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ESG and Litigation Risks

Introduction

In this article, we consider the nature of ESG litigation and the potential legal challenges ESG may bring.

As ESG issues continue to grow in importance and public awareness, ESG related litigation is likely to rise as a consequence. For example, the increase in ESG-related financial disclosures will likely give rise to claims based on those disclosures. Besides the direct and indirect financial losses that ESG-related litigation may cause an organisation (such as fines, damages and expenses), ESG issues often concern very high-profile events and can seriously impact the reputation and goodwill of an organisation, as well as impact on its relationships with employees, customers, business partners, and other stakeholders.

In November 2020 the UK Government stated its intention to bring about a "*green industrial revolution*" to stimulate recovery from the COVID-19 pandemic and its intention to implement a "*green taxonomy*", which will be the UK's version of the EU's regulation on sustainability disclosures in the financial sector, which came into effect on 10 March 2021 but was not implemented in the UK. It is clear that ESG issues are going to be at the forefront of public policy and legislation in the UK.

In addition, President Biden has been highly vocal about his ambitious plans to tackle climate change and environmental issues. Following his inauguration, the United States promptly re-joined the Paris Agreement on 20 January 2021. On 4 March 2021, against a backdrop of increasing investor focus and reliance on climate and ESG-related disclosures and investment, the United States' Securities and Exchange Commission ("**SEC**") announced the creation of a Climate and ESG Task Force in the Division of Enforcement. The Task Force announcement states that it will "*develop initiatives to proactively identify ESG-related misconduct. The task force will also coordinate the effective use of Division resources, including through the use of sophisticated data analysis to mine and assess information across registrants, to identify potential violations. The initial focus will be to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules. The task force will also analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies*"[1]. This apparent sign that the United States intends to pursue ESG-related misconduct and to hold those involved to account will be followed with interest around the world.

What types of claims are likely to arise from ESG related issues?

It is first worth saying that all the usual causes of action may be applied to an ESG related claim in much the same way they could be applied to any non-ESG related claim. Under English law, these claims would include, for example, **claims in tort** (e.g negligence, nuisance, conversion of property, trespass etc), **equitable claims** (e.g. unjust enrichment and breach of fiduciary duties by directors or trustees), **criminal claims** (e.g. modern slavery or child labour, money laundering etc), **statutory claims** (e.g. human rights claims under the Human Rights Act 1998, claims under consumer protection legislation, claims against issuers of securities who may have misled investors about ESG risks under section 90 or 90A of the Financial Services and Markets Act 2000, and claims based on breaches of directors' duties under the Companies Act 2006), and **administrative law** claims (e.g. challenges to planning decisions or environmental permits and approvals).

Where such claims may differ is in the particular facts relied upon and the legal regulatory framework against which any such claims may lie. There may also, of course, be specific claims available arising from ESG related legislation and regulation.

[1] https://www.sec.gov/news/press-release/2021-42

Particular areas where we have seen, or foresee, ESG issues and risks arising and leading to litigation or regulatory investigations include:

Claims arising from reporting and disclosure obligations

- Shareholder actions under, for example, ss.90 and/or 90A/Schedule 10A of the Financial Services and Markets Act 2000, which gives investors the right to sue public companies that publish: misleading statements within, or omissions from, prospectuses or listing particulars (s.90); or untrue or misleading statements within, or omissions from, other information published by the company, or as a result of a dishonest delay by the company in publishing information (s.90A).

Recent high profile examples of reporting and disclosure claims include:

Class actions in the US against BP (arising out of the Deepwater Horizon accident in 2012 for breach of US securities laws arising from alleged false statements in press releases, its annual reports, and sustainability reports about its safety program), and against Massey Energy.

- NGOs raising complaints to the UK's FRC Conduct Committee about climate change reporting; for instance, in 2018 Client Earth (an environmental law charity) made complaints against a number of UK companies (including EasyJet, Balfour Beatty and Bodycote). The FRC's response has been to launch an industry-wide investigation into climate change reporting.
- SEC investigations into, for example, Volkswagen (diesel emissions disclosures) and BP (BP agreed to a settlement with the SEC and paid a US$525 million penalty to settle charges of securities fraud following the Deepwater Horizon accident). and Litigation Risks.

Mis-selling / "Greenwashing" claims

- The growing awareness of ESG issues is mirrored by an increased reliance on information about the ESG characteristics of a particular company, product or investment when a "buying" decision is made. Such decisions, which could include the acquisition of a company or the purchase of financial products for example, could have been made in whole or in partial (or, indeed, without any) reliance on ESG factors and it will be a matter of fact in each case as to whether such a decision involved such reliance. However, much like other recent waves of "mis-selling" claims, even in cases where reliance on ESG factors is not at the heart of the dispute, it is likely that litigants who have suffered loss will seek to add such claims to their arsenal wherever possible.
- The difficulties faced by organisations in trying to categorise their activities, the varying and inconstant data sources available and the subjective nature of much of the language surrounding ESG issues could create the perfect storm where even parties that are genuinely trying to behave responsibly may be exposed to claims for mis-selling or breach of warranty in the corporate context.
- The scope for mis-selling claims is a particular concern for the financial services sector and it is here that there appears to be the most scope for a significant volume of claims. Although the FCA is live to the issue, and has published several discussion and feedback papers on the subject, it remains to be seen how the financial services industry will respond to these new challenges.
- In March 2021 BlackRock's former chief investment officer of sustainable investing, Tariq Fancy, published an article in *USA Today* entitled "*Financial world greenwashing the public with deadly distraction in sustainable investing practices*[2]". In it, he shared his opinion that claims of ESG investments have become a PR stunt, distracting from climate change, social injustice, and poor governance. His sentiments have been echoed by the SEC, when (as referred to above) it announced the Climate and ESG Task Force with the aim of "*proactively identify[ing] ESG-related misconduct*", such as inaccurate or incomplete disclosures by funds and companies, and looking into abuse of such disclosures.

Corporate and Operational issues

- Workforce, supply chain and human rights issues are now under considerable scrutiny. The working conditions of those within supply chains has been under closer public and regulatory scrutiny in recent years, including consideration of workers' human rights and the communities impacted by the activities of the supply chain. Globally there has been an increase in focus on modern slavery due diligence and human rights policies by corporations. In addition, the link is increasingly

[2] https://eu.usatoday.com/story/opinion/2021/03/16/wall-street-esg-sustainable-investing-greenwashing-column/6948923002/

being made in claims that poor health and safety conditions in a supply chain can lead to industrial accidents.

- Companies can expect a renewed focus on directors' duties (in particular, section 172 of the Companies Act 2006 and the concept of "*enlightened shareholder value*"), and shareholder activism in the ESG context. For example, Client Earth wrote to the trustees of a number of pension schemes to remind them of their duty to act in the best interests of members when making investment decisions, and to consider the exposure of the scheme's assets and scheme sponsor to climate risk when discharging fiduciary duties. Client Earth put the trustees on notice of their view that if this does not happen, the trustees could be acting in breach of their duties[3].
- More recently in June 2021, activist hedge fund investor, Engine No. 1 (which held just 0.02% of Exxon's shares), with the support and buy-in of a number of leading institutional investment firms gained control of three (out of 12) board seats at ExxonMobil. Engine No. 1 is among a new breed of shareholder activists, apparently driven by the idea that social good also benefits the bottom line.

Administrative and public international law claims

- Administrative law and public international law claims, including claims arising from human rights violations, against national governments and governmental organisations are likely to increase. In addition to domestic claims, many claims will cross borders or will be pursued in other jurisdictions than the accused state.
- Claims arising from infrastructure/projects: for instance, *R (Plan B Earth and Others) v. Secretary of State for Transport and Others*[4] where the Supreme Court reversed the Court of Appeal's decision that the planned third runway and expansion of Heathrow Airport was unlawful on climate change grounds, and determined that the UK Government had taken proper account of the UK's climate change commitments.
- As governments are increasingly implementing net-zero carbon targets, companies are establishing their own carbon-neutral or carbon-negative pledges. There is also an increased focus on infrastructure projects and whether or not these projects are aligned with the Paris Agreement; such issues are all likely to perpetuate ESG-litigation. Additionally, there are likely to be an increasing number of commercial disputes (such as insurance claims) arising out of climate change events/*force majeure* events.
- Claims arising from breach of duty of care on human rights grounds owed in relation to corporate climate change: for instance, *Milieudefensie and others v Royal Dutch Shell plc ECLI:NL:RBDHA:2021:5339*, whereby human rights arguments were successfully used before a Dutch Court to demonstrate that a corporation owes a climate-related duty of care which required it to increase its emissions cuts to bring it in line with the Paris Agreement.

Parent company liability – the Supreme Court decisions in *Vedanta* and *Okpabi*

Parent companies should be aware of, and increasingly concerned about, their accountability and potential liability for the actions (or inactions) of their overseas subsidiaries for ESG-related issues. ESG litigation can involve multiple claimants, often of limited means, who may be attracted in particular by the availability of lawyers and funding in England to pursue what will be both factually and legally complex claims against a parent company which may be perceived as having deeper pockets than its undercapitalised local subsidiary.

We have previously reported[5] on the April 2019 Supreme Court judgment in *Vedanta Resources Plc and Konkola Copper Mines Plc (Appellants) v Lungowe and Ors. (Respondents) [2019] UKSC 20* which involved (mass) tortious claims against a company headquartered in the UK but in respect of the operations of an overseas subsidiary for alleged environmental damage in the country of operation of its subsidiary (Zambia). The Supreme Court held that the claimants (being 1,800 Zambian citizens) had established jurisdiction in England and that the claim could proceed before the English High Court.

In particular, the Supreme Court:

a) placed emphasis on the high bar for striking out a claim as not disclosing a proper case to be tried;

b) appears to have widened to some extent the circumstances in which claims can be pleaded against parent companies in respect of the

[3] https://www.documents.clientearth.org/library/download-category/pensions/

[4] https://www.supremecourt.uk/cases/docs/uksc-2020-0042-judgment.pdf

[5] see https://www.shlegal.com/insights/vedanta-v-lungowe-a-slipping-of-the-anchor-by-the-supreme-court

negligent oversight of the conduct of their subsidiaries; and

c) also noted that if there is evidence of local law relevant to the claim it may be difficult to challenge that evidence on a summary judgment test.

More recently on 12 February 2021, in *Okpabi and others v Royal Dutch Shell Plc and Shell Petroleum Development Company of Nigeria Ltd* the Supreme Court reaffirmed its decision in *Vedanta* that UK parent companies may be liable for the overseas operations of their non-UK subsidiaries[6]. In summary, in *Okpabi* the Court found that the claimants were able to demonstrate an arguable case that the UK-listed parent company owed a duty of care to third parties affected by oil spills from its subsidiary-operated pipelines in Nigeria.

For claimants bringing ESG-related claims against a UK parent and its local subsidiary in a developing country, these two decisions are likely to assist them. Whilst each of *Vedanta* and *Okpabi* turned on their own specific facts (as was emphasised by the Supreme Court), those facts are by no means unique or rare, particularly not in relation to large global conglomerates[7]. Although the claim against Vedanta was settled and the substantive trial in *Okpabi* is yet to take place, it will no doubt prove to be an important milestone for this type of mass tort claim and the outcome of the trial will be awaited with interest by many, including in particular litigation funders and claimant law firms in class actions of a similar nature.

Whilst these two cases arose from environmental damage, the consequence of the decisions will not be limited to that issue alone, and by extension may apply to many other ESG-related issues, such as, for instance, human rights violations and modern slavery.

It is clear that these decisions put pressure on multinational corporations to recognise and manage ESG risks across all their subsidiaries and jurisdictions, even if they feel they are one-step removed from the operations at grass roots. Not only can ESG litigation have serious financial consequences for parent companies, such issues and litigation could cause significant reputational damage to the company's brand at a time when the public and international governments have a heightened awareness and focus on ESG issues.

What can organisations do now to mitigate the risks of ESG-related litigation?

1. Seek advice and input as necessary at an early stage from relevant external professionals in relation to existing and developing corporate ESG policies and/or disclosures.
2. Stress test and conduct risk assessments now with a view to anticipating and mitigating potential risk areas.
3. Identify any risks which may exist as a result of upward and/or downward supply chains and/or from local subsidiaries.
4. Actively review and manage reputational risk arising from ESG issues.
5. Engage with key stakeholders to understand their ESG requirements.
6. Understand the stewardship obligations of your investors and shareholders.
7. Educate and train management on their legal and regulatory obligations around ESG issues and best practices.
8. Dedicate sufficient resource to the increasingly broad legal and regulatory framework governing ESG issues and ensure they form an integral part of an organisation's internal governance.
9. Consider what checks and balances are in place in relation to ESG issues at local subsidiaries.
10. Embrace change to maximise performance, reputation and operational efficiency.
11. Have a crisis response and policy in place to deal with ESG issues and risks as and when they arise.
12. Recognise that increased scrutiny of an organisation's ESG policies and impact can also create positive opportunities and outcomes – it's not necessarily all bad news for an organisation's bottom line.

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[6] We reported on that case here (https://www.corporatecommercialdisputes.com/insight/facing-responsibility-parent-liability-overseas-subsidiary-actions-english-courts) and engaged in a roundtable discussion of the implications of that case with The Lawyer here https://www.corporatecommercialdisputes.com/insight/media-coverage-lawyer-roundtable-sins-father-reversed-discussing-okpabi

[7] It is noteworthy that on 17 July 2019 (i.e. after its judgment in *Vedanta*) the Supreme Court refused the Claimants' application for permission to appeal the Court of Appeal judgment in *AAA and others v Unilever PLC and Unilever Tea Kenya Limited* [2018] EWCA Civ 1532. The Claimants - 218 Kenyan nationals - were attempting to bring mass tort claims against Unilever Plc and its Kenyan subsidiary, the owner of a tea plantation in Kenya, at which the Claimants allegedly suffered ethnic violence at the hands of third-party criminals.

Conclusion

The green revolution is already upon us and is not likely to go anywhere; if ESG issues are not already at the top of every corporate agenda, they should be. The sheer breadth of the new obligations that are coming into force and the increased awareness and public scrutiny of ESG issues mean that claims are likely to increase by equal measure.

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