



## Alerts

### The Impact of Recent U.S. Supreme Court Decisions on Insurers and Other Companies and Market Consequences of ESG Missteps

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*Insights for Insurers*

Corporations have long taken into account environmental, social, and governance (ESG) issues or considerations in connection with being "good corporate citizens" and with respect to regulatory compliance. In the wake of the murder of George Floyd in 2020, however, ESG came to dominate the focus of corporate boards, management attention, and the policies, procedures, and activities of companies. Although ESG remains—and will remain—a dominant issue for insurers and other companies, there have been some recent developments that could impact the pace and mix of ESG considerations. Insurers and their corporate policyholders, together with their attorneys, must stay abreast of developments impacting ESG, not the least of which is recent U.S. Supreme Court decisions, and must understand the impact that their ESG-related actions and inactions will have on their customers, clients, and other stakeholders.

In this commentary, we examine some recent decisions by the United States Supreme Court and assess their impact on ESG. We also examine some market backlash that companies may sustain as a result of ESG-related missteps.

#### The Primacy OF ESG

Insurers have been taking the lead on ESG-related issues. Insurers have been impacted by ESG as business entities. Like other companies, insurers must address their own ESG policies, practices, and activities in connection with their operations. Insurers, however, are impacted by ESG more than most companies, as they are viewed as entities that can influence the ESG-related activities of their policyholders through underwriting activities, such as by refusing to underwrite fossil fuel companies or companies with inadequate ESG standards or track recorders, by imposing carbon and other underwriting criteria, and by pricing and terms of coverage. As large institutional investors, the investment decisions of insurers are subject to scrutiny from an ESG perspective. ESG also impacts insurers with respect to claims handling and coverage litigation as ESG has spawned new claim types (e.g., greenwashing claims) and influenced claims volume and payouts.

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Insurers have multiple stakeholders with a wide range of views on ESG-related issues. On many specific issues, there are disparate views within any given stakeholder. The pace and depth of ESG have been supercharged by social inflation, increased intensity of societal and political pressures, and the corresponding demands of various stakeholders.

In general, insurer internal stakeholders – such as employees and managers – have not only become less resistant to change but often are drivers of ESG, reflecting the reality that an increasing percentage of the workforce and management are Millennials and Generation Z. Younger employees tend to be more supportive and active on ESG-related issues. External stakeholders – such as vendors, suppliers, special interests and advocacy groups, and even some policyholders – have also put pressure on insurers. Regulators and rating agencies have imposed requirements and made demands upon insurers. Indeed, ESG has become a primary driver of federal government action as part of the "all of government" approach to ESG of the Biden Administration and many states.

## ESG Backlash

ESG is not exempt from the laws of physics. Anti-ESG efforts are, in some ways, a reflection of Sir Isaac Newton's third law that states "for every action (force) in nature, there is an equal and opposite reaction." The depth and pace of ESG activity make anti-ESG reactions inevitable. It may not be equal, but there is opposition to some aspects of ESG. Although the momentum remains on the side of ESG, the depth, pace, and concentrated focus on ESG — as well as the financial consequences — means that considerable opposition and anti-ESG measures will continue to be lodged.

It is important for companies to not only implement ESG policies and practices that are responsive to legal and competitive pressures. They must also monitor and assess developments continuously and adjust their ESG policies and practices. This includes compliance with binding court decisional authority, legislative and regulatory requirements, and adjustment based upon market and other developments and trends. Many ESG-related decisions can result in secondary, collateral, and unintended consequences. One thing is for sure, insurance company professionals and lawyers will remain busy on ESG-related issues.

## The Supreme Court Weighs in On Issues Related To ESG

Over the past couple of terms, the United States Supreme Court has issued decisions that should be reviewed, understood, and considered by insurers and their corporate policyholders in formulating, reviewing, and applying policies on environmental, social, and governance issues.

Of course, Supreme Court decisions on U.S. Constitutional issues may not be directly binding on many private companies. Yet, some companies – such as governmental contractors – do business or have contracts with the federal government that could bind them to some rulings and regulations. Further, businesses are subject to civil rights and other legislation. Additionally, the decisions of the United States Supreme Court could impact the litigation proclivities of parties and decisions and approaches of lower courts.

Accordingly, we examine some recent decisions of the United States Supreme Court.

### *Students for Fair Admissions Inc. v. President & Fellows of Harvard College* and the Potential Impact on Social and Governance Considerations

In a 6-3 decision issued on June 29, 2023, the United States Supreme Court struck down affirmative action admissions policies used by both Harvard and UNC. The Court's decision in *Students for Fair Admissions, Inc. v. President and Fellows of Harvard College*, No. 20-1199, and the attendant case *Students for Fair Admissions, Inc. v. University of North Carolina, et al.*, No. 21-707, effectively bars the consideration of race as an independent factor in university admissions and, in its sweep, raises questions for efforts aimed at increasing diversity in the application and hiring processes for other public and private institutions alike.



Plaintiff in both cases, the Students for Fair Admissions, Inc., filed the cases against Harvard and UNC in 2014, challenging both universities' use of race as a factor in admissions decisions. The case against Harvard asserted that the policy in place discriminated against Asian Americans, and the case against UNC asserted that the policy in place discriminated against white and Asian Americans. Lower courts upheld the policies, and the matter was taken up on certiorari.

Per Title VI of the 1964 Civil Rights Act, "No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance." Both Harvard and UNC receive forms of federal funding. The Equal Protection Clause, in turn, forbids discrimination on the basis of race by state and federal governments. As a state university, UNC comes within the Equal Protection Clause.

Chief Justice Roberts authored a 40-page majority opinion concluding that, while "commendable," Harvard's and UNC's goals, as stated with respect to their policies, are not "sufficiently coherent" to clear the "strict scrutiny" threshold required for any exception to the Equal Protection Clause. As outlined by Justice Roberts, "Those interests include training future leaders, acquiring new knowledge based on diverse outlooks, promoting a robust marketplace of ideas, and preparing engaged and productive citizens." However, in his estimate, "It is unclear how courts are supposed to measure any of those goals, or if they could, to know when they have been reached so that racial preferences can end."

The Chief Justice further concluded both universities' policies "unavoidably employ race in a negative manner" and "involve racial stereotyping." As he put it, "College admissions are zero-sum, and a benefit provided to some applicants but not to others necessarily advantages the former at the expense of the latter." Finally, his opinion pointed out that the admissions programs lack a "logical end point." On both of these additional points, Chief Justice Roberts concluded Harvard's and UNC's admissions policies "cannot be reconciled with the guarantees of the Equal Protection Clause."

Chief Justice Roberts was joined in the opinion by Justices Clarence Thomas, Samuel Alito, Neil Gorsuch, Brett Kavanaugh, and Amy Coney Barrett. Not unnotably, the opinion qualified that nothing therein "should be construed as prohibiting universities from considering an applicant's discussion of how race affected his or her life," leaving a possible opening in what would otherwise appear to be a wholesale prohibition. The decision further left open the possibility that military academies might continue their affirmative action programs given "distinct interests" at issue in those circumstances.

Justice Thomas issued a concurring opinion expressing his own criticism of the actual impact of admissions policies like those at issue, contending that "[f]ar from advancing the cause of improved race relations in our Nation, affirmative action highlights racial differences with pernicious effect." Justice Gorsuch also issued a concurring opinion, in which Justice Thomas joined, and in which Justice Gorsuch concluded that the admissions policies at issue are in violation of Title VI's prohibitions against discrimination on the basis of race. And lastly, Justice Kavanaugh concurred, emphasizing the need for a sunset provision on any admissions policies like Harvard's and UNC's.

Justice Sonia Sotomayor dissented from the court's holding, issuing a 69-page opinion, in which she was joined by Justices Elena Kagan and Ketanji Brown Jackson—the latter as to UNC only as she had recused herself from the matter as to Harvard. Justice Jackson issued her own dissenting opinion to the UNC matter, in which Justice Sotomayor and Justice Kagan also joined.

Justice Sotomayor's dissent celebrated admissions policies like those at issue as advancing "the constitutional guarantee of racial equality." In her view, the majority's decision "stands in the way and rolls back decades of precedent and momentous progress" on that guarantee. That said, Justice Sotomayor's dissent anticipates that "[a]lthough the Court has stripped out almost all uses of race in college admissions, universities can and should continue to use all available tools to meet society's need for diversity in education." Likewise, Justice Jackson criticized the majority's decision as "arrest[ing] the noble generational project that American universities are attempting," and further projects that "[t]ime will reveal the results."

The decision on affirmative action is not likely to have as significant of an impact on private employer diversity initiatives as private companies are not subject to the Equal Protection Clause. Although companies generally are governed by Title VII of the Civil Rights Act (as opposed to Title VI), the language of Title VII is very similar. Courts may be confronted with



arguments by private claimants and advocacy groups that the decision applies in other contexts in which race is a factor in decision-making, including employment, vendor and supplier contracting, and investment. Courts may, in turn, analogize to the decision and its rationale in those contexts. For further analysis of the decision, [see this \*Employment Law Observer\* blog post](#).

There have been lawsuits challenging supplier diversity programs and state-funded programs that take race into account. Companies should review their ESG (and DEI) programs, assess potential challenges, review internal and external communications and policies, and revise practices and messaging as appropriate. Companies could face reverse discrimination claims and should train and educate employees on reverse discrimination. Curtailing or eliminating DEI programs and practices could increase traditional discrimination lawsuits and even shareholder suits challenging these decisions and could present reputational and operational risks.

Trial court decisions previously have struck down laws impacting board of director composition and disclosures. For example, on May 13, 2022, a Los Angeles County Superior Court ruled, in *Robin Crest, et al., v. Alex Padilla*, 2019 WL 3771990 (Cal. Super. Ct. Trial Div. 2019), that a California statute (S.B. 826) requiring California-based public companies to have one to three women on their boards of directors, depending on their board size, violated the equal protection clause of the California constitution. Although the decision following a bench trial does not specifically address the related requirement in S.B. 826 that a company must disclose board member information to the secretary of state, the court's decision enjoins enforcement of the entire law. This decision followed the decision of another Los Angeles County Superior Court in April 2022, striking down a similar law (A.B. 979) requiring companies to include at least one member of an "underrepresented community" on their boards, concluding the law violated the Equal Protection Clause in the constitution of the State of California.

## *West Virginia v. EPA* And *Sackett v. EPA* and Their Potential Impact on Environmental Considerations

In each of the last two terms, the Supreme Court issued a decision impacting environmental considerations. On June 30, 2022, the Court issued its decision in *West Virginia v. Environmental Protection Agency*, 142 S. Ct. 2587, 213 L. Ed. 2d 896 (2022). In this case, the Supreme Court addressed the Clean Power Plan, a rule promulgated by the EPA to address carbon dioxide emissions from existing coal and natural gas-fired power plants. The Clean Power Plan set forth three important measures: (1) "heat rate improvements," which were practices that power plants could use to burn coal more cleanly; (2) a shift in electricity production from coal-fired power plants to natural gas-fired power plants; and (3) a shift from coal and gas plants to more renewable energy production, such as wind and solar power. The EPA also set forth "final emission guidelines for states to follow in developing plans" to regulate existing power plants. At issue was whether the EPA had the authority to regulate these emissions via the "best system of emission" identified in the Clean Power Plan. The Court found that the EPA, which purported to derive its authority from Section 111(d) of the Clean Air Act, did not have the broad authority to do so.

The case resulted in a 6-3 ruling, with the majority opinion written by Chief Justice Roberts. The Court began by addressing threshold issues of justiciability. The majority held the State petitioners had standing as they were injured because the EPA rule would require them to regulate power plant emissions within their borders more stringently. As to mootness, the court rejected the government's argument that the case is moot based upon its representation that the EPA does not intend to enforce the Clean Power Plan prior to promulgating a new Section 111(d) rule. The court stated that "voluntary cessation does not moot a case" unless it is "absolutely clear that the allegedly wrongful behavior could not reasonably be expected to recur." The court noted that the government did not suggest that, if this litigation were resolved in its favor, it would not reimpose emissions limits predicated on generation shifting. Although this aspect of the ruling is hardly groundbreaking, it will support the standing of states to challenge future agency action.

The Court reversed the D.C. Circuit Court of Appeal's ruling striking down the Trump administration's Affordable Clean Energy rule, which had repealed the Obama-era Clean Power Plan and replaced it with more limited regulations of carbon dioxide emissions from existing power plants. The Supreme Court instead restricted the EPA's "power to regulate greenhouse gas emissions from power plants, finding that the Obama administration exceeded its authority under the Clean Air Act by allowing states to issue regulations aimed at increasing the use of cleaner sources of electricity



generation.” The majority determined that the EPA exceeded the congressionally mandated authority by using the Clean Power Plan to give states the option to promulgate regulations that would encourage “generation shifting” or moving away from power sources like coal to cleaner ones, like natural gas or renewables. According to Chief Justice Roberts:

Capping carbon dioxide emissions at a level that will force a nationwide transition away from the use of coal to generate electricity may be a sensible “solution to the crisis of the day.” But it is not plausible that Congress gave EPA the authority to adopt on its own such a regulatory scheme in Section 111(d). A decision of such magnitude and consequence rests with Congress itself, or an agency acting pursuant to a clear delegation from that representative body.

Chief Justice Roberts stated the government – under the major questions doctrine – could not point to “clear congressional authorization” for its manner of regulations, but instead pointed to the EPA’s authority to establish emissions caps at a level reflecting “the application of the best system of emission reduction . . . adequately demonstrated.” The statute does not close to the sort of clear authorization required” by the Court’s precedent.

In her dissent, Justice Kagan stated that Section 111 of the Clean Air Act did, in fact, broadly authorize the EPA to devise the “best system of emission reduction” for power plants and that the parties did not dispute that the “best system” was generation shifting. Accordingly, Justice Kagan’s dissent viewed the majority’s decision as depriving the agency of “the power needed – and the power granted – to curb greenhouse gases.” Justice Kagan added that a key reason Congress makes broad delegations like Section 111 was so an agency could respond, appropriately and commensurately, to new and big problems. She accused the majority of substituting its own policymaking ideas for those of Congress and stated that the majority’s decision was “really an advisory opinion on the proper scope of the new rule EPA is considering” as the Biden administration stated it would not revive the 2015 Clean Power Plan.

The general consensus is that this decision will hinder, delay, complicate, or otherwise impact the Biden Administration’s climate goals. Although time will tell the true impact of the Court’s decision, the impact likely will not be as limiting on regulators as some fear and others hope. SCOTUS recognized that the EPA does have the power to regulate greenhouse gas emissions, and the ruling does not prevent the EPA from regulating outright power plant greenhouse gas emissions under Section 111(d) or under the Clean Air Act.

The EPA undoubtedly will look to other sources of authority, rely on more traditional tools such as those used to regulate other air pollutants, and will be required to exercise greater care in regulating greenhouse gas emissions. It may take more time and more steps to achieve its goals.

Much has been left undecided by the Supreme Court’s decision. For instance, the court did not decide whether the EPA must stay within the fence line of a power plant when crafting greenhouse gas emission regulations, as the Trump administration maintained in enacting the Affordable Clean Energy rule. The court’s decision also does not address the EPA’s regulation of greenhouse gas emissions from other sources, such as vehicles.

The decision potentially gives states a greater role to play concerning clean energy requirements, which likely will play out differently in traditionally red and blue states. Currently, many states tether their air quality standards to federal standards by specifically incorporating reference to parts of Section 111 into their own statutes and regulations. Others choose to implement the EPA’s determinations as a baseline or guide for minimum air quality standards. As such, the Supreme Court’s decision will have a direct impact on state law.

The Supreme Court’s reliance upon “the major questions doctrine” is significant. In his concurrence, Justice Gorsuch described the doctrine as a tool to ensure that the government does “not inadvertently cross constitutional lines.” The major questions doctrine has previously been used to guard against unintentional, oblique, or otherwise unlikely delegations of the legislative power. Both liberal and conservative justices have relied upon the major question doctrine in the past. The related “non-delegation” doctrine prevents Congress from intentionally giving away its own power. Application of the major questions doctrine often results in requiring Congress – the people’s elected representatives – to weigh in legislatively to solve more contemporary problems or issues. In the majority’s decision in *West Virginia v. EPA*, the doctrine was used to prevent the EPA’s authority from being based upon “vague” statutory grants and require the EPA to point to clear congressional authorization. This is likely to result in future challenges to EPA regulations and limit greenhouse gas rulemaking.



The decision – particularly its reliance upon “the major questions doctrine” – likely has implications beyond the EPA and greenhouse gas emissions. It signals the view of the majority of justices that the “administrative state” may be out of control and that it may be sympathetic to efforts to limit the broad and growing power of unelected government bureaucrats in federal administrative agencies. Stated differently, rather than treating such assertions of power as normal statutory interpretations, in which judges are highly deferential to agency actions, courts may approach extraordinary, novel actions of administrative agencies with far-reaching consequences with a greater degree of skepticism. As Justice Roberts stated, “[i]f Congress wishes to effect a sweeping overhaul of the nation’s economic activity, it must now do so explicitly--with clear congressional authorization . . . . Agencies may not, on their own initiative, transform a statutory scheme used for one thing to perform some other ambitious work, even if the law’s language makes their statutory interpretation “colorable.” The decision may have implications beyond the context of ESG as well.

On May 25, 2023, the United States Supreme Court issued a ruling in *Sackett v. EPA*, No. 21-454, narrowing the federal government’s authority to regulate bodies of water and effectively upending a Biden Administration rule that recently went into effect. The EPA classified the wetlands on the Sacketts’ property as “waters of the United States” because they were near a ditch that fed into a creek, which fed into Priest Lake, a navigable, intrastate lake. The EPA ordered the Sacketts to restore the site, threatening penalties of over \$40,000 per day.” The Supreme Court ruled that the federal government’s definition of the term “waters of the United States” must be restricted to a water source with a “continuous surface connection” to major bodies of water. The decision was unanimous on the merits, the court split 5-4 on determining how the federal government should go about defining water sources. According to the majority opinion authored by Justice Alito, understanding the Clean Water Act to apply to wetlands that are distinguishable from otherwise covered waters of the United States would substantially broaden the statute to define navigable waters as waters of the United States and adjacent wetlands.

On December 30, 2022, the EPA and the U.S. Army Corps of Engineers announced that they had approved a water of the United States regulation to be implemented in March 2023. After announcing this, EPA Administrator Michael Regan stated that the rule “safeguards our nation’s waters.” The rule opened the door for the federal government to regulate wetlands, lakes, ponds, streams, and “relatively permanent” waterways, largely mimicking a pre-2015 environmental rule set during the Obama administration, which implemented the changes in to curb water pollution. The regulation was the broadest interpretation to date of which water sources require protection under the Clean Water Act. Industry groups and some lawmakers criticized the regulation as an example of federal overreach. In April, a federal judge granted a request from 24 states and several trade groups to pause the implementation of the regulation. The Supreme Court’s decision was hailed for protecting farmers, ranchers, and landowners from overreach under the Clean Water Act.

These decisions are consistent with the trend of decisions of the Court – including the Court’s decision in *Department of Education v. Brown*, No. 22-535 (June 30, 2023), striking down the Biden Administration’s effort to forgive student loan debt – insisting that administrative agency actions particularly major actions be grounded in specific legislative authority to act.

On the whole, these decisions may slow the pace of agency-designed environmental regulation as well as any regulation specific to ESG, but these decisions are not likely to alter the direction or goals of the Biden Administration or to lessen the pressures companies face from stakeholders to undertake ESG efforts irrespective of the status of regulation on point.

## The Market Consequences of ESG Missteps

Apart from regulatory compliance issues, corporate missteps with respect to ESG issues – whether action or inaction – can have significant reputational and market consequences to companies. Adroit handling of ESG is required in today’s world and can provide a competitive advantage to companies. Navigating the vast minefield of matters falling under the broad heading of ESG is quite difficult. Satisfying the interests and expectations of various stakeholders with competing or differing agendas is challenging. The consequences of ESG missteps can be severe. We look at some recent examples in this commentary. ESG-related decisions may have substantial market impacts – favorable or unfavorable, large or small, and anticipated and unanticipated.



Ben & Jerry's ice cream provides an example in the context of D&O Claims. On June 15, 2022, U.K. consumer products company Unilever was sued by a shareholder alleging that the company mishandled the decision by its Ben & Jerry's unit to stop selling ice cream in Israeli-occupied Palestinian territories. Unilever acquired Ben & Jerry's ice cream in 2000, but Ben & Jerry's retained an independent board. In July 2020, the independent Ben & Jerry's board passed a resolution to end Ben & Jerry's sales of its products in areas the board considered to be Palestinian territories illegally occupied by Israel. The newly filed securities class action complaint in the Southern District of New York against Unilever and some of its executives alleges that the defendants made “false and misleading representations,” as “Unilever acknowledged the importance of maintaining successful customer relationships with existing customers but omitted discussing that the B&J board had already decided to end sales to existing Israeli customers, which risked reduced sales and a customer backlash.” According to the complaint, Unilever acknowledged that its brands and reputation are “valuable assets that could be impacted by unethical conduct but omitted discussing Ben & Jerry's boycott decision, which risked damage to Unilever's brands, reputation, and business results.” The complaint also states that “Unilever acknowledged that complying with all applicable laws and regulations was important but omitted discussing Ben & Jerry's boycott decision, which risked adverse governmental actions for violations of Anti-BDS Legislation.” As seen above, it was Ben & Jerry's social activism that gave rise to the lawsuit. Jonathan Stempel, *Unilever shareholder sues over Ben & Jerry's Israel boycott*, Reuters (June 15, 2022).

Another example is Disney's handling of The Parental Rights in Education Act, dubbed by some as the “Don't Say Gay” legislation, in Florida. The company's handling of the issue seemed to anger people on both sides of the issue and had adverse consequences for the company in terms of legislative action and stock price. In *Simeone v. Walt Disney Co.*, Del. Ch., C.A. No. 2022-1120, Will, V.C. (June 27, 2023) (Mem. Op.), however, the Delaware Court of Chancery rejected a corporate stockholder's demand for corporate records about the company's decision. The demand was based on the Disney Board's alleged mismanagement of the issue. But, key in the Chancery Court's decision was the conclusion that the evidence indicated the Disney Board had “actively engaged in setting the tone” for Disney's response to the legislation. The Board did not, as was contended, “abdicate its duties or allow management's personal views to dictate Disney's response to the legislation.” Rather, the court emphasized—and applauded—the Board's deliberations on the issue as an exercise of its business judgment in response to market forces.

The National Basketball Association's stand or failure to take a stand with respect to policies in China also may present issues. Simply stated, different people view many “S” and “G” policies differently, and individuals may be impacted differently by the policies even within the same constituency. The foregoing illustrates the importance of not mishandling ESG issues as well as the difficulties ESG issues can present to companies. Taking a position--or not taking a position--can impact a company.

A couple of more recent examples include the consumer backlash faced by Bud Light as a result of its affiliation with transgender actor and social media influencer Dylan Mulvaney. Target faced considerable backlash over Pride-themed clothing for children. Consumer reaction in those instances brought starkly into the fore the idea that brands might lose substantial market share and company stock values can be impacted markedly when they take positions on social issues.

Many insurers rightfully believe that policyholders with ESG awareness have a better risk profile than those not focused on ESG or policyholders with poorly conceived ESG policies or strategies. Understandably, insurers are reviewing policyholder ESG policies and performance with increasing frequency and in greater depth. Insurers also should recognize that, when a policyholder's ESG awareness transmogrifies into ESG activism, the policyholder may face additional risks resulting in claims against the policyholder. ESG activism could present similar risks to insurers in their own business strategies and policies. This applies to the “S” and “G” components of ESG – social and governance – as well as the “E” component.

See S.M. Seaman & J.R. Schulze, *Allocation of Losses in Complex Insurance Coverage Claims* (Thomson Reuters 11th Ed. 2023) at Chapter 19 Social Inflation and Sustainability/ESG (Environmental, Social, and Governance Considerations); S.M. Seaman, [“Insurers Take the Lead on ESG/Sustainability Initiatives”](https://www.jdsupra.com/legalnews/insurers-take-the-lead-on-esg-6954367/) (J.D. Supra October 1, 2021), <https://www.jdsupra.com/legalnews/insurers-take-the-lead-on-esg-6954367/>.



See, e.g., Press Release, White House, *FACT SHEET: President Biden Directs Agencies to Analyze and Mitigate the Risk Climate Change Poses to Homeowners and Consumers, Businesses and Workers, and the Financial System and Federal Government Itself* (May 20, 2021).

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