



ESG and Sustainability:

A New Era of Enforcement and Litigation Risks

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Agenda

- **Introductions**
- **What is ESG**
- **Why ESG matters**
- **Key takeaways**

What is ESG?



The Acronym



ENVIRONMENTAL

Conservation & protection
of the natural environment

Examples:

- Product and facility air emissions and air quality
- Climate change
- Energy use and conservation
- Natural resources and land use
- Hazardous materials use



SOCIAL

Relationships with
employees, suppliers,
clients & communities

Examples:

- Equal employment/Diversity
- Health care, education, and social justice
- Labor standards and employee relations
- Production quality and safety
- Local community impact



GOVERNANCE

Standards for company
leadership, risk controls &
shareholder rights

Examples:

- Board independence and diversity
- Ethical business practices
- Shareholder voting rights
- Board oversight of risk

Behind the Acronym

- ESG implicates:
 - Factors against which investors, consumers, and corporations comprehensively assess performance, value, and investment in a company
 - Factors reflective of overarching corporate responsibility and a company's objectives and approach to creating a favorable environment to live and work
- ESG has become a critical consideration for corporate operations, driving a focus on supply chain management, regulatory requirements, compliance issues, and socially responsible policies
- An effective ESG framework requires coordination between different internal and external constituents

Who is Interested?

Stakeholder	Possible Areas of Concern
Customers	Anything that impacts the reputation of the company; product quality and safety, raw material sourcing, environmental impact, treatment of employees, social responsibility
Traditional shareholders	Material information that could impact share price
Modern/activist shareholders	Behavior that contradicts the values of the shareholder
Investors	Anything that impacts profits or share price
Suppliers	Environmental impact, manufacturing practices, labor relations
Governments	Compliance in all areas and internal controls
Communities	Environmental impact, local employment and training, emergency response, diversity
Employees	Anything that jeopardizes company/job viability; wages, work/life balance, good governance

Why ESG Matters



Liability for ESG Disclosures and Practices

Key Sources of Liability for ESG Disclosures and Practices:

1. Federal securities laws and private litigation, for “material” misrepresentations and omissions in statements made to the investing public/market
2. State fiduciary law, for failure by the board to adequately supervise the company’s regulatory compliance or corporate governance practices
3. State and federal UDAAP/consumer protection laws, for “material” misrepresentations and omissions in statements made to consumers of the company’s products and services

ESG Disclosure Frameworks

Goal of ESG Disclosure Frameworks:

- Drive disclosure in the marketplace and create apples to apples comparisons
- To date, primary focus has been on environmental element; forces companies to develop plans for climate change regulation and incentivize companies to make climate impact reduction commitments

“Group of Five” Reporting Frameworks

- Carbon Disclosure Project (CDP)
- Climate Disclosure Standards Board (CDSB)
- Global Reporting Initiative (GRI)
- Sustainability Accounting Standards Board (SASB)
- International Integrated Reporting Council (IIRC)

The **ESG Key Performance Indicators** (KPIs) that appear **most frequently** among the **10 ESG Reporting Frameworks** are as follows:

ENVIRONMENTAL KPIs	ESG Framework Frequency
Climate change opportunities and risk	10/10
Emissions - Green House Gas Emissions	9/10
Environmental Policy	8/10
Energy	8/10
Environmental Management Systems	7/10
SOCIAL KPIs	ESG Framework Frequency
Supply Chain - Social	8/10
Stakeholder Engagement	7/10
Health and Safety	7/10
Workforce Development/Human Capital	7/10
Diversity and Equal Opportunity	6/10
GOVERNANCE KPIs	ESG Framework Frequency
Compensation Policy	7/10
ESG Reporting Standards	6/10
Board Level Oversight - ESG	6/10
Governance Policy	6/10
Governance Risk Assessment	6/10

ESG Liability Dynamics

- Hyper-transparency of corporate practices in an age of social media
- Escalating stakeholder (not just *shareholder*) activism (also fueled by social media)
 - In 2019, 181 large-company CEOs joined the Business Roundtable in adopting a multi-constituency approach. “Shareholder primacy” no longer the norm; “stakeholders” include **investors, employees, communities, suppliers, customers**
 - Many states (other than DE) have multi-stakeholder *statutes* expressly allowing/requiring companies to take stakeholder interests into account when making corporate decisions
- Changing societal expectations
- Growing investor focus on sustainability issues
 - See, e.g., annual letters from BlackRock, Vanguard, SSGA, etc.

Regulatory Focus on ESG

- On March 21, 2022, the SEC came out with its long awaited proposed rules for the enhancement and standardization of climate-related disclosure
- The requirements in the 500+ page proposing release are extensive and are mostly prescriptive
- Highlights from fact sheet include:
 - Climate-related risks and their actual or likely material impacts on the registrant's business, strategy, and outlook;
 - The registrant's governance of climate-related risks and relevant risk management processes;
 - The registrant's greenhouse gas ("GHG") emissions, which, for accelerated and large accelerated filers and with respect to certain emissions, would be subject to assurance;
 - Certain climate-related financial statement metrics and related disclosures in a note to its audited financial statements; and
 - Information about climate-related targets and goals, and transition plan, if any.

Regulatory Focus on ESG (cont)

- The comment period for the proposed rules was extended to June 17, 2022.
 - There have been hundreds of comments submitted with more expected to be submitted before June 17, 2022
- The SEC is moving forward with enforcement actions and other proposed rules:
 - In the Matter of BNY Mellon Investment Adviser, Inc.
 - SEC v. Vale S.A.
 - Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices

Private Litigant Focus on ESG

- Trending basis for 10b-5 shareholder class actions: failure to fully disclose Code of Ethics violations or inadequacy of corporate compliance efforts
- Most statements are considered “mere puffery,” and not actionable as misstatements of *fact*. *But see*:
 - *Equifax*
 - MTD denied in part, where issuer allegedly overstated strength of cybersecurity systems and commitment to data security and privacy, and failed to promptly identify and disclose massive data breach; where CEO had previously overseen an investigation revealing weaknesses in issuer’s systems. \$1.4B settlement of investor and consumer claims.
 - *Signet Jewelers*
 - MTD denied in part, where pervasive allegations of sexual harassment by senior execs minimized in SEC disclosures, and customer lending program misleadingly described as “conservative.” \$240MM settlement.

Private Litigant Focus on ESG (cont)

- *BP Oil*

- MTD denied in part in wake of Gulf of Mexico oil spill, based on alleged misrepresentations about the company's compliance with independent report recommendations re: safety improvement, company's ability to respond to oil spills, lack of retaliation against employees voicing safety concerns, and post-spill estimates of exact spill volume into the Gulf.
- \$175MM settlement.

- *In re Massey Energy*

- MTD denied, based on allegations that company misrepresented company's nonfatal days lost, company's commitment to and focus on safety, and minimization of number of mining policy violations.

State Fiduciary Laws

- Boards have an *affirmative duty* to implement a reporting and controls system **and monitor its functioning**.
- Prior to 2017, very few successful “failure to supervise” cases.
- Standard *then*:
 - “Only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to assure a reasonable information and reporting system exists – will establish ... liability.” *Caremark* (Del. Ch. 1996)
- Standard *now*:
 - Directors “must make a good faith effort to implement an oversight system and then **monitor it**.” *Marchand v. Barnhill* (Del. Sup. Ct. 2017)
- Not just required by the Courts; Regulators require it, too.
 - SEC: *Seaboard* standards
 - DOJ: <https://www.justice.gov/criminal-fraud/page/file/937501/download>

Directors Sued Under New Standard

- Fox News, Wynn Resorts -- \$90MM and \$41MM settlements of derivative claims over #MeToo issues
- Google – derivative suits arising from \$90 million to one ousted exec and \$45 million for another ousted exec
- McDonald's - \$70 million CEO payout
- Boeing - \$23 million CEO payout
- 10+ derivative suits (and counting) for failure to diversify board

Consumer Protection Laws

- UDAAP/consumer protection ESG litigation typically fails due to lack of materiality, causation. For example:
 - *Ruiz v. Dairygold* (Statements made in CSR report re: ethical treatment of workers and cows)
 - *Barber v. Nestle* (Website disclosures re: source of cat food deemed merely “aspirational”)
 - *Hall v. Sea World* (No causal link between statements re: treatment of whales and purchase of theme park tickets)
 - *Hodsdon v. Mars* (Alleged failure to disclose violations of foreign child labor laws)
- *But see:*
 - *Stanwood v. Mary Kay* (MTD denied in part, based on affirmative statements that company did not test products on animals, when it did)
 - *Equifax*

Consumer Protection Laws (cont.)

- FTC “Green Guides” last updated in 2012; provide little concrete proscriptive guidance on standards for use of terms such as “sustainable,” “organic,” “natural,” “non-toxic,” “recyclable,” “reusable,” etc.
 - Several states have issued guidance or policy statements, but substantive standards and enforcement remain inconsistent.
- Sample cases/outcomes re: use of “non-toxic” in product labeling:
 - Claims dismissed without prejudice: *Rivera v. S.C. Johnson* (SDNY 2021) (Windex line of cleaners)
 - *But note* similar claims filed in California and Wisconsin state court; those cases settled for \$1.3MM
 - MTD denied in part or in whole, followed by settlement:
 - Method Cleaners - \$2.25MM Settlement (9/21/2021)
 - Simple Green - \$4.35MM (2021)

Key Takeaways



Where Are We and Where Are We Going?

- Expectations of investors, consumers, enforcement agencies, and courts have shifted markedly toward increasing transparency of ESG efforts and proactive engagement by companies and boards with broader array of stakeholders
- Generalized statements about company’s “commitment to ethical conduct” are generally not actionable. BUT
 - Plain-vanilla risk disclosures may not suffice where CEO/board is aware of actual material defects in company’s ESG compliance program
 - Statements of fact (e.g., whether animals are used for testing products) vs. “aspirational” statements can create liability
- Boards now must proactively establish and monitor reasonableness of compliance programs, which is, in turn, closely tied to companies’ material risk assessments
- Legal challenges to regulation
- “Court of Public Opinion” can be much swifter and more effective than the judiciary

Thank you

Are there any questions?

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