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ESG LEGAL UPDATE

What Corporate Governance and ESG Professionals Need to Know

SOCIETY *for* Corporate Governance

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Contents

Executive Summary

Boards, corporate secretaries, and governance professionals operate in a dynamic landscape of evolving environmental, social, and governance (ESG) issues and risks. ESG research and analysis is increasingly important, and ESG-related shareholder proposals and engagement have reached new heights. Once limited to a small set of investors, ESG investing has expanded to the mainstream of mutual funds, exchange-traded funds (ETFs), and even private equity. ESG investing is not a new phenomenon, but its perceived importance has increased dramatically over the past decade.

As a result, companies face increasing demands from investors, research and ratings firms, and others for greater and more detailed disclosure on ESG topics. This brief examines the legal risks associated with ESG disclosures[1] and recent case law,[2] and outlines practices that can help companies mitigate their legal risks while still being responsive to investor demands for more disclosure.

1 As used in this brief, an ESG disclosure includes any statement or published policy related to environmental, social, or governance issues.

2 This primer updates and expands upon the legal developments discussed in our report *Legal Risks and ESG Disclosures: What Corporate Secretaries Should Know*, Society for Corporate Governance and Gibson, Dunn & Crutcher LLP, June 2018.

Introduction

Companies are significantly expanding their environmental and social efforts. This includes taking positive steps in areas such as environmental sustainability, human rights, and community involvement, as well as taking a more holistic look at how core, company-specific ESG issues affect strategy, risk, and the long-term viability of a company's business. Companies are also increasingly disseminating significant amounts of information about these current efforts and future commitments through channels including corporate social responsibility web pages, lengthy corporate responsibility and sustainability reports, public speeches and presentations to investors, and even filings with the US Securities and Exchange Commission (SEC) and information regarding company products. These statements often are not audited by third-party consultants for accuracy or reviewed or approved by boards of directors.

Moreover, many of these statements are made voluntarily. Companies make social-responsibility statements regarding how they handle ESG issues for a variety of reasons, including to satisfy growing investor and consumer interest in those issues, to provide information to various groups that rate the company's ESG practices, and to address company-specific concerns, such as negative attention regarding operations or practices.

For example, in his 2020 letter to S&P 500 CEOs, BlackRock CEO Larry Fink asked BlackRock's portfolio companies to publish disclosures in line with industry-specific guidelines issued by the Sustainability Accounting Standards Board (SASB) by year-end or to disclose a similar set of data in a way that is relevant to their businesses. He also asked them to disclose climate-related risks to their companies in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), including their plans for operating under a scenario in which the Paris Agreement's goal of limiting global warming to less than two degrees Celsius above preindustrial levels is fully realized, as expressed by the TCFD guidelines.[3]

In addition to these voluntary disclosures, disclosures about environmental and social issues are required or encouraged by an increasing number of international, federal, and state laws and regulatory bodies.[4] The SEC has not adopted new disclosure requirements, but it faces increasing pressure to do so. For example, in October 2018, institutional investors representing more than $5 trillion in assets petitioned the SEC to mandate standardized disclosure by public companies that identifies the ESG factors

3 Larry Fink, "A Fundamental Reshaping of Finance," BlackRock, accessed April 14, 2020, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

4 *See* Annex A for sample laws requiring disclosure on environmental and social issues.

ESG statements and disclosures can create significant litigation and liability risks for companies that do not exercise appropriate care and diligence.

that affect their businesses.[5] Other countries increasingly are requiring ESG disclosures as well.[6] In addition, investors are pressing companies to discuss how they are addressing the many issues related to human capital management arising as a result of COVID-19.

Regardless of the motivation for company ESG disclosures, these statements and disclosures can create significant litigation and liability risks for companies that do not exercise appropriate care and diligence. This includes providing for oversight at the board level so that the board understands what the company is saying about ESG issues and the processes for reviewing ESG disclosures before they are made public.

More broadly, boards of directors should be aware that their oversight responsibilities, and the attendant prospect of claims seeking to hold directors liable for oversight failures, may extend to ESG matters. ESG issues that create significant risks for a company may lead investors and others to ask, "Where was the board?" in the event of a significant environmental incident such as an oil spill or a significant compliance failure that affects the safety or privacy of customers. The heightened focus displayed by a broad array of stakeholders suggests an evolving expectation that the board, as part of its oversight role, will be actively engaged in overseeing ESG matters that are central to a company's business—and that investors and regulators may seek to hold the board accountable for perceived failures to perform this responsibility.

5 Jill E. Fisch and Cynthia A. Williams, "Request for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure," Oct. 1, 2018, https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

6 *See, e.g.,* "Global CSR Disclosure," Initiative for Responsible Investment, accessed Apr. 14, 2020, https://iri.hks.harvard.edu/csr.

Litigation Risks of ESG Disclosures

Potential Liability Under Federal and State Securities Laws

Over the past decade, public companies have increasingly included ESG-related information on their corporate websites, in corporate responsibility and sustainability reports (often available through corporate websites), and in public speeches. More recently, these companies have begun including these disclosures in their SEC filings as well—typically as ESG highlights in their proxy statements, with links to additional information on their social responsibility web pages and in their corporate responsibility reports. An increasing number of companies are also beginning to include ESG disclosures in other SEC filings, such as quarterly and annual reports.

When this information is included in proxy statements and other SEC filings, it becomes subject to the same scrutiny as other information included in SEC filings. If the information is false or misleading, companies may be subject to significant liability under federal securities laws. Moreover, even when ESG disclosures are provided outside of SEC filings—such as during earnings calls, in investor presentations, or on public websites—they can still create potential liability under federal securities laws.

Federal securities laws and SEC regulations make statements in securities filings (including hyperlinked materials)[7] and other statements to investors actionable for material misrepresentations. For example, under Sections 11 and 12(a)(2) of the Securities Act of 1933, companies may be strictly liable[8] for material misstatements made in connection with securities offerings such as statements in registration statements and prospectuses.[9]

Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act)[10] and SEC Rule 10b-5—the anti-fraud provisions of the federal securities laws—apply more broadly, creating liability for fraudulent statements made to investors, regardless of when or where those statements occurred, and even if the statements were made outside of SEC filings. Additionally, CEOs and chief financial officers of public companies—who are required to certify quarterly and annual reports filed with the SEC—could face "control-person" liability under Section 20(a) of the Exchange Act[11] if ESG disclosures included or hyperlinked in those filings are not accurate.

Most federal securities class actions arising from public ESG disclosures to date have been brought under Sections 10(b) and 20(a) of the Exchange Act. Often, these suits follow large

7 Under Item 105(c) of Regulation S-T, 17 C.F.R § 232.105(c), "[A]n external hyperlink within a filed document . . . will cause the filer to be subject to the civil liability and antifraud provisions of the federal securities laws with reference to the information contained in the linked material."

8 For strict liability claims, a plaintiff need not plead or prove scienter (fraudulent intent) on the part of defendant—a showing of a material misstatement or omission alone may be sufficient to establish liability.

9 15 U.S.C. § 77k.

10 *Id.* at 15 U.S.C. § 78j.

11 *Id.* at 15 U.S.C. § 78t.

industrial accidents or ESG problems that cause a significant drop in a company's stock price. Results in these cases have been mixed, but recent motion to dismiss decisions provide insight into how courts analyze ESG disclosures. Generally, decisions have turned on whether the ESG disclosures at issue were sufficiently concrete and measurable to form the basis for a misrepresentation claim. A statement must be false or misleading and material to a reasonable investor to be actionable under Section 10(b) of the Exchange Act.[12]

Several courts have rejected securities litigation challenges to ESG disclosures on the grounds that the disclosures were either sufficiently vague that they could not be shown to be objectively false or misleading, or were so clearly aspirational that a reasonable investor could not rely on them.

For example, in *Bondali v. Yum! Brands, Inc.*, the United States Court of Appeals for the Sixth Circuit affirmed the dismissal of a Section 10(b) action against Yum! Brands (Yum) challenging the company's statements about its commitment to responsibly sourcing its food.[13] Following public reports of food safety problems in Yum's supply chain, plaintiffs challenged statements in Yum's SEC filings and earnings calls about the company's commitment to "strict" food quality and safety standards, "work[ing] a lot with our suppliers," and "having the right suppliers." They also challenged statements in the company's code of conduct, such as "food safety is a primary responsibility . . . and nothing, including cost, is allowed to interfere."[14] In dismissing the case, the district court found that these statements were "too squishy, too untethered to anything measurable, to communicate anything that a reasonable person would deem important to a securities investment decision."[15] The court stated that the "vague, subjective assertions" made in SEC filings and on earnings calls—"such as 'strict' food safety standards" and "having the 'right' suppliers"—were "the mere opinions of management" and held "no obvious objective meaning to a reasonable investor."[16] The court also rejected claims based on statements in the code of conduct, holding that even though the code had been referenced in the company's proxy statement, such codes are "inherently aspirational" and thus could not be relied on by a reasonable investor.[17]

In a case involving a petrochemical company's alleged failure to disclose that former corporate officers were involved in a bribery scheme while working at the company, a federal district court in New York dismissed securities claims challenging statements in the company's sustainability reports, press releases, and code of conduct.[18] The sustainability reports at issue stated that "[t]ransparency, ethics and respect to Clients, Company Members, Shareholders, Suppliers and

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12 *See, e.g., Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148 (2008); *Basic Inc. v. Levinson,* 485 U.S. 224, 231 (1988); *In re Omnicare, Inc. Sec. Litig.,* 769 F.3d 455, 470 (6th Cir. 2014).

13 *Bondali v. Yum! Brands, Inc.,* 620 F. App'x 483 (6th Cir. 2015).

14 *In re Yum! Brands, Inc. Sec. Litig.,* 73 F. Supp. 3d 846, 855 (W.D. Ky. 2014), *aff'd sub nom. Bondali v. Yum! Brands, Inc.,* 620 F. App'x 483 (6th Cir. 2015).

15 *Id.* at 862–63.

16 *Id.* at 863.

17 *Id.* at 864.

18 *In re Braskem S.A. Sec. Litig.,* 246 F. Supp. 3d 731, 740 (S.D.N.Y. 2017).

society are inherent to [the company's] culture and actions," and that "corporate governance principles enforced by [the company include] ensur[ing] conformity with legal and regulatory bodies to whose authority [the company's] business are subject."[19] The challenged press releases and code of conduct touted the company's "trustworthy" culture, commitment to "integrity," and "compliance with the laws."[20] In dismissing the claims, the court found that "the statements . . . regarding [Defendant's] corporate culture are all immaterial puffery. None are actionable under the securities laws."[21] It further held that the company's code of conduct was "a particularly inapt candidate to serve as the basis for § 10(b) liability," as "statements within such codes tend to be explicitly aspirational, with qualifiers such as 'should.'"[22]

Another federal district court in New York dismissed a securities class action alleging that a pharmaceutical company made misstatements and omissions regarding purportedly inflated sales of its diabetes product line and matters of corporate integrity.[23] The plaintiffs challenged statements in the defendant's corporate social responsibility report, including: "[w]e maintain an effective compliance organization," and "[o]ur strategy focuses on establishing and enforcing clear rules that are consistent with the legislative framework and are aligned with the industry's best practices, while seeking to go beyond regulatory compliance through our efforts toward transparency, accountability, and disclosure."[24]

19 *Id.* at 744.

20 *Id.* at 755.

21 *Id.* at 757.

22 *Id.* at 755.

23 *In re Sanofi Sec. Litig.*, 155 F. Supp. 3d 386, 391 (S.D.N.Y. 2016).

24 *Id.* at 401.

Several courts have rejected securities-litigation challenges to ESG disclosures on the grounds that the disclosures were either sufficiently vague that they could not be shown to be objectively false or misleading, or were so clearly aspirational that a reasonable investor could not rely on them.

The court concluded that these statements "were not actionable under the securities laws" because they were "too general to cause a reasonable investor to rely on them" and amounted to nothing more than corporate "puffery."[25]

Some courts have finely parsed ESG statements and found most to be insufficiently specific and nonactionable but others to be more concrete or factual and actionable. For example, a federal district court in Texas recently dismissed a securities lawsuit against a pipeline company challenging statements in a code of business conduct (which was published on the company's website and incorporated by reference into the company's SEC filings) but noted that one statement could be actionable.[26] Following a company oil pipeline rupture and spill, plaintiff

25 *Id.*

26 *In re Plains All Am. Pipeline, L.P. Sec. Litig.*, 307 F. Supp. 3d 583, 624–26 (S.D. Tex. 2018).

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shareholders challenged statements including: (1) "[the company] supports its commitment to safe and environmentally responsible operations through extensive and ongoing education and training, as well as investment in any necessary equipment, systems, processes, or other resources"; and (2) "[o]ur commitment to safe and environmentally responsible operations also includes compliance with applicable environmental, health and safety rules, laws and regulations."[27] In dismissing challenges to the statements, the court found that they "[we]re not specific or objective factual representations, much less 'unambiguous representations' that every . . . pipeline was safely maintained or fully complied with all applicable laws and regulations."[28] Rather, the court noted that the statements did "not go beyond aspirational or general puffery," nor did they "falsely represent a record of past or present compliance" with company policies. The court did find one challenged statement potentially actionable and sufficiently concrete—a statement on the defendant's website that the company "performs scheduled maintenance on all of our pipeline systems and makes repairs when necessary or appropriate"—although it also held that plaintiffs failed to adequately allege scienter in connection with the alleged misrepresentation.[29] The United States Court of Appeals for the Fifth Circuit affirmed the decision on July 16, 2019.[30]

Similarly, following a dam collapse, a federal district court in New York dismissed challenges shareholders brought under Section 10(b) and Rule 10b-5 regarding statements in a mining company's sustainability reports that the company "focus[ed] on health and safety . . . building a positive legacy for communities . . . and adopting best practices in social and environmental management."[31] The court noted that the statements concerned what the company was "seeking to do," "aiming to do," "committed to doing," and "focused on" and therefore were not statements of "measurable fact" but rather "a set of aspirational generalizations" upon which reasonable investors would not rely.[32] However, the court also found that certain statements were actionable as "representations of present or historical facts," including statements that the company's "commitment to environmental and social issues is . . . reflected in the way [it] manage[s] specific kinds of waste in the production process" and that the company "ha[s] health, safety and environmental standards and risk management systems and processes in place to mitigate the risk of [environmental, health and safety] incidents."[33]

27 *Id.* at 624–25.

28 *Id.* at 626.

29 *Id.* at 626–28.

30 *Police & Fire Ret. Sys. of City of Detroit v. Plains All American Pipeline,* L.P., 777 Fed App'x 726 (5th Cir. 2019).

31 *In re Vale SA Securities Litig.,* No. 1:15-cv-9539, 2017 WL 1102666, at *8 (S.D.N.Y. Mar. 23, 2017).

32 *Id.* at *22.

33 *Id.* at *24.

The court also found certain forward-looking statements in sustainability reports actionable because the company's risk disclaimers were contained in *different* documents (annual reports), and therefore the court held they did not "accompany" the challenged statements, as required for "safe harbor" and "bespeaks caution" protection.[34]

In a Section 10(b) action brought against BP after the Deepwater Horizon incident, the Southern District of Texas found that the plaintiffs had adequately pled materiality and falsity for several statements BP made highlighting safety reform efforts after previous industrial accidents in 2005 and 2006.[35] The challenged statements were made in sustainability reports, in annual reviews and reports, and during analyst calls.[36] In finding the statements actionable, the district court pointed to statements such as BP's assertions that its safety-operations-management system "covers all aspects of our operations" when it allegedly did not apply to contractor-owned sites.[37] The court also found that a number of the challenged statements were "statement[s] of existing fact" rather than forward looking, and were thus not entitled to protection under the SEC's safe-harbor provisions for forward-looking statements.[38]

In another case precipitated by an industrial disaster—an explosion and fire in a coal mine—the Southern District of West Virginia similarly found that the plaintiffs had adequately pled materiality and falsity pertaining to ESG disclosures for Section 10(b) claims.[39] The plaintiffs in *Massey Energy Sec. Litig.* alleged that Massey Energy made "statements professing that safety was the 'first priority every day' at Massey," that the company was an "industry leader in safety," and that "safety at its mines [was] improving" in its corporate social responsibility reports, press releases (furnished on Form 8-K), and Forms 10-K and 10-Q.[40] The court agreed with the plaintiffs that these statements were "capable of being proven false given the number of safety violations" alleged and a comparison of the accident and fatality rates in the mines at issue to the national average.[41] The court held that because Massey's statements were "not stated in a context of a future prediction, but generally recognize[d] the company's past achievements and current goals," and Massey "closely aligned their statements of commitment to safety to their productivity and success of a company," the statements could form the basis for a Section 10(b) securities fraud action.[42]

One federal court in New York recently declined to dismiss securities fraud claims challenging ESG statements in a company's code of conduct regarding policies and prohibitions against sexual harassment.[43] The court found that the following company statements were not puffery or immaterial as a matter of law: that it made employment decisions "solely" on the basis of merit; that it was "committed to a workplace that was free from sexual, racial, or other unlawful harassment"; that it does not tolerate "abusive, harassing or other offensive conduct"; that it

34 *Id*. at *25.

35 *In re BP plc, Sec. Litig.,* No. 4:12-cv-1256, 2013 WL 6383968 (S.D. Tex. Dec. 5, 2013).

36 *Id*. at *23.

37 *Id*. at *27.

38 *Id*. at *31

39 *In re Massey Energy Sec. Litig.,* 883 F. Supp. 2d 597 (S.D.W. Va. 2012).

40 *Id*. at 617.

41 *Id*.

42 *Id*. at 618.

43 *In re Signet Jewelers Ltd. Sec. Litig.,* 389 F. Supp. 3d 221, 226, 231 (S.D.N.Y. 2019).

has "confidential and anonymous mechanisms for reporting concerns"; and that it disciplines "those who violate the standards in this code." The court noted the plaintiffs' allegations to the contrary of "rampant sexual harassment, including . . . conditioning subordinate female employees' promotions to their acceding to the sexual demands of their male supervisors . . . and retaliating against those who reported this misconduct."[44] It found that a reasonable investor "who [would] otherwise be concerned about how grave allegations concerning rampant sexual misconduct might affect her investment" could be misled by the challenged statements if the alleged conduct occurred.[45]

In another recent case involving similar allegations, however, another federal court in New York found that a different company's statements in business conduct and ethics codes relating to sexual harassment were neither material nor misleading.[46] Plaintiffs in the case brought securities fraud claims against CBS and its officers based on the alleged conduct of CEO and board chairman Les Moonves in "conceal[ing] a dark history of sexual misconduct and foster[ing] a hostile workplace culture that posed material business risks to the company."[47] Plaintiffs challenged company statements including: CBS "*believes* in a work environment that is free of workplace bullying"; "CBS has a *'zero tolerance' policy* for sexual harassment"; "CBS *will not tolerate* retaliation against any person who makes a good faith report of misconduct"; CBS "will take reports of violation or suspected violation of these policies *very seriously*"; CBS is "*committed* to maintaining the highest standards in everything we do"; "we all have a *responsibility to uphold* the highest standards of ethical and appropriate business actions"; and "*guiding* our Company is a strong and established ethical code."[48]

The court found that the challenged statements were "far too general and aspirational to invite reasonable reliance" and "were not made to reassure investors that no CBS executive . . . was susceptible to being the target of accusations of sexual harassment."[49] The court stated that although the alleged misconduct was reprehensible, it was not alleged "to be so pervasive that the [complaint] plausibly alleged that CBS, in fact, held none of its asserted aspirations."[50]

The court further noted that two additional sets of challenged statements "c[a]me close to being statements of fact" but were "nonetheless too general and disconnected from plaintiffs' [fraud] theory to be material," including: (1) CBS "will" take "all steps" and "remedial action" to stop "sexual harassment" and "protect the workplace environment," and (2) CBS "will promptly and thoroughly investigate" allegations of sexual harassment, and those who report sexual harassment "will not be retaliated against."[51] The court noted that the statements "d[id] not guarantee compliance or make any commitment to take concrete steps to address sexual harassment complaints."[52] The court found

44 *Id*. at 231.

45 *Id*.

46 *Construction Laborers Pension Trust for S. Cal. v. CBS Corp.,* No. 18-cv-07796, 2020 WL 248729 (S.D.N.Y. Jan. 15, 2020).

47 *Id*. at *1.

48 *Id*. at *8 (emphases in original).

49 *Id*.

50 *Id*.

51 *Id*.

52 *Id*.

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only one challenged statement to be "barely actionable": Moonves's statement at an industry event that "[#MeToo] is a watershed moment. . . . It's important that a company's culture will not allow for this. . . . There's a lot we're learning. There's a lot we didn't know."[53] The court noted that the statement implied that Moonves had not known of these problems previously, "even though, in truth, he was at that time [allegedly] actively seeking to conceal his own past sexual misconduct from CBS and the public."[54]

As these decisions indicate, there is a razor edge dividing potentially material representations from immaterial corporate puffery. While truly vague or aspirational statements of company ideals are not actionable, an unwary company could find itself facing costly discovery and potential liability for ESG statements that it thought were sufficiently vague but a court found concrete and falsifiable.

These decisions also demonstrate that ESG information need not appear in SEC filings to expose a company to liability under federal securities laws. ESG statements on websites and in corporate responsibility reports may be actionable under federal securities laws if the court finds that the information was intended to reach shareholders and the investing public. The risk of class action liability from website statements is generally lower than that from disclosures in SEC filings due to the reliance element of securities fraud claims and the legal presumption that statements in SEC filings are incorporated into the company's stock price and therefore that investors relied on those statements for class certification purposes. However, risks relating to statements on websites are nevertheless very real because of the increasing number of hyperlinks to corporate responsibility websites and reports in companies' SEC filings, as well as courts' increasing willingness to find such materials directed toward investors. Moreover, in light of growing investor and consumer interest in ESG issues, and statements from an increasing number of institutional investors that they consider environmental sustainability efforts in their investment strategies, there is also an increasing likelihood that courts will find statements regarding ESG activities material to investors in securities litigation.

53 *Id.* at *13.

54 *Id.*

Potential Liability Under Federal and State Consumer Protection and Anti-fraud Laws

ESG statements on websites, on products, and in corporate responsibility reports can also generate litigation and potential liability under federal and state consumer protection and anti-fraud statutes. Under most consumer protection laws, consumers must plausibly allege, and ultimately prove, that they relied on a material misrepresentation in making their decision to purchase from the company. As with liability under federal and state securities laws, a key question is whether the company's statements forming the basis of the action are sufficiently concrete as to be false or misleading.

A number of recent decisions have dismissed consumer class actions challenging statements in corporate responsibility reports or on corporate websites as insufficiently concrete or material to the plaintiff's purchase decision to state a misrepresentation claim.

For example, a judge in the Superior Court of the District of Columbia recently dismissed consumer protection law claims challenging "environmentally friendly" and "sustainable" labeling on tea as misleading based on the purported presence of trace amounts of glyphosate. The court found it implausible "that consumers could be misled" by the terms in the manner the plaintiff suggested and noted that the plaintiff did "not give any facts regarding consumer belief or cite to any consumer survey that could render th[e] claim[s] more than a non-actionable opinion."[55]

55 *Organic Consumers Ass'n v. Bigelow Tea Co.,* No. 2017 CA 008375 B (D.C. Super. Ct. Oct. 31, 2018).

A number of recent decisions have dismissed consumer class actions challenging statements in corporate responsibility reports or on corporate websites as insufficiently concrete or material to the plaintiff's purchase decision to state a misrepresentation claim.

Similarly, in *Ruiz v. Darigold, Inc./Northwest Dairy Association*, a federal district court in Washington dismissed claims under California, Oregon, and Washington consumer protection laws challenging statements regarding the treatment of dairy workers and cows in a corporate responsibility report published by the defendants.[56] Plaintiffs alleged that Darigold and the Northwest Dairy Association used the report to mislead consumers into thinking "'that the company's member dairies treated their workers and cows well' and/or that Darigold 'treat[ed] its workers and cows with respect and in compliance with the law.'"[57] The court disagreed, finding that "[e]ven if the Court considers the [language] on which plaintiffs' claims of misrepresentation and omission rely, when read in context they reflect nuanced assessments of the current situation,

56 *Ruiz v. Darigold, Inc./Nw. Dairy Ass'n,* No. 14-cv-1283, 2014 WL 5599989, at *3 (W.D. Wash. Nov. 3, 2014).

57 *Id.* at *2–3.

are aspirational statements, or have not been shown to be false in any material respect."[58] However, the court also implied that statements such as "[o]ur producers care for their herds by providing a nutritious diet, good medical care and healthy living conditions" or "Darigold follows 'a rigorous quality assurance program to ensure food safety and the highest quality products for our customer'" could have been actionable if plaintiffs had alleged facts sufficient to show that "producers do not provide 'world class animal care' and/or 'healthy living conditions'" or that "Darigold [did] not have a quality assurance program or that its products [were] unsafe or subpar."[59]

The United States Court of Appeals for the Ninth Circuit also recently affirmed a federal district court's dismissal of California consumer-protection-law claims challenging statements on a company's website about expectations for third-party suppliers. The district court found the company's statements that it expected suppliers "to adhere to all applicable laws and regulations . . . and strive to comply with international and industry standards" to be aspirational and nonactionable. In addition, it held that the statements would not mislead reasonable customers into thinking suppliers met those expectations in every instance.

Courts in consumer protection class actions also continue to reject challenges to ESG statements when plaintiffs do not allege that they viewed and relied upon the challenged statements before making purchase decisions. For example, the United States Court of Appeals for the Ninth Circuit recently affirmed a district court's dismissal of claims challenging website statements in a warehouse club's "Disclosure Regarding Human Trafficking and Anti-Slavery" and "supplier Code of Conduct."[60] The plaintiffs alleged that the supplier code's statements prohibiting forced labor and the disclosure's discussion of steps the company would take to curtail human trafficking in its supply chain were misleading based on purported violations by suppliers in Thailand, Indonesia, Vietnam, and Malaysia. The Ninth Circuit found that the claims were properly dismissed because the plaintiffs failed to plead reliance on the statements and therefore "were not . . . deceived" by them.[61]

One DC Superior Court dismissed the vast majority of a plaintiff's claims challenging ESG statements as nonactionable but found certain statements sufficiently concrete to form the basis of a consumer protection claim. A nonprofit organization brought suit under the District of Columbia's Consumer Protection Procedures Act (DCCPPA), alleging that the defendants violated promises supposedly made to the general public in ESG statements available on the defendants' websites.[62] The challenged statements described the defendants' general codes of conduct applicable to their suppliers, which prohibited child labor and promoted compliance with workplace safety requirements.[63] The statements also described the auditing practices

58 *Id*. at *4.

59 *Id*. at *4.

60 *Sud v. Costco Wholesale Corporation,* 731 F. App'x 719 (9th Cir. 2018).

61 *Id*. at 721.

62 *Nat'l Consumers League v. Wal-Mart Stores, Inc., J.C. Penney Corp., and The Children's Place, Inc.,* No. 2015-CA-007731, 2016 WL 4080541, at *1 (D.C. Super. Ct. July 22, 2016).

63 *Id*. at *2.

the retailers used to promote compliance with these standards.[64] The plaintiff alleged that the statements were misleading based on the collapse of a building containing factories that the retailers allegedly sourced clothing from, where many people, including some children, were injured and killed.

The court granted in part and denied in part the defendants' motion to dismiss. It held that most of the ESG statements challenged included terms such as "expect," "goal," and "ask" and were aspirational in nature and therefore nonactionable.[65] It also noted that the majority of the statements were "general in nature outlining the expectations of each retailer and efforts by each retailer to place pressure on its suppliers to be more socially responsible" and not "promises" or guarantees to "consumer[s] that the retailer[s] [were] ensuring compliance on the suppliers' part."[66] With respect to the defendants' factual descriptions of their auditing efforts, however, the court found that the statements were "capable of being verified," and could thus form the basis for a claim that consumers were misled, if proven false.[67]

A federal district court in California also recently allowed claims challenging "recyclable, check locally" statements on coffee-pod products to survive a motion to dismiss.[68] While the defendant argued that "check locally" disclaimers and other package statements clarifying that the pods may not be recyclable in all communities rendered deception claims implausible, the court found the plaintiff's allegations that the pods were not recyclable anywhere sufficient to state a claim.[69]

Another federal court in California also found statements regarding strict quality controls for pet food products actionable, based on allegations that the products were contaminated with significant amounts of the toxins arsenic and lead and the chemical bisphenol A (BPA).[70] The plaintiff challenged label statements such as "unrivaled quality standards," "optimal health," and "natural, safe and pure."[71] It also challenged website statements such as "during production, rigorous standards and practices are put in place to protect the nutritional integrity of our food," "we require all suppliers to meet stringent requirements and adhere to the highest standards, exceeding even the strictest requirements from the FDA," and "we have developed an extensive quality assurance program, guaranteeing that all our products are safe, pure and balanced."[72] The court found that "[t]hese are measurable claims that plaintiffs indeed seek to prove are false through this very suit."[73]

Courts have uniformly continued to dismiss consumer class actions asserting pure omission based claims that companies have failed to disclose to consumers ESG information such as the existence of slave or forced labor in supply chains. For example, the Ninth Circuit affirmed several district court decisions, noted

64 *Id*.

65 *Id*. at *6–8.

66 *Id*. at *5–6.

67 *Id*. at *7–8. Notably, the court did not address the issue of reliance on the challenged statements because the DCCPPA is one of the few consumer protection statutes that does not require a plaintiff to show reliance on a purportedly deceptive practice.

68 *Smith v. Keurig Green Mountain, Inc.,* 393 F. Supp. 3d 837 (N.D. Cal. 2019).

69 *Id*. at 847.

70 *Zeiger v. WellPet LLC,* 304 F. Supp. 3d 837, 851 (N.D. Cal. 2018).

71 *Id*. at 842.

72 *Id*. at 851.

73 *Id*.

Courts have continued to dismiss consumer class actions asserting pure omission based claims that companies failed to disclose to consumers ESG information such as the existence of slave or forced labor in supply chains.

in our 2018 publication,[74] that dismissed such claims. In *Hodsdon v. Mars, Inc.*, the Ninth Circuit affirmed a district court's dismissal of California state law claims challenging the failure to disclose on chocolate product labels that a company's supply chain may involve child or slave labor.[75] It held that in the absence of any affirmative representations, manufacturers do not have a duty to disclose alleged labor practices because those practices are not physical defects that affect the central function of the products.[76] According to the court, this was true even if the existence of forced or child labor was material to customers.[77] The court also held that the plaintiffs' proposed on-product disclaimers could conflict with the separate state policy of California's Transparency in Supply Chains Act, which requires only off-label disclosures regarding efforts to combat forced labor (and with which the defendant complied).[78] The Ninth Circuit then relied upon its decision in *Hodsdon* to affirm dismissals of several similar claims regarding duties to disclose.[79]

A federal district court in Massachusetts also recently rejected claims that a company's omission of the possible existence of child labor in its supply chain violated Massachusetts law. The court found that while a pure omission (involving a subject as to which the seller has said nothing) could be actionable under the law, it was "not plausible" that failing to disclose this information at the point of sale had the capacity to mislead customers. It further held that a company's act of merely offering its products for sale as fit for human consumption did not create any misleading impression about the treatment of workers in the supply chain.

Today, absent statutory or regulatory mandates such as those outlined in Annex A, companies are generally not required to make ESG disclosures about their products, methods, or supply chains. However, cases such as *Ruiz, National Consumers League, Zeiger,* and *Smith* demonstrate that when companies choose to do so, they face potential liability if their disclosures contain verifiable claims or measurable standards and they arguably fail to follow through on those promises or misrepresent the information stated.

74 Some of these cases are described in *Legal Risks and ESG Disclosures: What Corporate Secretaries Should Know,* Society for Corporate Governance and Gibson, Dunn & Crutcher LLP, June 2018.

75 891 F.3d 857 (9th Cir. 2018).

76 *Id.* at 860.

77 *Id.* at 864.

78 *Id.* at 867.

79 *See, e.g., Wirth v. Mars, Inc.,* 730 F. App,x 468, 468–69 (9th Cir. 2018) ("Plaintiffs failed to allege that the existence of forced labor in the supply chain affects the . . . products' central function. Therefore [defendant] was under no duty to disclose."); *Dana v. Hershey Co.,* 730 F. App,x 460, 461 (9th Cir. 2018) (same); *Hughes v. Big Heart Pet Brands,* 740 F. App,x 876, 877 (9th Cir. 2018) (same).

New Class Action Complaints

Although the majority of claims challenging ESG-related statements have been dismissed at the pleading stage, consumers and consumer groups continue to bring these cases.

In October 2019, for example, a consumer filed a nationwide class action against Ben & Jerry's and Conopco/Unilever challenging "happy cows" and "caring dairy" statements made on the companies' websites and ice cream products. The challenge was based on alleged inhumane treatment of cows in factory-style, mass-production dairy operations purportedly involving intensive confinement practices and extensive antibiotic use.[80]

From June through September 2019, consumers similarly filed eight class actions against Coca-Cola and Fairlife challenging milk product label and website statements pertaining to humane treatment of dairy cows, including the Fairlife brand name, "our promise," "extraordinary care and comfort for our cows," "exceptional quality milk standards," "traceability back to our farms," and "continual pursuit of sustainable farming." The complaints allege that the statements are misleading based on purported abuse of dairy cows by a milk supplier.[81]

In July 2019, two consumer associations filed a complaint on behalf of the general public of the District of Columbia against Tyson Foods, challenging marketing and advertising for chicken products stating that the products are produced in an environmentally responsible way, the company prioritizes animal welfare, and the chickens used in the products are healthy and treated humanely. Plaintiffs claim the statements are misleading based on the alleged use of factory farming, including contamination with antibiotic-resistant pathogens, use of toxic chemicals and emission of pollutants, crowding of birds in warehouses, and abuse of chickens by the defendant's employees and contractors.[82]

In May 2019, consumers filed class actions against leading manufacturers of tuna fish under various state consumer protection laws, alleging that the companies' statements regarding "responsible harvesting" and "sustainable" sourcing of fish are misleading because the companies source tuna from suppliers whose fishing techniques harm dolphins. The complaints also challenge "dolphin safe" labeling on the tuna products as misleading due to the purported supplier fishing practices.[83] In April 2019, consumers also filed a class action against

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80 *Ehlers v. Ben & Jerry's Homemade Inc.,* et al., No. 19-cv-00194 (D. Vt., filed Oct. 29, 2019).

81 *See, e.g., In re: Fairlife Milk Products Marketing & Sales Practices Litig.,* No. 19-cv-3924 (N.D. Ill.) (MDL master docket); *Salzhauer v. The Coca-Cola Company,* No. 1:19-cv-02709 (N.D. Ga., filed June 13, 2019); *Schwartz v. Fairlife, LLC,* No. 1:19-cv-03929 (N.D. Ill., filed June 12, 2019).

82 *Food & Water Watch et al. v. Tyson Foods, Inc.,* No. 2019 CA 004547 B (D.C. Super. Ct., filed July 10, 2019).

83 *See, e.g., Duggan et al. v. Bumble Bee Foods,* No: 4:19-cv-02564 (N.D. Cal., filed May 13, 2019).

a food manufacturer challenging "sustainably sourced" package labeling and statements regarding the company's goals and efforts to eradicate forced and child labor from its supply chain. The complaint alleges that the statements are misleading because forced and child labor purportedly exist in countries from which the company sources ingredients for its products.

These recent filings suggest that, in addition to ESG statements on websites, plaintiffs' lawyers are also now focusing on ESG statements made on product packaging.

Investors filing securities class actions also continue to bring claims based on ESG-related statements. For example, in early 2019, investors filed class actions against a Brazilian mining company arising out of the January 2019 collapse of a mining dam. The complaint in the consolidated action alleges, in part, that the company made material misstatements concerning its efforts to increase safety and mitigate risks in its 2016 sustainability report when it described a "[l]ife matters most" corporate value that "strives to achieve Zero Damage by investing in prevention, process standardization, [and] risk management," and in its 2017 and 2018 sustainability reports stating that the company "maintains the management of its dams in permanent alignment and updating with the good and strictest international practices, standards of which exceed the legal requirements." The plaintiff also challenges the company's statements that it aims to achieve "Zero Harm" to its employees and surrounding communities throughout its operations.[84]

84 *In re Vale S.A. Securities Litig.,* No: 1:19-cv-00526 (E.D.N.Y., amended complaint filed Oct. 25, 2019).

Books and Records Requests

ESG disclosures may also lead to books and records requests pursuant to Section 220 of the Delaware General Corporation Law and similar provisions in other states by shareholders (and their counsel) looking for documents and details to form the basis of a securities or shareholder derivative action. In at least one instance, a challenge based on and relating to ESG disclosures has survived the motion to dismiss stage in a Section 220 case. The Delaware Court of Chancery denied a motion to dismiss a Section 220 action seeking inspection of a chocolate-product company's books and records for evidence of mismanagement and possible breaches of fiduciary duty related to the use of child labor on West African cocoa farms in the company's supply chain.[85] In denying the motion to dismiss, the court pointed to the company's public statements and promises the company made that it would certify that its chocolate products were free of cocoa tainted with child labor and human trafficking violations by 2020 as evidence that its board of directors was aware of at least some instances of child labor use in its supply chain. The court further found that the plaintiffs had adequately alleged that this knowledge would trigger a "duty to inform" the relevant authorities under illegal labor and human trafficking laws in Ghana and the Ivory Coast.

85 *La. Mun. Police Employees' Ret. Sys. v. The Hershey Co.,* No. CV 7996-ML (Del. Ch.) (bench decision overturning master's recommendation made after oral argument on March 18, 2014; transcript available at http://lawprofessors.typepad.com/files/hershey-ruling.pdf).

State and Municipal Investigations and Lawsuits

Finally, ESG issues and disclosures can lead to investigations, enforcement actions, or civil suits by federal, state, or municipal actors. For example, several states and municipalities have brought investigations and lawsuits against energy companies regarding their alleged contributions to, and statements about, climate change. Municipalities from various states, including California, Colorado, Maryland, New York, and Washington, have filed suits against energy companies over climate change.

While most of these suits are based on state nuisance law relating to the production and distribution of fossil fuels, several focus on statements made by energy companies regarding the risks of climate change. The City and County of Boulder, Colorado, for example, alleged that energy and fuel companies misrepresented the dangers of fossil-fuel production in various advertisements.[86] The City of Baltimore similarly alleged that advertising statements by companies regarding the effects of fossil fuel on the climate were misleading and violated state consumer protection laws.[87]

86 *Bd. of Cty. Comm'rs of Boulder Cty. et al. v. Suncor Energy,* No. 1:18-cv-01672 (D. Colo., filed June 29, 2018).

87 *Mayor & City Council of Baltimore v. BP,* No. 1:18-cv-02357 (D. Md., filed July 20, 2018).

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The State of New York's lawsuit against Exxon Mobil is probably the highest-profile example of this type of suit. After a three-year investigation of the company, New York sued Exxon Mobil in 2018 under state anti-fraud laws, alleging that Exxon misled investors regarding the risk that climate change regulations posed to its business. The state alleged that Exxon knowingly deceived investors as to the company's true financial exposure to increasing regulations and policies adopted to mitigate the adverse effects of climate change.[88] In December 2019, after a 12-day trial, the court ruled that New York "failed to establish by a preponderance of the evidence" that Exxon violated New York law "in connection with its public disclosures concerning how [it] accounted for past, present and future climate change risks."[89] A significant number of Exxon's public disclosures were at issue in the case, including several ESG reports (such as responses to CDP's climate change survey and several reports that Exxon issued in response to shareholder proposals), its annual reports on Form 10-K, its annual corporate citizenship reports, and its annual reports to shareholders. The court rejected "the contention that reasonable investors would attach material significance to the fact that" Exxon had an internal method for determining the cost of complying with future climate regulations. Instead, Exxon's ESG reports "provided only conceptual information about how [Exxon] managed the risks of climate change in its business planning."

The Exxon investigation was not the first by the New York State attorney general (NYAG) into potential securities violations in connection with ESG disclosures. On November 8, 2015, the NYAG entered into an assurance

88 *People of the State of New York v. Exxon Mobil Corp.,* No. 452044/2018 (N.Y. Sup. Ct., filed Oct. 24, 2018).

89 *People of the State of New York v. Exxon Mobil Corp.,* No. 452044/2018, 2019 WL 6795771 (Table) (N.Y. Sup. Ct., Dec. 10, 2019).

of discontinuance with Peabody Energy Corporation (Peabody). This marked the end of the NYAG's investigation into Peabody regarding alleged misrepresentations to investors about risks posed by climate change and the potential effect of climate change regulation on its business. Specifically, the NYAG was investigating allegations that Peabody had internal economic projections indicating that climate change and climate change regulation could be far more damaging to its business model than the economic projections it released to the public and relied on in its SEC filings.

Peabody paid no fines under the settlement, but it agreed to provide "disclosures concerning projections that the company has been able to make regarding the impact on the company's business of certain potential laws, regulations, and policies involving climate change, and . . . projections of demand for coal." Peabody further agreed "not to represent in any public communications that it cannot reasonably project or predict the range of impacts" that future climate change regulations might have. Although Peabody avoided monetary fines, the cost of responding to these investigations alone can be considerable.

Municipal and state investigations also can result in shareholder and investor lawsuits. For example, a shareholder sued Exxon Mobil's directors and officers in May 2019 for allegedly misleading shareholders regarding climate change and its impacts on Exxon's business. The suit relies upon documents purportedly unearthed during New York's investigation and further cites to the various lawsuits filed by states and municipalities.[90] Another securities lawsuit brought by Exxon Mobil investors also relies on the New York investigation to allege that Exxon Mobil made material misstatements when disclosing costs relating to climate change to investors.[91] Both of these cases were pending as of March 2020.

Municipal and state investigations also can result in shareholder and investor lawsuits.

Thus far, these municipality and state investigations and related lawsuits have focused on the energy sector and climate change, but they demonstrate the risks involved in preparing disclosures dealing with highly scrutinized ESG issues, even when the disclosures themselves may be fairly routine.

90 *Von Colditz v. Woods et al.,* No. 3:19-cv-01067 (N.D. Tex., filed May 2, 2019).

91 *Ramirez v. Exxon Mobil Corp.,* No. 3:16-cv-03111 (N.D. Tex., amended complaint filed July 26, 2017).

Legal Issues Stemming from Board Oversight of ESG Issues

As investors, regulators, consumers, and other stakeholders have shown increasing interest in a host of ESG issues—and as company disclosures have expanded in response to stakeholder and investor interest—these issues increasingly have been elevated to the board level. In addition, there is a growing recognition among boards that ESG issues are inextricably linked to a variety of areas for which the board already has oversight, so these issues cannot be viewed in isolation. Instead, ESG issues must be evaluated as one component of what the board considers in overseeing key areas such as strategy, risk, and compliance. Diligent board oversight of the ESG aspects of a company's business helps to build long-term value for a company and its shareholders. It can also help reduce the risk that a company will face securities or consumer protection litigation of the type described in the first part of this brief—especially to the extent that a company's ESG disclosures emphasize the importance of those issues to the company—and protect the board from so-called *Caremark* claims that directors breached their fiduciary duties by failing to perform their oversight responsibilities effectively.

Under state law, directors owe fiduciary duties to a corporation and its shareholders. These duties primarily include a duty of care and a duty of loyalty. As part of the duty of loyalty, boards of directors also have what are often referred to as *Caremark* duties, named for the seminal 1996 case *In re Caremark International Inc. Derivative Litigation.*[92] In *Caremark*, the Delaware Chancery Court articulated the oversight and monitoring responsibilities of a corporation's boards of directors under Delaware law. Under *Caremark*, a corporation's board may be liable for breach of fiduciary duty when:

> "[T]he directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[93]

The legal standard for imposing liability on directors for oversight failures is a demanding one. It requires bad faith in the form of an "intentional dereliction of duty," "conscious disregard for one's responsibilities," or actions taken "with the intent to violate applicable positive law."[94] Because of the difficulty of proving bad faith, the Delaware courts have stated that a *Caremark* claim is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[95]

92 *See In re Caremark Int'l Inc. Deriv. Litig.,* 698 A.2d 959 (Del. Ch. 1996).

93 *Stone ex rel. AmSouth Bancorporation v. Ritter,* 911 A.2d 362, 370 (2006) (adopting and applying *Caremark*).

94 *City of Birmingham Retirement and Relief Sys. v. Good,* 2017 WL 6397490 (Del. Dec. 15, 2017).

95 *Id.* (citations omitted).

In spite of this, shareholders have brought *Caremark* claims alleging oversight failures with respect to issues ranging from executive compensation to risk oversight and legal compliance, and extending to ESG issues. In a case involving the board's oversight of environmental practices at Duke Energy Corporation brought in the wake of a major coal ash spill, the then chief justice of the Delaware Supreme Court, in a noteworthy dissent from the court's dismissal of *Caremark* claims against the company's directors, criticized what he viewed as conduct that was inconsistent with the directors' fiduciary duties:

> "I find that . . . it was the business strategy of Duke Energy, accepted and supported by its board of directors, to run the company in a manner that purposely skirted, and in many ways consciously violated, important environmental laws. Being skilled at running an energy company whose conduct presented environmental hazards, but whose operations provided an important source of employment, Duke's executives, advisors, and directors used all the tools in their large box to cause Duke to flout its environmental responsibilities, therefore reduce its costs of operations, and by that means, increase its profitability. This, fiduciaries of a Delaware corporation, may not do."[96]

Despite this dissent, the Supreme Court of Delaware affirmed dismissal of the claims against the directors because it found that the board exercised oversight by receiving management presentations on environmental problems at the company and actions management was taking to address them.

The closer ESG issues relate to core company risks, the more diligent oversight courts expect to see from boards. For example, the Delaware Supreme Court recently reinforced the importance of designing board-level systems of monitoring and reporting, particularly with respect to "essential and mission critical" activities.[97] In *Marchand v. Barnhill*, the Delaware Supreme Court for the first time reversed dismissal of *Caremark* claims. The court held that where a food company's management was aware of repeated, serious food safety issues over a period of years—and where those food safety issues eventually led to consumer deaths, an operational shutdown, and a liquidity crisis—allegations that there was no mechanism in place to prompt a relevant report to the board stated a claim under the first prong of *Caremark* (that is, that the directors "utterly failed to implement any reporting or information system or controls").[98] While the *Caremark* standard has not changed and remains a high bar, as seen in *Marchand* and other recent cases, Delaware courts are willing to allow *Caremark* claims to proceed, particularly when they involve a failure of oversight with respect to regulatory and legal compliance as to a company's "essential and mission critical" activities, which could be impacted by the descriptions of the relative importance of ESG matters in the company's ESG disclosures.

96 *Id*. at *65 (Strine, J., dissenting).

97 *Marchand v. Barnhill,* 212 A.3d 805, 824 (Del. 2019).

98 *Id. Stone,* 911 A.2d at 370. *See also In re Clovis Oncology, Inc. Derivative Litigation,* C.A. No. 2017-0222-JRS (Del. Ch. Oct. 1, 2019).

Companies would be well served to think carefully about how they describe the relative importance of ESG matters in disclosures, as those descriptions may affect how a court later defines "essential and mission critical activities."

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Expectations of the actions directors should take to satisfy their oversight responsibilities and the scope of the board's oversight role have evolved over time in other ways as well. In recent years, this development has been particularly apparent in shareholder derivative suits seeking to hold directors responsible for oversight failures in the wake of high-profile cybersecurity breaches at their companies. These suits—which have been brought against Target Corporation, Wyndham Worldwide Corporation, The Home Depot, and The Wendy's Company—have generally not been successful. The Target, Wyndham, and Home Depot suits were dismissed. The Home Depot suit was appealed but settled while the appeal was pending, and the Wendy's suit settled. Both cases settled in exchange for the adoption of certain governance reforms, including the following:

- Establishing a board-level technology committee with a written charter and oversight responsibility for cybersecurity and information technology matters (Wendy's)
- Providing the board with reports from management at least annually (or more frequently if requested by the committee) on the company's cybersecurity program and material cybersecurity risks (Wendy's)
- Giving the board the authority to retain outside experts to assist in oversight of cybersecurity (Wendy's and Home Depot)
- Continuing to convene the enterprise risk-management team on a regular basis to discuss and evaluate potential risks to the company, including cyber risks (Wendy's)
- Giving the board the authority to meet with the chief information officer in executive session as the technology committee deems appropriate (Wendy's)
- Documenting the duties and responsibilities of the chief information security officer (Home Depot)
- Maintaining an executive-level committee focused on data security (Home Depot)
- Providing the board with periodic reports from management about the information-technology and cybersecurity budgets (Home Depot)

Steps Companies and Boards Can Take to Mitigate Legal Risks Associated with ESG Disclosures

The risks associated with ESG disclosures are real and should not be underestimated. The cases discussed in this report reflect that ESG statement litigation continues to proliferate. Litigation filings are also likely to only increase in the future, as investors continue to state that ESG factors are relevant to their decision-making, companies publish more information about their ESG goals and efforts, and plaintiffs' attorneys increasingly scrutinize these statements. However, there are steps that companies can take to reduce the potential legal exposure created by these disclosures.

Include Disclaimers

Companies should consider accompanying ESG disclosures with disclaimers. The disclaimers can note that the standards or goals invoked in the ESG disclosures are not guarantees or promises. It also may be appropriate to note that the standards of measurement and performance for ESG issues are developing or are based on assumptions.

The inclusion of disclaimers is particularly important with respect to ESG statements posted on websites if a company plans to include a cross-reference or link to the website in its proxy statement or other SEC filings (disclaimers may also be appropriate near the links in the SEC filings themselves). Where ESG disclosures are included in actual SEC filings, the forward-looking disclosure statement in that filing should be updated to reflect the nuances of the ESG disclosures, and other disclaimers may be appropriate. Generally, the disclaimers should be located near the pertinent ESG disclosures to reduce the risk of investors or consumers asserting that they did not see the disclaimers when reading and relying on the disclosures.

Litigation filings are likely to only increase in the future, as investors continue to take ESG factors into account in their decision-making, companies publish more information about their ESG goals and efforts, and plaintiffs' attorneys increasingly scrutinize these statements.

Check the Facts

As with any other public statement, companies should confirm the accuracy of ESG disclosures before they are released to the public. Proposed ESG disclosures should be reviewed for overstatements, misstatements, or concrete statements about initiatives that might be rendered misleading or untrue by an adverse supplier or other event. Companies should understand that publishing commitments to achieve specific ESG goals or targets by certain dates may result in litigation alleging misrepresentations to consumers if those goals or targets are not met. As part of this review, companies should confirm they have adequate diligence procedures in place to accurately measure progress on ESG goals[99] and consider whether they need internal or external auditors to help verify or attest to the concrete facts and numbers included in ESG disclosures.[100] Companies should also consider creating a single data repository to house each year's ESG information once the year has closed and the information has been audited, with the understanding that thereafter, (1) no company personnel can use ESG data outside of the repository and (2) no one can use the data

99 This is especially true as companies increasingly use ESG-related goals in performance-based executive compensation, because companies need to verify the extent to which those goals have been achieved.

100 *See, e.g.,* AICPA's guidance on sustainability assurance, available at https://www.aicpa.org/interestareas/businessindustryandgovernment/resources/sustainability/sustainability-assurance-and-other-services.html. *See also* the World Business Council on Sustainable Development's "A Buyer's Guide to Assurance on Non-financial Information," Nov. 20, 2019, available at https://www.wbcsd.org/Programs/Redefining-Value/External-Disclosure/Assurance-Internal-Controls/Resources/A-buyer-s-guide-to-assurance-on-non-financial-information.

without having internal and/or external legal counsel review the interpretation and context. These steps may mitigate risks caused by ESG statements that construe the same data in different ways or take that data out of context.

Consider Using Aspirational Language and Estimates

Companies should evaluate whether to use words such as "should," "expect," and "strive" instead of making falsifiable assertions that the company, its employees, or its suppliers "do" comply, "are" in compliance, "must" be in compliance, or "will" be in compliance with applicable laws and standards. Companies can also minimize litigation risk when measuring progress on ESG goals by referring to "estimates" or "approximations" rather than relying on concrete measurements. This also means setting process-based or soft goals, rather than objective, clearly measurable targets such as a specific reduction by a specific date. Of course, a company may desire to include objective targets (such as greenhouse gas reduction goals) and associated progress toward those goals as part of its business strategy or to address stakeholder demands. In such cases, data accuracy is critical.

Understand That Location Matters

Including detailed ESG disclosures in SEC filings, on product packaging, or in other prominent locations may increase the risk of litigation, as it may be easier for plaintiffs to show that they saw the disclosure and reasonably relied on it in making their decisions. ESG statements on websites can also present heightened risks, particularly if products are sold through the websites. Companies should consider only using language suggesting that ESG initiatives and disclosures are material to the company, investors, or consumers if, in fact, they truly are. Fluffy assertions of materiality may simply aid the efforts of plaintiffs attempting to prove reasonable reliance in litigation while providing little upside to the company. Finally, a company should evaluate the location of its various ESG disclosures and consider the extent to which those disclosures should be included in other places—for example, whether the ESG risks disclosed in the Form 10-K are addressed in the sustainability report.

Educate Internally on Litigation and Related Trends

Employees who are responsible for updating and preparing ESG statements and supporting documentation should be educated about the growing risk of lawsuits based on alleged misrepresentations in these statements. Employees should also understand that ESG statements need to be consistent with descriptions of the company's business and material trends and risks in SEC filings. Companies should review ESG statements and SEC filings for consistency before releasing these documents. Even if ESG materials are not currently required or included in SEC filings, companies should be aware that they may face pressure to incorporate these materials in the future.

Companies also should monitor related developments in ESG reporting. For example, as discussed above, an increasing number of companies are modifying their ESG disclosures to address data points that are important to various ESG rating firms or to respond to the SASB's 77 industry-specific reporting standards[101] or other third-party standards. In another example, Delaware's Certification of Adoption of Sustainability and Transparency Standards Act, which went into effect in October 2018, established a voluntary disclosure regime to encourage dialogue on sustainability and responsibility among participating Delaware business entities and their various stakeholders.[102] The Act does not require business entities to use specific standards or criteria. Instead, it allows the governing body of an entity seeking certification under the Act to adopt standards or criteria that are based on or derived from a third party not controlled by the entity "that provides services, standards, or criteria with respect to measuring, managing or reporting the social and environmental impact of businesses or other enterprises." Qualifying entities may obtain from the secretary of state of the state of Delaware a certificate of adoption, although the secretary of state does not judge the quality of the disclosures. Importantly, the Act does not impose fines or penalties on entities that do not seek to be certified or that fail to satisfy their own performance standards once certified. Moreover, the Act provides that neither a decision not to seek certification nor a failure to meet the specified sustainability standards creates a right of action or otherwise gives rise to a claim for breach of fiduciary or similar duty.

101 *See* "SASB Codifies First-Ever Industry-Specific Sustainability Accounting Standards," SASB, November 07, 2018, https://www.globenewswire.com/news-release/2018/11/07/1646736/0/en/SASB-Codifies-First-Ever-Industry-Specific-Sustainability-Accounting-Standards.html.

102 *See* 81 Del. Laws, c. 279, § 1 (effective Oct. 1, 2018); "Adoption of Transparency and Sustainability Standards," Delaware Division of Corporations, accessed Apr. 14, 2020, https://corp.delaware.gov/adoption-transparency-sustainability-standards/.

Encourage Appropriate Internal Collaboration

Typically, the various teams involved in drafting, reviewing, and publishing ESG disclosures have different priorities and perspectives. Requiring them to collaborate and review proposed disclosures is a good way to integrate those priorities. Breaking down silos among different teams will both minimize mistakes and promote dialogue about the appropriate level of risk to take with respect to the company's ESG disclosures. To that end, an increasing number of companies are requiring their disclosure committees to review and approve ESG disclosures, even when those disclosures are not included in the company's SEC filings. Disclosure committees are a critical part of a public company's disclosure controls and procedures. They should consider whether the company's SEC filings should include voluntary ESG disclosures and, if so, to what extent.

Evaluate Board Practices

The legal principles defining the oversight responsibilities of boards of directors suggest that boards can take steps to provide for effective oversight of disclosures and other public statements about various aspects of a company's ESG practices. Improved board oversight can help minimize the risk that the board, and the company, will face litigation and potential liability.

Board Oversight: Cases involving board oversight of cybersecurity and legal and compliance risks offer insight into the types of actions that could help boards perform effective oversight of ESG issues. Themes pertinent to board oversight of ESG matters include: (1) regular reporting from management on issues including material risks; (2) empowerment of senior management with clearly defined responsibilities and a direct line of communication to the board or relevant committees; and (3) regular consideration of ESG risks at the board and/or senior management levels as part of the company's enterprise risk-management program. All of these practices—as well as programs to educate the board on the company's ESG risks and opportunities—can help board members understand the ESG issues that are core to the company's business operations and ensure that the company's regular enterprise risk-management processes are applied to these issues.

Evaluating Controls and Procedures: There is also a potential role for the board with respect to ESG disclosures. As a threshold matter, a board should be comfortable that the company has appropriate controls and procedures for seeing that the company's disclosures are accurate and relevant and do not create undue legal exposure for the company. Boards should understand that there is a continuum of legal risk associated with ESG disclosures—and that some types of disclosures may pose greater risk than others. Controls and procedures that boards can consider may include policies about providing disclaimers making clear that ESG disclosures are not guarantees or promises, and diligence procedures for fact-checking statements and reviewing them for overstatements or statements that create the potential for misrepresentations. Boards can also endeavor to understand who at their company signs off on ESG disclosures and consider what role, if any, directors and senior management have in the review and preparation of ESG disclosures.

Escalation Processes: Finally, boards can evaluate protocols to escalate ESG matters to the board before public statements are made. This may be appropriate when statements involve policy matters or changes in policy that normally would require board involvement. For example, before a company makes a public commitment to achieving gender pay equity by a specific deadline or to "going green" in a major line of business, it should consider whether to inform the board or submit the proposed commitment for board review or approval. Without appropriate board input, a subsequent failure to execute on these types of commitments could result in exposure for the company and the board. Regular reporting to the board on core ESG issues and how they relate to the company's strategy, operations, and risk management can reduce the potential for disconnections between a company's practices and its public statements.

Annex A

A number of laws and regulations also govern, and may trigger, ESG disclosures. The following are some examples:

1. The Modern Slavery Act 2015, c. 30 (UK), requires that any "commercial organisation" that carries on business or part of a business in the United Kingdom and has an annual after-tax revenue of at least £36 million must prepare—and, in some cases, issue—a yearly statement detailing the steps it and its subsidiaries have taken to ensure that neither slavery nor human trafficking is taking place in its supply chain.

2. The California Transparency in Supply Chains Act, California Civil Code § 1714.43, requires "[e]very retail seller and manufacturer doing business in [California] and having annual worldwide gross receipts that exceed one hundred million dollars ($100,000,000)" to "disclose . . . its efforts to eradicate slavery and human trafficking from its direct supply chain for tangible goods offered for sale" in a statement meeting certain specified minimum requirements. The California law has served as a model for several bills introduced in both houses of Congress in recent years that would require public companies to disclose to the SEC the measures they have taken to address forced labor conditions.[103]

3. The SEC's Conflict Minerals Disclosure Rule, Exchange Act Rule 13p-1, requires that "[e]very registrant that files reports with the Commission under Sections 13(a) . . . or 15(d) . . . of the Exchange Act, having conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured, shall file a report on Form SD" in the manner and time specified by that form.

4. The SEC has also issued guidance noting that Items 101, 103, 303, and 503(c) of Regulation S-K can sometimes require disclosure of risks and costs posed by climate change, environmental regulation, and environmental litigation.[104] The Climate Risk Disclosure Act of 2018 was first introduced in Congress in September 2018. It was reintroduced as the Climate Risk Disclosure Act of 2019 in July 2019 and was subsequently passed in the House Financial Services Committee. If enacted, it would amend the Exchange Act to include a subsection entitled "Disclosures Relating to Climate Change," under which issuers would be required to include in their annual reports disclosures regarding physical risks and transition risks posed by

103 *See, e.g.,* Business Supply Chain Transparency on Trafficking and Slavery Act, H.R. 4842, 113th Cong. (2014) (seeking to amend Section 13 of the Exchange Act).

104 Commission Guidance Regarding Disclosure Related to Climate Change, SEC Release Nos. 33-9106; 34-61469; FR-82 (Feb. 8, 2010).

climate change, along with any established corporate governance processes and structures to identify, assess, and manage climate-related risks.

5. In 2019, the Staff of the Division of Corporation Finance of the SEC released two identical new Regulation S-K interpretations conveying its expectation that in some situations, companies would need to disclose how they considered the self-identified diversity characteristics of directors or nominees.[105] Additional guidance or rulemaking on diversity may also be forthcoming, as the SEC's long-term rulemaking agenda for fall 2019 included plans to revisit proxy disclosure requirements such as corporate board diversity.[106]

6. For financial years beginning on or after January 1, 2017, the United Kingdom implemented the European Union (EU) Non-financial Reporting Directive (NFRD), which requires certain companies to publish annual reports containing information regarding environmental, social, employee, human-rights, and anti-corruption and -bribery matters.[107] This directive is similar to general EU law that requires large companies to disclose certain information concerning the way they operate and manage social and environmental challenges.[108] The European Union is currently considering changes to the NFRD that would expand the number of companies subject to its reporting requirements, potentially including subsidiaries of parent companies operating within the European Union that already report nonfinancial information at a group level under the NFRD.

7. The SEC adopted its CEO pay ratio disclosure rule on August 5, 2015.[109] The rule implements Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act to "require disclosure of the median of the annual total compensation of all employees of a registrant (excluding the chief executive officer), the annual total compensation of that registrant's chief executive officer, and the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer."

8. Many jurisdictions have adopted guidelines requiring certain companies to disclose statistics regarding the diversity of boards and executive officer positions. *See, e.g.,* European Union's Directive 2014/95/ EU (requiring large public-interest companies with more than 500 employees to disclose information on their diversity policy, covering age, gender, and educational and professional background); and France Loi numéro 2011-103 (requiring certain French companies to increase to 40% the number of women serving on boards). In the United States, similar legislation, the Improving Corporate Governance through Diversity Act of 2019, passed the US House of

105 *See* Compliance and Disclosure Interpretations, Questions 116.11 and 133.13.

106 *See* SEC, Long-Term Regulatory-Flex Agenda (Spring 2019).

107 *See* The Companies, Partnerships and Groups (Accounts and Non-financial Reporting) Regulations 2016.

108 *See* Directive 2014/95/EU, amending Directive 2013/34/EU.

109 *See* SEC Release Nos. 33-9877; 34-75610; File No. S7-07-13 (Aug. 5, 2015).

Representatives in Nov. 2019. If enacted, it would require public companies to disclose annually the gender, race, ethnicity, and veteran status of their directors, director nominees, and senior executive officers.[110] In January 2020, the state of New York enacted legislation that, among other things, requires domestic and foreign corporations doing business in New York to report the number of directors appointed to their boards and the number of directors who are female. A similar law enacted in Illinois in 2019 requires companies to report on the demographics of directors and executives based on gender and race.

9. Many jurisdictions in Europe have begun to require companies to disclose gender pay gaps. *See* Germany's 2016 Remuneration Transparency Act (requiring employers with more than 500 employees to publish status reports on gender equality and equal pay) and the United Kingdom's Equality Act of 2010 (mandating all companies with at least 250 employees in the United Kingdom to report gender pay gaps to the Government Equalities Office). There have been similar attempts in the United States to mandate public disclosure of gender pay gaps, but most of these have been at the state level, and some have failed to gain traction. For example, in 2017 the California legislature passed AB 1209, a bill that would have required companies to submit pay data categorized by gender, race, and ethnicity, but Governor Jerry Brown vetoed the bill. Also in 2017, Governor Andrew Cuomo of New York issued an executive order requiring state contractors with prime contracts having value in excess of $25,000 ($100,000 for construction contracts) to disclose the salaries of all employees in their work utilization reports.[111]

10. Environmental issues remain an important area for mandatory disclosure, not just in the United States but also in Europe. *See, e.g.,* the European Union's Directive 2013/34/EU (requiring disclosure by EU-registered oil, gas, mining, and logging companies of payments to governments for access to natural resources) and the 2015 French Energy Transition Law (requiring that public companies disclose financial risks associated with the effects of climate change).

110 *See* H.R. 5084, 116th Cong. (2019).

111 *See* E.O. No. 162, Ensuring Pay Equity by State Contractors (Jan. 2017).

Annex B

Steps Companies and Boards Can Take to Mitigate Legal Risks Associated with ESG Disclosures

1. Include disclaimers alongside ESG disclosures.
2. Set up internal controls and review procedures to confirm the accuracy of ESG disclosures.
3. Consider using aspirational language and estimates in ESG disclosures.
4. Understand that the location of ESG disclosures matters.
5. Educate internally on litigation and related trends relevant to ESG disclosures.
6. Encourage appropriate internal collaboration in developing and confirming ESG disclosures, including legal review.
7. Evaluate board practices for overseeing and evaluating ESG efforts, including ESG disclosures.

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