ESG Litigation in Europe

In tandem with investor pressure and regulation requiring ESG disclosures, such as the EU's Sustainable Finance Disclosure Regulation, the UK's Modern Slavery Act, and France's Duty of Vigilance, the last decade or so has also seen an increase in litigation in both the UK and the EU aimed at holding companies accountable for ESG impacts in their direct operations and their supply chains. In this article, Quinn Emanuel's ESG Litigation team considers ESG litigation risk and how to manage it.

What is ESG Litigation?

In many respects, ESG litigation is not a new concept. Lawsuits targeting businesses for their non-financial environmental, social and governance impacts have been attempted for decades, with varying levels of success. Previous ESG cases span various areas of legal practice, from environmental damage cases arising directly from business operations, such as the *Valdez* and *Deepwater Horizon* litigation in the United States, to claims under international law (for example, where businesses have assisted or otherwise aided regimes accused of war crimes or alleging use of forced labour), such as the claim against Canadian mining company, Nevsun, alleging forced labour at a mine in Eritrea.[i]

While not therefore a recent phenomenon, the past decade or so has seen significant developments in ESG litigation in the EU and UK. This reflects the increase in investor pressure and ESG disclosure regulation, and also a growing acceptance and formalisation of businesses' ESG and human rights obligations. The UN Guiding Principles on Business and Human Rights (**UNGPs**), for example, which were endorsed by the UN Human Rights Council in June 2011, have become accepted worldwide as setting standards of behaviour for corporates, including affirming the corporate responsibility to "respect" human rights (as juxtaposed with the state obligation to "protect" human rights). The acceptance of a normative framework for businesses' human rights obligations, and the development of an informal complaints system in OECD countries for breaches of those human rights obligations,[ii] has created more formalised expectations of behaviour. In turn, this has led to a push by civil society to ensure these standards of engagement are accompanied by legal consequences for non-compliance. In particular, the acknowledgment in the UNGPs and more widely, that companies can bear responsibility for the environmental and human rights impacts of their direct operations and through their wider business relationships, including companies in their supply chains, has led to increased attempts to create legal consequences for these harms. Equally, in relation to environmental claims, concerns about climate change have dramatically altered the profile of environmental litigation away from claims seeking to remediate environmental damage into claims attempting to proactively change company behaviour.

Broadly speaking, while there is some cross-over, the currently proliferating areas of 'ESG litigation' risk relate to (1) claims regarding mis-statements or omissions in ESG external reporting by companies; and (2) claims concerning the ESG impact of companies' operations, whether directly or in their supply chains, including claims related to climate change, environmental pollution, or human rights breaches.

Claims regarding ESG mis-statements or omissions

ESG disclosures have historically been governed mostly by voluntary frameworks. But the

voluntary nature of ESG reporting is on the wane, as evidenced for example, by the requirement

(since March 2021) for banks, private equity firms, pension funds, hedge funds and other asset managers to comply with sweeping new European rules set forth in Regulation 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector (EU Sustainable Finance Disclosure Regulation (SFDR)).[iii] The SFDR recognises that as the EU is increasingly faced with the "*catastrophic and unpredictable consequences of climate change, resource depletion and other sustainability-related issues, urgent action is needed*". As such, the SFDR is particularly aimed at regulating marketing of funds which promote themselves as having environmental, social, or sustainability objectives. It will address potential "green-washing" by requiring such funds to explain both in their marketing and on their websites their sustainability objectives and how they plan to meet them.[iv]

The SFDR is far-reaching, with all UK and US fund managers that distribute their funds into Europe likely to be forced to comply with Europe's new rules.[v] The UK Government has vowed to establish its own ESG disclosure regime.

As ESG standards and disclosure become not just best practice, but mandated by various cross-cutting regulations, the opportunity for claims based on negligent misstatement, misrepresentation or omissions in these disclosures has opened. Such claims have built on an existing body of case law establishing the clear liability of businesses for providing misleading information about their business practices. Relevant ESG disclosures, which have been targeted in litigation, have been in the form of human rights policies, sustainability sections on websites, press releases, and even internal codes of conduct. As countries increasingly mandate disclosures through legislation such as the SFDR, the Modern Slavery Act 2015 (UK), Transparency in Supply Chains Act 2010 (California), and the Duty of Vigilance Act (France), the publicly available information about companies' ESG practices is likely to only increase.

For example, in Europe, the Italian Competition and Markets Authority took the novel step of imposing a €5 million fine on a State-backed energy company Eni, after an advertising campaign was found to be misleading in its attempts to paint a new diesel fuel as "green". Claims in the UK are possible under tort law, through the doctrine of negligent misstatement, as well as through consumer advertising-based claims. Recently, a group of NGOs made a complaint against BP under the OECD Guidelines on Multinational Enterprises to the UK 'National Contact Point'. Under the OECD Guidelines, countries are obliged to set up National Contact Points to (amongst other obligations) receive complaints about compliance with the OECD Guidelines. The NGOs, led by ClientEarth, complained that BP's advertising was in breach of the Guidelines, because it was misleading, in relation to the proportion of renewables in its energy portfolio, the role of gas as a clean energy and the overall benefits of increases in global primary energy demand.[vi] The complaint was resolved before any hearing, with BP pulling the advertising campaign. The complaint against BP demonstrates a wave of growing complaints about "green-washing".[vii]

Climate, environmental and human rights impacts of companies' operations

An additional developing body of litigation seeks to hold companies liable for the climate, environmental, and human rights impacts of their operations, including their supply chains. Such claims have been principally framed in tort law and traditionally faced significant jurisdictional and corporate veil hurdles.

In the UK, in a recent decision in *Okpabi v Royal Dutch Shell Ltd*,[viii] the UK Supreme Court (UKSC) accepted that it had jurisdiction over Shell in relation to the acts of its subsidiary in Nigeria and

provided guidance on the circumstances in which a parent company may owe a duty of care to those affected by acts or omissions of its foreign subsidiary which allegedly led to environmental damage or human rights abuses.[ix] In particular, the UKSC made it clear that a company's ESG policies could be enough to create parent-company liability for the actions of its foreign subsidiaries. This Shell decision chimes with other decisions of the English courts, including *Vedanta Resources v Lungowe*,[x] in which the UKSC also accepted jurisdiction and found again that the public ESG commitments of Vedanta could give rise to parent company liability. Notably, in counterpart litigation brought in the Netherlands relating to Royal Dutch Shell and environmental damage caused from its Nigerian operations, the Netherlands court applied the UK decision *Vedanta* because English jurisprudence is persuasive in Nigeria.[xi]

There has also been a slew of climate change litigation including directly against companies. According to LSE's 2020 study of climate change lawsuit trends, litigation against major oil and gas companies has increased significantly since 2005 with at least 40 ongoing cases worldwide (albeit with the vast majority in the US).[xii]

In addition to claims aimed at the direct conduct of the companies in question, increasingly plaintiffs are asserting claims of 'supply chain liability' whereby companies are charged with liability for ESG impacts within their supply chains. For example, British American Tobacco and Imperial Brands are currently facing claims in the UK for the conditions of child labourers who work on tobacco farms in Malawi despite not owning the farms in question.[xiii] The claimants allege the companies facilitated unlawful and dangerous conditions and claim that they are liable in negligence and in unjust enrichment (for benefiting from the low pay of Malawian tobacco workers).[xiv]

Other high-profile supply chain litigation was launched in Germany after a fire at the Ali Enterprises textile factory in in Karachi, Pakistan which caused injury to 32 people, many seriously.[xv] Much of the damage was caused due to inadequate health and safety provisions in the factory. The claim was brought against KiK, a German discount retailer who had previously acknowledged it had bought at least 70 percent of the textiles the factory produced in 2011. The claimants alleged that KiK owed them a duty of care to procure a healthy and safe working environment and breached this duty by failing to do its share to prevent the fire, and the resulting harm. The claim was brought in Germany, but under the Rome II Regulation, the law applicable to the claim was the law of the place where the damage occurred (as a compensation claim arising out of tort). In KiK, while that would have been Pakistani law, Pakistan primarily applies English law – with the result that the German court would have been bound to apply English law. The case was heard in 2018 and ultimately rejected on the basis of a narrow limitation point.[xvi]

The complex nature of many supply chains, and the sadly still prevalent human rights and environmental issues in many parts of the world, makes supply chain liability claims a potential challenge for many companies. The risk of reputational damage from being linked to negative human rights and environmental effects is now clearly coupled with litigation risk. That risk may even be heightened where those negative effects are so endemic that it can be said the company *must* have known about them.

It is plain that there is a growing trend of claimants using businesses' public disclosures to underpin litigation. ESG industry leaders have been the target of litigation, with human rights and sustainability policies - especially those set at a group level - being used to assert that companies have taken responsibility for the environmental and social standards of subsidiaries and linked companies. Public commitments to take action on human rights impacts within supply chains have also been used to show an acknowledgment of those same issues.

One response to this might be to avoid publishing information about company efforts toward improved environmental or social measures or to stop setting such guidelines within groups of companies. As noted above, the prevalence of litigation against sustainability industry leaders certainly suggests that even pioneering ESG companies are not able to fully insulate themselves from litigation risk. However, not engaging with ESG issues or not maintaining ESG standards within a business is simply not an option in the current climate. ESG measures are not just being watched by claimant groups, but also by the market and investors, both from a moral perspective but also from a risk point of view. As shown by moves by investors to ESG-integrate their portfolios,[xvii] these are real and pressing concerns by major institutional investors. The reputational risk which can be caused to a company through insufficiently addressing ESG risks is likely to outweigh the risk that disclosure of risks within the business leads to opportunistic litigation claims. And, fundamentally, ESG risks in businesses are not minimised by avoiding disclosure: businesses are just less likely to know where those risks are and to be able to proactively mitigate them. Indeed, for many businesses, ESG risk necessarily persists because of the nature and size of its operations rather than because it disclosed information about its sustainability strategies.

The interplay between ESG litigation and 'soft law' ESG instruments

The increase in ESG litigation claims comes alongside various "soft law" international (and regional) developments, which set out agreed norms of company responsibility for human rights and the environment. "Soft law" agreements refers to non-binding declarations, principles, and/or frameworks promoted by international organisations,[xviii] as opposed to the "hard" law of binding legislation or at an international level, treaties. Of these soft law instruments, the UNGPs are the most high profile and generally applicable to all forms of business.

A particular feature of the UNGPs, and arguably a feature of soft law ESG instruments generally, is the acknowledgment of the trade-offs and tensions that arise in business operations. The (in many ways primary) obligation in the UNGPs is for businesses to conduct human rights due diligence. A modification of typical due diligence obligations, human rights due diligence asks companies to evaluate the actual or potential human rights impacts from a business' operations, with a focus on risks to the rights-holders, and to "identify, prevent and mitigate" those risks. The latter requirement is crucial: an aspect of human rights due diligence is to actively address the risks once identified.

The scheme of the UNGPs sets different obligations for companies depending on the level of connection between the company and a potential or actual human rights impact. Importantly, as well as asking a company to cease or prevent actions which are causing human rights impacts (or may do so), the UNGPs ask companies contributing to human rights impacts to cease or prevent that contribution and to take steps to exercise leverage to mitigate any remaining impact to the greatest extent possible. In relation to companies which are "directly connected" to human rights impacts, the UNGPs acknowledge that there is a balancing act to be undertaken in the precise response, how any leverage is used and what approach the company takes.

This recognition of the importance of working with suppliers and other businesses toward improved ESG outcomes is an important one, but one that does not always directly translate into litigation. The zero sum game of litigation provides limited scope for recognising the difficult matrix within which a business linked to an adverse ESG impact might have to triangulate its response. However, companies which can show they have robustly engaged with the UNGPs processes, effectively analysed any links in their business or wider business relationships to ESG

impacts and have accounted for those links in their behaviours and subsequent choices, may be able to head off claimant litigation at the pass.

The difficulty reconciling the guidelines in the UNGPs with the current ad hoc mix of ESG litigation, through various different legal mechanisms, does indicate the need for legal certainty in this area. There is a growing movement toward "hardening" the soft law of the UNGPs. The legalisation of these principles may have real benefits for business: a legalised framework will require clear, delineated obligations on businesses alongside appropriate and reviewable standards to discharge those obligations. At the moment, significant attention is being focused on mandatory human rights due diligence: taking the concept of "human rights due diligence" from the UNGPs and making it a legal requirement, with sanctions attached for failure to do so or failure to do so adequately. This proposal is the most advanced in the EU,[xix] and in some European Union member states like Germany. In the UK, discussion has centred around the adaptation of the "duty to prevent" formula from the Bribery Act 2010 into a "duty to prevent" human rights and/or environmental harms. This would allow mandatory due diligence or other proactive ESG work to be used as a defence to potential actions. Quinn Emanuel's Julianne Hughes-Jennett has co-authored a leading publication considering how such a 'failure to prevent' law might feasibly be implemented.[xx]

How best to mitigate ESG litigation risks?

Companies should consider takings steps to:

- Review ESG/human rights and sustainability policies (as well as any other policies which could be relied upon as imposing duties to prevent harm to third parties).
- Implement robust ESG training programmes
- Be clear on who has responsibility within a group for the operationalization of ESG/ human rights and sustainability policies
- Consider incorporating ESG/ human rights clauses in supplier contracts[xxi]
- Check obligations undertaken are clear, realistic and focussed on process (e.g. carry out due diligence according to the UNGPs), not outcomes (e.g. do not make statements regarding 'zero tolerance' of modern slavery or human rights impacts).
- Audit and document how obligations are being discharged, paying close attention to international and industry standards.
- Conduct ESG due diligence in conjunction with M&A transactions and joint ventures
- In the event that an ESG impact is identified, manage it pro-actively, including considering whether to engage in any UNGP compliant grievance mechanism, which may help to prevent litigation

How Quinn Emanuel can assist

Quinn is at the forefront of ESG matters. Our team is led by partner Julianne Hughes-Jennett, who is Chambers-ranked in business and human rights disputes and described as an "expert" in the field. Our practice covers both advisory work and direct experience of litigation claims in these areas. We are involved in complex, first of its kind, litigation on the international criminal law liability of corporates and executives in relation to their operations in a conflict zone, as well as "parent company liability" and duty of care cases in the English Courts; in class actions brought under the Alien Tort Statute in the US; as well as contentious complaints under the OECD framework across many jurisdictions. We advise on the ever increasing web of ESG legislation and regulation, on minimising legal risks for products with complex actual and potential supply chains and on international businesses working in high risk jurisdictions. We have expertise across a broad

range of sectors, from telecommunications, technology and artificial intelligence to construction and engineering and the extractive sector.

This experience means we are able to tailor our advice to address the legal risks we know are likely to emerge in subsequent challenges to company decision-making. We are able to balance the litigation decisions necessary to protect your position in court with potential reputational impacts and stakeholder engagement strategies. We can also work with your businesses proactively to identify ESG issues in their operations and supply chains and implement practical and effective systems to prevent them from materialising.

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If you have any questions about the issues addressed in this article, or if you would like a copy of any of the materials we reference, please do not hesitate to contact us:

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[i] *Nevsun Resources Ltd v Araya*, 2020 SCC 5.

[ii] Under the parallel, but ultimately similar in content, OECD Guidelines for Multinational Enterprises.

[iii] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2088. See also Jean Eaglesham and Anna Hirtenstein, Wall Street Journal, ESG Disclosure Rules From Europe Challenge U.S. Fund

Managers (22 March 2021) https://www.wsj.com/articles/esg-disclosure-rules-from-europe-challenge-u-s-fund-managers-11616405401?page=1 [last accessed 23 March 2021].

[iv] Simon Jessep, Kate Abnett, Reuters: EU prepares to turn the screw on asset managers over greenwashing (9 March 2021). Available at: https://www.reuters.com/article/europe-regulations-finance-idUSL5N2KZ657 [last accessed 23 March 2021].

[v] also Jean Eaglesham and Anna Hirtenstein, Wall Street Journal, ESG Disclosure Rules From Europe Challenge U.S. Fund Managers (22 March 2021) https://www.wsj.com/articles/esg-disclosure-rules-from-europe-challenge-u-s-fund-managers-11616405401?page=1 [last accessed 23 March 2021].

[vi] OECDWatch, ClientEarth vs BP: Case Overview, https://complaints.oecdwatch.org/cases/Case_556

[vii] Client Earth, BP greenwashing complaint sets precedent for action on misleading ad campaigns (17 June 2020). Available at https://www.clientearth.org/latest/latest-updates/news/bp-greenwashing-complaint-sets-precedent-for-action-on-misleading-ad-campaigns/ [last accessed 29 March 2021]

[viii] [2021] UKSC 3

[ix] See previous: Quinn Emanuel Client Alert, "UK Supreme Court makes England Attractive Forum for ESG Claims": https://www.quinnemanuel.com/the-firm/publications/uk-supreme-court-makes-england-attractive-forum-for-esg-claims

[x] *Vedanta Resources Plc & Anor v Lungowe & Ors* [2019] UKSC 20, [2019] 2 WLR 1051. The Supreme Court held that liability of the parent company depended on the extent to which, and the way in which, the parent company availed itself of the opportunity to intervene in, control, supervise or advise the management of the relevant operations of the subsidiary, or alternatively whether it publicly held itself out as doing so.

[xi] Oguru and Efanga v. SPDC and Royal Dutch Shell (Oruma) C/09/365498 / HA ZA 10-1677 + C/09/330891 / HA ZA 09-0579 (zaak b); see Cees van Dam, Shell liable for oil spills in Niger Delta (February 2021), available at https://media.business-humanrights.org/media/documents/BHRRC_-_Van_Dam_-_Shell_liable_for_oil_spills_in_Niger_Delta.pdf [last accessed 29 March 2021].

[xii] Joana Setzer and Rebecca Byrnes, Grantham Institute, Global trends in climate change litigation: 2020 snapshot (July 2020), available at: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2020/07/Global-trends-in-climate-change-litigation_2020-snapshot.pdf

[xiii] Rob Davies, The Guardian, BAT and Imperial tobacco firms profited from child labour, law firm alleges (18 December 2020), available at: https://www.theguardian.com/business/2020/dec/18/bat-imperial-tobacco-firms-child-labour-law-firm-alleges [last accessed 29 March 2021].

[xiv] Leigh Day, Claim against tobacco giants by poverty stricken farmers in Malawi (18 December 2020), available at: https://www.leighday.co.uk/latest-updates/news/2020-news/claim-against-tobacco-giants-by-poverty-stricken-farmers-in-malawi/ [last accessed 29 March 2021].

[xv] European Centre for Constitutional and Human Rights, KiK: Paying The Price for Clothing Produced in South Asia, https://www.ecchr.eu/en/case/kik-paying-the-price-for-clothing-production-in-south-asia/ [last accessed 29 March 2021].

[xvi] European Centre for Constitutional and Human Rights, KiK: Paying The Price for Clothing Produced in South Asia, https://www.ecchr.eu/en/case/kik-paying-the-price-for-clothing-production-in-south-asia/ [last accessed 29 March 2021].

[xvii] See for example, Blackrock's ESG Integration Statement (8 December 2020) https://www.blackrock.com/corporate/literature/publication/blk-esg-investment-statement-web.pdf [last accessed 29 March 2021].

[xviii] Elise de Groulx et al, Business and Human Rights as a Galaxy of Norms,[2019] Georget. J. Int. Law at 339, citing Andrew T. Guzman & Timothy L. Meyer, International Soft Law, 2 J. Leg. Analysis 171 (2010)

[xix] See for example updates provided by the Business and Human Rights Resource Centre: https://www.business-humanrights.org/en/latest-news/national-regional-movements-for-mandatory-human-rights-environmental-due-diligence-in-europe/

[xx] Available at the British Institute for International and Comparative Law: Peter Hood, Julianne Hughes-Jennett, Dr Irene Pietropaoli, Lise Smit, A UK Failure to Prevent Mechanism for Corporate Human Rights Harms (11 February 2021), https://www.biicl.org/publications/a-uk-failure-to-prevent-mechanism-for-corporate-human-rights-harms.[last accessed 29 March 2021].

[xxi] See for example the draft clauses on Practical Law (Westlaw UK), which was drafted by Quinn Emanuel's Julianne Hughes-Jennett: https://uk.practicallaw.thomsonreuters.com/w-013-1577?view=hidealldraftingnotes.