Corporate Sustainability

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This practice note (1) provides an introduction to the concept of sustainability; (2) generally describes the frameworks adopted by companies in connection with sustainability reporting; and (3) addresses recent trends related to sustainability disclosure, including an expansion of the working definition of sustainability, investor activism and emerging litigation.

Companies in the United States frequently release information about their corporate sustainability performance in a voluntary fashion. The trend generally encourages transparent business practices in the area of environmental protection, social responsibility, and corporate governance. However, voluntary disclosures can also trigger litigation risks. For further information on sustainability disclosures by US reporting companies, see Market Trends 2019/20: Proxy Enhancements.

What is Sustainability?

There are many names and terms used to describe sustainability. While there is no universally agreed definition, sustainability generally focuses on the balancing of business, social responsibility, and environmental protection by promoting transparency, better management of natural resources, regeneration of ecosystems, human rights, ethics, and improved quality of life. With respect to corporations, corporate sustainability generally refers to the mix of managing issues and risks related to economic, environmental, and social developments. This note will use the terms environmental social governance (ESG), sustainability, and corporate social responsibility (CSR) information interchangeably to mean a company's communications that are intended to publicly convey information about its behavior, processes, and other aspects of its operations related to its environmental compliance, social performance, and corporate governance.

Companies increasingly release ESG information in response to demands by a variety of stakeholders, including investors, consumers, supply-chain providers, nongovernmental organizations (NGOs), competitors, and the public. For example, many companies post annual sustainability reports on their corporate websites to provide their customers, investors, and others with information about their environmental and social performance. Companies also engage in social media campaigns and other marketing to promote their positive environmental and social activities. Given underlying trends, including evolving investor expectations, and litigation risks, it is important for counsel to identify potential risks and proactively engage with C-Suite and Board members on sustainability-related issues including disclosure decisions.

What Reporting Frameworks and Standards Guide the Disclosure of Corporate Sustainability Issues?

Approaches to sustainability reporting vary and there is a lack of consistency across companies or industries as to what and how ESG-information is disclosed. While some countries, states, and regions have made certain categories of CSR reporting mandatory (like the European Union and China), there are currently no broad regulatory mandates in the United States requiring comprehensive sustainability disclosure. Accordingly, since most ESG reporting in the United States is voluntary, there are a variety of approaches and a number of frameworks that a company may elect to follow in order to guide its ESG disclosure.

It is up to each company to select the ESG reporting framework that best meets its needs, often benchmarked against peers and competitors and based on its industry sector. Hundreds of reporting frameworks, standards, certifications, and other metrics, including industry-specific guidelines exist. Among these, key standards for voluntary reporting have been used by companies in recent years include:

1. Guidelines issued by the Global Reporting Initiative (GRI)

2. Standards issued by the Sustainability Accounting Standards Board (SASB) -and-

3. The framework of the International Integrated Reporting Council (IR)

Other frameworks have risen to prominence as complementary to the reporting structures. One example is the Task Force on Climate-related Financial Disclosures (TCFD) has gained prominence as a business-focused tool used in adjunct with other reporting standards to "help companies understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors' needs." Additionally, many companies have committed to the United Nations 2030 Sustainable Development Goals (SDGs), an ambitious set of goals adopted in 2015 that aim to combat and reverse the world's systemic challenges. The SDGs provide a shared framework for addressing sustainability issues across organizations, industries, and geographies and can help companies establish sustainability priorities and set quantifiable goals. Notably, the United Nation's Principles for Responsible Investing, to which many of the world's largest fund managers have signed on, are informed by the SDGs. See, e.g. Why the UN Sustainable Development Goals Matter to Clients.

As stakeholders seek standardization in order to accurately gauge material ESG-related risks and opportunities, there is increased focus on consolidation of and cooperation between frameworks. For example, in January 2020, the International Business Council of the World Economic Forum issued a consultation draft calling for the development of common and consistent ESG reporting metrics. On July 13, 2020 SASB and GRI announced a collaborative work plan that will help stakeholders review reports prepared under their respective frameworks. This trend is promising as it will help narrow the universe of potential frameworks and assist companies and stakeholders with ease of analysis.

Despite this trend toward standardized "material" reporting, the volume of ESG data and information released by companies is vast and easily accessible—thanks in large part to technology. For example, while some companies continue to prepare stand-alone annual sustainability reports following one of the above or other guidelines, many also engage in online, real-time CSR disclosure (such as through posts on social media). At the same time, governments are also making use of new technologies and automating the way data is shared with the public regarding companies' environmental, health, and safety compliance (including information about environmental performance provided via searchable, electronic databases). For example, the U.S. Environmental and Protection Agency and state environmental agencies maintain multiple databases that provide enforcement and compliance information by facility or company name, such as EPA's Enforcement and Compliance History Online database (ECHO). Other environmental-media specific databases like "AirData," which provides summaries of pollution data from two EPA databases, and similar databases also provide easily-accessible information to the public via online tools. Without a consensus on the metrics to be used when disclosing CSR information, this drive towards increased transparency also means increased risks.

Corporate Sustainability Trends

Three major corporate sustainability trends are driving business as of Fall 2020. First, the focus of sustainability action and activism has expanded to include environmental aspects beyond climate and a broader scope of social issues. Second, investor demands for robust ESG disclosures continue to rise, with no signs of slowing despite the reticence of U.S. regulators to mandate disclosure. Lastly, litigation challenging alleged misstatements or inconsistencies by companies in their voluntary sustainability communications is on the rise and diversifying. The corporate sustainability space is changing quickly and it will be important for reporting companies and their counsel to not only respond to company-specific investor concerns, but also keep apprised of global trends in ESG issues important to the investment community. These trends are discussed briefly below.

Expanded Scope of Sustainability Actions and Activism

The rise of ESG in the last decade has been synonymous with the rise of corporate climate change consciousness, until recently. In recent years, companies and their stakeholders have increased focus on other aspects of corporate sustainability, most notably, biodiversity and social issues. Against the backdrop of the COVID-19 pandemic, stakeholders will expect companies to address related risks.

Biodiversity conservation (protecting the variety of living species on Earth) has gained traction as a focal point for companies. Like climate change risk, investors are focusing on companies' plans to protect biodiversity and manage associated risks. In fact, a recent report shows that $44 trillion of value generation is dependent on nature and that biodiversity loss is linked to lower production yields and increased natural disasters. Notably, the COVID-19 pandemic has spotlighted research focused on the correlation between biodiversity loss and the proliferation of viruses, as scientists have begun to speak out regarding how biodiversity protects against infectious disease emergence and transmission.

International efforts to address biodiversity in a systemic manner are already underway. For example, a broad coalition of multinational organizations, NGOs, financial institutions and other stakeholders launched the Task Force for Nature-related Financial Disclosures (TNFD) in July 2020. The TNFD intends to redirect financing to nature-positive outcomes that correspond to the goals of international instruments including the Paris Agreement, the SDGs, and the forthcoming Global Biodiversity Targets. Additionally, companies seeking project financing from banks that subscribe to the Equator Principles must now comply with more stringent provisions related to biodiversity, adopted in the latest update (Equator Principles 4, effective October 1, 2020).

In addition to biodiversity, social issues have gained prominence over the past two years. For example, in 2018 the #MeToo movement drove many corporations to adopt comprehensive anti-sexual harassment policies, prioritize gender and racial diversity of leadership, and disclose and close gender pay gaps. In 2020, both the Black Lives Matter movement and the COVID-19 pandemic spotlighted corporate handling of social issues. In 2020, many companies announced widespread support for Black Lives Matter in a variety of ways, including by pledging funding for racial justice and developing diversity initiatives. The COVID-19 pandemic has also driven companies to emphasize employee and customer safety as their top priority, and many companies have mobilized to help communities in need. Stakeholders may be skeptical of public statements in support of social movements, and it is likely there will be increased focus on measuring corporate action with respect to addressing racial justice and public health issues.

Continued Investor Focus on ESG; Growing SEC Engagement

There have been calls from within the U.S. Securities and Exchange Commission (SEC) to address ESG disclosure requirements. For example, in May 2020 the SEC Investor Advisory Committee observed that "the use of ESG-related disclosures has gone from a fringe concept to a mainstream, global investment and geopolitical priority." On the heels of a statement by the Investor-As-Owner Subcommittee regarding sustainability, an ESG subcommittee was formed by the SEC's Asset Management Advisory Committee. The US General Accountability office weighed in in July 2020 with a report on public disclosure of ESG issues that concluded that investors are still not getting the ESG information they expect and need to make decisions. In 2016, over 26,000 public comments were submitted to the SEC in response to a concept release seeking public comment on sustainability related disclosures, showing clear interest on behalf of the investing public. Despite this, there is no consensus at the SEC on whether or not ESG disclosures fall within the agency's purview, and mandatory disclosure seems unlikely in the near future. See Pulling in Opposite Directions: Investor Community, US Regulators Diverge on Regulation of ESG Disclosures. In fact, on August 26, 2020, the SEC adopted long-planned amendments to Regulation S-K – the key rules guiding companies' disclosures with the SEC. Despite extensive comments on climate risk, human capital, and other ESG issues, those issues were largely ignored, with only modest amendments made to provisions related to human capital.

Institutional investors continue to try to fill this regulatory vacuum by publicly demanding more robust ESG disclosures and prioritizing ESG performance in their investment decisions. For example, the Climate Action 100+ initiative was formed in December 2017 to promote the goals of the 2015 Paris Agreement under the United Nations Framework Convention on Climate Change through investor participation in greenhouse gas emitting companies. The initiative now includes a group of 450 investors with collective control of more than US $39 trillion. In January 2018, Laurence D. Fink CEO of BlackRock (which manages more than $6 trillion in assets) sent shock waves with his annual letter to all CEOs in the S&P 500 emphasizing sustainability. He and other top asset managers have subsequently continued to focus on ESG.

With or without standardized reporting or mandatory disclosure requirements, companies are responding to increased investor focus on ESG issues with sustainability reporting and disclosure becoming the norm. For example, in 2011, approximately 20% of S&P 500 companies published some type of sustainability report while in 2019, a full 90% of them did so.

Litigation Risks

While it is perhaps well-known that sustainability issues can pose reputational risks to companies (for example, allegations of mismanagement of issues related to human rights, the environment, or employees), the risk of litigation by investor and consumer plaintiffs over voluntary disclosures has increased in recent years.

Securities Class Actions: Seminal Cases and Current Landscape

There have been a number of high profile securities class actions challenging companies' voluntary CSR statements. These cases generally make claims alleging reliance by consumers and investors on statements made in CSR reports, press releases, and during investor conferences that are allegedly untrue or inconsistent with reportable regulatory data.

By way of example, two high-profile securities class action decisions specifically addressed investors' alleged reliance on defendants' voluntary CSR statements, and both the Southern District of West Virginia and the Southern District of Texas held that certain CSR statements were actionable. In re Massey Energy Sec. Litig., 883 F. Supp. 2d 597 (S.D. W. Va. 2012); *In re BP P.L.C.*, No. MDL No. 10-md-2185, 2013 U.S. Dist. LEXIS 171459 (S.D. Tex. Dec. 2, 2013). Although these cases are not new, they remain relevant as part of the framework used by courts in analyzing whether shareholders can proceed on claims related to a company's CSR statements. Courts have since relied on the *Massey* case to permit investor class actions following major incidents, including another deadly mining accident and a massive data security breach. *In re Vale S.A. Sec. Litig.*, No. 19CV526RJDSJB, 2020 U.S. Dist. LEXIS 91150 (E.D.N.Y. May 20, 2020); In re Equifax Inc. Sec. Litig., 357 F. Supp. 3d 1189 (N.D. Ga. 2019). Likewise, courts have cited the *BP* case in dismissing similar cases on the grounds that the defendant company was merely engaged in inactionable "corporate cheerleading" by making statements that generalized positive goals rather than specific promises, unlike more specific statements made in the *BP* case. Police & Fire Ret. Sys. of City of Detroit v. Plains All Am. Pipeline, L.P., 777 F. App'x 726 (5th Cir. 2019); *Basin Edgar v. Anadarko Petroleum Corp.*, No. CV 17-1372, 2018 U.S. Dist. LEXIS 101780 (S.D. Tex. June 19, 2018).

In the aftermath of the April 2010 Upper Big Branch Mine incident that resulted in the death of 29 miners, a securities class action was filed against Massey Energy after a decline in its share prices. Following a 2006 fire, Massey Energy had released multiple statements in its SEC quarterly and annual filings, press releases, CSR reports and investor presentations promoting its commitment to safety. The court held that allegations in the plaintiffs' complaint regarding certain CSR statements about the company's safety record were actionable. Plaintiffs alleged that these statements were false and misleading in light of, among other things, defendant's fatality rate (alleged to be the worst in the nation) and the company's allegedly below-average compliance record under the Mine Safety and Health Act.

In permitting plaintiffs' *Section 10(b)* and Rule 10b-5 claims to proceed, the court found that plaintiffs adequately alleged statements by Massey that were materially false or misleading. Moreover, using defendant's safety violation record, plaintiffs sufficiently pled the false nature of the defendant's statements. Further, the court found that plaintiffs had shown justifiable reliance on the defendant's allegedly deceptive acts, and had shown the relationship between the drop in Massey's share price and news regarding Massey's true safety record. On June 4, 2014, the case settled with over $260 million awarded to class members. Order Awarding Attorneys' Fees and Expenses, *In re Massey Energy Sec. Litig.*, No. 5:10-cv-00689- ICB (S.D. W. Va., June 4, 2014).

The BP Deepwater Horizon incident in 2010 also triggered securities litigation in which a federal district court ruled that several BP CSR statements were actionable. *In re BP P.L.C.*, No. MDL No. 10-md-2185, 2013 U.S. Dist. LEXIS 171459 (S.D. Tex. Dec. 2, 2013). At issue were certain CSR statements of then-CEO Tony Hayward regarding BP's operating management system (OMS). Plaintiffs alleged that certain statements were "misleading because they repeatedly emphasized the all-encompassing, consistent nature of OMS, without disclosing that it was not designed to and would not apply to project sites owned by contractors." Such statements included, for example, that BP had implemented the OMS in the Gulf of Mexico in 2008.

The court held these and other statements to be actionable because six out of seven offshore drilling units in the Gulf of Mexico in early 2010 were owned by contractors and not BP, including, the Transocean-owned Deepwater Horizon. The case remains ongoing, and the court's ruling stands. Following the BP Deepwater Horizon incident, in addition to the private litigation noted above, the company also agreed to a settlement with the SEC and paid a $525 million penalty to settle charges of securities fraud. The SEC alleged that BP had made fraudulent public statements related to the flow rate of oil following the Deepwater Horizon accident. The SEC has since filed similar actions against other companies, as have state attorneys general.

Human Rights and Social Aspects: Expanding Scope and Novel Arguments

Consistent with a rise in importance of the "S" in ESG, there has also been a rise in shareholder litigation related to contemporary social issues. In recent years, plaintiffs have filed multiple unsuccessful consumer suits claiming that corporation's failure to disclose the possible presence of slavery, forced labor, and other human rights abuses in their supply chains has caused plaintiffs "economic injury." The First Circuit and Ninth Circuit Courts of Appeals have rejected these supply chain lawsuits for failure to state a claim for relief as a matter of law because the defendants had no duty under state law to disclose supply chain labor abuses on packaging, as such practices did not affect the product's central function. Tomasella v. Nestlé USA, Inc., 962 F.3d 60 (1st Cir. 2020); Hodsdon v. Mars, Inc., 891 F.3d 857 (9th Cir. 2018). In response, plaintiffs are taking a novel approach. In a case filed in 2019, rather than focusing on *omissions* by the defendant company, plaintiffs allege that the company made misrepresentations on its packaging where it states its products are "sustainability sourced" because the products are allegedly sourced from farms that rely on child slave labor. Thus far, the complaint has survived a motion to strike. Defendants have filed a motion to dismiss, which is expected to be briefed in Fall 2020. *Walker v. Nestlé USA, Inc.*, No. 3:19-CV-723-L-BGS (S.D. Cal., June 17, 2020). Relatedly, the U.S. Supreme Court has recently granted review of a Ninth Circuit decision allowing former child slaves to proceed on claims under the Alien Tort Statute against domestic corporations that allegedly aided and abetted child slave labor. *Nestlé USA, Inc. v. John Doe I* (No. 19-416); *Cargill, Inc. v. Doe I* (No. 19-453).

Numerous derivative shareholder suits have recently been filed against major corporations. In each of these cases, plaintiffs allege that the defendant company's board of directors breached their fiduciary duty by failing to carry out public statements about increasing diversity and inclusion within the company, including on the board itself. See, e.g., *Kiger v. Qualcomm Inc.*, 3:20-cv-01355-LAB-MDD (S.D. Cal. July 17, 2020); *Klein v. Oracle Corp.*, No. 3:20-cv-04439 (N.D. Cal. July 2, 2020). Although the complaints do not mention the Black Lives Matter movement, the cases come at a time of great societal concern regarding racial equality. COVID-19 has also inspired a number of shareholder lawsuits related to companies' public statements. For example, shareholders have filed lawsuits against companies regarding statements about customer safety and the adequacy of the companies' COVID response. See, e.g., *Hartel v. The Geo Group, Inc.*, No. 9:20-cv-81063 (S.D. Fla. July 7, 2020); *In re Carnival Corp. Securities Litigation*, No. 1:20-cv-22202-KMM (S.D. Fla. May 25. 2020).

Accordingly, false statements and omissions in CSR disclosures can create clear liability risks for companies in a variety of circumstances, including annual report, social media posts, SEC filings, forward looking statements in fact sheets, Health, Safety and Environmental reports displaying NYSE ticker symbols, operational fact sheets, and Annual Reports.

The trending litigation focusing on ESG issues reflects the importance of ensuring consistency and accuracy within a company's CSR communications and careful management of the types and content of voluntary ESG information released to the public.

Conclusion

As a practical matter, it is important for companies to manage the exposure and risk associated with increased disclosure of sustainability issues, regardless of context or whether the disclosure was voluntary. Teamwork between business managers, sustainability experts, and attorneys is critical to proactively address any potential risks. Attorneys can assist with identifying stakeholders, selecting reporting frameworks, and evaluating materiality of issues. Moreover, attorneys can help counsel the company on handling sensitive issues. For example, if an attorney is aware of threatened or pending litigation risks related to an ESG issue, he or she can recommend that its sustainability report or social media postings appropriately address (or refrain from making statements about) the issue. Attorneys can also review drafts of sustainability reports and filings to ensure accuracy and consistency with the company's environmental performance data. Comparison of environmental regulatory data in a sustainability report with that which is reported to federal and state agencies (often made available to the public via websites) is also important to ensure consistency and avoid future allegations of fraudulent disclosure.

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Ms. Orr works with financial institutions, private equity firms, and corporate clients to assess and manage environmental risks. She regularly advises clients on environmental issues in corporate and transactional matters in the oil & gas, power & renewable energy, petrochemical, metals & mining, manufacturing, and real estate sectors. She also represents both sponsors and lenders in connection with financing and developing major projects, and has particular experience with international environmental and social standards, including the Equator Principles.