et al., *A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*, 116 PENN ST. L. REV. 837 (2012).

136 Charles Hansen, *The Duty of Care, the Business Judgment Rule, and The American Law Institute Corporate Governance Project*, 48 BUS. LAW. 1355 (1993).

137 Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

138 *Id.*

139 *Guth*, 5 A.2d at 510.

140 DEL. CODE ANN. Tit. 8, § 141(e); *see Van Gorkom*, 488 A.2d at 872.

However, this reliance must be made in good faith and with reasonable care.[141] Finally, directors have oversight responsibilities to monitor the corporation's operations and ensure compliance with applicable laws, regulations, and internal policies.[142] While directors are not expected to manage day-to-day operations, they are responsible for implementing effective systems of oversight and risk management.[143]

Delaware courts apply the business judgment rule when reviewing directors' decisions.[144] Under this rule, courts defer to directors' decisions if they are made in good faith, are informed and have a rational basis, so that directors are generally protected from liability unless they engage in gross negligence, bad faith, or self-dealing.[145]

Directors who breach their duty of care may be held personally liable for damages resulting from their negligence or failure to fulfill their oversight responsibilities. However, Delaware courts generally afford directors considerable latitude in decision-making, recognizing the complexities of corporate governance and the need for directors to exercise discretion in fulfilling their duties.[146]

Critics of ESG integration argue that directors may run afoul of their duty of care if they prioritize ESG factors without sufficient evidence of their positive impact on shareholder value.[147] Directors must justify their decisions based on a rational business purpose and consider the potential consequences for shareholder wealth.[148] If directors fail to adequately assess the financial implications of ESG initiatives, or prioritize them without a reasonable basis, they could be deemed to have breached their duty of care.[149]

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141 *Id.*

142 *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

143 *In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343 (Del. Ch. 2023).

144 Gerard V. Mantese & Emily S. Fields, *The Business Judgment Rule*, 99 MICH. BAR J. 30 (2020).

145 Bodell v. Gen Gas & Elec. Corp., 132 A. 442 (Del. Ch. 1926).

146 *Van Gorkom*, 488 A.2d at 872.

147 Luh Luh Lan & Walter Wan, *ESG and Director's Duties: Defining and Advancing the Interests of the Company* (Euro. Corp. Governance Inst., Law Working Paper No. 737/2023, 2023), http://ssrn.com/abstract_id=4615870 [https://perma.cc/YN8P-M2PK].

148 Mark J. Loewenstein & Jay Geyer, *Shareholder Primacy and the Moral Obligations of Directors*, 26 FORDHAM J. CORP. & FIN. L. 105 (2021).

149 Lan & Wan, *supra* note 147.

2. Duty of Loyalty

Under the duty of loyalty, directors must act in the best interests of the corporation and its shareholders rather than serving their own interests or those of other parties.[150] This duty requires directors to act in the corporation's best interest,[151] avoid conflicts of interests,[152] not engage in self-dealing,[153] maintain confidentiality of business information,[154] and issue full and fair disclosures.[155] These considerations imply that directors must prioritize the interests of the corporation and its shareholders above their own personal interests or the interests of any other entity. This also means directors are encouraged to make decisions and take actions that are intended to maximize shareholder value and promote the long-term success of the corporation. Directors also have a duty to avoid conflicts of interest that could compromise their ability to act impartially and in the best interests of the corporation. A conflict of interest arises when a director's personal, financial, or other interests conflict with those of the corporation.[156] Thus, directors must disclose any potential conflicts of interest and abstain from participating in decisions where they have an undue interest that could influence their judgment.[157] Consequently, directors are prohibited from engaging in self-dealing transactions that benefit themselves, their family members, or their affiliated entities at the expense of the corporation or its shareholders. Self-dealing transactions include any transaction in which a director has a direct or indirect financial interest, such as contracts, loans, sales of assets, or other dealings involving the corporation.[158]

Finally, directors have a duty to maintain the confidentiality of sensitive information obtained in their capacity as directors and to

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150 *Guth*, 5 A.2d at 510.

151 Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

152 *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1167–68 (Del. 1995); *Id.* at 362–63.

153 *See, e.g.*, *In re* Primedia Inc. Derivative Litig., 910 A.2d 248, 256–57 (Del. Ch. 2006); *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 WL 1305745, at 33–35 (Del. Ch. May 3, 2004).

154 *See* Brophy v. Cities Serv. Co., 70 A.2d 5, 7–8 (Del. Ch. 1949).

155 Lynch v. Vickers Energy Corp., 383 A.2d 278, 279 (Del. 1977).

156 Nate Emeritz et al., *Recent Delaware Cases on Managing Conflicts: Board-Level Measures*, THE CLS BLUE SKY BLOG (Sept. 4, 2020), https://clsbluesky.law.columbia.edu/2020/09/04/recent-delaware-cases-on-how-boards-can-manage-conflicts/ [https://perma.cc/ZJJ9-B58L].

157 Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

158 Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

refrain from disclosing such information to unauthorized parties. This duty helps protect the corporation's trade secrets, proprietary information, and strategic plans from unauthorized disclosure, which could harm the corporation's competitive position. Crucially, each director has a duty to provide their shareholders with full and fair disclosure of material information relevant to the director's decision-making. This duty ensures that shareholders have access to accurate and timely information necessary to make informed decisions about their investments.

A director's breach of the duty of loyalty can result in personal liability for the director, as well as invalidation of corporate actions taken in violation of this duty.[159] Delaware courts closely scrutinize transactions involving potential conflicts of interest and self-dealing to ensure that directors uphold their duty of loyalty and act in the best interests of the corporation and its shareholders.[160]

Clements and Cunningham report that prioritizing ESG principles may conflict with this duty.[161] ESG initiatives involve considerations beyond traditional financial metrics, such as environmental sustainability, social responsibility, and corporate governance practices. While these factors may align with broad societal interests, they do not always directly correlate with maximizing shareholder wealth. As such, directors who prioritize ESG considerations over profitability could be perceived as breaching their duty of loyalty by placing other interests ahead of shareholder value.[162]

3. Business Judgment Rule

Delaware courts apply the business judgment rule to shield directors from liability for their decisions if they are made in good faith, with due care, and in the best interests of the corporation.[163] However, this protection does not immunize directors from liability for decisions that are arbitrary or undertaken in bad faith. While the business judgment

159 Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000).

160 Craig W. Palm & Mark A. Kearney, *A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part II)*, 42 VILL. L. REV. 1043 (1997).

161 Ross S. Clements, *The Directors' Role Amid the Debate Over Corporate Purpose, Stakeholders and ESG*, MAYER BROWN (Mar. 7, 2023), https://www.mayerbrown.com/en/insights/publications/2023/03/the-directors-role-amid-debates-over-corporate-purpose-stakeholders-and-esg [https://perma.cc/GDD8-X36T].

162 *Id.*

163 *Van Gorkom*, 488 A.2d at 872.

rule affords directors significant discretion in corporate decision-making, it does not absolve them of their fiduciary duties.[164]

If directors prioritize ESG principles over shareholder interests without a rational basis or evidence of potential financial benefits, they may fail to satisfy the requirements of the business judgment rule. Courts could scrutinize such decisions more closely, particularly if they result in diminished shareholder value or if there are indications of conflicts of interest or self-dealing.

B. Analysis of Right to Vote Claim

BlackRock also argued that allowing clients to vote their shares could be evidence that an investment manager is not necessarily pursuing ESG goals themselves.[165] BlackRock's defense of the client's right to vote their shares is supported by five arguments.

1. Client Autonomy: By permitting clients to vote their shares, the investment manager is empowering clients to express their own preferences and values through shareholder voting. The clients' ability to vote suggests that the manager is not imposing their own ESG agenda onto clients but rather facilitating clients' exercise of their rights.

2. Fiduciary Duty: Investment managers have a fiduciary duty to act in the best interests of their clients. Allowing clients to vote their shares aligns with this duty by giving them control over decisions that may affect their investments; it reflects a commitment to serving clients' interests rather than imposing the manager's own agenda.

3. Transparency and Accountability: Allowing clients to vote their shares enhances transparency and accountability in the investment process. Clients are able to directly influence corporate governance and express their views on ESG issues, fostering a more democratic and responsive investment approach.

4. Diverse Client Base: Investment managers typically serve a diverse client base with varying preferences and priorities. Allowing clients to vote their shares acknowledges and respects this diversity, recognizing that different clients may have different views on ESG issues; it demonstrates a commitment to client-centricity rather than imposing a one-size-fits-all approach.

5. Legal and Regulatory Compliance: Permitting clients to vote their shares is consistent with legal and regulatory requirements

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164 *Id.*

165 BlackRock, *supra* note 126.

governing fiduciary duty and client autonomy in investment management; it ensures compliance with applicable laws and regulations while empowering clients to participate in corporate governance.

Lupoi observes that, overall, allowing clients to vote their shares can be seen as a client-centric approach to investment management that respects client autonomy, fosters transparency and accountability, and ensures compliance with legal and regulatory obligations; hence, the right to vote is offered to provide evidence that the investment manager is not necessarily pursuing their own ESG goals but rather prioritizing the interests and preferences of their clients.[166]

BlackRock's defense, however, lacks persuasiveness as it fails to acknowledge the complexities inherent in assessing the legality of behavior within the advisor-client relationship. Legal judgments cannot be made in a vacuum solely based on formalistic grounds. Instead, they must be contextualized within the broader power dynamics at play between the advisor and the client. In many cases, the legality of behavior is not solely determined by adherence to formal rules or procedures but also by the underlying power imbalances and dependencies within the advisor-client relationship.[167] Clients often rely heavily on the expertise and guidance of their advisors, creating a dynamic where advisors hold significant influence over their clients' decisions and actions. Therefore, a more comprehensive approach to assessing the legality of behavior within the advisor-client relationship must consider the underlying power dynamics and potential for client exploitation. This requires examining the context in which advice is given and decisions are made, rather than relying solely on formalistic criteria. Only by understanding and addressing these advisor-client power dynamics can a more equitable and just assessment of legality be achieved.

There are five reasons behind mere formalism. BlackRock places an overemphasis on strict procedural rules, at the expense of the substantive reality of the advisor-client relationship. Its approach prioritizes technical compliance over investor protection, potentially leading to an aberrant outcome.

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166 Lupoi, *supra* note 129.

167 Stephen Foerster et al., *Retail Financial Advice: Does One Size Fit All?*, 72 J. FIN. 1441 (2017).

1. Influence Over Voting: While clients may have the ability to vote their shares, the investment manager may still hold significant influence over the voting process. The manager could provide recommendations or voting guidelines to clients, effectively shaping their decisions. This influence can be used to advance the manager's own ESG agenda, even if indirectly.

2. Selection Bias: The clients who choose to work with a particular investment manager may already share similar ESG preferences or values. Therefore, even if clients are voting their shares independently, the client base itself may be biased toward ESG-oriented investors. In this case, allowing clients to vote their shares does not necessarily indicate a lack of pursuit of ESG goals by the manager.

3. Investment Strategy Alignment: The investment manager may still align their investment strategy with ESG principles, regardless of whether clients vote their shares. The manager could actively seek out ESG-compliant investments, engage in shareholder advocacy on ESG issues, or integrate ESG factors into their investment analysis and decision-making process. Allowing clients to vote their shares does not preclude the manager from pursuing ESG goals through other means.

4. Market Expectations and Reputation: In the current investment landscape, there is growing pressure from stakeholders, including clients, regulators, and the public, for investment managers to incorporate ESG considerations into their practices. Even if clients vote their shares, the manager may still face expectations or reputational risks associated with ESG performance. Therefore, the manager may choose to pursue ESG goals to align with market expectations and maintain their reputation, regardless of client voting practices.

5. ESG Integration in Investment Process: Investment managers may integrate ESG considerations into their overall investment process, including security selection, risk management, and performance evaluation. Allowing clients to vote their shares does not necessarily address the broader question of whether the manager is actively considering ESG factors in their investment decisions.

In summary, while allowing clients to vote their shares may provide some evidence that the investment manager is respecting client autonomy, it does not necessarily indicate a lack of pursuit of ESG goals. The manager may still exert influence over voting, cater to a biased client base, pursue ESG goals through other means, respond to market expectations, or integrate ESG considerations into their investment process.

VII
ANALYSIS OF ECONOMIC ARGUMENTS

A. Critiques to ESG Principles

While ESG principles encounter legal objections, the economic argument against them is equally compelling. The U.S. Chamber of Commerce issued a statement lamenting that ESG "remains a novel and complicated rule that will likely have significant impact on businesses and their investors."[168] The organization had previously included the SEC's climate disclosure rule in a list of "top regulatory priorities,"[169] which, in its view, "pose a significant threat to America's economic growth and competitiveness." The Chamber of Commerce added that it "will continue to use all the tools at our disposal, including litigation if necessary, to prevent government overreach and preserve a competitive capital market system."[170]

One argument against the widespread adoption of ESG criteria is that it introduces additional complexities and costs into the business environment.[171] Companies may face increased regulatory burdens and compliance requirements associated with ESG reporting, diverting resources away from core business activities.[172]

ESG principles tend to have a disproportional impact on small and medium-sized enterprises (SMEs) compared to larger companies. SMEs often have limited financial and human resources, which makes the adoption of comprehensive ESG strategies challenging. Implementing ESG practices can require substantial investment in new technologies, processes, and trainings, which SMEs may struggle to afford.[173] The regulatory requirements associated with ESG

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168 Tom Quaadman, *U.S. Chamber Statement on the SEC Climate Disclosure Rule*, U.S. CHAMBER OF COM. (Mar. 6, 2024), https://www.uschamber.com/finance/corporate-governance/u-s-chamber-statement-on-the-sec-climate-disclosure-rule [https://perma.cc/6BMF-KDCB].

169 *3 Important Considerations for the Future of ESG*, U.S. CHAMBER OF COM. (Feb. 17, 2022), https://www.uschamber.com/on-demand/government-policy/future-considerations-of-environmental-social-and-corporate-governance [https://perma.cc/LXQ3-7LUP].

170 Quaadman, *supra* note 168.

171 Bradford Cornell, ESG Investing: Conceptual Issues (Jun. 7, 2020) (unpublished draft), http://dx.doi.org/10.2139/ssrn.3621163 [https://perma.cc/3GWN-2RQ9].

172 Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821 (2021), https://openscholarship.wustl.edu/law_lawreview/vol98/iss6/10 [https://perma.cc/G99W-37GN].

173 Matthew P. Johnson, *Sustainability Management and Small and Medium-Sized Enterprises: Managers' Awareness and Implementation of Innovative Tools*, 22 CORP. SOC.

compliance can be more burdensome for SMEs. They may lack the in-house expertise to navigate complex regulations, leading to higher costs for external advisory services or compliance fines.[174] Large companies benefit from economies of scale in their ESG investments. They can spread the costs of ESG initiatives over a larger revenue base, negotiate better terms with suppliers, and leverage their market power to implement changes efficiently. SMEs, on the other hand, often face higher per unit costs for these investments.[175] When ESG considerations are relevant to investors, SMEs may find it more difficult to attract capital due to perceived higher risks and lower visibility in implementing ESG practices.[176] This can hinder their ability to grow and compete with larger firms.[177] Large firms often impose ESG requirements on their suppliers. SMEs in the supply chain may face significant pressure to comply with these standards without the necessary resources to do so, potentially leading to strained business relationships or loss of contracts.[178] Large companies are better positioned to use ESG as a differentiator in the market.[179] They can leverage their ESG credentials to attract customers, employees, and partners. SMEs might struggle to achieve the same visibility and market access through their ESG efforts.[180]

RESP. & ENV'T MGMT. 271 (2013), https://doi.org/10.1002/csr.1343 [https://perma.cc/2T2C-F4EC].

174 Roberto Tombolesi, *Sustainability Performance and ESG Factors: A New Challenge for Small and Medium Sized Enterprises (SMEs)*, *in* THE IMPACT OF ORGANIZATIONS MEASUREMENT, MANAGEMENT AND CORPORATE REPORTING (Cristiano Busco et al. eds., 2023).

175 Jui-Ling Hsu & Meng-Cheng Cheng, *What Prompts Small and Medium Enterprises to Engage in Corporate Social Responsibility? A Study from Taiwan*, 19 CORP. SOC. RESP. & ENV'T MGMT. 288 (2011), https://doi.org/10.1002/csr.276 [https://perma.cc/M8AL-MCML].

176 Rafaela Gjergji et al., *The Effects of Environmental, Social and Governance Disclosure on the Cost of Capital in Small and Medium Enterprises: The Role of Family Business Status*, 30 BUS. STRATEGY & ENV'T. 683 (2020), https://doi.org/10.1002/bse.2647 [https://perma.cc/ZYT9-Q7RX].

177 Thorsten Beck et al., *Financial and Legal Constraints to Growth: Does Firm Size Matter?*, 60 J. FIN. 137 (2005), https://doi.org/10.1111/j.1540-6261.2005.00727.x [https://perma.cc/SX59-47GW].

178 Su-Yol Lee, *Drivers for the Participation of Small and Medium-Sized Suppliers in Green Supply Chain Initiatives*, 13 SUPPLY CHAIN MGMT. 185 (2008), https://doi.org/10.1108/13598540810871235 [https://perma.cc/QT4X-V9H6].

179 Witold Henisz et al., *Five Ways That ESG Creates Value*, MCKINSEY Q. (2019), https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx [https://perma.cc/YP38-MA2X].

180 *Id.*

Moreover, the subjective nature of ESG metrics and the lack of standardized reporting frameworks can lead to ambiguity and inconsistency in evaluating companies' ESG performance, potentially hindering comparability and investor confidence.[181]

Furthermore, critics of ESG argue that the emphasis on social and environmental objectives may detract from companies' primary goal of maximizing shareholder value.[182] By prioritizing ESG initiatives, companies may incur additional expenses and operational constraints that could impede their profitability and competitiveness in the market.[183] This could ultimately erode shareholder returns and undermine the efficient allocation of capital in the economy, contrary to the principles of capitalism.[184]

Finally, the integration of ESG criteria into corporate strategies may create moral hazard by allowing companies to mask underperformance in traditional financial metrics behind superficial adherence to ESG principles.[185] This phenomenon, known as "greenwashing" or "social washing," occurs when companies engage in token gestures or cosmetic changes to their practices without genuinely addressing underlying sustainability issues.[186] As a result, investors and stakeholders may be misled into believing that a company is more socially and environmentally responsible than it actually is, thereby leading to misallocation of resources and undermining market efficiency.

From a broader perspective, critics argue that the proliferation of ESG criteria reflects a broader trend of corporate social responsibility (CSR) initiatives that seek to align business interests with societal

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181 Soares, *supra* note 12.

182 *See* Chris Brooks & Ioannis Oikonomou, *The Effects of Environmental, Social and Governance Disclosures and Performance on Firm Value: A Review of the Literature in Accounting and Finance*, 50 BRIT. ACCT. REV. 1 (2018), https://doi.org/10.1016/j.bar.2017.11.005 [https://perma.cc/WV39-6LLL].

183 David Freiberg et al., *How ESG Issues Become Financially Material to Corporations and Their Investors* (Harv. Bus. School of Acct. & Mgmt. Unit, Working Paper No. 20-056, 2020), https://ssrn.com/abstract=3482546 [https://perma.cc/LMX8-62S6].

184 Cristina Parajon Skinner, *Capitalism Stakeholderism*, 47 SEATTLE U. L. REV. 643 (2024).

185 Stephanie Mooij, *Asset Managers' ESG Strategy: Lifting the Veil* (Smith Sch. Enter. & Env't, Working Paper, 2017), https://ssrn.com/abstract=3123218 [https://perma.cc/JV24-KJV4].

186 Chitra S. de Silva Lokuwadudge & Keshara M. De Silva, *ESG Risk Disclosure and the Risk of Green Washing*, 16 AUSTRALASIAN ACCT., BUS. & FIN. J. 146 (2022), https://vuir.vu.edu.au/43686/ [https://perma.cc/WDS2-BVW9].

goals.[187] While CSR initiatives may enhance companies' reputations and stakeholder relations in the short term, they may also detract from the fundamental purpose of businesses to generate profits and create value for shareholders. By diverting resources toward noncore activities, companies risk diluting their focus and losing sight of their primary mission, ultimately undermining their long-term sustainability and viability.

B. Counterarguments and Their Flaws

Proponents of ESG regulations offer counterarguments. Some argue that these regulations drive long-term value creation by promoting sustainable business practices that mitigate environmental risks and enhance social well-being.[188] Other studies suggest that companies adhering to ESG principles can outperform their peers financially in the long run due to increased efficiency, better risk management, and stronger reputational capital.[189] Furthermore, according to research, ESG regulations can level the playing field by setting clear standards and expectations, thus reducing the competitive advantage of companies that neglect sustainability.[190] This can lead to a more resilient and equitable economy, attracting investment from socially conscious investors and enhancing overall market stability.[191]

However, the counterarguments in favor of ESG regulations, while supported by studies indicating potential financial benefits and market stability, face conceptual challenges that ultimately undermine their persuasiveness. There are two major structural flaws to these ESG analyses.

1. Contextual Variability: The empirical evidence linking ESG adherence to financial outperformance is mixed and context dependent, with studies often varying in methodology and scope. This variability makes it difficult to establish a clear, universal causal relationship between ESG practices and economic success.

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187 Robert G. Eccles et al., *The Social Origins of ESG: An Analysis of Innovest and KLD*, 33 ORG. & ENV'T 575 (2020), https://doi.org/10.1177/1086026619888994 [https://perma.cc/3BVH-PFW9].

188 Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, 5 J. SUSTAINABLE FIN. & INV. 210 (2015).

189 Robert G. Eccles et al., *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 MGMT. SCI. 2835 (2014).

190 Gordon L. Clark et al., *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance*, SMITH SCH. ENTER. & ENV'T (2015), https://ssrn.com/abstract=2508281 [https://perma.cc/SQF8-XG5Z].

191 *Id.*

2. Stealth Costs: The broader economic impacts of ESG regulations, including their effects on job creation, economic growth, and innovation, require careful consideration. Overly stringent regulations could hinder economic dynamism and investment, particularly in emerging sectors or markets where compliance costs are prohibitive.

In conclusion, while there may be potential benefits to ESG regulations, the complexities and uncertainties surrounding their implementation and effectiveness warrant cautious assessment. The challenges of achieving a balance between regulatory oversight and economic vitality outweigh the benefits in advancing sustainable practices without stifling innovation and economic growth.

CONCLUSION

In conclusion, the mandate of ESG principles in financial law raises significant concerns that merit careful consideration. The two core arguments against such mandates highlight the inherent risks associated with delegating political pursuits to private entities and the potential for ESG frameworks to become tools for shielding investment managers from accountability while imposing undue burdens on businesses.

Firstly, the injection of political considerations into financial decision-making through ESG mandates risks blurring the lines between corporate responsibility and political activism. As noted by Reynolds, allowing private corporations to enforce ESG standards could lead to the concealment of political agendas under the guise of compliance.[192] This in turn undermines the integrity of financial markets and erodes public trust, as evidenced by cases such as the scandal caused by the closure of the bank account of Nigel Farage, one of Britain's most well-known political figures.[193] When financial institutions use ESG criteria to assess clients' alignment with organizational values, there is a danger of transforming banks into arbiters of acceptable political beliefs rather than impartial providers of financial services.

Secondly, the implementation of ESG principles can create avenues for circumventing accountability. ESG practices, while aimed at

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192 Reynolds, *supra* note 47.

193 Samuel Gregg, *Debunking De-Banking*, CITY J. (Aug. 20, 2023), https://www.city-journal.org/article/debunking-de-banking [https://perma.cc/ZV9P-EKKN].

promoting sustainability and social responsibility, often serve as a convenient shield, enabling companies to sidestep accountability for underperformance. By emphasizing their ESG efforts, organizations can deflect scrutiny and criticism, creating a perception of responsible business practices while potentially masking shortcomings in core performance metrics.

There are also two secondary arguments. The economic implications of ESG mandates, including compliance costs and operational burdens, disproportionately affect small and medium-sized businesses. By constraining the autonomy of businesses to prioritize ESG considerations, these mandates may hinder market efficiency, fragment the corporate market, and impede the natural process of capital allocation. Additionally, the transition from shareholder capitalism to stakeholder capitalism advocated by Klaus Schwab,[194] driven by an activist ESG agenda, threatens to undermine the foundational principles of the common law method. By intertwining political choices with regulatory frameworks, ESG mandates risk subverting the impartial application of rules and eroding the rule of law.[195]

In light of these concerns, it is essential to reassess the trajectory of ESG mandates in financial law. Rather than imposing prescriptive requirements, policymakers should prioritize transparency, accountability, and market-driven solutions. Allowing businesses the freedom to integrate ESG considerations voluntarily, while safeguarding against abuses of power, can foster innovation and responsible corporate behavior without compromising the principles of a free and fair market.

Ultimately, the debate surrounding ESG mandates underscores the need for a rebalanced approach that prioritizes the principles of economic freedom, individual liberty, and the rule of law over ESG objectives. The enduring principles of liberty, accountability, and market efficiency serve as foundational pillars of financial law, providing stability and predictability essential for sustainable economic growth. In contrast, the transient nature of political fashion underscores the risks associated with entrenching ideological agendas into regulatory frameworks.

As evidenced by the shifting tides against ESG mandates, it becomes apparent that the winds of change are blowing in favor of a more

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194 *See* KLAUS SCHWAB WITH PETER VANHAM, STAKEHOLDER CAPITALISM: A GLOBAL ECONOMY THAT WORKS FOR PROGRESS, PEOPLE AND PLANET (2021).

195 Reynolds, *supra* note 47.

pragmatic and market-driven approach to ESG considerations. By prioritizing transparency, accountability, and voluntary integration of ESG principles, policymakers can navigate toward a future where market dynamics and responsible corporate behavior coalesce, fostering innovation and sustainable development within a framework grounded in economic freedom and the rule of law.