BEST PRACTICES IN ESG:

INTERNAL MANAGEMENT OF PUBLIC COMPANY ESG PROGRAMS

CONDENSED SUMMARY REPORT

FEBRUARY 2022

orrick

INTRODUCTION

From the growing risks of climate change to a greater focus on diversity, equity and inclusion (DEI), and worker health and safety, several shifting dynamics are compelling companies to reorganize their environmental, social and governance (ESG) efforts.

However, internal ESG management systems and processes vary widely depending on the organization, and many of our clients have expressed that they would benefit from understanding how their peers are approaching this issue. In response to client demand and to provide greater clarity around best practices and effective governance in this area, we conducted a study of ESG internal management practices with 19 public companies headquartered in the U.S. We met with members of management, legal and sustainability teams and conducted research on their ESG programs.

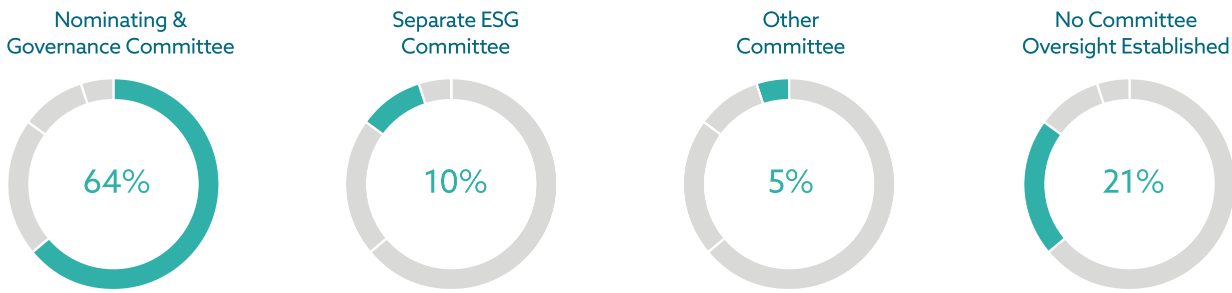
Using input from participants, we identified five key ESG management best practices:

- Effective Oversight by the Board
- Ownership by Executives
- ESG-Specific Functions
- ESG Reporting
- Setting Achievable ESG Goals

EFFECTIVE OVERSIGHT BY THE BOARD

Regulators, investors and proxy advisors are focused on board oversight of ESG because of its impact on long-term value. Therefore, we expect the focus on board oversight of ESG to increase as companies attempt to develop a more integrated ESG strategy and stakeholders call for more accountability and transparency.

Most of the participating companies we surveyed have actively addressed this topic. 79% percent of participants had established clear board-level oversight of ESG through a dedicated committee:



In some cases, companies employed a multi-committee approach. They assigned oversight of certain ESG topics, such as cybersecurity and human capital management, to committees where directors already had this subject-matter expertise. For example, 68% of participants assigned cybersecurity-related matters to their Audit Committee or the equivalent.

KEY TAKEAWAY:

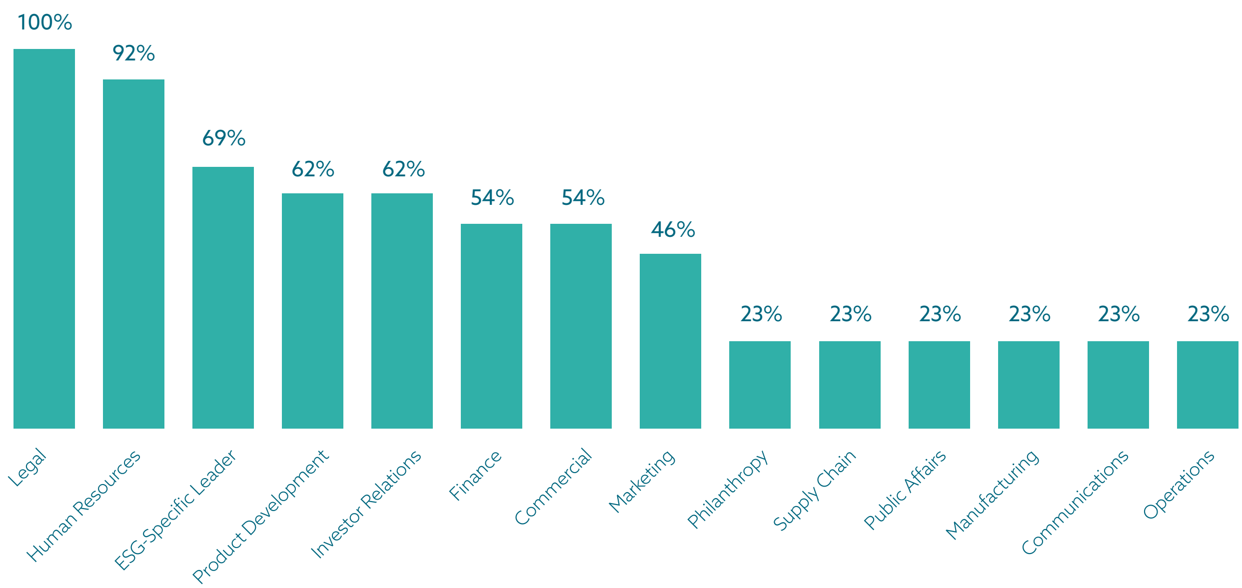
Board-level oversight of ESG is increasingly being explicitly allocated and disclosed, giving comfort to stakeholders that these issues are being taken seriously.

OWNERSHIP BY EXECUTIVES

Along with board engagement, our study found clear executive ownership is critical to increasing accountability.

Several participants mentioned a lack of clarity regarding who owned ESG enterprise-wide, as these initiatives were often siloed across different business units. These silos made it challenging for their organizations to improve both internal and external reporting. To solve this problem, many companies (74% of participants) have created an executive committee composed of senior leaders across different business functions that primarily included:

EXECUTIVE ESG COMMITTEE MEMBERSHIP:



Percentage of executives on participant Executive ESG Committees

KEY TAKEAWAY:

Creating a mature ESG program requires companies to cultivate greater executive buy-in and engagement. Many companies have focused on creating a framework and structure that allows cross-functional leaders to collaborate, identify areas for enterprise-wide improvement, and track and report on progress to both internal and external stakeholders.

ESG-SPECIFIC FUNCTIONS

Most participants (74%) indicated their organizations had a single ESG leader with two primary responsibilities: ESG reporting and execution. In many companies, this leader also oversaw a dedicated ESG team.

While most companies indicated they had a dedicated ESG leader, only 15% said this person sat on their executive leadership team, and, even then, did not have leadership on all ESG issues (in particular, human capital management and corporate governance).

The presence and placement of an ESG office also varied within companies:

Legal was the most common location for an ESG office among participants (21%), followed by the supply chain and outsourcing function (11%).

KEY TAKEAWAY:

Dedicated ESG functions are increasingly being employed to facilitate accurate, timely and easily accessible data and reporting, and, in some cases, to help operationalize strategy.

ESG REPORTING

Ninety-five percent of participants said their organizations had published an ESG report:

Participants indicated they faced demands for ESG reporting from diverse stakeholders, including shareholders, ratings agencies, regulators and civil society groups.

Regarding ESG disclosures, companies face a range of challenges, including issues with data accuracy, litigation and regulatory risks. Though participants said their disclosure process included some degree of legal review — including legal overseeing the ESG information included in securities filings — the level and nature of legal review varied by organization. Additionally, only 37% of participants received limited external assurance on their ESG reporting. Among those who did, 57% had assurance that covered only their greenhouse gas emissions, while the remaining 43% had assurance related to varied ESG topics, such as water use and workforce diversity metrics.

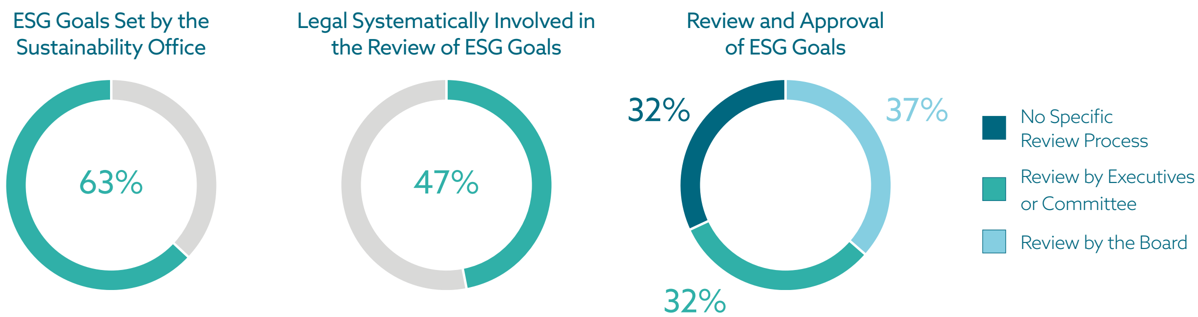
KEY TAKEAWAY:

Our study indicates companies that want to improve their ESG reporting processes are establishing more rigorous practices for ESG data collection, management and disclosures, including the use of assurance, though practice still widely varies.

SETTING ACHIEVABLE ESG GOALS

Lastly, our study found companies are increasingly setting ESG goals and stating them publicly.

Setting ESG goals was a common practice among participants — 89% of participating companies had published at least one specific, measurable and time-bound ESG goal. Our study also found ownership for developing these goals often resided within an ESG office or with an ESG-focused leader:



The level at which these goals were approved, and the degree of legal review, varied. Some companies with less centralized and formalized review expressed concern that their company's ESG commitments were aspirational and may be hard to achieve.

KEY TAKEAWAY:

Companies should consider the process of ESG goal setting, and the role of legal in reviewing these goals for achievability in light of regulatory expectations and other legal risks.

THE FUTURE OF INTERNAL ESG MANAGEMENT

Our study indicates ESG is moving from a peripheral effort largely focused on brand and investor relations to an approach that is more integrated into companies' operations and governance practices. With impending SEC rules around climate change disclosures, many participants are increasing their focus on data integrity and reporting processes to meet these new requirements and reduce compliance risks.

Though approaches vary, it appears that the five key ESG management best practices identified in our study contribute toward a more effective ESG program. Having strong ESG governance and a dedicated ESG function helps to operationalize ESG within an organization, effectively measure progress toward ESG goals, improve reporting and increase accountability. However, as our study indicates, organizations must still contend with issues such as data silos, lack of clear executive ownership and no uniform disclosure standards. As these issues are addressed — both within organizations and externally by regulators — companies will be better positioned to further improve governance and management of their ESG programs.

CONTEXT AND METHODOLOGY

CONTEXT OF THIS STUDY

This report presents the findings of an inaugural study conducted by Orrick from October to November 2021. The goal of this study was to identify and analyze current and emerging best practices in ESG governance and management at public companies, with the aim to help public companies identify and implement improvements to their ESG programs. This study was led by Carolyn Frantz, Co-Head of Orrick's Public Companies & ESG practice, in collaboration with J.T. Ho, Co-Head of Orrick's Public Companies & ESG practice; Ashley Walter, Partner-in-Charge, ESG; Hayden Goudy, ESG Business Intelligence Advisor; and Allison Marill, ESG Research Analyst.

OUR METHODOLOGY

Orrick conducted interviews with 19 participating public companies and collected information on 1) their approach to ESG governance and management oversight, 2) their process for setting ESG goals and KPIs, 3) their process for preparing ESG disclosures, and 4) the overall satisfaction of the company's internal approach to ESG. Participants in our study consisted of large multinational companies primarily headquartered in the United States. We met with and interviewed approximately 40 representatives from internal legal and sustainability functions from across the participants, with the majority of interviewed participants sitting in internal legal functions with responsibility for ESG disclosures. Additionally, our interviews were supplemented by desktop research into the ESG programs of the participants, including a review of the participants' ESG disclosures and third-party ESG ratings.

For this study, we adopted a qualitative and exploratory approach to identify elements of best practice, rather than collect data from a statistically significant population. Our goal was to capture and understand different approaches to ESG management, rather than develop a quantitative understanding of current market practice.

We did not focus only on companies that had the most advanced ESG programs. Participants in our study have a wide range of ESG practices and different levels of maturity in their ESG programs. In our view the heterogeneity of our study sample helped to identify a wide range of market practices on ESG. Our goal was to identify the current shape of ESG governance and management systems, and to identify where there were common areas for improvements to be made.

SAMPLE INTERVIEW QUESTIONS

- If your company has an ESG committee, who is on it? Does this include a Board-level committee, management-level committee, or functional ESG team?
- Does the company have a dedicated single leader for ESG? If yes, what is their background, and where in the organizational structure do they sit?
- Who is involved in setting climate and other environmental goals?
- What is your company's process for drafting and reviewing ESG reports and other disclosures, and what role does the legal department have in this process?
- Does your company feel satisfied with the way ESG is managed internally? What are the areas most in need of improvement?

ABOUT ORRICK

Orrick counsels companies in the technology & innovation, energy & infrastructure, and finance sectors globally. Our clients include eight of the top 15 tech companies by market cap, eight of the top 15 energy companies, and 10 of the top 15 financial institutions – giving us a broad perspective on market trends. We focus on delivering strategic advice on the day-to-day issues that concern management and Boards the most – and value-added support for transactions and litigation.

Our emphasis on innovation – in our advice and service delivery – has earned the firm top-three rankings in *Financial Times'* Most Innovative Law Firms report six years in a row. And we provide our clients with inspired, consistent and inclusive teams by being a *Fortune* 100 Best Companies to Work For, also for six years in a row.

Our Public Companies & ESG practice advises on ESG best practices and execution in four principal areas: reporting and disclosure, governance and risk controls, analytics, and investigations and litigation.

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