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SPECIAL REPORT Q&A June 2021

Climate and ESG-related disputes

FW discusses climate and ESG-related disputes with David Schreuders, Emily Blower, Etienne Kowalski, Harald Glander and Stuart Doxford at Simmons & Simmons LLP.

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Q&A:

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THE PANELLISTS

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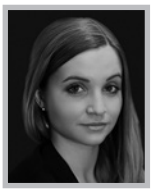

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Emily Blower is a supervising associate in the dispute resolution group in London, with a wealth of experience dealing with substantial, high-profile disputes, including parallel proceedings arising from the same event. She has a special interest in ESG disputes and risk management and is a member of Simmons & Simmons' ESG Disputes practice. Her work has involved advising clients in relation to climate change and other ESG risks, environmental pollution and business and human rights.

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FW: Reflecting on the last 12 months or so, how would you describe general awareness and discussions around climate and environmental, social and governance (ESG) issues? What factors are driving these points up the corporate agenda?

Doxford: ESG considerations have never been more important, both in the UK and globally. The legislative and regulatory environment is changing fast and investors, stakeholders, current and prospective employees, ratings agencies and lawmakers are more focused on ESG strategy than ever before. ESG is now on most board agendas. The 'environment' in ESG has been the principal focus for some time, primarily in the context of the EU Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Framework Regulation, but the focus is broadening out from the environmental aspects of ESG and into the 'social' in ESG. Companies are more focused than ever on what their corporate purpose is and what to do with ESG. What are they really trying to achieve?

Schreuders: In the Netherlands, general awareness and discussions around climate and ESG have increased in recent years. For example, in May 2019, the Judicial Division of Administrative Law in the Council of State found that the government's policy regarding nitrogen deposition was not in line with the EU Habitats Directive. And in December 2019, the Supreme Court ordered the State to take action against climate change in the *Urgenda* case. This decision was based on the UN Climate Convention and the European Convention on Human Rights. In terms of the 'social' domain in ESG, human rights issues such as anti-discrimination and modern slavery are topical, and the issues covered are broad. Last year, for example, large companies such as Gillette, Bavaria and Zespri withdrew their commercials from a Dutch television programme because one of the presenters had made distasteful jokes on the Dutch equivalent of the Black Lives Matter (BLM) movement. We also saw earlier this year, Dutch importers of solar energy panels being heavily criticised because their raw materials were mined in areas of China where the Uyghur people were subject to forced labour by the Chinese government. So, we really are talking about a broad ranges of issues.

Kowalski: There has been growing awareness of climate and ESG issues in France. Since 2017, under French law, companies are required, via the publication of a due diligence plan – referred to as a vigilance plan – to identify risks to human rights and fundamental freedoms, personal health and safety and the environment, take appropriate actions to mitigate risks or prevent serious harm and implement a system to ensure alerts are raised for risks that emerge. There has been an increase in cases before the French courts relating to breaches of this law and particularly relating to a lack of information in vigilance plans. Moreover, since 2019, companies can specify their corporate mission in their articles of association. By adopting a corporate mission, companies are bringing ESG to the core of corporate strategy and publicly defining the undertakings and values that guide their strategy, and to which internal resources should be applied. ESG issues are therefore a key element of corporate strategy and the number of CAC 40 index companies' board committees focused on ESG has doubled since 2019.

Glander: The consideration of ESG factors by asset managers, which is my area of focus, is not a new phenomenon but its significance for EU-domiciled asset managers is growing. With a combination of the recent legislative initiatives, the implementation of the new regulatory ESG framework, regulatory scrutiny and continued media coverage of sustainability, ESG has become an increasing priority for investors and, therefore, a key consideration for asset managers. It is important to note that many institutional asset managers are stressing that ESG is driven not only by regulations, but also by investors and clients who are demanding sustainable products.

Blower: ESG considerations are now firmly in the world's mind. This is, in part, in response to a changing global attitude to ESG, including as a result of global initiatives such as the climate emergency, and the BLM and #MeToo movements. As such, we are seeing a significant reset of stakeholder – regulators, shareholders, investors, consumers and employees – expectations of companies across industries in respect of their ESG impacts, their corporate purpose and their ability to identify and manage ESG-related risks. Although climate change remains the predominant focus, with a particular

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emphasis on reaching 'net zero', other environmental factors such as biodiversity loss, as well as social and governance issues, are coming into the fore. This is reflected in the increasing amount of legislation and regulation introduced, or proposed, on E, S and G matters, as well as soft law and industry guidance nationally and internationally.

FW: Are you seeing an increase in disputes arising from climate and ESG issues? What are the associated risks for companies in this area?

Kowalski: In France, there is an increase in disputes arising from climate and ESG issues, especially disputes brought by non-governmental organisations (NGOs) supported and echoed by public opinion. In February 2021, the Paris Administrative Court found the French state guilty of failing to meet its commitment to curb greenhouse gas (GHG) emissions and, in particular, the engagement taken as signatory of the Paris Agreement. This ruling has confirmed that courts are able to control the state's climate policy and GHG emissions, not only in the adequacy of the targets, but also in the measures implemented. It is foreseeable that courts may take a similar approach with companies, which will see them facing increasing risks related to their climate change engagement.

Blower: While the UK may not be as progressed as other jurisdictions in these types of disputes, a series of recent court decisions is broadening the reach of corporate accountability for the acts of third parties, such as subsidiaries and suppliers. These claims could fuel the interest of claimant law firms and litigation funders, encouraging claims arising from ESG issues, such as environmental pollution and modern slavery. That said, these claims have only been considered at summary judgment. The attraction of English courts is ultimately likely to depend on whether an actual, rather than merely arguable, corporate duty of care is established once these cases are considered on their merits. These decisions place pressure on UK companies to manage risks across their groups and supply chains, particularly in the current ESG-focused climate. A failure to mitigate these risks could result in litigation, not only for the damage caused by the third party, but also, for example, any misrepresentations made in the company's statements or disclosures, or breaches of statutory duty. It may also cause significant harm to a company's reputation and share value.

Doxford: Even though disputes and regulatory investigations that centre around ESG remain in their infancy in the UK, we are expecting to see a spotlight, post-COVID-19, in relation to government support, employee treatment and supply chain management. The pandemic crisis has highlighted the need to build resilience across all sectors. Corporate reputations aside, businesses face significant regulatory and litigation risks, including claims arising from the misselling and greenwashing of ESG investments at a product level and entity level, data breaches, issues with internal culture and conduct, directors' liabilities and reporting, and inadequate due diligence. The most talked about and obvious litigation risk is greenwashing. The most likely basis of a claim would be in misrepresentation, but duty of care or advisory claims and breaches of statutory duty are also possible.

Glander: Due to the increasing importance of ESG in the EU, in particular from an investor perspective, companies are facing not only challenges in satisfying investors' demand but also mitigating risks associated with reputation, increasing regulatory requirements, such as disclosure requirements under the SFDR, and consequential exposure to claims for damages by respective investors.

Schreuders: In the Netherlands, as regards climate change, the nitrogen deposition case is considered a pilot case, which assumes that more are to follow. As for human rights, there was a case against a leading Dutch dredging company which

allegedly was responsible for damaging an Indonesian fishing community. The case against Shell is also significant. In this case, the Court of Appeal in The Hague ruled that the parent company of Shell was liable for oil spill damages inflicted on a rural community in Nigeria by its subsidiary in that country.

FW: Have any recent climate or ESG-related cases caught your attention? What insights can we draw from these disputes and their outcome?

Doxford: There have been some interesting cases regarding the financial risk of climate change and how companies should identify and manage that risk. Perhaps most interestingly recently, in Australia, a pension fund settled a claim, agreeing that its trustee had a duty to manage that risk. It also agreed to manage its investments with a goal of net zero emissions by 2050.

Glander: There has recently been an interesting judgment by the First Senate of the German Federal Constitutional Court that held that certain provisions of the German Federal Climate Change Act (*Bundes-Klimaschutzgesetz* – KSG), governing national climate targets and the annual emission amounts allowed until 2030, are incompatible with constitutional rights (*Grundrechte*) insofar as they lack sufficient specifications for further emission reductions from 2031 onwards. The KSG stipulates that GHG emissions shall be reduced by at least 55 percent by 2030, relative to 1990 levels. Further, the KSG sets out the reduction pathways applicable during this period by means of sectoral annual emission amounts. The Federal Constitutional Court is of the view that this mechanism violates the constitutional freedom rights (*Freiheitsrechten*) of the young complainants as it irreversibly offloads major emission reduction burdens onto periods after 2030. To meet the constitutional climate goal stemming from the German Constitution (*Grundgesetz*), and the Paris target, the reductions are still necessary after 2030 and will have to be achieved with ever greater speed and urgency. The Federal Constitutional Court is of the view that these future obligations to reduce GHG emissions have an impact on practically every type of freedom because so many aspects of human life still involve the emission of GHG and are therefore potentially threatened by drastic restrictions after 2030. Therefore, the German legislator should have taken precautionary steps to mitigate these major burdens in order to safeguard the freedom guaranteed by fundamental rights as the statutory provisions on adjusting the reduction pathway for GHG emissions from 2031 onwards are not sufficient to ensure that the necessary transition to net zero is achieved in time. In accordance with the order of the Federal Constitutional Court, the German legislator must now enact provisions by the end of 2022 that specify in greater detail how the reduction targets for GHG emissions are to be adjusted for periods after 2030. This is a very important decision. It has shown that the targets set forth by the Paris Agreement are constitutionally binding. The German legislator must now amend the KSG by setting significantly more ambitious targets and instruments to meet the agreed targets, which will have an impact on, among others, the German economy.

Schreuders: The Shell oil spill case in the Court of Appeal in The Hague is important because it involves a parent company in a strict liability context. However, the Court of Appeal had to apply Nigerian laws, where strict liability was codified. From this perspective, the verdict should be considered as case-specific. In the case against the dredging company, a different court ruled that the NGO's claim was inadmissible because of a lack of connection to the Dutch legal system. The court found that the claim did not meet jurisdiction requirements that were recently sharpened.

Blower: In an ongoing claim against Shell in the Hague, the court has been asked to order Shell to expedite the reduction of its GHG emissions. If successful, it will mark a significant shift in climate cases against companies, from damages claims to corporate responsibility for climate change. If successful, emissions-based claims, once reserved for oil and gas companies, could soon find other targets, such as technology companies whose operations result in significant carbon emissions. Another interesting case worth flagging is a shareholder claim in Poland which prevented the defendant company from building a new coal factory because its construction would harm the economic interests of the company and its shareholders as a result of climate-related financial risks.

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Kowalski: Lawsuits are multiplying in France in relation to the duty of vigilance law I described earlier, particularly in relation to the environment. Total, for example, has been summoned twice in the past two years for non-compliance: in October 2019 for the non-revision of its vigilance plan in order to take into account an oil project in Uganda and in January 2020 for not including enough substantial details in its vigilance plan to curb carbon emissions. More recently, at the beginning of March 2021, a lawsuit was filed in a French court against the Casino Group, a large supermarket chain, claiming that the business' supply chain practices in Brazil and Colombia are linked to land-grabs and deforestation in the Amazon. This last case illustrates that corporate duty of care applies to the entire supply chain and that companies will not be spared from any risks and infringements identified with regard to the activities of subcontractors and suppliers.

FW: Have you seen any notable developments in climate and ESG-related regulation? How do you envisage the scope for disputes as new regulation is introduced and public interest in the subject increases?

Blower: The legislative push towards mandatory human rights and environmental due diligence requirements across the EU and in the UK reflects the increasing stakeholder focus on corporate accountability for ESG issues. In the UK, the government has announced that it will introduce "an ambitious package of measures to strengthen and future-proof the Modern Slavery Act's transparency legislation". Furthermore, a mandatory environmental and human rights due diligence obligation has been proposed for the Environment Bill. Where businesses do not undertake due diligence of their operations and supply chains in relation to ESG issues, or fail to do so adequately, they expose themselves to regulatory risk, as well as to the risks of civil claims, reputational damage and share value loss.

> THE CREATION OF THIS ENVIRONMENTAL CJIP IS A SIGN OF FRANCE'S COMMITMENT TO COMBATTING CLIMATE CHANGE, AS WELL AS THE CREATION OF AN 'ECOCIDE' OFFENCE ADOPTED BY THE PARLIAMENT DURING DISCUSSION OF THE NEW ENVIRONMENTAL BILL.
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> ETIENNE KOWALSKI
> Simmons & Simmons LLP

Kowalski: A notable development is the French legislation imposing mandatory due diligence frameworks which inspired the European parliament to introduce, on 10 March 2021, a resolution recommending that the European Commission adopt a directive on corporate due diligence and corporate accountability. Regarding climate offences, the French parliament expanded, in December 2020, the scope of a corporate settlement mechanism known as a judicial public interest agreement (CJIP), to include environmental offences alongside corruption, tax fraud and other financial crime. The creation of this environmental CJIP is a sign of France's commitment to combatting climate change, as well as the creation of an 'ecocide' offence adopted by the Parliament during discussion of the new environmental bill.

Schreuders: In the Dutch dredging case, the claimant NGO lost its case because of a lack of connection to the Dutch jurisdiction. However, there is new legislation in the Netherlands that makes it easier to acquire legal standing in the Dutch courts in ESG-related civil matters: the Mass Damage Settlement Act in Collective Action, which came into force in January 2020. Separately, the Dutch Child Labour Prevention Act was published in November 2019 and is expected to enter into force in 2022. This law relates to mandatory supply chain due diligence requirements, with regulatory and criminal enforcement. Finally, in March 2011 a legislative proposal called the Bill on Responsible and Sustainable International Business was lodged. The proposed bill focuses on the implementation of the Organisation for Economic Co-operation and Development (OECD) guidelines for multinational enterprises that deal with human rights, employment and industrial relations, and the environment. It is anticipated that this development in the Netherlands could have the impact of speeding up European compliance with the guidelines.

Glander: In Germany, notable developments in domestic ESG-related regulation are the adoption of a draft supply chain act by the German Federal Cabinet, the passing of a draft bill to strengthen Germany as a fund jurisdiction, and the implementation of directive (EU) 2019/1160, which amends Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings by the German Federal Parliament. On 3 March 2021, the German Federal Cabinet adopted a draft of a Supply Chain Act which establishes duty of care obligations with regard to internationally recognised human rights. It is envisaged that the German Federal Parliament will pass the Supply Chain Act in the current legislative period.

Doxford: The increasing responsiveness of the UK market to climate and wider sustainability issues, combined with related mandatory and voluntary disclosures, will increase both regulatory and litigation risk. We can expect the financial regulators, and particularly the Financial Conduct Authority (FCA) to challenge firms where it sees potential greenwashing of products and potentially also around breaches of mandates. We expect the FCA to be looking closely at the quality of climate risk controls and governance to ensure that there is proper understanding, oversight and accountability around climate risk and related disclosures. Senior engagement is also needed with that, as there is a senior management requirement here. A company's disclosures will also be scrutinised by its stakeholders, increasing the chances of those stakeholders then holding the company and its directors to account.

FW: In the event a company becomes embroiled in a climate or ESG-related dispute, how should it respond? What initial assessments generally need to be made?

Kowalski: Companies should keep in mind that climate disputes and ESG may arise from what they have declared they are doing and not what they actually do. This distinction in mind, an initial assessment should identify the issues raised and all related information and data should be gathered in order to assess the accuracy of the claim. Then, companies should be ready to produce data evidencing actions or processes, their quantitative impact and list them in a vigilance plan that can effectively control the risk identified.

Schreuders: A proactive approach is always better than a reactive one. This means that companies should anticipate comprehensive ESG legislation. A first step in this proactive approach is to conduct thorough risk assessments, followed by building robust compliance programmes and also including transparency and disclosure provisions in contracts with parties in the supply chain. Because the violation of human rights and corruption often walk hand-in-hand, a practical step-up is to make use of already existing anti-corruption compliance systems. This could also result in companies complying with the law not just out of fear of being fined, but because companies as a whole have higher integrity standards. And companies with high ESG ratings could become more attractive to investors: the shift from 'corporate values to company's value'.

Doxford: The company should conduct a thorough investigation of the relevant operation, subsidiary, supplier, investment or product, as appropriate, as well as the due diligence, disclosures, statements and decisions made in relation to it at the relevant time in order to assess the allegations. One of the biggest challenges, at an early stage, is piecing together decision making relating to, for example, a particular disclosure or categorisation of a product. For this reason, a part of mitigating ESG disputes risk is having a robust and defensible audit trail of decision making in place. This makes the early stages of addressing an ESG-related dispute easier to get a handle on, and also any subsequent investigations cheaper and more efficient to carry out.

Blower: The nature of many ESG risks means that, if not managed, they bring the potential for regulatory enforcement, civil claims and criminal sanctions, potentially all at once. At the outset of any climate or ESG dispute, the company should assess the possibility of parallel proceedings, and actively manage the interplay of the various issues that will arise, including balancing strategic interests, managing multiple stakeholders, handling case materials, liaising with witnesses and addressing related decisions and judgments.

Glander: If a company becomes embroiled in an ESG-related dispute, it should, in coordination with external service providers such as legal advisers and communication experts, assess legal, commercial and reputational risks. For this purpose, it should conduct an internal investigation to collect relevant information for an initial assessment. Based on this information, the company may address the specific ESG-related dispute in the most appropriate manner.

FW: What advice would you offer to companies on avoiding accusations of greenwashing and mitigating the risk of climate or ESG-related disputes?

Blower: The time to conduct internal due diligence, anticipate risks and put in place robust processes and data management is now. Companies should

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consider auditing their operations, supply chains and investments. They also need to implement quality controls and governance to ensure that they adhere to any standards adopted, as well as any ESG-related targets they may have, or due diligence or disclosure obligations. Following the UK Supreme Court decision in *Okpabi v Shell*, some companies may be deterred from implementing group-wide ESG policies because of a perceived risk of parent company liability. Conversely, one of the better solutions for avoiding such liability is to ensure that ESG risks are effectively mitigated through appropriate ongoing due diligence and parent company-level grievance mechanisms. Furthermore, companies are increasingly expected by their stakeholders to demonstrate how ESG policies are set, implemented and governed throughout the group. Ultimately, every company will need to consider how it balances these competing risks.

Kowalski: The first recommendation would be for companies to invest in ESG and be transparent about the real and measurable impact of their activities on climate and ESG issues. Recent cases brought before French courts demonstrate the willingness to identify in mandatory vigilance plans what could be considered missing or mitigated. To prevent accusations, we believe companies should conduct a detailed and thorough analysis and audit their activities with regard to climate or ESG risks. This should be done and validated by independent auditors. It should not be forgotten that, under French law, the entire supply chain should be taken into account. Companies should consider implementing ESG internal and external compliance processes to evaluate controls around ESG disclosure and measurement. This thorough analysis may be a good opportunity to engage the board, shareholders, employees, suppliers and clients and allow companies to set achievable quantitative targets.

Glander: In order to prevent greenwashing and mitigate the risk of climate or ESG-related disputes, companies should implement and continuously develop a robust internal framework covering three lines of defence, with functions that own and manage risks, oversee risks, and provide independent assurance and an external framework covering cooperation with external service providers.

> A PROACTIVE APPROACH IS ALWAYS BETTER THAN A REACTIVE ONE. THIS MEANS THAT COMPANIES SHOULD ANTICIPATE COMPREHENSIVE ESG LEGISLATION.
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Doxford: Consistency is key and there are a few important areas to focus on. A business should be reporting on an ongoing basis its performance against its sustainability objectives. This is about giving consumers the information they need to understand whether the stated objectives have been achieved in a quantifiable and measurable way. A firm should assure ESG data quality, understand their source and derivation, and articulate clearly and accessibly how it is used. Any product's ESG focus should also be clearly stated in its name and reflected fairly and consistently in its objectives. Where a product claims to target certain sustainability characteristics, or a real-world sustainability impact, its objectives should set these out in a clear and measurable way.

Schreuders: Regulated entities will have regulators who will address greenwashing. Mitigating liability risks for companies may be achieved by instituting ESG committees, which focus on analysing the present situation, identifying risks, determining metrics and goals, involving important stakeholders and setting priorities.

FW: How prominent are climate and ESG matters likely to be in the years ahead? What are your expectations for the nature and frequency of disputes in this area?

Glander: In light of the ambitious goals of the EU, we expect that the importance of ESG is likely to increase in the future. With the rising importance of ESG, we expect that the frequency of related disputes will increase in the near future.

Doxford: Businesses face increasing ESG expectations. This means a wider range of ESG targets, more focus on managing climate change and sustainability impacts, and more scrutiny over corporate purpose. Those that adapt to this challenge are likely to benefit, while those that do not face increased regulatory and conduct risks and the prospect of civil litigation. ESG risk is a focus for all, but the risk implications vary from sector to sector and business to business. Consequently, all businesses need to identify and manage their ESG risk. Directors and senior managers must reflect on whether they collectively understand enough about ESG matters to mitigate this risk. Reporting obligations on ESG issues continue to develop and the regulatory landscape is moving toward far

greater transparency on ESG issues. It is evident that any information disclosed by a company, and its senior managers, will be scrutinised – and therefore it follows that increased reporting will increase the chances of businesses being held to account.

Schreuders: Against the background of a recent shift in society about how people think about food, health and climate, as well as the fact that industries and leading global asset managers have shifted their focus to a different corporate goal, we believe that ESG matters will be increasingly important and are here to stay. Our expectation for disputes is that given the legislation initiatives, corporate compliance and risk management will be expanded with ESG factors as well. Legislation on mandatory due diligence will have no effect if an enforcement system is not incorporated. The legislative proposals contain provisions on a wide range of legal remedies: grievance mechanisms in a civil law context, civil claims based on international treaties and domestic laws as well as regulatory and even criminal enforcement. We expect that the frequency of disputes in ESG domains will increase in the near future.

Kowalski: The last couple of years have shown that climate and ESG issues and disputes are key drivers for citizens, as well as for states. This increase is due to citizens' growing interest, awareness and concerns regarding these issues. Another key factor is the implementation of regulations making it mandatory to address these issues in the years ahead. The power of public opinion will also drive companies to set ESG targets. In terms of disputes, we expect more cases to be brought before French courts and the first rulings may encourage claimants to initiate more claims which, in turn, will compel companies to address climate and ESG issues. We also expect claims, or at least questions, to come from shareholders and employees who wish to see a change in how ESG issues are addressed.

Blower: The COVID-19 pandemic has been a stark example of the devastation an ESG issue can wreak on the world's markets. As the world recovers, the focus is shifting to the next crisis: climate change and other ESG issues. We can therefore expect the increased regulatory focus on ESG issues to continue, as well as the rise in ESG due diligence and reporting obligations. Increased reporting will increase the chances of stakeholders holding companies to account. This may be through investment decisions, pressure on reputation, shareholders exercising voting rights or through civil liability actions. Novel claims are being brought across the globe. As they succeed, more will follow. ■