



# Corporate Sustainability

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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. 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 investor activism and emerging litigation.

## WHAT IS SUSTAINABILITY?

There are many names and terms used to describe sustainability issues. 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 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 presently no 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. Three key standards for voluntary reporting are used by the majority of reporting companies:

1. Guidelines issued by the Global Reporting Initiative (GRI), at <https://www.globalreporting.org/standards/>
2. Standards issued by the Sustainability Accounting Standards Board (SASB), at <http://www.sasb.org/standards-navigator/>
3. The framework of the International Integrated Reporting Council (IR) at <http://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>

GRI is currently the dominant reporting guideline but other frameworks appear to be closing the gap. Over the past decade, these standards have largely evolved from recommending the disclosure of hundreds of issues to a focus on materiality that connects a company's ESG performance with its financial performance. As of now, each of the GRI, SASB, and IR frameworks adopts a different definition of "materiality" and focuses on different elements of sustainability. Hundreds of other types of reporting frameworks, standards, certifications, and other metrics, including industry-specific guidelines also exist.

Despite this trend toward "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**

Two major Corporate Sustainability trends emerged in 2017 and early 2018. First, investor demands for robust ESG disclosures are on the rise and gaining momentum. 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. Second, in recent years, there has been an increase in litigation challenging alleged misstatements or inconsistencies by companies in their voluntary sustainability communications. Both are discussed briefly below.

### **Growing Investor Focus on ESG**

*Over the past decade, the US Securities and Exchange Commission (SEC) has targeted the disclosure of certain environmental and social issues in response to Congressional mandates, such as climate change and conflict minerals. In April 2016, the Obama Administration SEC issued a concept release (available at <https://www.sec.gov/rules/concept/2016/33-10064.pdf>) seeking public comment on (among other topics) how sustainability-related information should be presented by companies, and which existing sustainability reporting frameworks (if any) the SEC should rely upon in developing additional disclosure requirements. Over 26,000 public comments were submitted to the SEC, many calling on the US government to improve ESG disclosure requirements to*

provide investors with comparable and useful material sustainability-related information, including expanded and enhanced disclosures in the areas of environmental impacts, climate change, and human rights.

With a new Republican administration and a new SEC Chairman, it seems unlikely there will be a near-term federal impetus for mandatory ESG disclosure. However, company disclosure of environmental and social issues were prominent targets of shareholder proposals in the 2017 proxy season (see <http://www.proxymonitor.org/Forms/2017Finding1.aspx>) and certain institutional investors have recently attempted to fill this regulatory vacuum by publicly demanding more robust ESG disclosures and prioritizing ESG performance in their investment decisions. For example, on December 12, 2017, a group of major investors with collective control of more than US\$26.3 trillion announced their participation as signatories to the Climate Action 100+ initiative, which is designed 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 (primarily in the oil and gas, electric power, and transportation sectors). See <https://climateaction100.wordpress.com/>. Shortly thereafter, in his January 2018 annual letter to all CEOs in the S&P 500, Laurence D. Fink CEO of BlackRock (which manages more than \$6 trillion in assets) urged companies to develop long-term strategies that “articulate a path to achieve financial performance” clearly informed by an understanding of “the societal impact of [their] business as well as the ways that broad, structural trends – from slow wage growth to rising automation to climate change – affect [their] potential for growth.” See <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>.

In turn, 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 2016, 82% of them did so. See <https://www.ga-institute.com/press-releases/article/flash-report-82-of-the-s-p-500-companies-published-corporate-sustainability-reports-in-2016.html>.

### 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 recently come to light. Over the past few years, plaintiffs have filed multiple consumer suits claiming that defendants’ failure to disclose the possible presence of slavery, forced labor, and other human rights abuses in their supply chains has caused plaintiffs “economic injury.” To date, California courts have rejected these supply chain lawsuits for failure to state a claim for relief as a matter of law because there is no duty under the state’s consumer protection laws to make the disclosures that plaintiffs seek and because California’s supply chain disclosure law creates a “safe harbor,” precluding such claims. However, seven such cases were consolidated on appeal in the United States Court of Appeals for the Ninth Circuit, where the California Attorney General has submitted an *amicus curiae* brief arguing that the Supply Chains Act does not provide a safe harbor and therefore does not preclude these claims. Oral arguments occurred on December 8, 2017 and the Ninth Circuit’s decision is expected in 2018.

There have also been a number of high profile securities class actions to challenge 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 PLC, Sec. Litig.*, No. 4:12-cv-1256 (S.D. Tex. Sept. 30, 2013).

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 an earlier 2006 explosion at Alma No. 1 mine in West Virginia, Massey Energy 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. Such statements included, for example:

- “No coal company can succeed over the long term without a total commitment to safety” (from a 2009 Corporate Social Responsibility Report).
- Statements emphasizing that “safety first” was “not just a slogan” (from various 2008 press releases); and “we have a better performance record than the industry . . . and safety programs in place that exceed the law . . . [w]hat you often don't see in the press is number one, how safe the industry is; number two, how safe Massey is in comparison” (statement by Massey's then-CEO at an energy industry conference).
- In a March 2010 prospectus supplement: “Our primary objectives are to capitalize on current market conditions and to continue to build upon our competitive strengths to enhance our position as one of the premier coal producers in the U.S. by: Maintaining focus on high safety standards. We believe a safe mine is a profitable mine. We strive to maintain safe operations and continue to develop and implement new safety improvement initiatives that exceed regulatory requirements. For the year ended December 31, 2009, we recorded an all-time Company best Nonfatal Days Lost (NFDL) rate of 1.67. The bituminous coal mining industry average NFDL rate was 2.95 in 2008. We continually review and update our safety procedures and equipment, and we believe our focus on high safety standards has resulted in fewer injuries and accidents and cost savings related thereto.”

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. After the 2010 accident, the MSHA released data that showed that the number and severity of violations at the Upper Big Branch mine increased dramatically in 2009 and 2010 as production at the mine increased.

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 defendants' safety violation record, plaintiffs sufficiently pled the false nature of the defendants' statements. Further, the court found that plaintiffs had shown justifiable reliance on the defendants' 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. Memorandum and Order, *In re BP PLC, Sec. Litig.*, No. 4:12-cv-1256 (S.D. Tex. Sept. 30, 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:

- In a 2008 Annual Review, statement that the OMS “turns the principle of safe and reliable operations into reality by governing how every BP project, site, operation, and facility is managed”

- In BP's 2008 sustainability review (signed by Hayward), a statement that OMS "is to be implemented at each BP site"
- In BP's 2009 Sustainability Report, the statement that "BP continues to implement its [OMS], a cornerstone of achieving safe, reliable, and responsible operations at every BP operation." and "[W]e seek to ensure an infrastructure is in place to deal effectively with spills and their impacts. Our operating facilities have the capacity and resources to respond to spill incidents and we participate in industry and international forums to coordinate contingency planning and emergency response"
- Hayward's statements in the 2009 sustainability review that OMS had been implemented 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.

Accordingly, false statements and omissions in CSR disclosures can create clear liability risks for companies in a variety of circumstances, including annual report, social medial 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 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 such as the U.S. Environmental Protection Agency (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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