Risk, Resilience and Reputation

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CMS Funds Group

ESG Litigation Risk
Risk, Resilience and Reputation Webinar Series

The latest webinar in our ***Focus on Funds | Risk, Resilience and Reputation*** *series saw CMS partners Laura Houët, Kenny Henderson and Tilman Niedermaier discussed the latest developments covering ESG litigation risk. Here is a high level write up from our event. The full recording is available here.*

The funds industry is in a constantly shifting and evolving ESG and sustainability-focused regulatory and legal landscape. There has been a profound and conscious shift from ESG concerns being a footnote in most investment strategies to placing them at the core of financial markets participants entity level and product level frameworks. A litigator's perspective on how this new landscape affects the litigation risk within the industry, was discussed in the seminar hosted on the 17 March 2022 by Laura Houët, Kenny Henderson, and Tilman Niedermaier. In this summary, we explore how the key ESG legal and regulatory developments translate to specific litigation risks.

Litigation Lens – where is the risk?

Some of the key features of ESG-related litigation to monitor are:

- *New and fast-paced developments:* It is a challenge to predict litigation risk in relation to new ESG legislation – for example the Sustainability Finance Disclosure Regulation – because the majority of the issues have yet to be tested in the courts. With new laws and regulations proliferating, the task of keeping up with the regulatory changes creates an administrative burden and uncertainty on precisely where litigation risk arises.
- *Type of claimant:* ESG litigation attracts highly motivated claimants, such as climate activists or animal rights campaigners. The claims brought by such stakeholders aim to force behavioural and cultural shifts. To that end, the cost-benefit analysis of ESG litigation changes too. The chances of winning at court may feature much less prominently in the claimant's cost-benefit analysis if the aim is to garner public attention and support and reputational damage needs to be monitored closely. Those types of claimants will also seek to change behaviours in pre-litigation dialogue.

- *Claims against directors:* ClientEarth is pursuing a claim in the UK, as shareholder derivative action, against Shell's directors for failing to manage climate risk and align the company to a transition towards net zero in accordance with the Paris Agreement. Directors' duties and fiduciary duties are therefore under the spotlight with individuals' responsibilities and achievements (or failures) tested against company's published ESG-related strategies, targets, and reports.
- *New class action litigation tools:* As part of its New Deal for Consumers initiative, the EU introduced the Directive on Representative Actions (link), which gives Qualified Entities standing to bring local and cross-border claims on behalf of consumers. Once implemented, the directive could substantially increase ESG litigation risk when deployed in combination with the Sustainable Finance Disclosure Regulation, the Paris Agreement, or other legislation.

The table below illustrates how litigation risk can become crystalised in relation to ESG regulations.

Behaviour	Subject matter	Type of claim	Potential consequences
Non-provision of disclosure • **Conscious choice** • **Insufficient data**	Corporate conduct	Injunctions to require disclosure	Forced disclosure
Inaccurate information	Corporate conduct	Investor claims (typically for listed companies)	Damages
		Injunction requiring disclosure (disclosure may be involuntary)	Behavioural change (possibly significant)
	Product/service	Misrepresentation	Damages Recission
		Breach of contract	Damages – contractual measure of harm

Inaccurate advice	Investment decisions	Tort	Damages
		Breach of contract	Damages

Future regulations - EU proposal on corporate due diligence

The European Commission recently published the proposal for a Directive on Corporate Sustainability Due Diligence (**CSDD**). If implemented in its current form, it will mark a sea change in ESG governance and litigation risk. The proposal applies to European companies with more than 500 employees and a turnover of over €150 million and to foreign companies with a turnover of more than €150 million in the EU. Lower employee and turnover thresholds apply for both EU and foreign companies active in certain textile manufacturing and trading, agriculture, forestry, fishing, food manufacturing and extractive industries.

Companies in scope of CSDD will be required to identify, prevent, mitigate and remediate the adverse impacts of their activities on human rights and the environment in Europe and beyond. It makes provisions for a new sanctions regime and, if implemented, will increase litigation risks by giving parties impacted by breaches of international conventions and voluntary guidelines the right to sue in damages.

The table below lists several examples of international treaties and conventions, which would become directly enforceable under CSDD.

Soft Law → Hard Law	
Adverse human rights effects	The Universal Declaration of Human Rights
	The International Covenant on Civil and Political Rights
	The International Labour Organization's fundamental conventions (including Right to Organise and Collective Bargaining Convention 1949 and the Equal Remuneration Convention 1951)
Adverse environmental effects	OECD Guidelines
	The Paris Agreement
	Future environmental legislation

The table below gives examples of potential claims that could be advanced under the directive.

New potential claims under the EU proposed directive on corporate due diligence			
Behaviour	**Subject matter**	**Type of claim**	**Potential consequences**
Poor working conditions	Corporate conduct	Injunction requiring remedial action	Behavioural change (possibly significant)
		Inadequate governance	Damages (directors can be held personally liable)
Environmental damage	Corporate conduct	Injunction requiring remedial action	Behavioural change (possibly significant)
		Inadequate governance	Damages (directors can be held personally liable)
	Product/service	Misrepresentation	Damages Recission
		Breach of contract	Damages – contractual measure of harm

Dispute Prevention

While ESG-related litigation risk looms large, financial markets participants can actively limit that risk by:

- Adhering to existing rules and documenting these efforts;
- Linking their PR strategy to litigation risk, which may help to anticipate claims that seek publicity and could bring reputational damage; and
- Anticipating the shift away from voluntary frameworks to compulsory measures and complying with and adapting to such voluntary frameworks early.