Climate Risk

The post-COP26 landscape

2022
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Foreword

At COP26 institution after institution came forward to make stronger commitments to what is now broadly seen in most countries as a common goal: to reduce global carbon dioxide emissions. In particular, the private sector stepped up to the plate. For example, the Glasgow Financial Alliance for Net Zero posited a potential USD 130tn of private capital to accelerate the green transition. COP26 also escalated the role of climate disclosures in achieving net zero. To achieve global comparability, the International Sustainability Standards Board (ISSB) is to deliver a global baseline that gives investors information about the climate and sustainability risks in relation to companies they (may) invest in. Further, the UK introduced requirements for all listed companies to produce net-zero transition plans by 2023. These are seen as drivers for achieving climate-positive investing.

International commercial lawyers have a crucial role to play in navigating and implementing the frameworks that emerge from COP26. Being guardians of the rule of law and facilitators of business and trade, lawyers will be at the centre of discussions on what our clients are required to do, and also on what they should do in light of wider societal and reputational considerations. It is in our clients’ interests that we guide them toward outcomes in line with wider societal ambitions. To do otherwise would, among other things, risk placing them at a competitive disadvantage as the world pivots toward a clearer climate mitigation agenda.

Climate Risk is a broad term and covers a multitude of concepts. This report focuses on three legal risks. First, of financial institutions holding corporates to account over perceived climate risks. Second, the risk to corporates on what they do and say about the impact on their business from (or from their business on) climate change. Finally, risk of litigation against corporates relating to climate change.

As lawyers, what we see is broadly a great desire among our clients to be part of the solution on climate change. Almost all major corporate clients that we speak to wish to take positive steps that are in line with the desire for climate action, and also to capitalise on the opportunities presented as we transition to a net zero economy. We find that, among the investment community, vast capital is ready and available to be deployed on infrastructure and other projects that will push the agenda forward. The question is whether there is sufficient clarity on the agenda, the rules and the risks involved.

As this report shows, a key driver of Climate Risk for corporates revolves around information. Both quantifiable information about the potential direct impacts of climate change on particular sectors and businesses. And also consistent, comparable and reliable information about the companies themselves. Companies are producing reports that are deluging investors on how they are measuring and managing their impact on and from climate change. However, there is some distance to go before investors can compare the information across the economy to make informed decisions.

Organisations such as Baringa, who have kindly contributed to this report, support the same clients from a parallel perspective. They help investors and corporates to assess climate risk exposure by using Baringa’s Climate Change Scenario Modelling. Tools such as these are invaluable for making the best decisions from the information available on risks to companies and the credibility of their adaptation and transition plans.

On climate litigation, this is a direct and growing risk to corporates who fall under the spotlight of a variety of potential claims against an increasing number of potential claimants. It is prudent to actively manage this risk through dispute avoidance strategies, having plans in place to deal quickly and effectively with the situation where a claim is brought, and understanding the key features that are typically at play in such litigation.

Corporates are well aware that climate risks are an integral feature of their business planning. What some occasionally criticise is the lack of long term certainty. Making knee jerk decisions based on woolly political sentiments that could change tomorrow rarely makes good business sense. Clearer long term policy statements from governments and inter-governmental institutions can help on this, as well as clearer policies on how governments see the shape of the future zero carbon economy, and the pathways to it.

Quite apart from the outcomes of COP26, with the private sector committing en masse to the climate agenda and the ability to scrutinise the private sector’s response through climate disclosures, net zero plans and other actions they take, we anticipate that the issue of Climate Risk will continue to rise up boardroom agendas.

Munir Hassan
Partner, Head of Energy & Climate Change Group
T +44 20 7367 2046
E munir.hassan@cms-cmno.com
Drivers of change for Financial Institutions: The “Big Picture”

Climate change will affect the whole economy and is a systemic risk to the financial system. What is happening is that the World is warming. The estimated increase in global average temperatures above pre-industrial levels by 2100 will vary, depending on future actions:

- If we take no action, global surface temperatures will rise to 4°C by as early as 2060.
- Current policy does not achieve what needs to be done to reduce greenhouse gases enough to keep such warming to below 2°C.
- The Paris Agreement aims at “limiting global warming to well below 2°C.

Physical and Transition Risk

The associated risks from global temperature rising are in two categories:

a) Physical Risks: with each degree of warming there is an increase in events such as flooding, wildfires and droughts, as well as chronic patterns like rising sea levels, droughts and failing crops; and

b) Transition Risks: transitioning to a lower-carbon economy will entail extensive policy, legal, technology and market changes to address mitigation and adaptation requirements related to climate change.

Impacts on the economy from these risks will include:
- Business disruption;
- Asset destruction;
- Funding challenges;
- Reconstruction / Replacement of assets;
- Lower Values of Stranded Assets, and
- Increased Volatility in Energy Prices.

Impacts on companies could include:
- Production facilities going offline;
- Supply chain disruption & liabilities;
- Increased long-term operating challenges, and increased costs;
- Increasing product demand uncertainty;
- Increased risk of stranded assets, and
- Opportunities from climate technology & green products.

Regulatory and investor pressures

Despite the challenge of the “Tragedy of the Horizon” highlighted by Mark Carney, banks and investors are rapidly incorporating climate change into their lending and investment decisions in response to regulatory and investor pressures. There is a recognition by groups such as the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), European Central Bank (ECB), and Bank of England (BoE) of climate change being a source of major systemic risk and increasing regulatory requirements on firms to manage those risks. The speed of this transition was reinforced at the COP26 held in Glasgow, UK where the time between updates to the Nationally Determined Contributions (NDCs) was reduced from the five years agreed in Paris to just one year – with all countries requested to present NDCs with increased ambition at COP27 to be held in Sharm El-Sheikh, Egypt in 2022.

Investor pressure is mounting too from groups such as the United Nations Environment Programme (UNEP) Finance Initiative, TCFD and Share Action. There is a recognition that climate change is a source of major financial risk and that investor mandates are reflecting an appetite for sustainability and a need to manage climate risk.

Banks’ and investors’ response

Banks and investors have started to respond to these regulatory and investor pressures by making both external commitments and developing their internal capabilities. Typical external commitments may include:
- Developing and publishing climate change risk management capability
- Aligning lending / assets under management to Paris / a below 2°C outcome
- Having net zero emissions by 2050
- Halving financed emissions by 2030
- Publishing 2025 targets aligned with these commitments

Typical internal capabilities under development may include:
- Climate change scenario analysis capability – both transition and physical risk.
- Client-level measurement of financed emissions.
- Client-level measurement of temperature alignment.
- Incorporation into credit sanctioning and pricing.
- Incorporation into strategy and opportunity identification.
How FIs measure their climate risk exposure

FIs measure their climate risk exposure by modelling decarbonisation pathways and estimating Counterparty Probability of Default (PD). Lacking the skills and expertise needed to develop these pathways in-house, FIs frequently use external providers such as the Climate Change Scenario Model, created by Baringa and developed in partnership with BlackRock. These models can help FIs answer the fundamental questions that every Financial Services organisation has to answer, and gives them the data to be able to respond.

Typical questions include:
— What is my climate change risk, and the value that will be lost from my balance sheet?
  • How will the value of my assets, and my clients’ assets, change over the next 30+ years due to climate change?
  • How does this differ under different scenarios? How do I respond to the regulators’ scenario analysis requirements?
— How are the investments we have made impacting the climate, and how does this compare with my peers?
  • Is this congruent with my values, and the values of my clients and investors?
— Now that we understand our position, what opportunities exist to reallocate capital to improve our impact on the climate at the same time as making commercial returns?
  • What is my strategy going forward?
  • What opportunities are there to change what we invest in and fund?
  • How will I engage with the market and demonstrate that I am taking this seriously and having a positive impact on society as well as protecting my investors’ capital and making commercial returns?

The outputs of these models are used to assess the climate risk of companies which is then used in the lending decisions of FIs through metrics such as Probability of Default. FIs can manage their climate risk exposure by understanding the impacts and opportunities across the board and optimising the portfolio of individual asset levels. The impact on the market value capitalisations of individual companies in the future, e.g., 2030, can be modelled for a given temperature alignment. Aggregating these positive or negative impacts on value across all of the companies in a portfolio provides a view as to whether each company increases or decreases the portfolio’s climate risk exposure.
Finally, FIs are assessing companies ‘Credible Transition Plans’ (CTPs) to help mitigate their risk exposure. In order to understand a customer’s transition strategy, FIs ask questions such as:

a. What targets have they set, and how are these defined?
b. What are the specific, implementable elements of the strategy, what is the timeframe and to what extent will it deliver targets?
c. Model their emissions and temperature alignment
d. Financial starting point – i.e. cash flow creating ability to change strategic direction.
e. The specific policy / regulatory environments in which they operate given their geographical footprint.
f. Operations / investments to date.
g. Management’s track record on strategy delivery
h. How are management / Exec incentives aligned to the strategy?
i. How have they evaluated the strategy (e.g. under what scenarios have they assessed it)?
j. What tangible evidence (e.g. investments, shifting capex, etc.) is there of the new strategy being implemented?
k. Do they demonstrate how their financial performance will evolve under the strategy?

Building a repeatable assessment framework and toolkit to enable FIs to assess CTPs requires four key steps:

1. Create a Paris Agreement-aligned scenario and translate into transition pathways.
2. Define building blocks of a credible transition plan and required data set.
3. Create a CTP assessment framework: customer questionnaire, scorecard and checklist for frontline staff.
4. Pilot the approach to upskill and engage coverage teams.

In conclusion, FIs are now incentivised and engaged in understanding the climate risks of their clients. In future, we are expecting further engagement between banks and investors and their clients, and increasing importance assigned to the plans for the decarbonisation of each company’s operations.

Jim Fitzgerald
Director, Baringa Partners
E Jim.fitzgerald@baringa.com
EARTH

SAVE THE PLANET
Climate change: financial risk

Climate change, and more specifically the risks of inaction in the face of climate change, have been reported for many years but have become progressively part of our daily awareness as a result of – primarily – the news of regular extreme weather events across the globe.

The change needed cannot result only from the small improvements we individually choose to make: complete and rapid structural and systemic change is required as we transition to a low carbon economy and aim to meet the standards of the Paris Climate Agreement. Firms that choose not to address climate change, or do not do so quickly enough, are and will continue to face material financial losses.

The IMF Global Financial Stability Report of April 2020 said “Disasters as a result of climate change are projected to be more frequent and more severe, which could threaten financial stability.”

Central banks, regulators and policy makers recognise that climate change is a source of financial stability risk and have been responding with unprecedented levels of standards, regulation, and legislation. The purpose of this must be two-fold: (1) ensuring the stability of the financial system (managing risk) while (2) encouraging capital allocations towards sustainable investments to support the low carbon transition (positive change).

Much has been said about COP26 but we have already moved on. The important factor is how financial institutions engage with, respond to, and implement the many significant initiatives that were discussed in Glasgow to ensure that the outcome is an accelerated, transparent flow of capital towards climate adaptation issues.

What are climate-related financial risks?

The Taskforce on Climate-related Financial Disclosures (TCFD) divided these risks into two main categories:

— Physical risks: these may be event-driven (acute risks), including extreme weather events such as flooding, as well as other longer-term changes in climate patterns (chronic risks). Physical risks may, for example, cause direct damage to assets and disrupt supply chains, quality of output, erode the value of financial assets, and/or increase liabilities.

— Transition risks: these relate to the process of moving towards a low-carbon economy, including regulatory changes designed to mitigate and adapt to climate change, improvements in technology, or shifts in market standards away from - and the obsoletion of - high carbon emitting industries (e.g. fossil fuels). Transition risks may result in varied losses, including stranded assets, reputational damage and litigation and other legal costs.

Both physical and transition risks give rise to a third category: liability risks. As discussed in the section ‘Litigation: a key driver for climate justice’, we are seeing increasing litigation and activism focussed on holding companies responsible for environmental damage or their lack of behavioural change.

James Gorman, CEO of Morgan Stanley

If we don’t have a planet, we’re not going to have a very good financial system.
The entire economy is subject to these risks, with financial institutions consequently becoming increasingly destabilised both from internal and external pressures.

The Glasgow Climate Pact does not go as far as many hoped, but it does look to address some of these risks at a national level by requesting that countries revisit and strengthen their climate action plans, known as nationally determined contributions (NDCs), for 2030 in time for COP27 in Egypt in November 2022.

What are climate-related financial opportunities?

The carrot for institutions comes in the form of the enormous opportunity for those entities who are best placed to adapt to the low carbon economy and to take advantage of the changing policy landscape and market needs during the move to net zero.

The cost of attaining net zero by 2050 is estimated to be between USD 100tn and USD 150tn. Mark Carney noted that “only mainstream private finance can match the scale of climate action needed for the net zero transition”.

While ensuring the stabilisation of the financial system through the management of risk, and discouraging investment in activities that will not contribute to the solution, positive action is also needed to push economies towards investment in low-carbon alternatives, new technologies and sustainable products and services.

Organisations that innovate and develop new products, that seek investment in low emission products and services, and that improve their own energy efficiencies, will be more resilient and better able to adapt to the low carbon future.

To this end, the Glasgow Financial Alliance for Net Zero (GFANZ), comprising membership of more than 450 asset managers, banks and insurers, has committed over USD 130tn of private capital to transforming the economy for net zero by 2050.

What are immediate considerations for financial institutions?

The Network for Greening the Financial System (NGFS), a group of central banks and supervisors, has stated that “climate-related risks are a source of financial risk [and it] falls squarely within the mandates of central banks and supervisors to ensure the financial system is resilient to these risks.”
However, although there is enormous momentum in how central banks and regulators are responding to climate change, there is also widespread divergence in approach. The implications of a piecemeal solution will impact the way in which organisations and financial institutions react and adapt. To date, the proposed solutions have focussed on disclosure, governance, and risk resilience. To ensure that the GFANZ commitments are reached, we expect to see a more joined up approach – including through policy initiatives announced at COP – across the market players and a strengthening of the information and tools the market needs to support the transition.

In seeking to comply with the myriad standards, and to keep up with the GFANZ ambitions, we see the main considerations for financial institutions as:

1. **Monitor international regulatory developments**

The EU has been a clear first mover with detailed disclosure requirements for financial institutions and other large organisations. The impact of these rules (particularly the Sustainable Finance Disclosure Regulation, the Taxonomy Regulation and the revised Non-Financial Reporting Directive) have wide ranging implications for both financial institutions and the companies in which they are invested. Within the EU, France has taken a strict line on the ability of asset managers to market sustainability labelled products to retail investors if they do not meet very high standards of compliance. The UK will follow a TCFD approach, already a widely accepted voluntary code, which may become the global mandatory standard. These are but a couple of examples of changes we are seeing across the globe.

Institutions must keep a close understanding of the divergent rules from a legal and compliance perspective – many rules have an extra-territorial impact. It is also crucial to know the landscape so as to engage with home regulators, to keep up with shifting market standards, to have an early appreciation of the compliance burden and issues, and to consider the impacts which may follow in their own jurisdictions.

The announced formation of the International Sustainability Standards Board (the ISSB) is a crucial step forward towards a harmonised approach, as this will be the body responsible for developing global standards of disclosure – building on the TCFD. How existing regulation will fit in or be adapted is a key point to watch but we expect that there will be swift implementation once the standards are developed.
2. Look inward, as well as outward
We see a huge number of sustainability focussed financial products being issued. However, taking advantage of the market trends while not also considering how to embed climate and other sustainability risks into governance and risk structures will begin to negatively impact financial institutions from a reputational and supervisory perspective.

Financial institutions should be setting standards from board level, with climate considerations integrated into every aspect of the business. Developing a detailed climate policy with a focus on strategy, governance and risk will help to drive wider change and keep financial institutions prepared for – or ahead of – challenging supervisory and prudential requirements.

Any successful net zero strategy must be embedded throughout the business, and financial institutions will need to deal with the challenges of building up adequate resources, identifying their carbon footprint (including Scope 3) and accessing the necessary, correct data as well as the gaps therein.

3. Identify the compliance challenges as early as possible
With a focus on disclosure, one of the main challenges facing institutions is data. Many of the metrics to be disclosed are currently underdeveloped or not required to be reported by underlying organisations. In addition, the requirements of different jurisdictions may result in institutions being obliged to report on a number of different standards: in short this may change with the ISSB.

It is well accepted that there will be significant data gaps as reporting requirements evolve and methodologies for data capture improve. Some of the issues arising are:

- Identifying all of the required metrics and any efficiencies to be gained from an international or group perspective;
- Ensuring a compliant and robust strategy for gathering and reporting data;
- Identifying where estimates and third-party providers can be used;
- Involving all relevant business lines – legal, compliance, risk, product, and reporting to name a few; and
- Considering liability issues where data is (1) lacking, (2) obtained from third parties or (3) subject to change.

4. Consider the possible reputational and market risks alongside the strict letter of the law – ie, do more than you need to.
The climate-related financial risks discussed above are compounded by the reputational and market risks of not acting quickly enough to become part of the solution. The risks of greenwashing – either real or perceived – should be a central consideration in the development of internal strategies for ensuring that firms are doing what they say they are doing. Points to consider are:

- Developing an integrated understanding of climate and sustainability risks as they apply to your business;
- Being clear internally as to the organisations’ risk parameters and terminology around sustainability;
- Reviewing governance policies and processes, including remuneration;
- Ensuring that all staff have the appropriate level of training;
- Verification of all disclosures on sustainability; and
- Ensuring board level accountability and involvement in product disclosure.

Regardless of the strict requirements of any applicable law, investors and climate groups will increasingly hold financial institutions to account for their public statements and for their failures.

It is imperative that the reputational and legal risks are managed as closely as the physical and transitional risks of climate change.

Laura Houët
Partner
T +44 207 367 3582
E laura.houet@cms-cmno.com
Litigation: a key driver for climate justice

Climate change litigation is ascending the corporate risk register. NGOs and individuals are increasingly using the courts to try to achieve their objectives, including to enforce corporate and government adherence to environmental regulations, sustainability targets and broader ESG (Environmental, Social and Governance) principles. Litigation also raises public awareness of climate change, environmental harms and other human rights infringements to encourage behavioural change. Spurred on by landmark judgments in the Netherlands, Germany, Norway, Italy, France, Ireland and the UK, climate change claims have now been filed in over 40 countries.¹

Here, we look at the key types of climate change litigation that are on the rise in Europe. In doing so, we examine two key categories of climate change litigation in order to illustrate how the courts are being used to drive change. This is a rapidly developing area, and corporates and governments need to remain abreast of the evolving litigation and reputational risk.

Human rights and judicial review claims

Claims brought by NGOs and environmental groups frequently do not seek damages. They are often brought against nation states, public sector defendants or corporates, seeking injunctive or declaratory relief to prevent or stop climate-harming activities, or applications for judicial review of government decisions with potentially detrimental environmental consequences.

Some claims of this kind have been brought to enforce treaty obligations and human rights laws. A high-profile example of this type of climate change litigation is the Urgenda Foundation case in the Netherlands. There, an NGO and a group of Dutch citizens succeeded in their claim against the Dutch Government for infringement of article 2 (right to life) and article 8 (right to family life) of the European Convention on Human Rights (ECHR) on the basis that the Government had failed to pursue a more ambitious reduction of greenhouse gas emissions. The court ordered the Dutch Government to reduce emissions emitted in the Netherlands by at least 25% by the end of 2020.

The Urgenda Foundation case has led to a spate of similar claims internationally. For example, a claim filed in May 2021 by climate litigation charity Plan B against the UK Government alleges infringement of the right to life, right to family life and right to protection from discrimination in respect of these rights and freedoms under the ECHR as implemented by the Human Rights Act 1998 (UK). The claimants argue that these rights must be interpreted in the context of the UK’s commitments under the Paris Agreement on Climate Change and that the Government has breached those human rights by failing to adequately implement the Paris Agreement domestically. The claim is led by three students in their early 20s but stated to be brought “on behalf of themselves and countless others”. In January 2022, ClientEarth and Friends of the Earth filed a claim against the UK Government, seeking to judicially review its net zero strategy that had been published in October 2021. ClientEarth and Friends of the Earth argue that the strategy will illegally fail to deliver binding international commitments to reduce commissions.

¹ Sabin Center for Climate Change Law, at 22 August 2021.
Urgenda is used as a crowbar in further international climate change litigation with similar types of claims being brought against corporates, most notably in *Vereniging Milieudefensie v Royal Dutch Shell plc* (C/09/57193/HA ZA 19-379). In a high profile ruling in May 2021, The Hague District Court ordered Shell to cut its 2019 carbon emissions by 45% by 2030 (compared with 2019 levels). This was the result of a collective legal action brought by Friends of the Earth Netherlands (Milieudefensie) together with 17,000 co-plaintiffs and six other organisations.

According to claimant Milieudefensie, the company needs to contribute to the prevention of dangerous climate change via the corporate policy it determines for its group and its entire value chain, on the basis of a duty of care. This duty of care was substantiated with human rights articles 2 and 8 of the ECHR and soft law instruments such as the UN Guiding Principles on Business and Human Rights (UNGP).

The court ruled that Royal Dutch Shell (RDS) was responsible for its overall group policy and needs to observe a certain duty of care regarding emissions and climate change policies. The Court ruled that Milieudefensie could not invoke the human rights under the ECHR directly, but in interpreting the specific duty of care applicable in this context, the Court followed the UNGP. RDS appealed against this judgment. RDS emphasised that it takes all reasonable efforts to be CO2 neutral in 2050, but that it now needs to speed up this process.

*Vereniging Milieudefensie & ors v Royal Dutch Shell plc* C/09/571932/HA ZA 19-379 is a turning point in history: it is the first time a judge has ordered a large corporation to comply with the Paris Climate Agreement and it will have major consequences for other companies by forcing them to play their part in tackling the climate emergency. The oil company's sustainability policy was found to be insufficiently “specific” by the Dutch court and it was told it owed a duty of care. This unprecedented ruling will have wide implications for the energy industry, as well as for multinational companies in other sectors.

In France, environmental organisations, such as Notre Affaire à Tous, have lawsuits against the French government and French oil multinational Total. On 3 February 2021, the Administrative Court of Paris issued a decision recognising that France’s inaction has caused ecological damage from climate change and awarded the plaintiffs the requested one euro for moral prejudice caused by this inaction. Furthermore in a landmark judgment on 1 July 2021, the highest administrative French court, the Council of State (Conseil d’État), ruled that the French government had failed to take sufficient action to mitigate climate change and ordered it to take additional measures to redress that failure. “The Conseil d’État therefore instructs the government to take additional measures between now and March 31, 2022, to hit the target,” the council said. According to the claimants, the French municipality of Grande-Synthe and several associations, the government did not meet its obligations by admitting that its current measures were not enough to meet the climate goals by 2030 but that it does not want to take additional measures.

In the international context it is relevant that claimants have long used planning laws to challenge development with the potential to cause environmental harm, such as noise and water pollution; these same laws are now being used in an attempt to block projects on the grounds that they are likely to accelerate climate change. For instance, in *ClientEarth v Secretary of State*, environmental law charity ClientEarth sought judicial review of the UK Government’s approval of Drax Power’s (part of the Drax Group) development application in relation to building Europe’s largest gas-fired generation plant. Despite the English High Court and Court of Appeal finding in favour of the Government, Drax Group announced in February 2021 that it would be suspending the expansion of the gas-fired generation plant and focussing on renewable power instead. Climate change activists have pointed to this outcome as achieving the objective of preventing the development even though the court found against ClientEarth.

Climate change litigation has also involved the corollary of the applications referred to above, i.e. where corporates seek judicial review where planning permission has been refused or withdrawn on the basis of climate-related concerns. For example, West Cumbria Mining sought judicial review of Cumbria County Council’s decision to withdraw planning permission for the first development in several decades of a coal field in England. Such applications may become fewer in future because, as climate change awareness grows amongst consumers and investors, there is an increasing risk of reputational harm for those seeking to challenge such decisions.
Claims for damages

Claims seeking damages for environmental harms are likely to increase significantly in the coming years. Pre-existing causes of action, such as the tort of nuisance or the tort of negligence, can be suitable for certain types of environmental claims against an alleged polluter. More novel are claims for breaches of company law.

Claimants may also seek damages for loss suffered by reason of breaches of company law, such as a failure to disclose climate change risk in respect of certain investments. Relatedly, there is a risk of claims against companies for deceptive ‘greenwashing’ marketing campaigns or misleading environmental impact claims. As the focus on sustainability and ESG issues intensifies, businesses will be scrutinised on their policies, making environmental claims fertile ground for future litigation. In the UK, several consumer organisations and financial bodies have recently published guidance in relation to environmental impact claims; for example, on 21 May 2021, the Competition and Markets Authority (CMA) issued a consultation on its draft consumer protection law guidance for all businesses making environmental claims.

However, many damages claims will face significant hurdles in proving causation: demonstrating that the defendant caused the damage complained of. Multiple sources of emissions may have contributed to a specific incident that is said to have caused loss, and the burden of proving causation typically sits with the claimant. The growth and advances in attribution science i.e., the science of determining the causes of unusual climate trends and climate-related events, offers one possible solution for demonstrating causal links in climate change claims. In Lliuya v RWE, German Watch is spearheading a claim utilising attribution science to link RWE AG’s emissions in Germany to its proportionate responsibility for melting of glaciers in Peru and the consequent need to build flood protections.

The courts may also choose to adopt a more flexible approach to causation. There is precedent in the UK, where the English courts developed the Fairchild principles in mesothelioma personal injury claims where scientific techniques were unable to determine, on the balance of probabilities (the required standard of proof), whether a defendant’s conduct caused the claimant’s cancer. Instead, the Fairchild principle – which the courts developed of their own volition – considers whether the defendant’s conduct “materially increased the risk” of the injury. This more relaxed approach to causation has not been applied in climate change litigation to date, but it is a precedent which shows that the courts can develop creative solutions to difficulties with causation. Adoption of an equivalent, more

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Fairchild v Glenhaven Funeral Services Ltd [2003] 1 AC 32 (7) (Lord Bingham).
Climate change litigation risk – what next?

Climate change litigation encompasses a growing variety of claims against a range of defendants. Whether the claims are brought by NGOs who are seeking behavioural change or by claimant law firms and litigation funders seeking damages, the common theme is that they are not waiting for governmental or regulatory action: the claimants are pushing the boundaries, often successfully, which then encourages further claims. The most obvious targets are governments and companies with a significant carbon footprint or that contribute to other emissions or pollutants. Banks and financial institutions that arguably facilitate these activities are one step removed, but they also need to be aware of the developing legal risks. An area of potential significant activity in the coming years is climate change class actions. The legal framework for European class actions is developing apace and there is a real risk of climate change class actions becoming mainstream. Collective actions have already been seen in jurisdictions such as the US and Australia with a well-established class action regime. Climate change class actions would potentially enable claims for personal injury, financial loss or damage to property caused by the consequences of climate change, such as intense floods, wildfires, rising sea levels, impacts on agriculture and fisheries and air pollution. While claims such as those in Lliuya v RWE referred to above have been for a relatively small monetary amount (€ thousands), aggregating claims in the form of a class actions could potentially lead to claims for much greater amounts (EUR millions or even EUR billions). The risk of climate change litigation should, therefore, be on the radar of many corporates.

The expectation is that climate change litigation will significantly increase due to further government climate change policies (following, among other things, the Urgenda judgment) imposing stricter and more enforceable obligations on companies. In France and the Netherlands, the courts have already ordered governments to take action in this respect. Besides this, there is also an increasing trend of soft law commitments (guidelines, codes of conduct, non-binding and binding declarations) that could indirectly create civil law obligations for companies.

The litigation threat is relevant for sectors with production and logistic processes that impact climate change, such as airline, beef, cacao, dairy, palm oil, seafood and steel industries.

Companies should be mindful of their role in the climate transition and their sustainability processes, and as such put in place an adequate international risk assessment and crisis management process in order to tackle possible class actions in an early stage. The ESG umbrella is of course broader than climate change, and corporates involved in the supply chain of other potential contaminants, such as microplastics, should also be aware of the increasing litigation risk.

Kenny Henderson
Partner
T +44 20 7367 3622
E kenny.henderson@cms-cmno.com
The perspective of our clients

Interview with Kristy Duane, Corporate Partner, Co-Head of the CMS Infrastructure & Projects Group.

Q: Do you see your clients actively engaged in considering the impact of climate risks on their business?
A: It very much depends on the nature of the business. Those that are making a positive impact (such as renewables businesses) are actively engaged because their stats are good and they want to publicise them. Those that have less of an impact are engaging with it but the active engagement is quite recent and not necessarily well understood across the business.

Q: What do you think is driving the engagement? For example, do you see corporate clients being engaged by their shareholders, investors, banks, insurers or customers on the topic of their position on climate matters?
A: Insurance is relevant to certain sectors more than others but I would say that each of these are having an impact now and also employees.

Q: For those that are actively engaging, how are they responding to their findings on the impact of climate risks on their business or sector? Do they generally consider climate to be a risk to their business, or an opportunity, or a mix?
A: On the whole it is a risk/cost at this stage. Some are using it as an opportunity to change policies or develop products and services, but it is the preliminary phase for most corporates and there are a limited number of corporates that have identified it as an opportunity, save those that are operating squarely in the climate change adaption/mitigation space such as renewables or energy efficiency. It is now accepted that this is a direction of travel and there are opportunities out there but possibly less identified at this stage.

Q: Are they, for example, looking to restructure their businesses, or signing up to Energy Transition Plans, Net Zero strategies or other decarbonisation agendas in place or under development?
A: Restructurings tend to be mostly for those in the “dirty industries” where brown is being separated from green (e.g. mining companies). At this stage, some corporates are still in the exploratory stage of understanding what the various plans are and strategies could be, and how such a plan, commitment or strategy would impact their business/financials but others have started to make good progress in this area.

Q: How much do you see climate being a driver of M&A activity?
A: It is certainly driving disposals of dirty industry assets. It is also fuelling demand for clean energy or low emissions assets and other sustainability orientated businesses including tech.

Q: Does the rise of the huge dedicated climate and energy transition funds affect the opportunities for corporates?
A: There is arguably a concern of crowding out but the scale of change/investment that is needed to achieve net zero is so large that it is unlikely that funds will take up all of that and therefore corporates will still be able to invest.

Q: Are some corporates looking to divest away from sectors (such as conventional coal fired power stations) which are perhaps seen as most at risk?
A: Yes this is happening. Traditional energy companies recognize they need to balance their energy generation mix and increase the percentage of renewables.
Greenwashing: reputations on the line

As global heating and other environmental issues have come to the forefront of public consciousness in recent years, with extreme weather events and increasingly urgent warnings about the damage humans are doing to the planet, consumers have taken a greater interest in the environmental impact of the products they buy and use. Dozens of surveys have revealed that consumers prefer environmentally-friendly products, and that they are willing to pay a premium to get them. Naturally, business have responded to this concern, with brand-owners increasingly highlighting the benign or even beneficial effects their products and services have on the natural world.

However, environmental issues are highly technical, and therefore raise a significant risk of confusing and misleading consumers, who may be persuaded to part with their cash to obtain products whose environmental benefits may be less than they appear. A European Commission website screening project, which reported in January, found that green claims were exaggerated, false or deceptive in 42% of cases, and more than half the time the information provided was inadequate. 2021 therefore saw an increased focus from regulators on misleading green claims. In the UK, the Competition and Markets Authority recently published a new Green Claims Code, setting out six key principles for traders to follow when making environmental claims, together with over 100 pages of examples and more detailed advice, and has implied that enforcement in this area may follow soon in 2022. The Advertising Standards Authority recently carried out a review of its regulation of green claims regulation, announcing its decisions following the first stage of its review in September. In January 2021 the Netherlands Consumer and Markets Authority published Guidelines on Sustainability Claims, and in August 2021, the French government issued its Climate and Resilience Law. Similar developments are in train across Europe.

Given the level of public concern about the environment, we expect that a finding that a business has been misleading consumers about its environmental credentials has the potential to be even more damaging to its reputation than other advertising breaches. Here are some key points to remember when making green claims.

1. Be clear
   Environmental claims are often technical and complex. Where terms are unclear, explain what you mean by them. Use appropriate qualifications and clarifications in the ad – significant qualifications should not be on a separate web page or another location where they are likely to go unread – but remember that these must be genuine qualifications of clarifications, and must not contradict the main claim. Avoid industry jargon, or explain it when used.

2. Be specific
   Identify the specific environmental benefit of your product or service and state it clearly. Avoid terms like “sustainable”, “green”, “environmentally friendly”, “eco-friendly” or “kind to the planet”, which are largely meaningless. Comparative claims, such as “more sustainable” or “greener”, may be acceptable if you explain the specific environmental benefit clearly. A claim made for a product or service generally should be based on a “cradle-to-grave” assessment, taking into account the environmental effects of inputs such as raw materials, water and electricity, manufacturing, transport, use and end-of-life disposal. Even with more narrowly-framed claims, make sure you consider all aspects – a common pitfall is to claim that packaging is recyclable or plastic free, without considering whether inner packaging, glue or tape, all of which form part of the packaging, meet that description.

3. Limit your claims to what you can prove
   Start with the evidence you have, and work out what claims you can make based on that evidence. A common pitfall is to start with the claim and then cast about for evidence to support it, which often leads to
a broader claim than can be substantiated. If you have taken waste out of the supply chain, limit your claim to the supply chain. If you have reduced CO2 emissions from transport, limit your claim to transport.

4. **Substantiation should be thorough and detailed**
Because they are often technical and detailed, environmental claims may require in-depth substantiation, and you may need to expend significant time and effort compiling it. For example, claims regarding carbon neutrality or reduced carbon require a thorough survey of a business’s operation and supply chain over a significant period, first to determine its baseline carbon emissions and then to track its progress towards reduced carbon or carbon neutrality. Be aware that terms such as “biodegradable”, “organic”, “renewable”, “compostable”, “recycled”, “recyclable”, “reusable” and “carbon-neutral” have specific technical meanings, and be ready to substantiate them accordingly. Substantiation by reference to an independent test standard, such as ISO 14021 on self-declared environmental claims, tends to be more persuasive than a standard developed in-house. Take care with symbols, which have specific meanings and rules for use. Make sure evidence is up to date. Make sure claims are accurate for normal use of the products, or qualify them accordingly – for example, if a product is only biodegradable in a specialist facility, and is likely to go to landfill where it will not degrade any quicker than normal products, do not claim “biodegradable”, or at least state that specialist facilities are required.

5. **Don’t claim normal product features, or things you are required to do by law, as environmental benefits**
For example, in the UK, rinse-off toiletry products must not contain micro beads. Claiming such products are “micro bead free” is misleading, as it implies that the products have a particular environmental advantage over other products, which they do not.

6. **Take care with comparisons**
Comparative advertising raises its own specific issues, and, where it refers to a competitor or its product or service by name, can substantially heighten risks by opening up the possibility of trademark infringement. Make sure you compare like with like – the comparison should be of products or services meeting the same needs or intended for the same purpose. The features compared should be material and representative, and also “verifiable”, which requires the detailed basis of the comparison to be disclosed proactively, either in the advertising itself or by way of a “signpost” in the ad directing readers to the source of information.

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**Stuart Helmer**  
Of Counsel  
T +44 20 7367 2687  
E Stuart.Helmer@cms-cmno.com
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cms-lawnow.com

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