YEAR IN REVIEW

ESG DISPUTES

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What is ESG?

ESG stands for "Environmental, Social and Governance" and is the metric used for measuring the sustainability and ethical impact of a business or company.

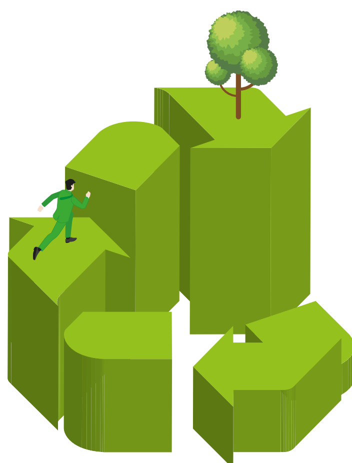
For the purposes of ESG, the three key measures are:

- **Environmental.**
  How an organisation acts towards the welfare of the planet and what kind of impact it has on the environment.
- **Social.**
  How an organisation treats its employees, customers, suppliers and local communities. This includes factors such as racial diversity, inclusiveness and recruitment practices.
- **Governance.**
  How an organisation is run, including the way it is audited and the way it administers shareholder rights. This also covers attitudes to executive pay as well as how a business communicates and generally interacts with its shareholders.

The number of investment funds that incorporate ESG factors has been growing rapidly since the beginning of this decade, and is expected to continue rising significantly over the decade to come.

According to Bloomberg Intelligence's (BI) latest 'ESG 2021 Midyear Outlook' report, ESG assets are on track to exceed $50 trillion by 2025, representing more than a third of the projected $140.5 trillion in total global assets under management.

As millennials, GenZers, and the generations to follow step into investor shoes, they are increasingly likely to select their portfolios based on companies that measure up to ESG metrics. According to recent figures, 9 out of 10 millennials cite investing with a focus on ESG to be a central goal, with one third exclusively investing in funds that take ESG into account.



Climate Change and The Paris Agreement

The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 parties at COP 21 in Paris, on 12 December 2015, and entered into force on 4 November 2016. Its goal is to limit global warming to well below 2 degrees Celsius (preferably to 1.5) compared to pre-industrial levels.

To achieve this long-term temperature goal, countries aim to reach global peaking of greenhouse gas emissions as soon as possible to achieve a climate neutral world by mid-century.

The Paris Agreement is a landmark in the multilateral climate change process because, for the first time, a binding agreement brings all nations into a common cause to undertake ambitious efforts to combat climate change and adapt to its effects.

Litigation as Activism

According to the Grantham Institute's 2021 'Global Trends in Climate Change Litigation Policy Report', the number of climate change-related cases has more than doubled since the Paris Agreement.

The impetus for many of these cases came in 2019, when the Dutch sustainable transition non-profit Urgenda won a landmark claim against the government of the Netherlands, successfully arguing that the state was taking insufficient action to address climate change, which was an abnegation of its responsibility to protect human rights.

In March 2022, ClientEarth took the battle to the UK courts, starting legal action against Shell's 13 executive and non-executive directors. It is the first ever case seeking to hold company directors personally liable for failing to properly prepare a climate strategy that is consistent with The Paris Agreement.

ClientEarth argues that the board's failure to adopt and implement a climate strategy that truly aligns with the Paris Agreement is a breach of their duties under the UK Companies Act. It is anticipated that this landmark case will open up the floodgates when it comes to ESG claims; enabling action to be taken against not only businesses, but also those individuals who control the companies and make the decisions, piercing the corporate veil.

What to expect in 2023

According to the Grantham Institute, as at 31 May 2022 there were 2,002 cases of client change litigation globally.

As we move into 2023, we expect to see a growing trend in ESG litigation brought by private individuals, not just climate activist groups. The main driving factors behind this are:

Toughening up of Global ESG Regulatory Framework

One issue to date is that the regulatory standards and metrics surrounding ESG have not been well developed, making it easier for businesses to make inaccurate or exaggerated statements about ESG practices (i.e. "greenwashing"). However, Global ESG regulation is set to make a leap with new requirements for private businesses to report on and prevent adverse impacts on climate, the environment and human rights.

For example, The European Commission has adopted a proposal for a directive on corporate sustainability due diligence ("CSDDD"). The CSDDD would impose a corporate due diligence duty on in-scope large companies operating in Europe to help ensure that they contribute to sustainable development and the sustainable transition of economies. The due diligence measures would require the identification, prevention and mitigation of human rights and environmental impacts connected with companies' own operations, as well as in relation to their subsidiaries and value chains. Non-compliant companies could be subject to pecuniary sanctions and civil liability, imposed by designated supervisory authorities operating throughout the European Union.

Anticipated disclosure requirements in the US

Another factor making "greenwashing" easier until now has been the unstandardised ESG disclosure practices in place.

On 21 March 2022, the U.S. Securities Exchange Commission (SEC) proposed rules to require climate change disclosure in the annual reports and registration statements of public companies registered with the SEC, including any company (domestic or foreign) whose stock is listed on a U.S. stock exchange.

If adopted, the proposed rules would require SEC-registered advisers to include ESG factors and strategies for investors in fund prospectuses, annual summaries and brochures.

Increased funding options

Litigation is often very expensive, and the costs involved in bringing a legal claim against an organisation or individual directors are likely to make this an unrealistic option for many. To be viable many of these cases require litigation funding.

Thankfully, the litigation funding market is now much more sophisticated and well placed to assist than it was only a couple of years ago. The funding market is expected to grow by 8.3% a year, reaching $18bn by 2025, on the back of an expanding global legal services market and better penetration of litigation funding.

The recent successes in group actions, such as that against VW, will undoubtedly have a positive impact on the level of risk imposed by litigation funders when it comes to funding similar litigation in future.

A report from Deminor, a Brussels-based funder that has an office in London, said ESG was already having an impact:

"Groups of claimants have taken action in European courts, to claim damages for environmental harm that has occurred outside Europe.

Courts have shown an openness to hear these cases. In addition, we have seen the emergence of climate litigation and human rights actions. Responsible litigation funders can play a positive role in supporting these cases and bringing about social change."

Growing climate-related group actions

Group litigation is on the rise, spurred on by the global nature of business and the introduction in some jurisdictions of legislation friendly to, for example, class action lawsuits.

In the UK, lawyers say that there are several reasons why group action litigation is growing in popularity. Firstly, there is an increasing availability of opt-out procedures in England, which automatically aggregate those affected unless they withdraw their name. Secondly, new technology is enabling certain opt-in claims that would previously have been too administratively expensive to be issued and managed at low cost. Thirdly, the increase of claimant law firms and third-party litigation funders within the market enables such claims to get off the ground. And finally, in a number of major cases, the UK courts have shown a willingness to break down barriers to large claims.

In May this year, Volkswagen agreed to pay £193m to settle 91,000 legal claims in England and Wales linked to the "dieselgate" emissions scandal that rocked the German carmaker. The prospect of large settlements such as this make group actions more attractive to litigation funders and law firms.

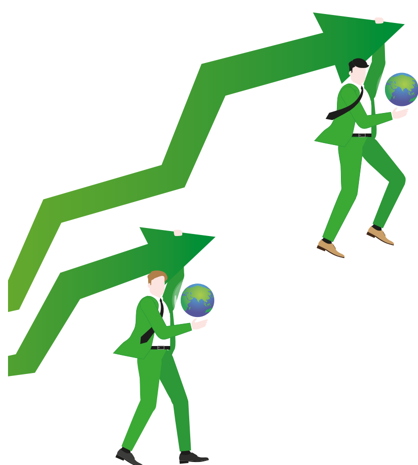
Just a few years ago, such cases were rare, but now litigation is becoming an increasingly important tool when it comes to holding companies and governments to account over their contribution to global warming.

Crackdown by Watchdogs

UK and EU Watchdogs are beginning to crackdown on how organisation present their ESG credentials to the general public.

Earlier this month, the Advertising Standards Authority (ASA) found that HSBC had misled customers with "greenwashing adverts". In the landmark ruling, the ASA said that HSBC had made unqualified claims and omitted material information about its environmental credentials in two high street adverts that appeared in October last year in the run up to COP26.

The EU's markets watchdog has suggested that a 'quality label' for market benchmarks would help prevent investors being misled by ESG claims.



Future trends in litigation

We predict litigation arising from the following scenarios:

- Investors who rely on false or misleading statements about ESG practices when deciding whether to invest in a fund.
- Shareholders of private limited companies relying on ESG information that turned out to be false or misleading.
- Shareholders in listed companies relying on false or misleading information published in listing particulars, the prospectus, annual reports and accounts directors' reports, strategic reports and corporate governance statements.
- Shareholders of a subsidiary relying on a parent company to exercise a degree of supervision and control of its subsidiaries, but when it does not in fact do so. The failure to exercise an appropriate degree of supervision and control may constitute the abdication of a responsibility that it has publicly undertaken through its ESG disclosures, and thus leave it liable to claims.

Bringing claims in such scenarios will not be straightforward, and claimants will likely face some tricky hurdles. For example, how does one prove what level of reliance each particular shareholder or investor placed on the inaccurate statement(s) when deciding to invest in a particular company or fund?

Similarly, there are likely to be issues quantifying a claimant's losses. In instances where the value of a company or fund decreases upon the revelation of false information, one might point to that difference in value as being the loss. But what about in instances where there are multiple factors at play; how does one measure what damage has been caused by which individual event?

Mitigating ESG risks

As the pandemic has shown, planning for every eventuality is impossible. However, companies can anticipate and mitigate ESG risks.

Ways of doing this might include:

- Conducting risk assessments
- Planning for the low-carbon / carbon-neutral economy
- Setting achievable targets and commitments
- Carrying out due diligence (e.g. in supply chains)
- External auditing / validation
- Undertaking public engagement

What is for certain is that ESG is not going anywhere anytime soon, and businesses need to adapt and evolve if they intend to survive.