The rise of ESG litigation

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Environmental, social, and governance, or ESG, is a set of criteria used to assess a company's impact on society and the environment, as well as its corporate governance practices. Increased regulatory requirements, growing investor demands, and the global climate crises have led to the rising need for companies to manage and report ESG performance.

Such growing rules and regulations, alongside existing legislation, have increased ESG-related litigation risk for companies. The potential financial and reputational damage from ESG litigation is significant, making it a rising concern for businesses globally.

What is ESG litigation?

Litigation and regulatory enforcement actions and threats related to environmental, social, and governance (ESG) company policies, practices, and disclosures have been in the spotlight recently.

This is due, in part, to increased mandatory reporting requirements for certain types of entities. The principal litigation risks arise from shareholder activism and related investor claims against companies and their directors, particularly in relation to materially false or misleading ESG disclosures or representations made in prospectuses or investor reports.

Environmental

The environmental aspect to ESG deals with 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

The 'social' element 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

Governance 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.

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.

2,341 cases have been captured in the Sabin Center climate change litigation databases, 190 of which were filed in the last 12 months. The growth rate in cases appears to be slowing but diversity in cases is still expanding according to LSE (see Global_trends_in_climate_change_litigation_2023_snapshot.pdf (lse.ac.uk)).

A potential liability occurs when ESG disclosures are false, misleading, or cannot be substantiated – causing financial harm to an investor. Companies that engage in "green-washing" in disclosures are therefore at an increased risk of investor-related litigation.

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.

However more general commercial litigation is also contemplated in circumstances where a company's ESG compliance has been overstated or misrepresented to investors and/or shareholders.

Recommendations from our experts

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 its corporate officers will potentially arise. Investors are incorporating ESG criteria into their investment and valuation decisions, so where incorrect information or misrepresentations are made there is a genuine risk that it could result in subsequent litigation.

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.

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