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ESG and securities litigation: An increased focus on allegations of "greenwashing"

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Over the past few years, regulators, businesses, and the market in general have become increasingly focused on environmental, social, and governance (ESG) issues. From the U.S. Securities and Exchange Commission (SEC) proposing new disclosure requirements for climate-related matters, to increasing state regulations, to litigation accusing public companies of failing to follow through on their commitments to diversity, ESG is seemingly in the headlines every day. This ever-increasing focus has created a climate where companies, understandably, want to make public statements promoting their own positive commitments to ESG issues. But those statements come with a risk, including litigation or even regulatory actions that seem to challenge those statements as false or misleading—whether in consumer actions concerning the products or practices at issue, or in shareholder actions asserting claims for alleged violations of federal securities laws.

As discussed in the examples later in this article, the SEC and securities plaintiffs have brought a number of such actions recently against public companies, indicating increased scrutiny over company ESG statements—particularly those promoting a company's positive impact on environmental issues. These claims have mainly focused on allegations of "greenwashing" (i.e., making false or misleading statements that make a company's business, products, policies, or practices appear more environmentally friendly or sustainable than they truly are).

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Given this trend, companies must carefully assess the risks they or their officers or directors face when making public statements or disclosures regarding ESG-related practices.

Background and SEC proposed disclosure requirements

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expected to account for 15% of all investments by 2025.[1]

This growing market interest also has drawn the attention of regulators—at state and federal levels. As an example, last year, the SEC made headlines when it proposed rule changes that would require registrants to include certain ESG-related disclosures in their registration statements and periodic reports.[2] If those rules were made final (which has yet to occur), they would require registrants to disclose, among other things, information about their greenhouse gas emissions and “climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics.”[3] If implemented, those rules could have wide-ranging implications for a number of public companies, including the substantial cost that would likely be associated with ensuring their compliance with these rules.

The SEC has not stopped there. It also has proposed new rules for investment advisers and investment companies to promote “consistent, comparable, and reliable information for investors concerning funds and advisers’ incorporation of environmental, social, and governance (ESG) factors.”[4] Those rules appear to be targeted mainly at investment advisers that represent commitments to ESG investing as part of their strategies.

Trends in ESG litigation

This increasing focus has likewise extended to the plaintiffs’ bar, with various lawsuits filed concerning ESG issues recently. In the area of shareholder litigation, an early example of that trend was a series of derivative lawsuits filed against public companies across the country in the wake of the national discussion on political and social justice issues. More than a dozen derivative lawsuits were filed concerning companies’ practices and representations regarding diversity, equity, and inclusion (DEI) initiatives.

These lawsuits, brought against the boards of directors for a wide variety of companies, generally alleged that the company’s directors and/or officers breached their fiduciary duties by either allowing the company to fall short of its commitments to diversity and/or by issuing statements concerning such commitments that were false or misleading in violation of federal securities laws. Some of these plaintiffs also cited studies connecting board diversity to increased profits to support the assertion that allowing a lack of diversity to persist amounts to a breach of the fiduciary duties that directors or officers owe to the company.

While most of those derivative lawsuits were unsuccessful, that has not caused the plaintiffs’ bar to shy away from ESG issues. Litigation has continued, but recent lawsuits indicate the scrutiny has shifted to challenging companies’ statements promoting their environmental practices—alleging that those statements are nothing more than greenwashing. Although not exhaustive, below are several examples of such matters, both in the context of regulatory actions and private shareholder litigation.

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Vale S.A.

One example is an SEC enforcement action against Vale S.A., a publicly traded Brazilian mining company. [5] In 2019, Vale's Brumadinho dam collapsed, killing 270 people and causing significant environmental harm by releasing toxic mining waste into a local water supply. The mine collapse allegedly caused a loss

regarding the safety of its dams. Specifically, the SEC alleged that Vale falsely stated that it evaluated the safety of its dams by employing a rigorous audit process; in reality, it allegedly manipulated this audit process and was aware the Brumadinho dam faced an unreasonable risk of collapse. In a press release announcing these charges, the SEC underscored its focus on ESG disclosures, noting that "[m]any investors rely on ESG disclosures like those contained in Vale's annual Sustainability Reports and other public filings to make informed investment decisions."[6]

On March 28, 2023, the SEC announced that Vale, without admitting liability, had agreed to pay $55.9 million to settle these claims.[7] The settlement, which is subject to court approval, requires Vale to pay $25 million in disgorgement and $5.9 million in prejudgment interest, as well as a $25 million civil penalty. It also permanently enjoins Vale from violations of various securities laws. The settlement does not resolve the SEC's claims for relief under Section 10(b) of the Securities Exchange Act, Rule 10b-5, and Section 17(a)(1) of the Securities Act. As part of the settlement, the SEC agreed to no longer oppose Vale's motion to dismiss those scienter-based claims. In a press release, the SEC stated that this settlement "demonstrate[s] that public companies can and should be held accountable for material misrepresentations in their ESG-related disclosures."[8]

BNY Mellon

Another recent example involves BNY Mellon.[9] In May 2022, the SEC announced that a BNY Mellon Investment Adviser had agreed to pay $1.5 million to resolve charges alleging it had issued false and misleading statements regarding ESG investment policies for certain mutual funds under its management. Certain investment funds managed by BNY Mellon were allegedly represented as having undergone "ESG quality review" when, according to the SEC, that was not always the case.

BNY Mellon, without admitting or denying the allegations, agreed to pay a $1.5 million penalty and take remedial measures to resolve this action. In a press release regarding this settlement, the SEC reiterated its focus on ESG-related investing, stating that "the Commission will hold investment advisers accountable when they do not accurately describe their incorporation of ESG factors into their investment selection process."[10]

Enviva

An example in the realm of private shareholder litigation is a lawsuit filed against Enviva Inc., a company that develops, constructs, acquires, and owns and operates fully contracted wood pellet production plants.[11] Enviva touted itself as a "growth-oriented" ESG company with a platform "to generate stable and growing cash flows."[12] Among other public statements, Enviva represented that "[s]ustainability is the foundation of our business and is increasingly an area of focus for our investors, who place a great deal of value on having Enviva as an ESG investment in their portfolio" and that the company's displacement of 64 million tons of coal was an "amazing statement about sustainability."[13]

In October 2022, a short seller published a report regarding Enviva, alleging the company was "flagrantly greenwashing its wood procurement" and characterizing its claims of being a "pure play ESG Company" as "nonsense on all accounts." Following the issuance of this report, Enviva's stock price declined, and litigation ensued.

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The plaintiff, an Enviva investor, filed a putative class action in the U.S. District Court for the District of Maryland. The investor asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act, alleging that Enviva and certain of its officers and directors made false and misleading statements regarding the environmental sustainability of Enviva's wood pellet production and procurement. This

plastics company that became publicly traded through a merger with a special purpose acquisition company.[14] The company claimed that its proprietary product—a biodegradable plastic substitute—was 100% biodegradable, renewable, and sustainable.

However, the *Wall Street Journal* published an article raising questions regarding the biodegradability of this plastic substitute product. Shortly thereafter, an investor filed a putative securities class-action lawsuit against Danimer in the U.S. District Court for the Eastern District of New York, asserting claims under Sections 10(b) and 20(a) against the company, its CEO, CFO, and seven members of the company's board of directors. Among other things, the complaint alleges that statements touting the company's biodegradable plastic product as a revolutionary product were merely greenwashing. The defendants recently moved to dismiss the amended complaint, asserting that this lawsuit resulted from baseless allegations raised by short sellers. That motion is still pending.

What it all means

In some ways, these recent securities class actions are not inherently unique. The general theory of the claims is similar to the general theory in most securities class actions (i.e., the plaintiff alleges that the company and/or its officers made false or misleading statements that inflated the company's stock price and that investors were harmed when the "truth" was publicly revealed, leading to a stock price decline). But the seemingly increasing trend of this litigation is nonetheless notable, and something companies should be aware of when evaluating their own statements.

As an initial matter, the intense focus on ESG issues—by the market, regulators, and others—means that company statements regarding ESG issues are likely to draw particular scrutiny. The nature of ESG statements from companies also may indicate an increased risk of litigation for those statements. For instance, company statements concerning commitments to ESG issues are often not the type of statements that easily can be shown to be true or false. Take, for example, statements about companies being committed to reducing their environmental impact—or being "carbon neutral" in the future. Commentators have questioned whether there is a standard method of measuring carbon neutrality.[15] Defendants may point to those types of statements as easily defensible or even nonactionable under federal securities laws. But, at the same time, those types of general statements may provide a larger target for a plaintiff (or short seller) to argue that a discrete practice of the company is inconsistent with that general commitment, thus making the statement misleading. In other words, the difficulty in proving whether broad statements concerning ESG issues are objectively true could increase the risk of such statements being challenged in a securities lawsuit.

Given the increased attention by all market stakeholders to ESG issues, it is understandable that companies want to make public statements about their own ESG initiatives and practices, including those concerning the environment. Companies and their officers should be aware of the increasing scrutiny of those statements from regulators and litigants when deciding to what extent and how such statements are made. Companies would benefit from staying informed of developments in this recent trend of securities litigation—especially given that it is too soon to tell how these matters will ultimately be resolved.

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Takeaways

- Businesses, regulators, and the market have shown an increasing focus on environmental, social, and governance (ESG) issues.

practices.

- Litigation and enforcement actions regarding greenwashing claims are still largely in the early stages, and it is unclear to what extent these claims will be successful.
- The nature of some ESG statements and greenwashing allegations present potential advantages and disadvantages to both plaintiffs and defendants in securities litigation.
- Companies should carefully consider these litigation risks and potential enforcement actions when making statements regarding their environmental practices or other ESG issues.

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12 See Complaint ¶ 2 (Dkt. 1), Fagen v. Enviva Inc., et al., Case No. 8:22-cv-02844-DKC (D. Md.), https://www.dandodiary.com/wp-content/uploads/sites/893/2022/11/Enviva-complaint.pdf.
13 See Complaint ¶ 20 (Dkt. 1), Fagen v. Enviva Inc., et al., Case No. 8:22-cv-02844-DKC (D. Md.)
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