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Managing ESG litigation risk for companies

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We hear a lot about ESG - Environmental, Social, Governance - but less about ESG-related litigation risk. ESG-related litigation is here to stay and likely will expand in the coming years. Fortunately, there are several guidelines that may help mitigate against that risk for corporations.

But first, what exactly is ESG? At its core, ESG is about corporate actions taken for the benefit of various stakeholders (e.g., employees, the environment and the community) beyond actions that may provide short-term, economic benefit to shareholders. Some call this the merging of *stakeholder values* with *shareholder value*. And since stakeholder values may implicate competing political or policy perspectives, ESG is frequently controversial and contentious.

ESG-related *litigation* can take many forms. Sometimes, shareholders sue a company alleging that directors or management have improperly elevated a stakeholder's interests above shareholders. One of the earliest of these cases occurred here in California. In the 1870's, Contra Costa Water-works Company sold drinking water to the residents of Oakland. At some point, Contra Costa decided to provide water for free to the City of Oakland for municipal purposes such as maintaining parks and flushing sewage. A shareholder sued, alleging that the practice of giving away water was resulting in "diminution of the dividends...and...the decrease in the value of their stock." *Hawes v. Oakland*, 104 U.S. 450, 451 (1881). In essence, the plaintiff argued that a company has no right to take money from shareholders for the benefit of stakeholders.

The U.S. Supreme Court ultimately rejected the plaintiff's claim holding that the directors are best situated to determine whether spending money for the community - in this case, giving away water to the city for free - was in the best long-term interest of the company. Acknowledging the important relationship between the company and the city, the Court further noted that "[i]t may be the exercise of the highest wisdom to let the city use the water in the manner complained of." *Id.* at 462. In sustaining Contra Costa's decision to donate the corporation's water to the City of Oakland, the opinion stands as one of the first to establish a core principle of corporate governance related to ESG - namely, the significant operational discretion of management and directors to prioritize benefits other than short-term shareholder profit. For further discussion of this principle, *see* Leaving the Lights Off: A Short History of the Legal Issues Related to ESG (Israel et al) in "Environment, Social, Governance: The Professional's Guide to the Law and Practice of ESG." (ABA 2023).

A second form of ESG-related litigation pertains to the accuracy of marketing claims. In these cases,

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consumers, NGOs, regulators or even competitors allege that a company has made marketing claims that are inaccurate or misleading. For example, in May of 2023, a putative class action was filed against Delta Air Lines alleging that Delta had inappropriately asserted that it was "the world's first carbon-neutral airline" thanks to the purchase of voluntary carbon offsets. The plaintiff asserted that Delta's representations were "manifestly and provably false" due to "replete" problems with the voluntary carbon offset market, including inaccurate accounting and speculative benefits. *Berrin vs. Delta Air Lines, Inc.*, Central District of California, 2:23-cv-04150. In August, 2023, Delta filed a Motion to Dismiss arguing, among other things, that the plaintiffs' claims are preempted by the Airline Deregulation Act, which prevents states from enforcing laws that impact airline rates, routes or services. In another example, a putative class sued Keurig Green Mountain alleging that Keurig's "recyclable" single-serve plastic coffee pods were mislabeled. After losing a motion to dismiss in 2019, Keurig agreed to pay $10 million and update labeling on its coffee pods. *Keurig Green Mountain, Inc.*, 393 F.Supp.3d at 841.

Similarly, many California district attorneys have brought actions related to environmental claims in recent years. In 2021, for example, Sonoma County (along with nearly two dozen other counties), resolved green marketing cases with Chewy, PetSmart, Petco and Target based on allegations the companies sold dog waste bags to California residents that were labeled as "eco–friendly" and "biodegradable," but did not meet those standards. Press Release, Sonoma County District Attorney, "District Attorney Jill Ravitch announces greenwashing settlements with Chewy, Petco, PetSmart, and Target," (Aug. 11, 2021). As another example, in 2018, the Monterey County District Attorney and others announced a $1.5 million settlement in a case against Amazon, alleging Amazon misled consumers by advertising plastic products as "biodegradable" and "compostable."

Today, a third novel form of ESG-related litigation, while untested, is brewing. Increasingly, companies are being sued not just about the accuracy of their ESG marketing claims, but also the congruency. What does that mean? Airline companies, fashion companies, energy companies, etc. are being sued alleging that their sustainability, carbon neutrality and other ESG-related statements are fundamentally inconsistent with their underlying business. In other words, an ESG-related statement could be completely accurate and verifiable, but allegedly lack *congruency* with the overall enterprise.

For example, in March of 2021, three environmental groups filed a complaint with the U.S. Federal Trade Commission against Chevron, alleging that Chevron had misled consumers about the "green" nature of its operations. *See* Earthworks, "*Accountability groups file first of its kind FTC complaint against Chevron for misleading consumers on climate action*.

Among other allegations, the environment groups argued that Chevron's statements implied that its business operations do not harm the environment despite Chevron's role in oil spills, the small amount of capital investment (less than 0.2 percent) on renewable energy sources, and other claims. The interesting aspect of these allegations, however, was not that Chevron's statements were themselves inaccurate but that Chevron allegedly mischaracterized its broader business.

From these examples, there are several clear takeaways for companies seeking to mitigate against the risk of ESG-related litigation. Here are six:

The Business Judgment Rule is here to help

First, when undertaking an ESG initiative that may go beyond regulatory compliance, consider articulating the long-term benefits to the company in addition to the benefits to others. That is, while companies are often quick to celebrate environmental and community benefits, it may also be helpful to explain how the action comports with the company's overall policies and values, including delivering long-term shareholder value.

There is no substitute for substantiation

Companies should be prepared to provide robust, scientific proof of the accuracy of any ESG-related claims, including reliable accounting methodologies for any climate-related assertions. As a general matter, the more technical the claim, the more detailed the evidence supporting it must be. Consider also whether the evidence for a claim will need to be updated over time.

Rely on neither ambiguity nor precision

Sometimes companies mistakenly assume that either adroit ambiguity or legalistic precision will rebut an ESG-related marketing claim. Truthfulness and substantiation requirements, however, increasingly apply to reasonable inferences of ESG marketing claims, even if those inferences are beyond the express statements made. Thus, it is wise for a company to consider not just the specific words, but also possible inferences from those words.

Understand the jurisdiction

In this rapidly changing area of the law, federal, state and common law requirements differ across jurisdictions. Companies need to know the precise laws, regulations, guidance, and precedents that are potentially applicable to the claims. For example, pursuant to AB 1305, California now requires entities making carbon neutrality, net zero, and GHG emissions reductions claims to "show their work" to substantiate such claims, among other requirements.

Consistency matters…a lot

Increasingly, claimants are using inconsistent language found in an advertisement, social media post, SEC filing or sustainability report (among other sources) as a basis to argue that a claim is misleading. Accordingly, it is critical for companies to ensure that they are speaking consistently about the ESG-related values of the company or benefits of particular products or services.

Pay attention to the entire business

While most ESG-related litigation thus far has focused on claims related to specific products, increasingly claimants are looking to the entire enterprise in order to argue that a particular claim is misleading. Thus, it may be worth evaluating methods of articulating claims to ensure congruence with the company's overall business.

In sum, navigating the opportunities and risks associated with ESG-related initiatives and claims is both challenging and important. For some companies, it may make sense to undertake a legally-driven audit to obtain expert advice on how to manage ESG-related litigation risks. For others, simply paying careful attention to these key principles may help.