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Companies Face Increasing Scrutiny Over Their ESG Disclosures — Including by ESG Critics

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Key Points

- Courts have often held that generalized statements about a commitment to safety or environmental sustainability are too vague to be actionable under the securities laws. At the same time, a company may have a duty to make more detailed disclosures, including about potential risks, if it provides specifics about a particular environmental matter.
- Companies should be aware that there may also be a duty to disclose specific risks of impending changes in environmental regulations, and they should consider including those in their risk factor disclosures.
- Although most suits challenging corporate diversity disclosures have been dismissed for failure to plead falsity with the requisite particularity, plaintiffs have resorted to books and records demands in hopes of uncovering information to bolster their claims.
- While companies continue to grapple with increased scrutiny of their ESG efforts and disclosures, they should also monitor anti-ESG efforts challenging the validity of those initiatives.

As public interest and scrutiny into environmental, social and governance (ESG) issues continue to rise, companies face an ever-evolving landscape relating to their ESG disclosures. The Securities and Exchange Commission (SEC) has proposed rules that could require increased ESG disclosures. Although those rules are still pending, the agency has brought enforcement actions challenging ESG disclosures under the existing regime.

Additionally, shareholders have continued to file securities and derivative actions challenging ESG disclosures and are using books and records requests to obtain information to support their claims. Accordingly, companies should carefully manage how they implement and disclose their ESG initiatives.

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Environmental Disclosures

Regulatory actions. On March 21, 2022, the SEC issued a press release announcing proposed rule changes that would require registrants to include disclosures in their registration statements and periodic reports regarding climate-related risks and the company's greenhouse gas emissions. Although these proposals have not yet been adopted, the SEC has already brought enforcement actions under existing law. For example:

- In April 2022, the SEC commenced an action against a Brazilian mining company stemming from a dam collapse that resulted in the release of toxic mining waste into a local water supply. The SEC asserted that representations about safety that the company made in its sustainability reports — including statements about "environmental responsibility," adherence to "best practices" and audits certifying safety — were false and misleading. The action ultimately resulted in a $55.9 million settlement payment by the mining company.
- In May 2022, the SEC charged a registered investment adviser with misrepresenting that investments in certain funds had undergone an ESG quality review. The adviser ultimately agreed to pay a $1.5 million penalty.

Shareholder actions. In addition to the SEC, shareholders are filing actions to hold companies accountable for their environmental-related disclosures. For example:

- ***Fagen v. Enviva Inc.***, No. 8:22-cv-02844 (D. Md.) In November 2022, a securities suit was filed in the U.S. District Court for the District of Maryland against Enviva Inc., the world's largest producer of wood pellets, a renewable alternative to coal. Investors challenged Enviva's statements touting sustainability as "the foundation of [its] business," relying on a short-seller report stating that Enviva was "flagrantly greenwashing its wood procurement" and that Enviva's claim to being a "pure play ESG Company" was "nonsense on all counts."
- ***In re Danimer Scientific, Inc. Sec. Litig.***, No. 1:21-cv-02708-HG-SJB (E.D.N.Y.) In May 2021, investors filed a securities lawsuit against Danimer Scientific, Inc., a biodegradable plastics company, challenging the accuracy of statements that the company's plastic substitute was 100% biodegradable and sustainable.

Although these lawsuits remain pending, earlier ones provide insight into how courts have addressed similar claims. In September 2020, for example, an investor filed a securities lawsuit against Peabody Energy, the world's largest coal mining company, challenging the company's disclosures on its commitment to safety after a fire at a mine in Australia halted coal production at the mine for over a year. *In re Peabody Energy Corp. Sec. Litig.*, 2022 WL 671222 (S.D.N.Y. Mar. 7, 2022).

The court granted a motion to dismiss in part, finding many of the challenged statements — including statements that Peabody "maintains constant vigilance toward safety," "commits to safety and health as a way of life" and "achieved record safety this past year" — to be nonactionable puffery. But the court denied the motion to dismiss as to other claims, holding that, once the company disclosed the detection of elevated gas levels at the mine at issue, it had a "duty to disclose the whole truth about the situation," which would have allegedly included disclosure of the sighting of smoke — details that could constitute material omissions.

Similarly, in December 2022, the U.S. Court of Appeals for the Second Circuit vacated the dismissal of a securities suit, finding that the complaint adequately pled a duty to disclose the impact of an impending environmental regulation that threatened sales of a significant fuel product. The Second Circuit agreed with the district court that most of the challenged statements were nonactionable, including several that were considered puffery and corporate optimism.

But the court found that omissions regarding the impact of an impending regulation that would restrict fuel oil use and that was allegedly known to defendants would likely have a material effect on the company's financial condition or operations, creating a duty to disclose under Item 303 of SEC Regulation S-K. *Moab Partners, L.P. v. Macquarie Infrastructure Corp.*, 2022 WL 17815767 (2d Cir. Dec. 20, 2022).

Board and Workforce Diversity Disclosures

Regulatory initiatives. On the diversity front, the SEC approved a Nasdaq Board Diversity Rule requiring Nasdaq-listed companies to disclose board diversity data and comply with board diversity requirements, or explain their reasons for noncompliance. The rule, which is the subject of an appeal before the U.S. Court of Appeals for the Fifth Circuit, is emblematic of the broader corporate movement toward promoting inclusion and underscores the importance of considering boardroom diversity and related disclosures.

Shareholder actions. In the last three years, shareholders have filed more than a dozen lawsuits challenging the accuracy of public companies' stated commitments to diversity. These lawsuits have generally been dismissed, frequently because the challenged statements were deemed nonactionable puffery or plaintiffs failed to plead specific facts demonstrating that the statements at issue were false. (See our June 2022 *Insights* article, "ESG in Focus: An Overview of Recent Litigation and Regulatory Developments.") Many plaintiffs have thus resorted to requesting access to corporate books and records, including board materials, under Section 220 of the Delaware General Corporation Law (220 Demands), in hopes of supporting more specific allegations of falsity.

- For example, in March 2021, a shareholder challenged the truth of representations made by Qualcomm Technologies, Inc. in its proxy statements about its policy to instruct any search firm it engages to include candidates of diverse backgrounds in the pool from which the company selects director nominees. In dismissing the complaint, the court found that the plaintiff failed to plead facts supporting a reasonable inference that the statements were false or misleading. *Kiger v. Mollenkopf*, 2021 WL 5299581 (D. Del. Nov. 15, 2021). But the same shareholder later filed a 220 Demand to gather more information to support her claims, which were used to file another complaint in early 2023. *Kiger v. Mollenkopf*, No. 2023-0444-JTL (Del. Ch. Apr. 21, 2023).
- Other shareholders have adopted the same strategy as the one in the Qualcomm case, including in:
  - *Asbestos Workers Phila. Welfare & Pension Fund v. Scharf*, No. 3:23-cv-1168 (N.D. Cal. Mar. 15, 2023), in which shareholders relied on 220 Demand documents to allege that the Wells Fargo board ignored “pervasive issues of discrimination” that resulted in multiple scandals, including allegations that the bank held fake interviews with minority candidates.
  - *In re Tesla Inc. Stockholder Deriv. Litig.*, No. 1:22-cv-00592-LY (W.D. Tex. June 16, 2022), in which shareholders relied on 220 Demand documents to allege that the Tesla board ignored repeated warnings of a company culture tolerating sexual harassment and racial discrimination.

Anti-ESG Efforts

As companies grapple with the demands of regulators and shareholders that they improve their commitment to ESG initiatives, they should also be aware of anti-ESG efforts challenging such initiatives. For example, the U.S. Senate passed legislation in March 2023 to nullify a Department of Labor (DOL) rule allowing retirement plan managers to formally consider ESG factors in investment decisions. And earlier in the year, a group of 25 Republican attorneys general brought an action against the DOL, alleging that the rule violates the Employee Retirement Income Security Act (ERISA) and undermines protection for retirement savings. That case is currently pending.

Although President Joe Biden vetoed the Senate bill, many states are passing their own anti-ESG bills. Florida, for instance, recently adopted a law barring state officials from investing public money based on ESG standards.

Growing anti-ESG sentiment has also led a number of state attorneys general to investigate whether collaborative ESG initiatives in the financial sector violate antitrust laws by restricting financing and investments in carbon-intensive industries. Recently, state attorneys general have also begun inquiring about ESG efforts in the insurance industry, raising similar concerns that collaborative efforts may be restricting the supply of underwriting services to high-emission sectors.

Growing anti-ESG scrutiny has already impacted participation in these collaborations, with The Vanguard Group, Inc. recently exiting the Net Zero Asset Managers initiative and major insurance companies leaving the Net-Zero Insurance Alliance.

Further, shareholders have recently started challenging diversity-based initiatives and seeking more information about them via Section 220 Demands. For instance, they have claimed that such efforts violate Title VII of the Civil Rights Act and corporate anti-discrimination policies while also failing to further corporate profits or maximize shareholder interest.

In Sum

Given this constantly evolving landscape surrounding ESG-related issues and their controversial nature, it will be important for companies to monitor further developments closely and to carefully manage their ESG-related initiatives and disclosures to help reduce the risk of litigation.

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