

Expert Q&A: Trends in ESG Litigation and Enforcement

by Practical Law Litigation

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Litigation and regulatory enforcement actions and threats related to environmental, social, and governance (ESG) company policies, practices, and disclosures have been in the spotlight recently. The topics encompassed by ESG, such as corporate diversity policies, workplace sexual harassment, and climate change-related issues, are not new areas for litigation. However, the increased focus by companies on ESG issues has engendered more litigation by private litigants and heightened scrutiny by governmental and regulatory agencies.

Practical Law asked [Mike Delikat](#), [Stacy Kray](#), and the rest of the cross-practice ESG team at Orrick, Herrington & Sutcliffe, LLP to provide an overview of the current and developing landscape of ESG-related litigation and regulatory enforcement actions.

What kinds of ESG-related enforcement actions has the SEC taken to date?

Q&A with [Cynthia Angell](#) and [Stacy Kray](#) at Orrick

The SEC is currently utilizing antifraud, reporting, and internal controls provisions of the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), as well as various related rules, to bring ESG-related enforcement actions. In March 2021, the SEC also announced the creation of a Climate and ESG Task Force (Task Force) within the Division of Enforcement that is tasked with developing initiatives to proactively identify ESG-related misconduct and focus on material gaps or misstatements in issuers' disclosure of climate risks under existing rules ([SEC: SEC Announces Enforcement Task Force Focused on Climate and ESG Issues](#)). Since then, the Task Force has brought multiple ESG-related enforcement actions.

In one high-profile example, the Task Force brought an enforcement action against Vale, S.A., a Brazilian mining company, for securities fraud following the collapse of one of its mines, which resulted in numerous deaths and extensive harm to the environment. The SEC claimed

that Vale had manipulated its safety audits, obtained fraudulent stability certificates, and misstated to investors that its mines met safety standards.

More recently, the Task Force brought an enforcement action against BNY Mellon Investment Adviser, Inc. for alleged misstatements it made about its ESG investments. The SEC alleged that although BNY represented that the investments underwent a quality review, some investments had no quality review score when they were made.

The SEC has also brought employment-related issues under its mandate with the recent \$35 million settlement with Activision Blizzard over claims by the SEC that the company lacked adequate disclosure controls for assessing reports of excessive workplace misconduct.

These actions highlight the SEC's growing commitment to expand its reach on ESG-related issues.

Do you expect the SEC's new climate disclosure rules, if finalized, will change the scope of its ESG-related enforcement actions?

Q&A with [Cynthia Angell](#) at Orrick

Enforcement actions covering topics that are now known as ESG-related are not new. Historically, these actions typically alleged violations of disclosure controls and procedures or material misstatements, as noted above. However, the SEC's proposed climate rules would require detailed information about a company's climate-related risks, greenhouse gas emissions, and climate-related financial metrics and targets, vastly increasing the amount of information disclosed in securities filings. As a result, the SEC would have more areas to police and companies would have more areas to govern with internal controls and procedures.

For more information on ESG-related rulemaking and guidance, see [Practice Note, Key Developments in ESG and Climate Disclosure Tracker](#).

What are the SEC's anticipated human capital management disclosure rules?

Q&A with J.T. Ho at Orrick

In 2020, given growing investor focus on human capital matters, the SEC adopted a rule by a 3-2 vote along party lines, requiring companies to disclose the human capital management measures and objectives that they focus on in managing their businesses, to the extent they are material to the company's business as a whole. This rule was principal-based and did not require any quantitative metrics beyond the already required headcount of employees, on the ground that human capital management disclosures were industry-specific. This principal-based approach was criticized by the two SEC commissioners, representing the Democratic party, who did not approve the rule, as well as by investors who asserted that it did not effectively provide them with the information they were seeking.

With Democrats now holding a 3-to-2 majority among SEC commissioners and given investor preferences, the SEC is working on a new rule that would require public companies to disclose more data about their workforces. Based on remarks from the current chair of the SEC, the rule could include "metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety" (SEC: Prepared Remarks at London City Week).

What other government or regulatory bodies bring ESG-related actions?

Q&A with Jonathan Nail and Stacy Kray at Orrick

The SEC is not the only regulator looking to bring enforcement actions related to ESG. At both the federal and state level, regulators have their sights set on companies' ESG practices. For example, the Federal Trade Commission (FTC) has the authority to initiate enforcement actions based on deceptive or unfair marketing practices and has increasingly used that authority in recent years to challenge companies' environmental marketing claims. Currently, it is in the process of revising its "Green Guides," which help companies determine whether certain marketing statements about the environmental benefits of their products would mislead consumers.

At the state level, attorneys general have brought actions challenging companies' ESG-related disclosures. For example, in *People v. Exxon Mobil Corp.*, the New York State Attorney General brought an action against ExxonMobil under state securities fraud laws that claimed Exxon made false and misleading disclosures about how climate change regulations could impact its operations and value, arguing that ExxonMobil's vulnerability was significantly greater than its disclosures indicated. The litigation lasted over three years, including a 12-day trial. The court ultimately held that the State failed to prove its securities fraud claims but noted that nothing in the decision was intended to absolve Exxon Mobil from responsibility for contributing to climate change through its production of fossil fuel products. (*Exxon Mobil Corp.*, 119 N.Y.S.3d 829 (N.Y. Sup. Ct. 2019).)

At the other end of the political spectrum, conservative state attorneys general have become increasingly hostile to companies exhibiting pro-ESG policies. In March 2023, attorneys general from 21 states sent an open letter to 51 asset managers alleging that their actions to influence climate-related and diversity-related policies at companies in which they hold investments were a breach of their fiduciary duties and otherwise violated laws, including state anti-discrimination laws. A similar letter to insurers who are members of the Net-Zero Insurance Alliance followed in May 2023. Also in 2023, a coalition of 26 states filed a lawsuit against the US government seeking to strike down a rule allowing retirement plans to consider ESG factors when selecting investments.

What are "greenwashing" and "greenhushing" claims?

Q&A with Stacy Kray, Crystal Milo, and Jonathan Nail at Orrick

Greenwashing refers to false or misleading statements about the environmental benefits or performance of a product or an operation. In the past, companies have only infrequently been challenged in describing their products as green, sustainable, or eco-friendly. As concern about climate change has heightened in recent years, however, companies have faced increasing pressure regarding their environmental marketing claims, and more states, such as California, have passed green marketing laws to protect consumers. Companies with aspirational net zero goals who fail to follow best practices for emissions reporting and reduction also face risks related to greenwashing claims. For example, companies that pay to plant trees (which reduce carbon in the atmosphere) to offset their

own carbon emissions may be seen as greenwashing in cases where companies do not match those offset efforts with reductions in their own carbon emissions.

Greenhushing occurs when companies keep information about their sustainability goals, DEI initiatives, and progress on these issues private. Due to increasing scrutiny by regulators and backlash from conservative politicians and activists, greenhushing may be a growing trend. According to a 2022 study by the consultancy South Pole, 23% of companies with science-based greenhouse gas emissions reduction targets do not plan on publishing them ([South Pole: Net Zero and Beyond: A Deep Dive on Climate Leaders and What's Driving Them](#)). Greenhushing may slow the transition to a carbon neutral future because it may hinder opportunities for collaboration on climate initiatives and take pressure off companies who have yet to confront climate-related risks.

What types of shareholder actions have been brought in court to address DEI issues?

Q&A with Hong Tran at Orrick

The ESG-related private actions brought by shareholders have mostly focused on DEI issues under the social component of ESG, alleging either that:

- The company and its board of directors failed to live up to their promises made in proxy statements to increase employee and board race and gender diversity.
- The company and its directors and officers allowed a culture of sexual harassment or gender discrimination in the workplace to persist unchecked.

Shareholders have brought these actions mostly as derivative suits, and few have survived motion practice.

Suits Challenging Disclosures on Diversity Aspirations

In recent years, many companies adopted more ambitious DEI policies mostly in response to shareholder proposals and grassroots movements seeking to improve racial and gender diversity in senior executive and board roles. Companies falling short of their professed DEI commitments are now facing shareholder litigation. Nearly 40 suits have been filed against companies, including Delta Airlines and Wells Fargo, for failing to live up to their DEI commitments.

These derivative actions were largely brought in federal court under Section 14(a) of the Exchange Act and SEC

Rule 14a-9 promulgated thereunder, claiming the boards of directors had made or allowed to be made false and misleading proxy statements containing aspirational diversity-related statements that were never honored. The courts in these actions have so far granted all of the motions to dismiss filed by the defendants because the complaints either:

- Failed to state a claim upon which relief could be granted under Federal Rule of Civil Procedure (FRCP) 12(b)(6) (See *Elliemaria Toronto Esa v. Nortonlifelock Inc.*, 2021 WL 3861434 (N.D. Cal. Aug. 30, 2021), *aff'd*, 2022 WL 14002189 (9th Cir. Oct. 24, 2022); *Ocegueda v. Zuckerberg et al.*, 526 F. Supp. 3d 637 (N.D. Cal. 2021)).
- Failed to meet the heightened pleading standard for shareholder derivative actions under FRCP 23.1, which requires the plaintiff to plead particularized allegations that the plaintiff either:
 - made a pre-suit demand on the board that the board wrongfully refused; or
 - was excused from making a pre-suit demand because the board's conflicts would have rendered a demand futile. (See *City of Pontiac Gen. Employees' Ret. Sys. v. Bush*, 2022 WL 1467773 (N.D. Cal. Mar. 1, 2022); *Elliemaria Toronto Esa*, 2021 WL 3861434; *Lee v. Frost*, 2021 WL 3912651 (S.D. Fla. Sept. 21, 2021); *In re Danaher Corp. S'holder Deriv. Litig.*, 549 F. Supp. 3d 59 (June 28, 2021); *Falat v. Sacks*, 2021 WL 1558940 (C.D. Cal. Apr. 8, 2021); *Ocegueda*, 526 F. Supp. 3d 637.)

For more on the pre-suit demand requirement in shareholder derivative actions, see [Practice Note, Litigating Demand Refusal and Demand Futility in a Shareholder Derivative Action](#) and [Practice Note, Pre-Suit Demand Pleading Procedure in a Shareholder Derivative Action](#).

Suits Challenging Workplace Sexual Harassment and Gender Discrimination

The Delaware Court of Chancery recently denied dismissal of a defendant officer in *In re McDonald's Corp. Stockholder Derivative Litig.*, a derivative action in which the shareholder alleged the officer breached his fiduciary duty of oversight by failing to prevent a culture of sexual harassment that persisted in the McDonald's Corporation. The defendant officer personally engaged in sexually harassing behavior. The Court of Chancery held for the first time that corporate officers owe a duty of oversight. (*In re McDonald's Corp. S'holder Deriv. Litig.*, 289 A3d 343,

358 (Del. Ch. 2023).) This holding could portend new suits against corporate executives for alleged breaches of the duty of oversight (referred to as *Caremark* claims), including for alleged ESG failures. The complaint was later dismissed against the defendant directors (*In re McDonald's Corp. S'holder Deriv. Litig.*, 291 A3d 652, 674 (Del. Ch. 2023)).

In 2020, Signet Jewelers settled a securities fraud class action which included claims under Sections 10(b) and 20(a) of the Exchange Act, alleging Signet Jewelers misled investors about a culture of sexual harassment and gender discrimination at the company. The parties settled the class action for \$240 million. (*In re Signet Jewelers Ltd. Sec. Litig.*, 2020 WL 4196468, at *3 (S.D.N.Y. July 21, 2020).) Although most shareholder actions challenging DEI issues have been derivative, *In re Signet Jewelers* is an example of a direct shareholder action that resulted in a large settlement for the plaintiffs.

What types of claims are being asserted against DEI initiatives, and how can companies avoid these claims?

Q&A with [Mike Delikat](#) at *Orrick*

Recently, a new wave of activist shareholder demands and proposals have sought to move away from ESG commitments with demands for retraction of certain DEI initiatives, accompanied by threats and actual filings of cases alleging reverse discrimination under Title VII, Section 1981, and state antidiscrimination laws. For example, a suit is pending against Starbucks in the US District Court for the Eastern District of Washington, where Starbucks and the individual officer and director defendants have filed a motion to dismiss (*Motion to Dismiss, Nat'l Ctr. for Pub. Policy Rsch. v. Howard Schultz*, No. 2:22-CV-00267-SAB (E.D. Wash., May 19, 2023).)

Individual reverse discrimination suits by employees claiming that DEI policies discriminate against white male employees have also been on the rise, with a recent jury verdict of over \$10 million, reduced to approximately \$4 million on post-trial motions, in favor of a senior executive who convinced a jury he was fired to further the stated goals of the company's DEI program (*Duval v. Novant Health Inc.*, 2022 WL 3331263 (W.D.N.C. Aug. 11, 2022)).

To avoid these kinds of securities law and employment law claims, companies should:

- Have employment counsel review their current DEI initiatives and programs to make sure they are legally compliant.
- Frame corporate objectives in favor of DEI initiatives to include achieving long-term value for shareholders.
- Train managers on compliance with Equal Employment Opportunity (EEO) laws when implementing DEI initiatives.
- Avoid overpromising actual results on representational goals and timetables, focusing more on progress instead of outcomes.

What types of ESG-related shareholder actions do you anticipate in the future?

Q&A with [Andrea Mazingo](#) and [Alex Talarides](#) at *Orrick*

The volume of securities fraud class actions and shareholder derivative litigation will likely increase if the SEC finalizes the new climate-related disclosure rules as expected and proposes more detailed disclosures for human capital management issues. For climate change disclosures, public company reporting is governed by existing SEC regulations and interpretive guidance issued more than ten years ago. Based on this guidance, many companies continue to disclose only high level, generalized risks about climate change that can be difficult to challenge as material misstatements or omissions.

The new proposed rules would require companies to disclose climate risks in much greater detail, including information on the governance of climate-related risks and risk-management processes, the potential impact of climate-related risks, and, in some cases, the quantity of greenhouse gas emissions in the company's value chain, and goals and targets for reducing the emissions. These more specific and detailed reporting requirements create more risk that actual company results may fail to align with company statements. If, for example, a company fails to meet an emissions target and also suffers a stock price decline, investors may file securities fraud actions claiming that the failure to meet targets resulted in the decline.

The new rules are also likely to give additional ammunition to activist shareholders in pushing pro climate-related practices or results. Activist shareholders may seek to inspect corporate books and records to prepare and file shareholder derivative litigation alleging that the board of directors breached their fiduciary duties by failing to implement adequate processes to tackle

climate change issues or by otherwise failing to prevent an adverse climate change-related event.

For information on preparing ESG disclosures and understanding market participant expectations, see [ESG Disclosure Toolkit: US](#).

What types of shareholder and consumer claims have been brought in court to address climate change issues?

Q&A with [Andrea Mazingo](#) and [Alex Talarides](#) at *Orrick*

Shareholder suits challenging companies' climate change policies often are brought as securities class actions challenging the accuracy of the companies' climate-related disclosures. For example, a recent securities class action filed against Danimer Scientific Inc. alleges violations of the Exchange Act and SEC Rule 10b-5 after the company purportedly exaggerated its product's biodegradability in oceans and landfills. The action was filed after various news reports suggested the product was not as biodegradable as claimed and Danimer's stock prices fell. (Consolidated Complaint, *In re Danimer Sci., Inc. Sec. Litig.*, No. 1:21-CV-02708 MKB (E.D.N.Y. May 14, 2021).)

Plaintiffs have also sued under state false advertising laws, claiming companies' climate-related statements are false and misleading. For example, a shareholder recently sued Delta Airlines in California federal court for allegedly falsely advertising the company's carbon neutrality (Complaint, *Mayanna Berrin v. Delta Airlines, Inc.*, 2:23-CV-04150 (C.D. Cal. May 30, 2023)). Similarly, Coca-Cola was sued by plaintiffs who claimed the company's statements about climate goals and its bottle labels proclaiming 100% recycling were false and misleading. The claims against Coca-Cola, made in two separate suits, were defeated on motions to dismiss. (*Earth Island Inst. v. Coca-Cola Co.*, 2022 WL 18492133 (D.C. Super. Ct. Nov. 10, 2022); *Swartz v. Coca-Cola Co.*, 2022 WL 17881771 (N.D. Cal. Nov. 18, 2022).)

Other than actions challenging climate change-related disclosures, in what other areas can climate change-related actions arise?

Q&A with [Stacy Kray](#), [Crystal Milo](#), and [Jonathan Nail](#) at *Orrick*

Climate change litigation can also arise from the alleged harm to the environment caused by current or historic

greenhouse gas emissions. For example, multiple states have recently filed litigation against fossil fuel companies seeking to hold the companies responsible for losses caused by extreme weather events, like fires and floods. Many of these recent actions have been founded on a failure to warn investors and consumers of the risks of climate change, theories similar to states' largely successful past actions against cigarette companies related to the harm caused by tobacco products.

The Environmental Protection Agency, the Department of Justice (DOJ), and state and local regulators may also bring enforcement actions for failing to meet greenhouse gas emission requirements found in various environmental regulations. Governmental enforcement actions and private lawsuits involving greenhouse gas emissions and climate change have cited violations of the federal Clean Air Act, the Endangered Species Act, the National Environmental Policy Act, and various other statutes and common law theories. Climate lawsuits based on environmental justice theories should also be on the radar for companies. For example, the DOJ formed the first-ever Office of Environmental Justice in May 2022, which has begun enforcement activities against corporate and governmental entities under a variety of environmental laws.

How can companies, directors, and officers prepare for the increased focus on ESG issues in litigation? What can they do to avoid liability for Caremark and corporate waste claims?

Q&A with [Jaryn Fields](#) at *Orrick*

The evolving threat of ESG litigation has created new considerations for public companies, including their directors and officers. Historically, ESG disclosures were not always well-integrated into public companies' overall governance framework, but investor demand is beginning to drive public companies to develop and disclose policies linked to various ESG measures. As investors increasingly use ESG disclosures in evaluating their investment decisions, public companies need to be increasingly thoughtful in developing an ESG framework that can best mitigate ESG litigation risks.

In assessing these risks, directors and officers should consider:

- Developing a functional corporate governance framework with clearly delineated roles and responsibilities for members of management and directors. This may also include incorporating ESG into a company's internal control function. In light of recent Delaware Supreme Court and Court of Chancery decisions permitting *Caremark* claims to move past the pleadings stage, Delaware companies should ensure that there are governance systems in place to allow directors to effectively evaluate ESG disclosures and the overall ESG framework (see, for example, *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019)). These systems may need to be tailored over time, and companies should not be afraid to revise their governance frameworks as the need, or best practice, arises.
- Conducting a proper internal review of ESG disclosures to ensure that management, directors, and the employees with subject matter expertise have access to ESG disclosures before they are made publicly available. A broad range of subject matter experts need to be a part of the review process.
- Ensuring that director discussions on ESG metrics, disclosures, and reports take place at regular cadences (and more frequently as the need arises), and that these discussions are memorialized in board minutes.
- Conducting a comprehensive review of employment and indemnification agreements, as well as a review of the scope of the directors and officers (D&O) insurance policies to ensure that liability for ESG risks is properly addressed.

In sum, an effective governance framework is the best tool to manage ESG risks. Every company will have different needs specific to their industry, size, and investor base, but the tips above will help focus the process. With plaintiffs testing novel ESG litigation strategies and the SEC considering implementing disclosure requirements for climate change, cybersecurity, and other ESG-related topics, companies should ensure that ESG risks can be appropriately managed and effectively mitigated as ESG litigation risk is on the rise.

For resources on ESG policies, and training, see [ESG and Sustainability: Policies and Training Toolkit \(US\)](#).

For a model presentation to board members and others who may need training on ESG issues, see [Standard Document, Environmental, Social and Governance \(ESG\): Introduction to Risks, Regulation and Reporting Requirements: Presentation Materials](#).

Do you expect more litigation arising from ESG contractual requirements?

Q&A with [Ashley Walter at Orrick](#)

Over the last few years, there has been increased focus on the development of robust ESG contractual provisions as a method to require business partners and vendors to agree to ESG standards. Flowing down these ESG contractual requirements has proven challenging, as companies may find that suppliers have not developed their own ESG policies and practices, or that the ESG policies and practices that suppliers have developed do not neatly align with the company's approach, with the possibility of material gaps. Generally, customers (that is, buyers) have eschewed strictly enforcing these provisions in favor of working with cooperative suppliers to improve performance and capacity for adherence. However, given the growing scrutiny on supply chains and oversight of supply chain-related risk, customers may seek to enforce ESG provisions, particularly for uncooperative suppliers.

One of the more challenging aspects of drafting ESG provisions relates to the obligations and performance of suppliers up the supply chain (that is, beyond the first tier). Customers will generally look to require the direct supplier to impose on its suppliers requirements equivalent to the requirements being imposed on the direct supplier, and potentially require the direct supplier to take action to cause or monitor the compliance of upstream suppliers. As full supply chain mapping becomes more common (for example, it is contemplated by the Uyghur Forced Labor Prevention Act and some greenhouse gas reporting protocols), these flow-down provisions will likely become more fulsome, and customers will become more aggressive in requiring suppliers to undertake obligations with respect to suppliers upstream.

For resources on ESG issues as they relate to supply chains, see [ESG in the Supply Chain Toolkit](#).

Is there ESG-related litigation outside of the US that US practitioners should keep an eye on?

Q&A with [Timo Holzborn and Karsten Faulhaber at Orrick](#)

In Europe, ESG-related litigation arises in a variety of situations. A primary target has been the fossil fuel

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industry. Media attention was attracted by the case *Milieudefensie v. Royal Dutch Shell plc*, in which a Dutch court determined that the global giant Shell is obligated to reduce its CO2 emissions by 45% by 2030 (compared to 2019). Another notable case is the pending suit by a Peruvian farmer to hold the leading German power generating company RWE accountable for catastrophes caused by climate change. Additionally, environmental activists pursue claims on an administrative level, such as challenges of permits or claims for specific actions by public authorities, including the reduction of traffic in inner city areas.

ESG-related litigation is further relevant under the recent EU Green Deal legislation (EU-Taxonomy, Sustainable Finance Disclosure Regulation (SFDR), Corporate Sustainability Reporting Directive (CSRD), and Green Bond Standard

(EUGB)), which affects US subsidiaries active in Europe. Aimed at activating private investments, the legislation requires considerable non-financial disclosure, ranging from climate data to social responsibility data, under a new accounting standard. This enables third parties to assess the risks arising from sustainability issues and undertake a comparison with peers, but it also means this data may become the subject of disputes. Companies will have to adapt continuously to this dynamic regulatory landscape. Companies should also review the proposed EU Corporate Sustainability Due Diligence Directive (CSDDD), which will establish due diligence duties for directors.

For resources on ESG matters across jurisdictions, see [Global Environmental, Social and Governance \(ESG\) Toolkit](#).

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