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What is ESG and how can it affect your business?

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Environmental, social, and governance, or ESG, is a framework used by organisations to improve risk management by incorporating material ESG risks into investment decision making.

There are growing investor demands for companies to demonstrate their ESG credentials and failure to do so can result in litigation. The potential financial and reputational damage from ESG litigation is significant, making it a rising concern for businesses globally.

What is ESG?

Historically, ESG stems from previous versions of sustainability-focused strategic and/or regulatory frameworks, such as EHS (environmental, health, and safety), corporate sustainability, CSR (corporate social responsibility). However, by the late 2010s ESG emerged as a more proactive and holistic framework that has become an integral part of an organisation's structure.[1]

ESG represents a more stakeholder-centric approach to doing business. Factors such as climate change, conservation, sustainability, and employee health and safety are becoming increasingly important when considering potential investments. Investors are becoming increasingly focused not only on the financial outcomes of their investment decisions, but also on the non-financial outcomes which relate to ESG. Regulators globally are moving towards mandatory disclosures of material ESG risks.

There are three pillars used to measure the sustainability and ethical impact of an investment[2].

Environmental

This relates to the organisation's impact on the environment, such as climate change, resource depletion, water waste and water pollution, air pollution, and deforestation. ESG imposes a framework which allows a business to target different areas of its organisation and implement more sustainable, ethical practices.

Social

This relates to the effect of an organisation's behaviour regarding social issues. This relates to an organisation's impact on people, such as working conditions, workplace culture, health and safety in the workplace, employee relations, diversity, and income inequality.

Governance

This relates to how an organisation behaves internally, and is largely focused on the processes of decision-making, reporting and the logistics of running a business, i.e., is the organisation acting with probity and transparency, and is it reporting clearly and honestly about its activities? The governance pillar includes board diversity, structure and culture, as well as executive pay and bribery.

What is corporate greenwashing and greenhushing?

Commensurate to the increased interest in ESG is the increased rise in corporate "greenwashing" and "greenhushing". This is when companies provide false information in respect of their alleged ESG practices and it's become an increasing concern for investors and regulators.

Greenwashing

Greenwashing refers to the practice where companies give a false impression of their environmental friendliness. They exaggerate or fabricate claims about their sustainability efforts or products to appear more environmentally responsible than they actually are. This can be done through misleading marketing, vague language, or irrelevant claims.

Greenhushing

On the other hand, greenhushing refers to when companies understate or hide their positive environmental actions. They may do this for various reasons, such as fear of criticism, not wanting to draw attention to their overall environmental impact, or a belief that their efforts are not significant enough to promote.

Both practices can have implications for a company's credibility and stakeholder relations.

The rise of ESG litigation

ESG litigation is on the rise globally against corporations and other entities, including governments. The most commonly reported ESG litigation has taken the form of legal activism, often issued by charities to trigger greater scrutiny of a company's ESG impact and/or regulatory compliance. However more general M&A litigation is also contemplated in circumstances where a company's ESG compliance has been overstated or misrepresented to investors and/or shareholders.

If a premium value has been attached to a company for its warranted sustainability or ESG compliance, which later proves to be false, repercussions for the company and/or is corporate officers will inevitably arise. Investors are incorporating ESG criteria into their investment assessments and valuation decisions, so where incorrect information or misrepresentations are made there is a genuine risk of subsequent litigation[3].

ESG litigation is novel, with new and creative legal arguments being raised to reflect each factual circumstance and the relevant pillar impacted (environmental, social or governance). Given the far-reaching impact of ESG, we are likely to see more commercial and/or regulatory litigation relating to these areas across all industries and sectors. This should trigger a level of caution for all businesses that report inaccurate information and any incumbent corporate officer ought to be live to the risk of overstating or understating ESG compliance.

How can Ogier help?

Ogier offers multi-disciplinary Sustainable Investing and ESG services. Ogier's team provides cross-jurisdictional advice that covers BVI, Cayman, Guernsey, Ireland, Jersey and Luxembourg laws, including regulations around ESG and sustainable investment activities.

[1] https://corporatefinanceinstitute.com/resources/esg/esg-environmental-social-governance/

[2] https://ternplc.com/2022/04/what-is-esg-and-its-three-pillars/

[3]https://www.reuters.com/sustainability/sustainable-finance-reporting/comment-with-greenwashing-lawsuits-proliferating-boards-need-step-up-scrutiny-2023-08-21/

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