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DISCUSSING THE TRENDS

Q&A with Sara K. Orr and Bart J. Kempf

The Legal Risks Associated with Corporate Sustainability Reporting

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Investors, consumers and other stakeholder groups are driving a growing demand for companies to disclose more information about their environmental, social and governance (ESG) and sustainability practices. Many companies are responding to this demand by issuing sustainability reports and other ESG communications to the public. But what information should be included in these communications? Are there mandatory guidelines or strategies for ESG reporting? How is accurate reporting ensured? This lw.com interview defines ESG communications, discusses ESG reporting trends, standards and guidelines, and details how Latham & Watkins is helping companies address reporting risks.

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What are ESG communications?

Orr: When it comes to talking about "sustainability," different people use multiple names and terms to mean many different things, which is a bit confusing. So to be clear, when we use the terms "environmental, social and governance," or "ESG," and "corporate social responsibility," or "CSR," we mean, essentially, communications made by a company that are intended to convey to the public information about a company's behavior processes and other aspects of its operations related to its environmental compliance, social performance and corporate governance.

Why are ESG communications increasing in popularity?

Orr: As the sustainability "mega-trend" has developed over the past 10 years or so, there has been an increased focus by multiple stakeholders on the environmental and social performance of both public and private companies, and stakeholders are requesting more detailed information to be provided by companies about their ESG performance. The stakeholders asking for this information include consumers, non-governmental organizations (NGOs), local communities, investors, shareholders, and government agencies — particularly with respect to public companies that must disclose certain risks associated with climate change or usage of "conflict minerals."

Some major retailers also have their own sustainability initiatives which are establishing sustainability metrics for their suppliers. Due to the sheer scale of the affected companies that supply these retailers and the increased public demand for information about environmental and social performance, we are seeing now that the majority of companies seek to voluntarily disclose at least some ESG information to the public or within supply chains.

What are the mandatory sustainability reporting requirements that US companies must follow?

Orr: Currently in the United States, there are no broad regulatory mandates that require comprehensive sustainability reporting. Of course, public companies that file reports with the US Securities and Exchange Commission (SEC) are required to disclose certain CSR issues — for example, risks related to climate change or for companies that use certain metals, information required by the new conflict minerals disclosure rule. But generally, in the United States,

the ESG information that companies share on their websites and through social media is voluntarily disclosed.

There are mandatory requirements in other jurisdictions, like the European Union, which just adopted a directive in September of 2014 that requires certain public companies to disclose different ESG issues, including human rights, anti-corruption, bribery, environmental and social impacts, and diversity. Member states will have two years to implement that directive into their own laws. That's something that we're keeping a close eye on here at Latham, as many of our clients with operations in the European Union will need to evaluate the new requirements and make sure they are in compliance.

What are some commonly used types of reporting frameworks?

Kempf: There are currently dozens of voluntary sustainability reporting frameworks, and companies use a variety of requirements, standards, certifications, rankings and other metrics to demonstrate their sustainability performance. But during the last 15 years or so, a few standards have emerged as the leading lights, guiding companies in ESG reporting. The first is the Global Reporting Initiative, or GRI. GRI is an international not-for-profit organization, which was the first to issue sustainability reporting guidelines. The GRI guidelines were developed in partnership with NGOs and industry. Initially, their approach was quite broad, with more than 100 ESG indicators used mainly to promote change toward a more sustainable economy. GRI has been periodically updated over the course of the last 15 years, with the most recent fourth-generation of standards, or G4, having been released January 2015.

Another leading reporting group is the Sustainability Accounting Standards Board, or SASB. SASB was formed in 2011 as an alternative to GRI, but the focus of SASB is on US publicly listed companies. The overarching goal of SASB is to encourage sustainability reporting on ESG issues that are financially material to a particular business.

What are the trends you have been seeing in sustainability reporting?

Orr: Companies in the US have been sharing sustainability information for at least a decade, in various ways, without a comprehensive mandatory requirement. But many CSR professionals are predicting that some form of mandatory reporting will be required in the US in the next decade, similar to what the European Union is doing now. Companies will need to keep an eye on governmental discussions and, in particular, efforts by NGOs, environmental groups and community activists who are seeking to standardize this type of reporting.

While stakeholders push for more transparency, another trend is that companies are trying to find a standardized system focused on disclosing only material ESG items that impact the financial performance of the company. So instead of issuing a 100-page glossy annual sustainability report, which details every single one of the company's ESG initiatives with lots of engaging pictures, there is a movement towards focusing only on the major issues that could impact the company's bottom line. We think that's very interesting and something that would require some legal judgment as to what issues are considered to be material for the purposes of ESG reporting.

There is also a focus on supply chain due diligence and sustainability. One example of this in the mandatory reporting context is the conflict minerals rule that I mentioned earlier. Latham works with many public company clients and private company suppliers to comply with this rule's due diligence, auditing and reporting requirements. We are seeing a push for sustainability due diligence into other supply chains (outside of the "conflict minerals" context) as well, which may increase the volume of ESG data shared by companies as their customers demand the information.

Kempf: Another trend is digital, real-time data flow in sustainability reporting. For many years, as companies began to wrap their arms around their ESG performance, the primary way they would communicate their sustainability performance was through an annual, glossy sustainability report posted on the company's website or mailed in hard copy to shareholders, consumers and others. Over time, with the advent of social media and the Internet, companies have gradually moved toward releasing CSR information to the public in real time. For example, companies often have a dedicated website focused solely on its environmental and social performance. Companies are very active on social media as well. So, a lot of experts in the field are pointing to the fact that it is not so much about the annual report anymore — it is about companies conveying CSR information digitally, in a real-time manner.

Orr: In addition to companies being able to share this information with just a click of a button, government agencies also have similar abilities to easily release information about companies' environmental performances. There are now many online databases where you can look up a specific company's environmental compliance record or other

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environmental performance metrics, and compare that data with the information that companies are stating in their reports, websites and social media feeds.

What are the litigation risks for companies regarding mandatory and voluntary reporting requirements or standards?

Kempf: With respect to litigation risks in companies' voluntary CSR reporting, investor and consumer plaintiffs are becoming sophisticated in the legal claims they have been asserting, taking square aim at companies' CSR statements. What we are seeing in investor and consumer class actions is that plaintiffs are litigating their alleged reliance on sustainability communications, whether they are made through CSR reports, press releases or other voluntary means. Plaintiffs are claiming that they relied on those communications when making an investment or a purchasing decision.

For example, in the investor realm, we have seen several cases where a plaintiff has alleged that they relied on statements that companies made in their sustainability reports — statements about their worker-safety program or their environmental compliance. And then, subsequent to the statements made by the companies, there were industrial incidents, followed by a drop in the price of the company shares. Plaintiffs who held shares in those companies and allegedly were harmed or damaged by the drop in share price claim that they had relied on companies' statements about the quality of their workers' safety programs or environmental programs when making a decision to purchase and hold the shares – and were, essentially, wrongfully induced by the CSR statement into purchasing those shares.

In a couple of these cases, plaintiffs were able to survive motions to dismiss, which in litigation context is significant because if the defendant defeats a lawsuit in the motion-to-dismiss phase, then it has not invested a terribly significant amount of resources on the litigation. But if the plaintiffs' claims survive the motion to dismiss phase, the company may go through years of discovery and briefing, which of course vastly increases the amount of resources a company has to commit to defending on the litigation.

What are some of the risks associated with consumer class actions?

Kempf: On the consumer side, we've seen many class actions filed in the last couple of years, mainly in California, asserting state consumer protection claims. Generally, plaintiffs are alleging that they are making purchasing decisions based on companies' ESG statements, based on how the products are made in an environmentally friendly way, how they may or may not use animals in testing the product, and so forth.

In these cases, the plaintiffs are carefully scrutinizing companies' annual sustainability reports, statements made on companies' websites and then also reading other types of information about companies and their performance (whether it is from NGOs, documentaries or other third-party sources of information). Plaintiffs claim they are finding disparities between what is stated in the sustainability reports and what allegedly is happening in real life. Consumer plaintiffs then file a lawsuit saying that they were wrongfully induced into buying the company's product because of false and misleading statements in its sustainability reports or on sustainability websites. We have seen an uptick in those types of cases brought in the past several months. So plaintiffs are testing some legal theories, and we expect to see more of that in the coming months and years.

How does Latham help clients meet their mandatory and voluntary sustainability reporting requirements while managing the associated risks?

Orr and Kempf: Latham has vast experience with a variety of sustainability issues, including one of the largest environmental practice groups in the world. Our attorneys assist our public and private company clients with both mandatory reporting requirements (for example, SEC reports) and voluntary sustainability reporting disclosure, including working with companies to ensure that their ESG communications are consistent and accurate, and evaluating potential risks. We counsel our clients on how to best position themselves to both capture market opportunities related to sustainability while defending against inaccurate characterizations of their practices and products.

Our transactional attorneys assist companies, lenders and investors assess sustainability-related risks and benefits, and our regulatory teams help companies capture any possible regulatory benefits of their sustainability programs

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along with counseling clients on anticipated changes in the regulatory arena. Finally, Latham litigators are well-versed in defending securities, consumer and environmental class actions, including those involving claims related to sustainability. These are just a few examples of the ways in which Latham lawyers can provide full-service expertise to clients on a myriad of sustainability issues.

For More Information

For more information on this topic, download and read the February 24, 2015 *Law360* article by Sara Orr and Bart Kempf titled "Emerging Trends In Corporate Sustainability Reporting."

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