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Commentary

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ESG Initiatives Face Increased Pressure From Potential Antitrust Challenges

A recent letter from 21 state Attorneys General to various asset managers demonstrates a focus on using antitrust and unfair competition laws to oppose ESG efforts.

Key Points:

- ESG investing initiatives are not immune from the antitrust laws.
- As ESG investing continues to attract the attention of stakeholders across the political spectrum, participants should assess their ESG investing efforts and consider whether they are susceptible to accusations of unreasonably restraining trade.

Investing initiatives that emphasize environmental, social, and governance (ESG) factors have become a subject of focus and debate among companies, investors, and other stakeholders. As part of that discussion, some members of Congress and state Attorneys General (State AGs) have warned that they believe certain ESG initiatives could raise potential antitrust concerns.

The antitrust laws' limits on collective action have been a background part of the ESG discussion for some time. A recent letter issued by 21 State AGs (the AG Letter), however, advances that discussion and reflects increasingly nuanced theories of harm under state and federal competition laws. Notably, the AG Letter warns that enforcement actions may be forthcoming.

The 19-page AG Letter was sent to asset managers in the US on March 30, 2023.[1] The letter, which focuses primarily on support of net zero initiatives, describes how such support could potentially implicate areas of state and federal law, including antitrust, securities, deceptive trade practices, and fiduciary obligations. This development reflects the evolving legal landscape around ESG matters and suggests that companies, investors, and asset managers must be prepared to justify and defend ESG initiatives, not only against political opposition, but also against potential legal claims.

This Client Alert reviews the major enforcer and congressional statements over the past year that have raised antitrust and competition concerns with ESG initiatives; analyzes how the AG Letter reflects a refinement of theories of harm under state and federal competition laws; and provides guidance to entities implementing ESG policies on how to minimize legal risks.

Antitrust Warnings Over ESG in Review

Over the past several years, as companies have increasingly factored ESG into their strategic decision-making — and investment advisors increasingly advocate for enterprises to participate in sector-wide ESG initiatives — enforcers have raised concerns that such activities could implicate antitrust restrictions against coordinated behavior.

One of the more high-profile examples of this dynamic took place during the last administration, when, in September 2019, the Antitrust Division of the Department of Justice (DOJ) launched an investigation into whether automakers that agreed with the state of California to emissions standards that went beyond those proposed by the Trump Administration had engaged in illegal coordinated behavior.[2]

In October 2022, 19 State AGs served subpoenas on six large US banks seeking information regarding their involvement in the UN's Net-Zero Banking Alliance.[3] In announcing the investigation, the Missouri Attorney General called the alliance a "massive worldwide agreement" that implicated US laws.[4] And during a hearing last year by the US Senate Judiciary Subcommittee on Competition Policy, Antitrust, and Consumer Rights, both Federal Trade Commission Chair Lina Khan and DOJ Assistant Attorney General Jonathan Kanter confirmed that there is no exemption that would permit collusive activities within the ESG context.[5]

Relatedly, members of Congress and State AGs have issued warnings over the past year connecting antitrust to corporate adoption of ESG initiatives. For example:

- In May 2022, then Arizona Attorney General Mark Brnovich claimed that ESG initiatives like Climate Action 100+ facilitated coordination among financial institutions in pursuit of efforts to mitigate climate change.[6] Further, he alleged that Climate Action 100+ members promoted climate goals during shareholder meetings, opposed directors and proposals that did not align with an ideological agenda, pressured companies to shut down coal and natural gas plants, asserted that these activities likely were contributing to rising gas prices, and announced an investigation into potential unlawful market manipulation.
- In July 2022, Arkansas Senator Tom Cotton wrote a letter to BlackRock CEO Larry Fink requesting information about BlackRock's involvement with Climate Action 100+.[7] Senator Cotton alleged that BlackRock participated in a "scheme" to reduce oil and gas drilling. He described the investor participants of Climate Action 100+ as engaging in a "conspiracy to restrict the supply of fossil fuels and impose various other unlawful restraints on trade." He further referred to the collaboration of Climate Action 100+ investor participants as appearing to function like a "climate cartel."
- In August 2022, 19 State AGs wrote a letter to Fink, questioning BlackRock's stance on energy investments related to state pension funds.[8] The State AGs expressed concerns that coordinated conduct among financial institutions to impose net zero goals could amount to group boycotts, restraints of trade, or concerted refusals to deal.
- In November 2022, five Senators wrote letters to 51 large law firms regarding ESG-related legal advice, noting that the firms have a duty to inform clients of the potential risks of "participating in climate cartels and other ill-advised ESG schemes."[9] The letters said that Congress planned to "increasingly use its oversight powers to scrutinize the institutionalized antitrust violations being committed in the name of ESG, and refer those violations to the FTC and the Department of Justice."
- In December 2022, the US House of Representatives Committee on the Judiciary wrote a letter to Climate Action 100+ and the group's North American investor representative, a leading pension fund, alleging that their role in coordinating companies to pursue ESG initiatives may violate antitrust laws. The letter included a detailed list of documents that the recipients were to produce to the Committee relating to the practices of Climate Action 100+ in goal setting as well as

communications with proxy advisory firms and financial service companies relating to ESG-related goals. The letter concluded by instructing the recipients to preserve all existing and future records and materials relating to the topics of the letter.

Despite these many statements referencing the antitrust laws in the context of ESG, most of the concerns raised by the enforcers and members of Congress have been generic in nature. Indeed, in response to the August 2022 letter to Fink, 15 other State AGs noted that any concern “that asset managers that consider ESG factors may be violating antitrust and competition laws is unsupported.”[10] In that letter, the State AGs noted that the initiatives being criticized only make “a broad recommendation that each manager can elect to follow (or not) consistent with their clients’ preferences” and that “[a]n expression of general recommendations or a statement in favor of or against certain policies does not, without more, constitute a violation of the Sherman Act.”[11]

New Angle on Legal Attacks to ESG Initiatives

The AG Letter sent on March 30, 2023, warns that asset managers’ adoption of ESG initiatives, including those relating to Climate Action 100+ and the Net Zero Asset Managers (NZAM) initiative, raises potential concerns about “their adherence to fiduciary requirement, representations to consumers about their services, and compliance with antitrust laws.”[12] The letter alleges that “asset managers have committed to use client assets to change portfolio company behavior so that it aligns with the [ESG] goal of achieving net zero by 2050,” and raises a particular concern with “resolutions related to net zero and social issues” under consideration during the 2023 proxy season.[13]

The AG Letter begins by asserting that asset managers are required to comply with obligations to act as fiduciaries to their clients and exercise duties of care and loyalty.[14] The letter notes that asset managers have a duty to comply with state laws prohibiting unfair or deceptive trade practices, as well as securities laws that prohibit fraudulent or misleading practices or self-dealing.[15] The letter then charges that some asset managers may have violated these legal requirements by failing to adequately disclose the role that ESG considerations are playing in fund management as well as the associated financial risks.[16]

Similar to prior congressional and enforcer statements, the AG Letter expresses concern that participation in ESG initiatives could constitute collusive behavior in violation of the antitrust laws. Notably, the State AGs present their legal theories in more detail than seen in prior articulations. The letter notes that participants in initiatives like Climate Action 100+ exert “coordinated pressure” to seek commitments from boards and senior management to reduce greenhouse gas emissions and “commit to forcing” portfolio companies to align with their ideals.[17] The letter claims that “unlawful coordination appears throughout Climate Action 100+’s documents” and that “[d]espite boilerplate disclaimers,” members commit to communicate a central message that threatens companies with punishment for noncompliance with the initiative’s goals.[18] The letter goes on to state that Climate Action 100+ appears to be an “agreement to limit the types of asset stewardship services offered by asset managers across ‘all assets under management’” and that this “will have adverse effects on competition.”[19]

Notably, the State AGs attempt to head off any justifications for the conduct by arguing that “there appear to be less restrictive means that accomplish most of the goals related to disclosure while also providing significantly less exclusion of competition in asset-manager services offered in our states.”[20] The availability of less restrictive means is a key part of the legal test applied to collaborative conduct among competitors.

The AG Letter also suggests that companies may be orchestrating group boycotts and refusing to deal with entities that do not support certain ESG initiatives. For instance, according to the letter, As You Sow, a nonprofit shareholder advocacy group, is "pushing three companies to stop using Vanguard as the default plan for their employee 401(k) accounts."[21] The letter states that As You Sow's actions are not based on the level of investment Vanguard makes in fossil fuel companies, but rather are a response to Vanguard's withdrawal from the NZAM in December 2022.[22] Further, the letter warns that "[a]sset managers voting for the exclusion of one of their competitors has clear antitrust implications."[23] In a similar vein, the State AGs note that many ESG proposals "carr[y] the implied threat to directors that their failure to respond to that proposal in the desired fashion will result in a coordinated effort to have those directors removed."[24]

The AG Letter raises the specter that asset managers that use climate benchmarking tools, including proxy advisor voting guidelines, in corporate voting decisions may be running afoul of antitrust laws. The State AGs note that due to "horizontal agreements between asset managers that underlie Climate Action 100+ and NZAM, any asset manager using that benchmark in engagement or supporting that benchmark in votes should know that their efforts could lead to changes in control of target companies."[25] The State AGs thus appear to be warning asset managers that unilaterally using proxy advisor guidance that aligns to the Climate Action 100+ and NZAM commitments in voting may be deemed a violation of the antitrust laws.

Key Takeaways

The AG Letter illustrates that State AGs intend to explore a range of antitrust and competition theories of liability under their respective federal and state antitrust and unfair competition laws to challenge or curtail certain ESG initiatives and commitments. Accordingly, companies or funds, including asset managers, that are signing on to ESG initiatives and/or making ESG-related commitments should take certain actions to minimize the likelihood that their conduct will result in scrutiny. For example:

- Consult with competition counsel before negotiating, diligencing, or signing on to any ESG initiative that commits the entity to a course of conduct that its competitors or peers may likewise be considering.
- Ensure that the company's decision to entertain any ESG initiative is made unilaterally without regard to competitors' or peers' actions.
- Consider avoiding agreements that suggest joint refusals-to-deal or implicit group boycotts.
- Consider avoiding any agreements or the appearance of agreements that will allow a company to infer or affect downstream pricing and/or strategy of a direct competitor.
- Ensure that any initiatives or commitments a company signs on to are narrowly tailored to only that which is necessary to achieve procompetitive benefits.
- Ensure that the company maintains a clear record of the procompetitive rationale for its decisions, and ensure that such rationales align with the company's governance structure and fiduciary duties thereunder.

Finally, companies or funds that have already signed onto ESG initiatives and/or have made ESG-related commitments would be well-advised to review their initiatives or commitments with the above guidance in mind. Similarly, they should be prepared for any potential future scrutiny and/or to be intentional about whether or not to continue or potentially alter these initiatives or commitments.

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Endnotes

[1] March 30, 2023, letter to asset managers from the State AGs of Montana, Louisiana, Utah, Alabama, Arkansas, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Mississippi, Missouri, New Hampshire, Ohio, South Carolina, Tennessee, Texas, Virginia, West Virginia, and Wyoming, https://attorneygeneral.utah.gov/wp-content/uploads/2023/03/2023-03-30-Asset-Manager-letter-Press-FINAL.pdf.

[2] David Shepardson, "U.S. Launches Antitrust Probe into California Automaker Agreement," Reuters (Sept. 6, 2019), https://www.reuters.com/article/us-autos-emissions/u-s-launches-antitrust-probe-into-california-automaker-agreement-idUSKCN1VR1WG.

[3] Alex Swayer, "19 states subpoena six major banks for ESG records, say 'woke, climate agenda' hurts U.S. firms," Washington Times (Oct. 20, 2022), https://www.washingtontimes.com/news/2022/oct/20/19-states-subpoena-six-major-banks-for-esg-records/.

[4] *Id*.

[5] US Senate Subcommittee on Competition Policy, Antitrust and Consumer Rights, Oversight of Federal Enforcement of the Antitrust Laws (Sept. 20, 2022), https://www.judiciary.senate.gov/meetings/oversight-of-federal-enforcement-of-the-antitrust-laws.

[6] Mark Brnovich, "ESG May Be an Antitrust Violation," The Wall Street Journal (May 6, 2022), https://www.wsj.com/articles/esg-may-be-an-antitrust-violation-climate-activism-energy-prices-401k-retirement-investment-political-agenda-coordinated-influence-11646594807?mod=Searchresults_pos1&page=1.

[7] July 13, 2022, letter from Senator Tom Cotton of Arkansas to Larry Fink, Chairman and CEO of BlackRock, https://www.cotton.senate.gov/imo/media/doc/blackrock.pdf.

[8] August 4, 2022, letter from 19 State AGs to Larry Fink, Chairman and CEO of BlackRock, https://www.texasattorneygeneral.gov/sites/default/files/images/executive-management/BlackRock%20Letter.pdf.

[9] November 3, 2022, letters from US Senators Tom Cotton, Michael Lee, Charles Grassley, and Marsha Blackburn to 51 Big Law firms, https://fingfx.thomsonreuters.com/gfx/legaldocs/znvnbdgxnvl/ESG%20letters%20to%20law%20firms.pdf.

[10] November 21, 2022, letter from 15 State AGs general to Senators Sherrod Brown and Patrick J. Toomey and Representatives Maxine Waters and Patrick McHenry, https://oag.dc.gov/sites/default/files/2022-11/ESG%20Letter_Final_11.18.22.pdf.

[11] *Id*.

[12] *Supra* Note 1 at 1.

[13] *Id*.

[14] *Id*. at 2.

[15] *Id*.

[16] *Id*. at 3-4.

[17] *Id*. at 3.

[18] *Id*.

[19] *Id*. at 6.

[20] *Id*.

[21] *Id*. at 11.

[22] *Id*. at 11-12.

[23] *Id*. at 12.

[24] *Id*. at 14.

[25] *Id*. at 15.