OSSERVATORIO ESG

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To date, ESG risk litigation has largely focused on climate change and catastrophic environmental events. However, while climate change will continue to have an important influence in relation to ESG risk litigation, the breadth of such litigation is much broader. Large-scale ESG risk litigation matters go to the heart of a company's business purpose, reputation, corporate values and approach to risk.

EMERGING ESG RISK LITIGATION

Introduction

ESG investing refers to an approach that integrates environmental, social and governance factors into the investment process along with other more traditional financial factors. This investment approach has attracted significant interest from investors, financial institutions and policy makers.

The size of the UCITS ESG fund market has also grown considerably in Europe at a steady pace over the past five years in response to ever-increasing demand for sustainable investments. Based on Morningstar data as of December 2020, there were 2,873 ESG funds with net assets of EUR 1.2 trillion[1].

In the last two years, a large number of regulations have been approved in Europe since the "*Action Plan: Financing Sustainable Growth*" was presented by the European Commission in March 2018, with the aim to redirect capital flows towards sustainable investments, integrate sustainability in risk management and promote transparency and long-term financial decisions.

These include the Directive 2019/2088 related to disclosing the sustainability in the financial services sector (SFDR)[2], the Directive 2020/852 related to the definition of sustainable activities at the hearth of ESG investments and establishing amendment of SFDR regulation (EU Taxonomy)[3] and the recent package of measures published by the European Commission on 21 April 2021 within the framework of the EU Action Plan for sustainable finance and climate neutrality objectives by 2050, which includes the proposal for a Directive on Corporate Sustainability Reporting (CSRD)[4] and intends overcome the NFRD and to introduce a uniform reporting standards to a larger number of companies which guarantee the comparability of information for consumers, lenders and investors.

Increase of legal litigations

The more the mandatory ESG disclosure increases, both through corporate reporting and other tools, in response to the increasingly pressing demands of regulations, regulators and investors, and the more there can be an increase in the number of legal disputes. Complaints can arise regarding deficient/inadequate disclosure of ESG information, allegations of greenwashing and the risk of attracting liability for the activities of controlled entities, as a consequence of overestimating a parent company's ability to supervise and control such entities in group accounting. Similarly, companies are directly blamed for alleged ESG-related performance and operational shortcomings related to sustainability.

As the importance of ESG factors continues to grow, the same number of sustainability disputes will take place, and the rise in errors and litigation signals will generate a growing need to carefully manage data sources, methodologies, processes and the same ESG declarations will no longer be

[1] EFAMA, Market insight, ISSUE #4 | March 2021, "ESG INVESTING IN THE UCITS MARKET. A powerful and inexorable trend".

[2] REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector

[3] REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

[4] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting

an optional "*nice to have*" for companies. It will be increasingly dangerous to ignore them and the same dissemination of information on sustainability required by the SFDR regulation, if not precise, could lead to claims for reimbursement based on public reporting (or the absence of public reporting).

1. **ESG Litigation Roadmap**[5]
   ESG litigation has the potential to greatly impact a company and its ongoing viability. Large-scale ESG litigation matters go to the heart of a company's business purpose, reputation, corporate values, approach to risk management, and relationships with investors, suppliers, customers, employees, and other stakeholders.
   To date, ESG litigation has largely focused on climate change litigation and catastrophic environmental events. However, while climate change will continue to have an important influence in relation to ESG litigation, the breadth of ESG litigation is much broader.
   ESG-related litigation will be of particular relevance to, and require the attention of, boards of directors and senior management teams and based on their review, the key categories of ESG-related litigation are:
   - ESG-related litigation that is directed at national governments or governmental organizations and has indirect effects on companies (*Government ESG Litigation*)
   - ESG-related litigation that is directed at significant infrastructure projects. This litigation might involve companies, national governments / governmental organizations, or both (Infrastructure ESG Litigation)
   - ESG-related litigation that concerns companies themselves divided across three categories:
     - ESG-related litigation that concerns companies and their operations (*Company Operations ESG Litigation*)
     - ESG-related litigation that concerns companies and their governance arrangements (*Company Governance ESG Litigation*)
     - ESG-related litigation associated with corporate reporting and disclosures (*Corporate Disclosure ESG Litigation*)
   - ESG-related litigation against board directors concerning alleged breach of duty of care or duty of loyalty under state laws in the US (*Fiduciary Duty ESG Litigation*)
   - ESG matters that are addressed through "soft law" and/or informal dispute resolution mechanisms, which typically target sectors, individual companies, or groups of companies (*Informal ESG Disputes*)

2. **Growing ESG risks: the rise of litigation**[6]
   The explosion of ESG based funds and investments predicated on company statements about ESG performance will amplify the litigation risks associated with incomplete or inaccurate information or failed performance. In short, the ESG path forward for companies will grow increasingly difficult, intensifying pressure to ensure comprehensive programs that achieve high-level ESG performance accompanied by accurate, complete, and aligned ESG statements and communications to avoid:
   - Litigation Developments related to ESG Misstatements and Omissions like *i*) claims regarding misrepresentations on product labels, *ii*) claims regarding product label omissions, *iii*) claims challenging ESG statements in company reports, Websites, and Other Marketing Materials and
   - Litigation Developments related to ESG Performance.

Conclusions

The signs are evident towards a greater appetite for better corporate information on ESG performance, the momentum is driven by regulations like that on sustainability-related disclosures in the financial services sector (SFDR) which requires not only aspirational ESG data but also detailed company commitments, statements, metrics and specific commentary.

Directors and senior managers should therefore reflect on whether they collectively have the necessary understanding of ESG matters and/or are able to aquire externally necessary expertise from law firms' ESG practices, especially in an initial stage of ESG disclosure process, in order to prevent potential future litigations.

References ESG Law firms

Lisa Shuchman, February 19, 2021, "*ESG Catches Fire: Can Law Firms Play a Role in Sustainability and Human Rights*?", Law.com international, https://www.law.com/international-edition/2021/02/19/esg-catches-fire-can-law-firms-play-a-role-in-sustainability-and-human-rights/?slreturn=20210413090706

[5] Latham&Watkins, wbcsd, fall 2020

[6] David Hackett, Reagan Demas, Douglas Sanders, Jessica Wicha, and Aleesha Fowler, Environmental Law Institute®, Washington, DC. Reprinted with permission from ELR®, http://www.eli.org, 1-800-433-5120