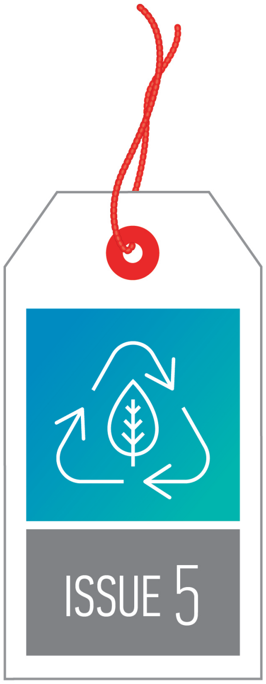
Updates



Heightened Regulatory and Litigation Risks

From investors and shareholders to customers and employees, key stakeholders are increasingly demanding both corporate action and broad-based public disclosure of environmental, social, and governance (ESG) issues. As corporations take action and report on their ESG challenges and achievements, they will be well served to take steps to mitigate the risks of both regulatory enforcement and private litigation.

Increasing Regulatory Attention to ESG Claims

Regulators in the United States and abroad this year have focused closely on ESG claims and disclosures by public companies and how they are reported and substantiated. The Securities and Exchange Commission (SEC) has recognized the market's interest and reliance on climate and other ESG disclosures and taken a number of steps, including the creation of a Climate and ESG Task Force, to identify ESG misconduct with an initial focus on gaps and misstatements in public company disclosures. The SEC's Division of Examinations also issued a Risk Alert targeted at ESG investment funds and their advisers offering guidance about the adequacy, among other things, of "controls to ensure that ESG-related disclosures and marketing are consistent with the firm's practices." SEC Chair Gary Gensler announced in May an intention to propose new public company disclosure requirements relating to climate change and human capital, and in June, SEC Commissioners Hester M. Peirce and Allison Herren Lee publicly discussed the role of ESG for corporate investor relations teams and boards of directors. Likewise, in June, 12 state attorneys general, led by California Attorney General Rob Bonta, called upon the SEC to mandate disclosures related to financial risk associated with climate change. Determining what is "material" to investors for ESG and sustainability disclosures is another challenge recently addressed by Perkins Coie in the Summer Sustainability Series.

Private Party Litigation and ESG Claims

In addition to growing enforcement risks, ESG communications are increasingly targeted by private party litigation in both securities contexts as well as consumer class actions. These cases allege that private parties saw and relied upon an allegedly false or misleading ESG statement in making their investment or purchase decision.

For example, in May and June, consumers brought class action suits against a grocer and seafood restaurant brand alleging that the sourcing of their seafood products was not as sustainable as the companies claimed. This follows a series of complaints filed last year against the makers of Ducktrap salmon products; one case has already resulted in a nationwide class action settlement. Similarly, plaintiffs' counsel have increasingly targeted recyclability or other sustainability-related claims, in lawsuits filed both on behalf of private plaintiffs, as well as nonprofit organizations whose stated missions are geared towards sustainability issues. The use of nonprofits as plaintiffs has come with a corresponding pivot—or arguably, expansion—on legal theories, with some of these cases asserting public nuisance as a cause of action. It remains to be seen how courts will receive these theories, as these sort of public nuisance-framed claims are often dismissed outright in private party class litigation concerning product labeling.

Another area of expansion has been the types of materials plaintiffs point to as potentially misleading. In general, consumer class actions have tended to focus on labeling statements so that plaintiffs' lawyers can argue that all purchasers would have seen the contested claim or statement. But plaintiffs' counsel are now increasingly mining corporate websites, social media accounts, corporate sustainability reports, corporate social responsibility reports, and similar materials as potentially deceptive. Here again, this is an issue where courts have yet to definitively resolve the matter. The consumer protection laws of many states (including California) typically require some form of reliance. And, in the run of cases it is simply untrue that a plaintiff will have combed through, read, and relied on hundreds of pages of corporate sustainability reports before making a purchase decision. So, challenges based on these sorts of materials often fail on reliance grounds. But this rule is not immutable. Not all states' consumer protection statutes incorporate reliance. And in jurisdictions like the Superior Court of the District of Columbia, nonprofit plaintiffs point to these sorts of statements with increasing frequency as forming the basis of their deception claims. Short sellers, too, are also threatening to file stock drop class actions alleging false statements in corporate sustainability communication. So, while the formal rules on liability for ESG statements made in these sorts of noncommercial materials remain in flux or are jurisdiction-specific, continued diligence in reviewing these statements for accuracy and substantiation remains ever-important.

Takeaways

The takeaway from the recent steps taken by the SEC and the increase in private litigation is that the world is watching. To mitigate the risks associated with ESG claims, companies might consider how their policies and procedures address the adequacy of disclosures to shareholders on ESG topics, substantiation of ESG claims with appropriate documentation, and the bounds of aspirational and similar ESG statements. While such considerations cannot entirely eliminate the risks of potential enforcement or litigation actions, they may reduce the risks.

In the next installment of the Perkins Coie Summer Sustainability Series, our advertising and marketing colleagues will be diving into further guidance regarding ESG compliance.

As in other areas, the best litigation strategy often begins with active investment in assessments and ongoing compliance. Formalizing, assessing, measuring, and documenting a company's efforts to translate its ESG values into corporate policies and communications can make it less likely that anyone will find a basis for legal action, and will likewise facilitate the process of refuting such allegations should they arise. Similarly, developing strong ESG frameworks and knowledgably evaluating ESG risks is worth both the up-front and ongoing investment.

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