Insight

ESG Pledges Risk Antitrust Infractions

FRED ASHTON | MARCH 2, 2023

Executive Summary

- Members of Congress have raised concerns about, and launched investigations into, industry-coordinated environmental, social, and governance (ESG) practices, alleging they may violate antitrust laws.
- Federal Trade Commission (FTC) Chair Lina Khan stated that company pledges to adopt ESG policies will not be considered an affirmative defense in otherwise illegal business activity or mergers.
- Nevertheless, the White House continues to promote ESG policies; in order to limit businesses' uncertainty in navigating antitrust laws, the FTC must issue a policy statement or more detailed guidance on what constitutes a permissible pursuit of ESG practices.

Introduction

A 2004 report from the United Nations (UN) titled *Who Cares Wins* is "considered the first mainstream mention of ESG [environmental, social, and governance] in the modern context." One goal of the ESG movement is to expand upon traditional investment evaluation metrics such as profit margin, return on investment, and return to shareholders to include a company's pursuit of certain social goals.

Measuring a company's environmental footprint, its social engagement within the community and with its employees, and governance involving executive pay and the decision-making process are all factors typically included in ESG metrics. The recommendations outlined in the UN document provided a more detailed framework for business and government ESG pledges and policies that have resulted in limiting financial services firms from working with gun manufacturers, private prisons, and the fossil fuel industry.

Many of these ESG efforts have involved industry-coordinated action, in which businesses collaboratively intervene in a market to alter activity, prompting members of Congress and state attorneys general to question the legality of such arrangements under antitrust law. As ESG efforts continue to gain popularity, the FTC must provide clear guidance outlining proper individual business and industry-coordinated behavior to prevent companies pursuing these policies from running afoul of antitrust laws.

The UN Report and Recent Government and Business Actions

The *Who Cares Wins* report offered a framework companies could leverage to advance ESG practices. It outlined a series of recommendations for analysts, financial institutions, companies, investors, pension fund trustees, consultants and financial advisers, regulators, stock exchanges, and non-governmental organizations on how they can promote ESG goals. *Figure 1* is the "graphical summary of key recommendations" included in the report.

Figure 1

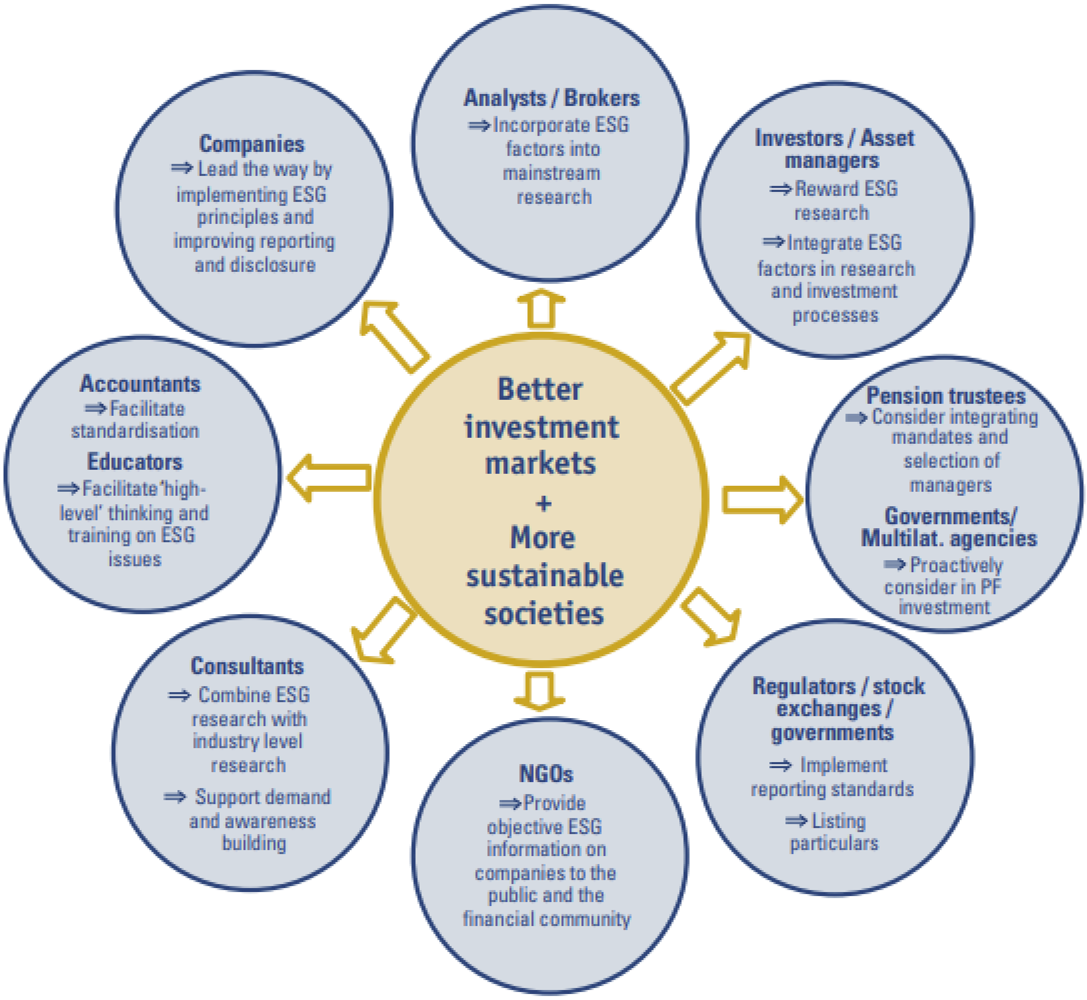

*Illustration taken from 2004 UN Report *Who Cares Wins*

Many of these recommendations have been implemented in the United States and globally, affecting nearly every aspect of the economy. The United States, according to Bryter, "has traditionally relied on voluntary, private-sector-led ESG guidelines, where compliance is driven by market competition and stakeholder engagement." By contrast, the European Union has mandated certain ESG standards, mostly targeting the financial services industry.

More recently, President Biden issued an executive order on Climate-Related Financial Risk that directed various federal agencies to develop climate-related financial risk strategies. In response, agencies have proposed and adopted rules promoting ESG goals. The Department of Labor implemented a rule that removed barriers to considering ESG factors in the fiduciary duties of investing for employee benefit plans, reversing a 2020 rule implemented by the Trump Administration that restricted such ESG considerations. Furthermore, the Securities and Exchange Commission proposed a rule that would "require registrants to include certain climate-related disclosures in their registration statements and periodic reports…."

In the private sector, global securities marketplace operator Nasdaq published an ESG reporting guide for public and private companies in 2017. Nasdaq updated the guidelines in 2019 to "[include] the latest third-party report methodologies widely adopted by industry and aims to help both private and public companies navigate the evolving standards on ESG data disclosure."

Individual business initiatives and industry-coordinated ESG efforts have been implemented since the UN report, but some of these programs risk violating antitrust law.

ESG Efforts That Could Violate Antitrust Laws

Section 1 of the Sherman Act prohibits any contracts "in restraint of trade or commerce." Such contracts include price fixing, market allocation, and boycotts. Individual firms enacting ESG policies run little risk of violating antitrust law, but industry-coordinated efforts risk infraction.

Firms that collude to boycott individual firms or entire industries are likely to face antitrust scrutiny. For example, if financial firms collude to stop financing the fossil fuel industry over alleged failure to adhere to voluntary ESG standards, such an action may be found by the antitrust agencies to restrain trade by limiting output, thus violating antitrust law. Similarly, collusion to boycott purchasing products from certain firms failing to adopt ESG strategies could be found illegal.

Firms sharing sensitive business information in the name of ESG could also risk violation of antitrust laws. While trade associations often lobby for ESG policy on behalf of members – and such activity is lawful – advancing ESG goals within a trade association that includes divulging sensitive business information, such as certain business strategies or names of suppliers, could provide rivals with insights into competitors' prices or levels of output. Such action could cause a company to alter its own activities, thus changing the competitive landscape. These sorts of activities would likely violate antitrust law.

Congressional and State Pushback

Senator Tom Cotton (R-AR) asked FTC Chair Lina Khan if there is an antitrust exemption "because you call something ESG" during a Senate Subcommittee on Competition Policy, Antitrust, and Consumer Rights hearing in September 2022. Khan responded, "No. To the contrary, we've seen firms come to us and try to claim an ESG exemption and we've had to explain to them clearly that there is no such thing." In other words, Khan stated that if the FTC were investigating a business activity or evaluating a merger, the parties involved could not use ESG as an affirmative defense.

In the same hearing, Senator Cotton referenced the actions of Climate Action 100+ a group of "investors and activists…[that] have pledged to limit fossil fuel production both individually and collectively." He noted that 19 state attorneys general (AGs) sent a letter to financial powerhouse BlackRock, a "prominent member of [Climate Action 100+]," which highlighted antitrust concerns related to the company's involvement with the organization. The letter stated that "coordinated conduct with other financial institutions to impose net-zero also raises antitrust concerns. Group boycotts, restraining trade, or concerted refusals to deal, 'clearly run afoul of' Section 1 of the Sherman Act." Section 1 of the Sherman Act states "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce… is declared to be illegal." The specific conduct in question, according to the AGs, was a series of shareholder votes "against companies for failing to meet disclosure standards that are not required by law." The AGs claimed that such actions qualify as energy boycotts, thus violating antitrust laws.

Climate Action 100+ was also the focus of a letter from House Judiciary Committee Republicans in December 2022. The letter, which was addressed to two members of Climate Action 100+'s steering committee, claimed the group "work[ed] like a cartel" to advance ESG policies. The Republican members claimed that when "companies agree to work together to punish disfavored views or industries, or to otherwise advance [ESG] goals, this coordinated behavior may violate the antitrust laws…."

Republican Senators Marco Rubio (FL), Tom Cotton, Marsha Blackburn (TN), Chuck Grassley (IA), and Mike Lee (UT) sent a letter to 51 law firms "reminding them of their duty to inform clients of the antitrust risk they incur by pursuing ESG initiatives." The letter referred to the aforementioned Senate hearing warning them against "participating in climate cartels and other ill-advised ESG schemes."

Recently, the House and Senate passed a joint resolution nullifying the Department of Labor rule that "allows private retirement plan fiduciaries to consider [ESG] factors when making investment decisions for their clients." While it is likely President Biden will veto the bill, such congressional pushback on agency ESG initiatives is likely to continue.

Current Guidance Is Insufficient

The FTC and the Department of Justice do not consider all industry collaboration as anticompetitive. In 2000, the agencies jointly published the *Antitrust Guidelines for Collaborations Among Competitors* that establish the agencies' enforcement policy with respect to competitor collaborations. The agencies acknowledged that some collaborations are necessary to "achieve goals such as expanding into foreign markets, funding expensive innovation efforts, and lowering production and other costs," and are thus "procompetitive."

While the guidance includes much detail, it has proven insufficient. Chair Khan supplemented her comments to the Senate subcommittee with an opinion piece specifically about merger activity and ESG pledges that made clear "antitrust laws don't permit [the FTC] to turn a blind eye to an illegal deal just because the parties commit to some unrelated social benefit."

Of course, an opinion piece penned by Chair Khan is not the binding policy of the FTC. The agency must issue a policy statement, approved by the majority of the commissioners, that makes clear to businesses that boycotts or other collusive behavior to advance an ESG agenda will face antitrust scrutiny and not be considered an affirmative defense for otherwise illegal business activity or mergers.

International Wrinkle

The United Kingdom's Competition and Markets Authority (CMA), the agency responsible for antitrust enforcement, is taking a different approach to that of Khan's FTC.

CMA has proposed to loosen the antitrust rules concerning the environmental focus of ESG, specifically initiatives to address climate change. The reported proposal "would consider climate change mitigation a benefit to society that would fit within [the] 'fair share' exemption, and would not punish companies co-operating on policies that would have a substantial and demonstrable impact on climate change." Chief Executive Officer of CMA Sarah Cardell explained that under Section 9 of the United Kingdom's Competition Act, the current "assessment of whether consumers receive a fair share of the benefits from the restrictive agreement has focused on the benefits flowing to consumers in the relevant product market – that is, to customers of the products or services covered by the agreement." Cardell stated that "CMA is proposing to take a different approach for climate change agreements" because it "represents a special category of threat."

CMA is still working on guidance, but clearly the agency is taking a different approach to that of the FTC. Such a divergence in policy could sow even greater uncertainty among businesses operating internationally.

Conclusion

Congress and state AGs are likely to continue investigating potential antitrust violations related to ESG and may take further action. Congress is also likely to continue pushing back on any agency rules that promote ESG.

As individual businesses and industries continue to promote and implement ESG initiatives, the FTC must provide sufficient guidance for businesses seeking to avoid antitrust scrutiny. Absent such guidance, businesses could continue to operate under the belief that the FTC does offer "ESG exemptions," risking antitrust enforcement by the FTC and DOJ.