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Advising the Board on **ESG Risk**

Report looking at Risks Arising from ESG Related Disclosures and Marketing Claims

Risk, Resilience and Reputation

Directors' risk report

Environmental, social and governance (ESG) related disclosures are one of the main means by which businesses communicate their ESG performance, strategy and impact to stakeholders. Corporates also increasingly make marketing claims, commitments and pledges relating to ESG factors, or about their products' or services' ESG credentials and metrics.

While ESG related disclosures are increasingly mandatory, even voluntary disclosures can provide significant benefits and opportunities to businesses, such as enhancing their reputation, attracting new business and capital, and fostering stakeholder engagement. However, they also entail significant risks, especially in terms of regulatory and litigation exposure.

Businesses that make ESG related disclosures and/or marketing claims may face regulatory action or legal challenges if their disclosures or marketing claims are found or appear to be inaccurate, incomplete, inconsistent, misleading or non-compliant with applicable laws and regulations. This risk is compounded by claimants bringing novel complaints, alongside onerous regulatory sanctions for non-compliance, such as imposing penalties equivalent to a certain percentage of turnover. In many jurisdictions, there are also liability considerations for individuals, including directors and officers.

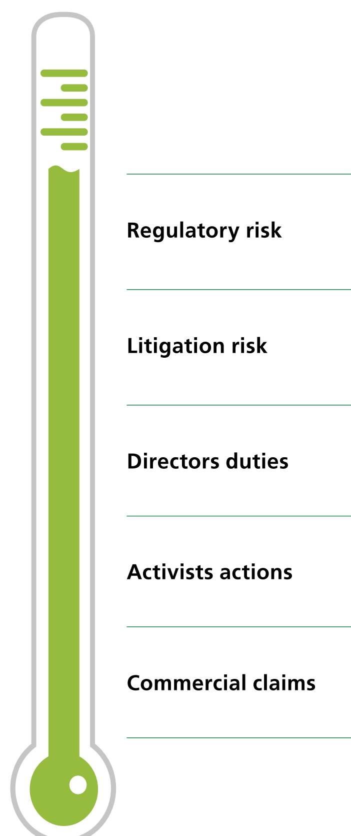
ESG related disclosures and marketing claims are therefore a significant board level risk.

Scope of this report

ESG reporting is a vast topic and it will impact different companies in different ways depending on the sectors and jurisdictions in which they operate, the regulatory regimes that they are subject to, and the scope of ESG related disclosures that a company is either required to make or chooses to make.

The purpose of this report is to provide a high-level overview of some of the key risks that arise from making ESG related disclosures and marketing claims by reference to real life examples. Not all of the risks below will be relevant to every company as much will depend on the particular features of each business. The risks outlined below are prepared with a UK focus, save where other jurisdictions are specifically identified.

Risk thermometer



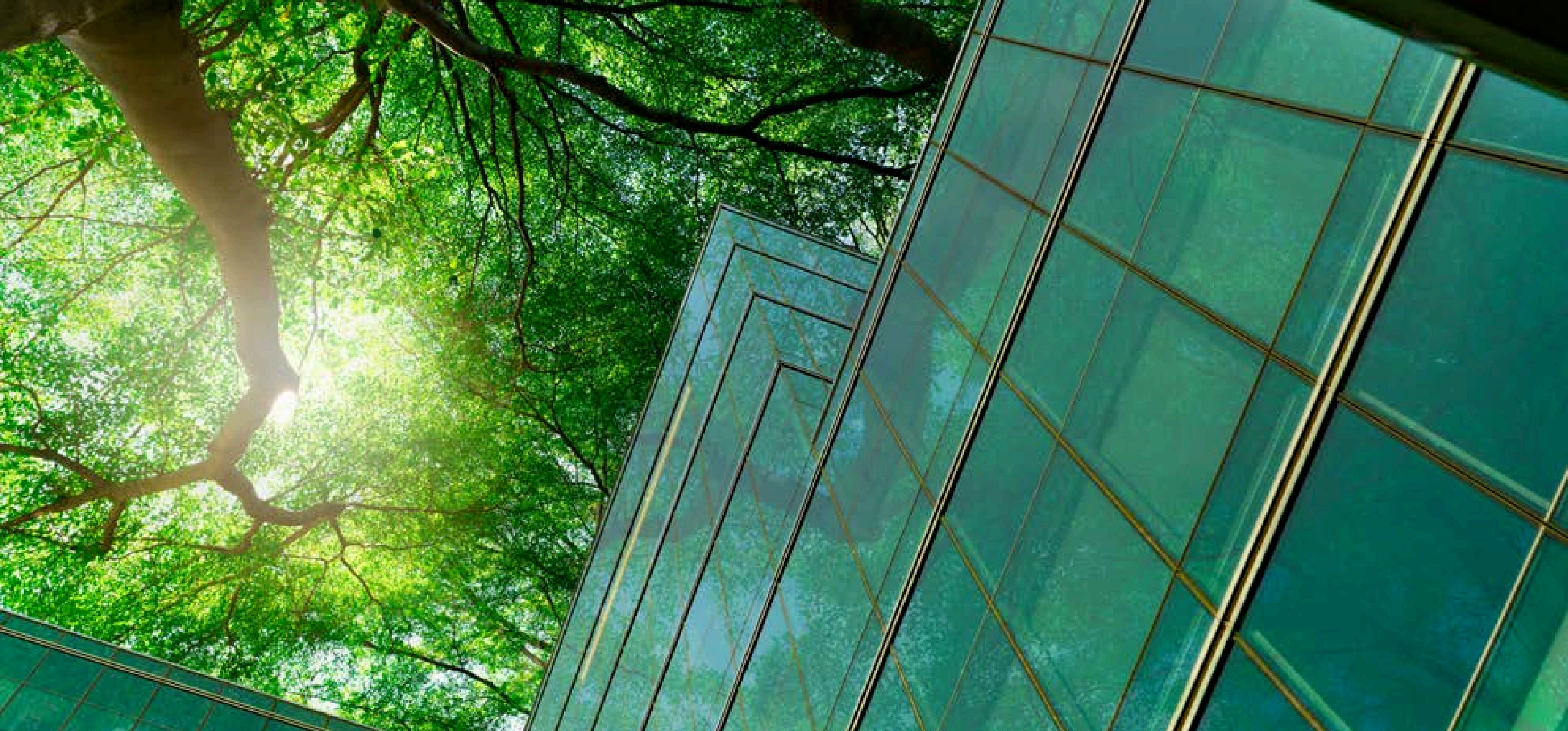
Regulatory risk

Litigation risk

Directors duties

Activists actions

Commercial claims



Regulatory risk

Financial regulators

For those businesses that are subject to regulation by the UK Financial Conduct Authority (FCA), we can anticipate an increased focus on enforcement action in the coming years in relation to ESG related disclosures and marketing. To date, the FCA has not taken enforcement action in this area, but the FCA has recently introduced a new "anti-greenwashing" rule (in force from 31 May 2024) and the FCA has also emphasised the overlap between ESG related marketing of investment products to retail customers and the new Consumer Duty ("consumer understanding" element).

By way of example of regulatory enforcement action that could be on its way to the UK, the US Securities & Exchange Commission (SEC) fined a financial institution USD 19 million in September 2023 after finding that the institution had told the market that they followed certain ESG policies when they either did not follow the policies (or could not evidence them having been followed). In another recent example, the US SEC fined an institution USD 1.5 million in 2022 for misstatements and omissions regarding their ESG credentials.

Competition regulators

In the UK, the Competition & Markets Authority (CMA) published a new Green Claims Code in 2022 to provide guidance to businesses as to their obligations under consumer protection law when it comes to making environmental claims about their goods and services.

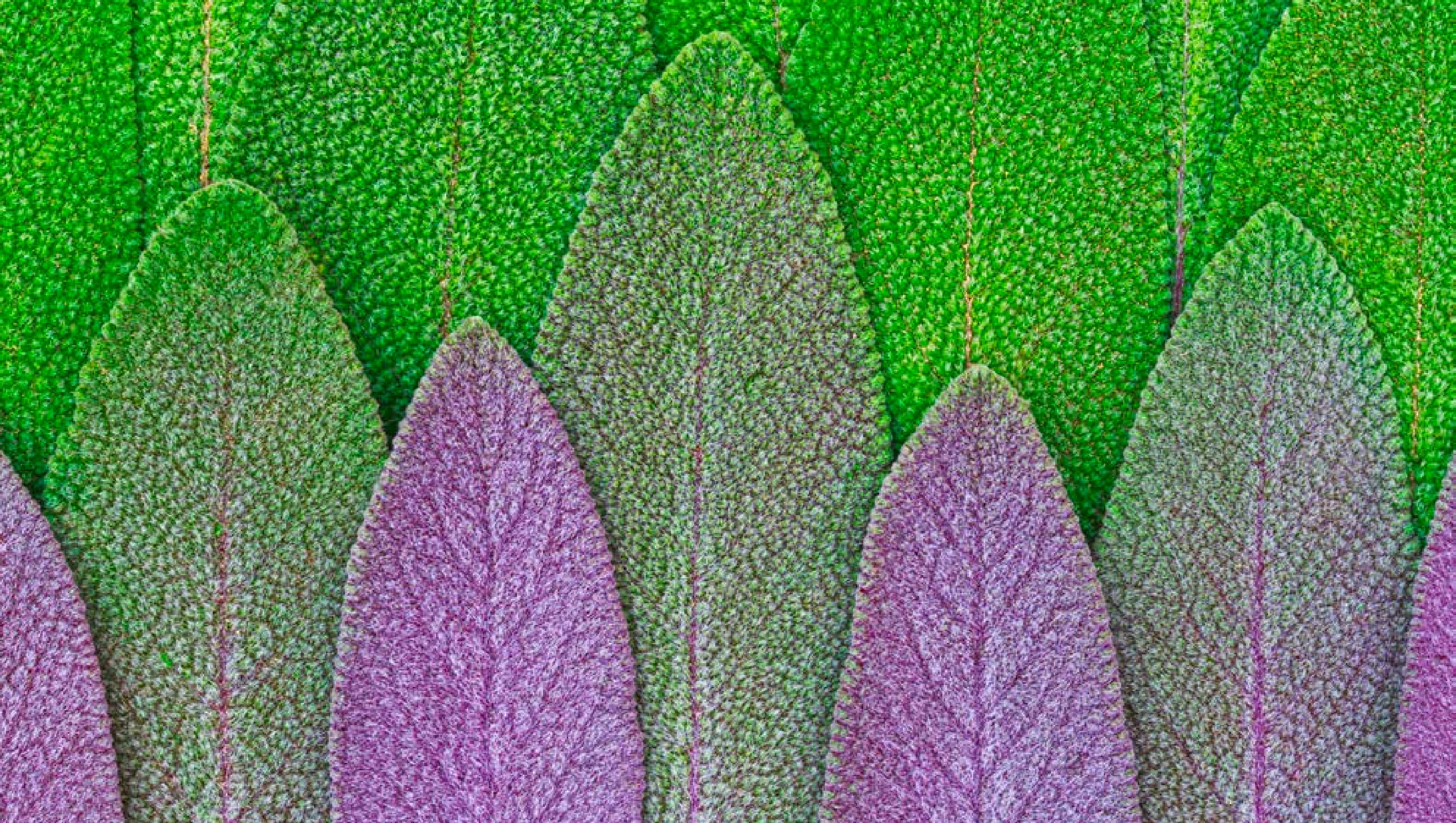
The CMA has been actively investigating business's adherence on a sector by sector approach and is currently investigating various fast fashion chains to determine whether their sustainability claims constitute greenwashing.

The UK Digital Markets, Competition and Consumer Bill is currently being debated. Once enacted later in 2024, it is likely to give the CMA the power to fine companies up to 10% of their global turnover for making misleading green claims.

Advertising Standards Agency

The UK Advertising Standards Agency (ASA) has brought more than 20 actions regarding greenwashing against companies across a variety of different sectors (airlines, banks, fashion brands, energy companies).

By way of example, ASA is focused on whether advertisements provide customers with a full and balanced picture of the advertiser's green credentials. Two advertisements from a bank were challenged by ASA on the basis that, although the adverts contained factually accurate statements from the bank as to the green initiatives they were supporting, ASA found them to be misleading adverts in the round as they did not also refer to the financing that the bank provided to companies generating greenhouse gases.



Litigation risk

Activists

Companies are increasingly being targeted by activists who are bringing novel legal claims in relation to ESG related matters to bring public attention to their complaints and to attempt to drive changes in corporate behaviour.

Recent examples of activist claims in the UK include:

- *Client Earth v Shell* (2023) where Client Earth alleged the Shell board were in breach of directors' duties in failing to adopt and implement an energy transition strategy that aligns with the Paris Agreement.
- Client Earth's attempt to judicially review a decision of the FCA in 2023 to approve the prospectus of a UK oil and gas company.

Both of the above legal claims by Client Earth were ultimately unsuccessful. However, a primary purpose behind activists bringing legal claims is to raise the profile of the issues in complaint and to ensure boards are aware that corporate actions may be subject to public challenge. We can therefore anticipate that these types of legal action will continue, and activists will be paying close attention to corporate ESG related disclosures and ESG strategies.

In addition to activists that are seeking to encourage corporates to engage more with ESG related issues, there are other activists who are seeking to reign in what they consider to be an inappropriate pursuit of ESG goals. This is an issue that is currently being played out in the US. For example, in 2023 various "Red-States" (Republican) wrote letters to companies who have signed up to climate change organisations such as the Net Zero Alliance. These states have alleged breach of anti-trust laws and breach of fiduciary duties asserting that climate change policy is for politicians and government and not something that corporates should address. There have also been various claims filed in US courts against pension funds alleging breach of fiduciary duty in pursuing ESG goals instead of solely focusing on maximising commercial returns. It remains to be seen how far this "anti-ESG" activism spreads outside of the US. However, it is clearly another risk area for companies making ESG related disclosures.

Commercial claims

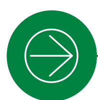
Separately to activist actions above, there is a growing risk of ESG-related litigation from claimants who are seeking commercial returns from the litigation.

By way of some examples of the types of litigation risk:

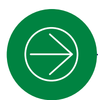
- In the UK, there is an increasing focus on consumer-led litigation and a growing group action risk with sophisticated claimant law firms and litigation funders seeking out opportunities to pursue claims. There is a risk of consumer claims where "green" investments or other products have been sold on a misleading basis.
- The UK is also seeing a rise in "securities litigation" where shareholders are bringing claims against companies as a result of alleged losses suffered. These claims are brought under the statutory liability regimes provided for by the UK Financial Services and Markets Act 2000 and common law claims in fraud or negligent misstatement. Claims are usually brought by way of group action and there is an increasing risk of such claims arising from ESG related disclosures to the market and ESG related corporate scandals.
- Greenwashing claims have also started to emerge as issues in antitrust damages litigation between rival companies.
- As ESG-related disclosures become more common place, we are likely to see an increase in claims in the context of commercial agreements or M&A transactions, where a counterparty considers that the information provided was inaccurate.
- The law in the UK in relation parent company responsibility for the actions of overseas subsidiaries is developing with recent Supreme Court decisions in the context of ESG related claims. This has a direct overlap with ESG related disclosures as a key test will be the extent to which the parent company has exercised sufficient control and intervention over the subsidiary's operations and management which may be evidenced via public disclosures. Depending on the final outcomes in these test cases, this may be an area where the UK sees further group actions brought against UK parent companies in respect of alleged ESG related misconduct committed by foreign subsidiaries.
- Related to the above, UK companies are also exposed to claims for the alleged misconduct of companies within their supply chain, where the UK-based company exercises some level of control over those supply chain companies. This can present a dilemma for UK companies that rely on overseas suppliers: if the UK company requires supply chain companies to adopt certain minimum standards this may expose the UK companies to claims via the control/intervention principles above; whereas a failure to act at all may risk claims based on alleged assistance and/or encouragement of unlawful practices. This is a developing area of the law where there are no clear answers at present.
- Directors are exposed to shareholder derivative claims alleging breach of director duties. For example, ESG related claims may allege breach of section 172 (duty to promote the success of the company having regard to, amongst other matters, the company's operations on the community and the environment) and section 174 (duty to exercise reasonable care, skill and diligence) of the UK Companies Act 2006.
- A director may be subject to a claim arising from a statement in a directors' report, strategic report, directors' remuneration report or any separate corporate governance statement, where it is alleged that they have been dishonest or reckless in making the relevant statement or knew it dishonestly concealed a material fact (section 463 Companies Act 2006).

Practical Guidance

To mitigate the regulatory and litigation risks arising from ESG related disclosures, businesses should consider the following practical guidance:

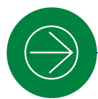


Understand and comply with the applicable ESG disclosure requirements or standards in the jurisdictions where the business operates or is based and monitor any changes or developments in the ESG disclosure landscape.

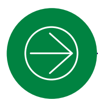


Implement a consistent and credible ESG disclosure framework that is aligned with the business's strategy, values, and stakeholder expectations, and that covers the material ESG issues that affect the business's operations, performance or prospects.

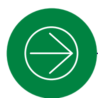
Ensure that the ESG disclosures are accurate, complete, consistent, balanced and verifiable, and that they are supported by robust data, evidence and assurance processes.



Avoid making false, misleading, or exaggerated ESG claims or representations, or omitting material ESG information, that could mislead or deceive consumers, stakeholders or other third parties.



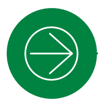
Consider any ESG disclosures carefully in the context of any ESG pledges, commitments or marketing claims already published or planned, and vice versa, to ensure consistency.



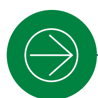
Disclose any ESG risks, uncertainties, assumptions, or limitations that may affect the ESG disclosures or the ESG performance of the business and explain how the business manages or mitigates them.

Engage and communicate with stakeholders or third parties on ESG disclosures and the ESG performance of the business, and respond to any feedback, concerns, or complaints in a timely and transparent manner.

Review and update ESG disclosures on a regular basis, and report on the progress, achievements, or challenges of the ESG performance of the business.



Conduct regular ESG risk assessments to review internal policies and procedures.



Monitor trends in regulatory enforcement of ESG related issues and ESG related litigation and consider whether and how such trends may impact your business.

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