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Why ESG Disclosures Belong in the Legal Department

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Cheat Sheet

- **The ESG ecosystem is complex.** It involves ambiguous and emerging regulations, multi-jurisdictional concerns, investor and stakeholder pressure, and competing priorities within the company.
- **ESG is part of risk management.** In-house counsel should focus on ESG-related disclosures risk and ensuring they are not false or misleading.
- **Establishing controls is critical.** Once the legal department has full visibility into past ESG disclosures, it's time to set up procedures for accurate future ESG disclosures.
- **Empower the legal department.** Companies that encourage legal departments to take an

active role in ESG disclosure management will be best positioned to handle this increasing responsibility.

The environmental, social and governance (ESG) landscape is rapidly expanding and becoming increasingly diverse, complex, and risk-laden. We are entering a new pivot point for ESG, moving from voluntary to mandatory disclosure of many ESG-related risks, observing a global increase in ESG-related litigation, and starting to see the impact of the anti-ESG movement on company communications regarding ESG more generally.

Beyond their own four walls, companies are increasingly expected to assess and account for ESG-related risks throughout their value chain, resulting in a greater focus on supply chain management and customer impacts. As expectations for greater and more in-depth ESG disclosures grow, in-house lawyers and legal professionals play a crucial role in balancing the need for disclosure with the risks associated with statements that, in hindsight, could be viewed as false or misleading.

Why ESG is important

ESG issues affect capital allocation and credit ratings

Because ESG also plays an increasingly important role in capital allocation and credit ratings, decisions about what ESG-related information to disclose and where to disclose it can have a significant impact on a company's access to capital. As reported in a recent PwC report, "[a]sset managers globally are expected to increase their ESG-related assets under management (AUM) to US$33.9 [trillion] by 2026, from US$18.4 [trillion] in 2021. With a projected compound annual growth rate (CAGR) of 12.9 percent, ESG assets are on pace to constitute 21.5 percent of total global AUM in less than five years." On the credit ratings side, Moody's stated in 2022, that "[f]or nearly a quarter of scored entities, credit ratings would be different if not for ESG issues."

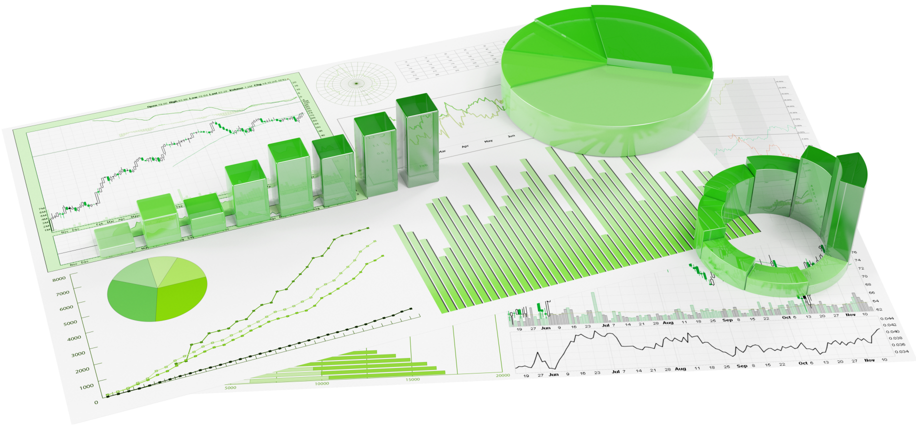
Consumers and employees value sustainability

ESG also plays an important role in the way that consumers make purchasing decisions. For example, in a 2020 study by McKinsey US, 60 percent of respondents reported that they would pay more for a product with sustainable packaging than one without it. Consumers' focus on sustainability is even more pronounced when narrowing the sample to Gen Z (born from 1997 to 2012). A recent study by First Insight and the Baker Retailing Center at the Wharton School of the University of Pennsylvania reported that more than 75 percent of Gen Z respondents think that sustainable purchases are more important than brand names.


Consumers prefer and will pay more for products with sustainable packaging. Iryna Mylinska / *Shutterstock.com*

Corporate ESG programs are also utilized by companies to differentiate, compete for, and retain employees. In a recent IBM survey, nearly 70 percent of respondents reported that they would be more likely to accept a job with an organization they consider to be environmentally sustainable and roughly half of all respondents would accept a lower salary to work for these companies. That same IBM study also found that 7 out 10 workers say they are more likely to stay with an employer that has a good reputation on environmental sustainability.

From voluntary disclosure to SEC enforcement actions



Sustainability reports are needed in order to express ESG data to higher-ups. Robert Kneschke / *Shutterstock.com*

Historically, companies have relied on voluntary, standalone sustainability reports as the primary vehicle for disclosing ESG-related performance, policies, and programs, with more than [90 percent of S&P 500 companies] now publishing sustainability reports in some form, as do approximately 80 percent of Russell 1000 companies. Because of the important role that sustainability reports and ESG-related disclosures play in (1) responding to investor pressure, (2) facilitating institutional investor capital allocation, and (3) enhancing the company's creditworthiness, sustainability reports have evolved from largely marketing-based documents to an important means of conveying critical ESG-related information to stakeholders and markets.

However, these reports are typically not drafted under the shield of attorney-client privilege, usually profess a stakeholder capitalism approach even when the company's corporate governance documents and securities filings are more focused on shareholder primacy, and often use the term "material" in describing ESG-related risks without distinguishing between ESG materiality and materiality for SEC reporting purposes — a distinction that a reasonable investor may not understand.

Although many registrants have limited the disclosure of ESG-related risks in securities filings on the basis that such risks are not material to their business, financial condition, liquidity or results of operation, proposed regulations in the United States and the European Union (EU) that would mandate expansive disclosure of ESG-related risks and opportunities in public filings are likely to change this approach. Moreover, the Securities and Exchange Commission (SEC) has formed a Climate and ESG Task Force that is actively looking for instances in which issuers may be falsely stating that they have met ESG-related targets or omitted disclosure of material events related to ESG issues. The SEC has started bringing [enforcement actions] based on allegedly false statements related to ESG matters in sustainability reports, periodic filings, and other disclosures.

Legal departments need to take an active role to minimize ESG risk

Consequently, in-house legal departments must play an active role in reviewing ESG-related disclosures in public statements such as SEC filings, sustainability reports, press releases, marketing materials, and company websites to ensure that such disclosures are not false, misleading, or inconsistent with other government filings. ESG-related statements made in voluntary disclosures are subject to Rule 10b-5 liability and could give rise to litigation under an array of legal theories and/or regulatory enforcement action, regardless of the means of dissemination.

To prevent any litigation risks, always be sure to review ESG-related disclosures in public statements. fizkes / *Shutterstock.com*

Regulatory and litigation risks

By not actively reviewing and monitoring ESG-related claims, companies expose themselves to regulatory and litigation risks.

SEC takes aim at ESG-related disclosures

On the regulatory front, the SEC Division of Enforcement has identified climate-related disclosures and “greenwashing” as a priority area for its enforcement program. The term “greenwashing” refers to efforts to persuade the public that a company’s products, policies or services are “green” or environmentally friendly by overstating such claims. In addition, the SEC staff have continued to issue comment letters to registrants relating to the climate-related disclosures in their Form 10-Ks.

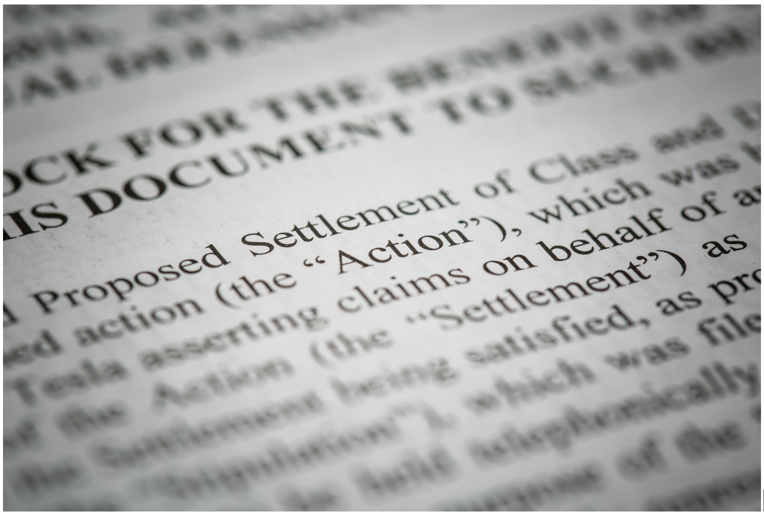
We expect the SEC to increasingly take aim at ESG-related disclosures in public filings once the SEC’s proposed rules on the enhancement and standardization of climate-related disclosures go into effect. In addition, the Federal Trade Commission (FTC) is in the process of updating its Green Guides, and enhanced regulation of environmental claims and corporate sustainability statements at the federal and state level are expected.

The high cost of greenwashing litigation

On the litigation front, companies face risk both in terms of investor and consumer litigation, including greenwashing claims. The risk of litigation or regulatory action becomes particularly heightened when disclosing climate-related targets and goals. For example, if a company establishes a goal of achieving net zero greenhouse gas emissions by 2035 and that goal is not met, the company could potentially face litigation from investors that relied on that goal as material information when they made their investment decisions or from consumers who relied on that goal when making purchasing decisions. Subsequent elimination or modification of a previously disclosed goal or restatement of ESG data used in securities filings to show progress toward reaching that goal could also increase the risk of litigation, similar to the risk associated with restating earnings or other financial data.

On the investor front, plaintiffs have alleged that they relied on statements that companies have made in their sustainability reports, such as statements about the companies' worker-safety program or environmental compliance. Such companies subsequently experienced high-profile incidents, which included a decline in share price. The decline in share price, in turn, facilitated claims that investors were harmed or damaged by the reliance on company statements about such programs — in essence arguing that the plaintiff was wrongfully induced by the company's ESG-related disclosure to purchase shares.

Consumer lawsuits on the rise



False statements in companies sustainability reports are leading to an increase in class action lawsuits. William Sawalich / *Shutterstock.com*

Additionally, consumers in the United States are increasingly filing class action lawsuits under state consumer protection laws or the federal Lanham Act**.** Many states, relying heavily on the FTC's Green Guides, have enacted laws specifically targeting environmental marketing claims. In these cases, plaintiffs allege, based on statements made in a company's sustainability report, press releases, websites, and/or advertisements, that there are disparities between the claims being made and the actual underlying environmental performance (i.e*.,* greenwashing).

Based on these disparities, plaintiffs also allege that they were wrongfully induced into buying the company's product because of these false and/or misleading statements. We are also seeing a rise in ESG litigation globally, particularly in Europe, with non-governmental organizations (NGOs) most commonly asserting greenwashing claims against companies in the energy, consumer products, and financial sectors.

Reputational risks remain

Beyond traditional legal risk management efforts, in-house counsel should also consider reputational risks associated with sustainability and ESG-related issues. For example, human rights concerns or cybersecurity breaches can have a sudden and significant impact on the company's share price and negatively affect the company's license to operate. As well, because consumers increasingly make purchasing decisions based on a company's sustainability performance, reputational damage from an errant statement could also have commercial ramifications. Consequently, reputational risks, as well as legal risks, should be considered when reviewing ESG-related disclosures.

How to mitigate ESG risk

There are steps that in-house legal departments can take to mitigate the risks associated with ESG-related disclosures:

Step 1: Inventory ESG disclosures, statements, and claims

First, the legal department should take an inventory of all ESG-related disclosures, statements, and claims made by the company to date. This would include particular attention to claims related to environmental performance of products and services, workplace safety, and climate-related targets and goals. Without a robust understanding of the ESG-related disclosures that the company has made in the past, it will be difficult to ensure consistent and risk-mitigating messaging moving forward.

Step 2: Put ESG controls and procedures in place

Once the legal department has full visibility into the company's prior ESG-related disclosures, it should evaluate whether the company has the necessary disclosure controls and procedures in place to ensure the accuracy and consistency of future ESG-related disclosures. Some companies are beginning to implement the same level of controls for non-financial ESG-related information as they maintain for financial disclosures. Many companies are also seeking third-party assurance for certain ESG-related disclosures such as greenhouse gas emissions disclosures.

Step 3: Establish regular legal team review and action items

Next, the company should establish a process by which the legal team reviews all ESG-related disclosures prior to publication, which will mitigate the risk of regulatory enforcement and greenwashing litigation. If the company has established an ESG steering committee or ESG council, the legal department should have strong representation on that committee/council. Other actions that can potentially mitigate regulatory and litigation risks include:

- Establishing a cadence for management's assessment of ESG-related risks and communication of material risks to the board and board committees;
- Assigning responsibility for oversight of ESG-related risks to the appropriate board committees;
- Evaluating whether the company's directors and officers insurance or other insurance coverage can protect their directors, officers, and employees from potential liability related to ESG disclosures;
- Developing procedures and controls for evaluating and tracking the company's ESG-related performance, including implementing data management systems that will support substantiation of the company's ESG-related statements and claims;

- Engaging the company’s internal audit group or retaining external auditors for purposes of assuring the accuracy of ESG metrics and other quantitative ESG disclosures in its annual sustainability report and SEC filings; and
- Implementing training for the company’s marketing, communications, and sustainability teams on the importance of using aspirational language or appropriate disclaimers when drafting ESG-related statements, including in marketing materials and on the company’s website.

Empowering the legal department on ESG

Because legal departments play a critical role in enterprise risk management, monitoring ESG-related disclosures and ensuring that the company has the necessary internal controls and procedures to assure that ESG-related disclosures are not false or misleading should be a focus for in-house counsel and legal professionals. Companies that empower their in-house legal departments to play an active role in reviewing and monitoring ESG-related disclosures will be in the best position to mitigate ESG-related risks going forward.

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Mike Dillinger is currently the AVP of environmental, social, and governance (ESG) and strategic programs at USAA where he is responsible for ESG strategy and protecting the economic goodwill of a $40B Fortune 100 private insurer and bank with over 38,000 employees. He was previously the VP of sustainability, environmental, and permitting at NuStar Energy where he led the Environmental, Regulatory Affairs, Remediation, Customs, and Permitting Departments and served in senior legal counsel roles.

Mike has over 30 years of military service including in the Army National Guard, active-duty Air Force and Air Force Reserves. He is also currently serving as the president of the Association of Corporate Counsel South/Central Texas Chapter and vice chair of the State Bar of Texas Environmental and Natural Resources Law Section.

Mike's education includes an LLM in Litigation Management from Baylor University School of Law, LLM in Environmental Law from the George Washington University School of Law, JD from the University of North Dakota School of Law, and BS in Social Behavioral Sciences from the University of Mary. Some of his certifications include the National Association of Corporate Directors (NACD) Directorship Certification, being a

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[Heather Palmer](#)

Partner

Heather Palmer is an environmental and energy partner who has been recognized for her work on environmental, social, and governance (ESG) matters. She serves as a co-leader of the firm’s ESG and climate change practices. She plays a strategic role in advising clients on a broad range of ESG issues and related risks, including the disclosure of climate change risks in SEC filings, the review of shareholder proposals relating to ESG topics, the development of corporate ESG programs and goals, the establishment of greenhouse gas emissions reduction targets, the preparation of sustainability and corporate responsibility reports, and the sustainable sourcing of products and raw materials.

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Evan Grosch’s practice focuses on Environmental, Social, and Governance (ESG) issues, strategic investor relations, and corporate governance involving public companies. He has experience advising clients on a broad range of ESG issues, including the disclosure of climate-related risks in SEC filings, the review of shareholder proposals relating to ESG topics, the development of corporate ESG programs and goals, the preparation of sustainability and corporate responsibility reports, advising companies in response to investor pressure related to ESG issues, and aligning disclosures with voluntary reporting frameworks such as the GHG Protocol, the Global Reporting Initiative, the International Sustainability Standards Board, the Sustainability Accounting Standards Board, and the Task Force on Climate-related Financial Disclosures.