CLIFFORD

CHANCE

ESG: MANAGING SUSTAINABLE GROWTH

– THOUGHT LEADERSHIP

SEPTEMBER 2020

ESG: MANAGING SUSTAINABLE GROWTH

ESG – Environmental, Social and Governance issues – are a major challenge for boards and board members as public scrutiny grows. In this briefing, our experts discuss the rise in climate change litigation, shareholder activism, managing human rights and social change and the impact of ESG ratings on access to capital. It is clear that the ability of boards to manage these issues effectively will be critical to the reputation and financial stability of many companies.

The rise in climate change litigation

Litigation and shareholder activism on climate change are a growing risk for businesses across a range of sectors. This is due, in part, to "increasing shareholder activism; NGOs' use of litigation as a campaigning tool; and legislative and regulatory change," says Roger Leese, a London-based Partner in Clifford Chance's Disputes Practice, and co-head of the firm's business and human rights group.

"The risks of climate change are now very much in the mainstream, as is a recognition that those risks might substantially harm the value of a business itself if that business does not manage those risks appropriately," he adds.

Activism may take the form of proposing or supporting resolutions at a company's AGM requiring a business to reduce its emissions. This has been a recent feature in the energy sector. Banks have also been targeted by activists proposing resolutions that the bank ceases to finance carbon-intensive industries. Pushing for these resolutions has become a key tactic of activists such as ShareAction and has proven successful.

More aggressively, shareholders have also pursued a number of legal cases against companies, often based on variants of established legal theories. For instance, arguing that the company is failing to report properly on the risks climate change poses to its business; or that the directors are not fulfilling their fiduciary duties properly by not taking climate change risks seriously enough in their decision-making.

The risks of climate change are now very much in the mainstream, as is a recognition that those risks might substantially harm the value of a business itself.

—**ROGER LEESE**
Partner

The role of NGOs

Shareholder actions are often led or supported by NGOs, but we are also seeing NGOs use litigation as part of their overall campaigning strategy. Several NGOs specialise in this and have the resources to pursue cases. ClientEarth, for example, recently received a £17 million donation from Pink Floyd's David Gilmour, which was raised by auctioning his guitars.

NGOs also support litigation by alleged victims of climate change against businesses, and also, increasingly, by bringing complaints before OECD National Contact Points, for breach of OECD Guidelines for multinational enterprises. Governments adhering to the OECD's Guidelines are required to set up a National Contact Point whose functions include:
"contributing to the resolution of issues that may arise from the alleged non-observance of the Guidelines in specific instances. NCPs assist enterprises and their stakeholders to take appropriate measures to further the observance of the Guidelines. They provide a mediation and conciliation platform for resolving practical issues that may arise with the implementation of the Guidelines."

NCPs are usually housed inside government ministries, but they may, for instance, employ a professional mediator to handle a particular complaint.

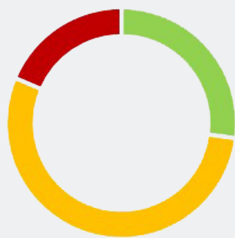
"This process does not lead to binding judgments, but can generate a good deal of publicity, and is also attractive to NGOs because it is relatively cheap," says Leese.

An NCP complaint was brought by Greenpeace and other NGOs in relation to financial services group ING's involvement in fossil fuels. That process ended in 2019, following about two years of talks, with a final public statement, which recorded ING's agreement to bring its loan portfolio in line with the Paris Agreement, including an agreement to exit from thermal coal by 2025.

Climate change regulation

Law and regulation on climate change is increasing, particularly in the EU, which increases the litigation risks. For example, we have already seen litigation against Total in France based upon a new law requiring companies to carry out human rights and environmental due diligence.

During a recent webinar with clients we asked the following question: To what extent do you think your company is vulnerable to litigation and/or shareholder activism on climate change in the near future?



Not at all · Moderately · Very much so

Climate change disputes

As climate change becomes a pressing issue for business and disputes are on the rise, there are a number of questions for the courts. Moritz Keller, a Frankfurt-based partner in our Litigation & Dispute Resolution Group, focusing on complex, often cross-border and sector-defining international arbitration and litigation proceedings, says: "The big question appears to be: Who is responsible? Who will bear the financial burden of the lasting changes caused by climate change? In the US and Continental Europe, many disputes stem from this unresolved question."

The Climate Case Chart – which is an online tool offered by Columbia University – already counts hundreds of cases worldwide, and some are expected to shape the development of the law and the debate on climate change more broadly.

Amongst these is the case of a Peruvian farmer, Saúl Luciano Lluiya, who brought a claim against German energy company RWE in a court in Germany. Mr Lluiya owns some land in a valley in the Peruvian Andes located just below a glacier, which is melting, and there appears to be an increasing risk of flooding. Mr. Lluiya argues that RWE AG should bear 0.47% of the cost of protective measures necessary to safeguard his property against flooding – this amount, according to Mr Lluiya, corresponds to RWE's proportionate share of global greenhouse gas emissions.

"The interesting question at stake is one of causation," says Keller. "Is it possible to prove that RWE's emissions in Germany have caused the glacier in Peru – that is some 10,000 kilometres away – to melt?"

The District Court of Essen dismissed the claim, in essence saying that there was no evidence of such causation. The case is now pending at the Higher Regional Court, following an appeal by Mr Lluiya. On appeal, the Higher Regional Court of Hamm found that Mr Lluiya has shown a *prima facie* case. The case has now progressed to the stage of taking of evidence. "The question is can anyone prove that an emission somewhere in the world causes an effect somewhere else in the world? And if that were true, wouldn't we all be responsible for some emissions and the corresponding impact somewhere in the world? I think there is a valid concern that individual cases such as this one are not the right way to tackle the issue – we need a comprehensive, global solution," says Keller.

He adds that the fact that the court takes the allegation seriously enough to take evidence – expert opinions are currently being rendered – has already turned the case into a landmark. Most similar cases globally have been dismissed for a lack of standing, but not this one. "If Mr Lluiya were even to prevail, claims based on

The big question appears to be: Who is responsible? Who will bear the financial burden of the lasting changes caused by climate change?

—**DR. MORITZ KELLER**
PARTNER

climate change damages might become a new reality globally."

This case is just one of many disputes currently playing out across the world. In the US, for example, several cities have brought cases against energy companies and are trying to hold the companies responsible for the financial consequences of climate change – by, for example, claiming compensation for damages caused by climate change phenomena such as hurricanes.

"Climate change disputes are also used as a policy-making tool. NGOs are supporting and financing cases with the explicit aim of influencing corporate behaviour and strategies. So, the goal is not to actually obtain a favourable decision and to be paid: it is rather about driving the public debate forward and raising public awareness for this cause. Mr Lluiya's German case, for example, is largely driven by NGOs – the actual compensation claimed is only a few thousand Euros. The litigation costs, however, are assumed to be millions of Euros," says Keller.

Challenging companies' decision-making processes

There are also cases where the purpose of the proceedings has been to challenge the actual decision-making processes of companies. For example, ClientEarth, a non-profit environmental law organisation, which holds shares in Polish power company Enea, brought a case stating that a resolution by Enea's shareholders consenting to the construction of a coal-based power plant in Poland contradicts the economic and social interests of Enea and poses financial risks as climate issues were not adequately taken into consideration. The court has ruled that the resolution is legally void considering the economic risks. Amongst the economic risks cited was the decrease in prices for renewable energy, while the prices for carbon have been consistently on the rise.

"What this means is that the Courts have taken on board that climate change-related financial risks are growing rapidly and therefore that these risks need to be considered by the companies' management," says Keller. "It is quite plausible that we will see an increase of similar cases, where board decisions are challenged based on climate change-related aspects."

In addition to disputes involving companies, there is also movement in the area of public law and challenges to governments on climate change issues. For example, a group of German farmers and Greenpeace have taken the German government to court for its alleged failure to reach its own goals stemming from a Climate Protection Plan that the government passed in 2014.

The aim of the Plan was to reduce greenhouse gas emissions by 40% below 1990 levels by 2020. When the government announced that the emissions would only be reduced by 32%, the farmers and Greenpeace initiated court proceedings on the basis of an alleged violation of their right to health and life (Art. 2 Abs. 2 GG), occupational freedom (Art. 12 GG) and right to property (Art. 14 GG).

However, the court ruled that the plaintiffs had no standing – mainly because the government's Climate Protection Plan was not legally binding, and the government had broad discretion in deciding how to fulfil its protective duties towards the plaintiffs and the German public as a whole.

Human Rights instruments have also been used in global climate change disputes concerning Germany. In the case of Sacchi et al. v. Argentina et al., 16 children – including Greta Thunberg – have filed a petition accusing several countries, including Germany, of violating their rights under the United Nations Convention on the Rights of the Child. Their goal is to force the states to review their laws and mitigate climate change through future legislation.

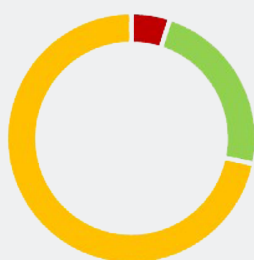
In the Netherlands, Urgenda, a foundation, which wants to achieve, in its own words, "a sustainable Netherlands," has taken the Dutch state to court over its alleged failure to take effective action on climate change. The case made headlines globally in 2015 when the court

The Courts have taken on board that climate change-related financial risks are growing rapidly and therefore that these risks need to be considered by companies' management.

—**DR. MORITZ KELLER**
Partner

found in favour of Urgenda and ruled that the government must cut greenhouse gas emissions by at least 25% by the end of 2020 (in comparison with 1990 levels). The case came to an end with a final judgment of the Supreme Court in late 2019 – again finding in favour of Urgenda. "The outcome surprised many – as it is quite uncommon for a court to dare to oblige a State to take action. And in many ways this was the beginning of the global wave of climate change cases," says Keller.

During a recent webinar with clients we asked the following question: For your company to achieve sustainable growth, do you see climate change as a risk or an opportunity?



Human rights and environmental due diligence

Human rights and due diligence are an increasing area of focus. In the Netherlands, for example, the Dutch Child Labour Due Diligence Act of 2019 requires that certain companies doing business in the Netherlands certify that they have conducted due diligence in relation to child labour in their supply chains.

Roger Leese says that the current trend should be placed in the context of the UN Guiding Principles adopted in 2011, which put due diligence at the heart of business's responsibility to respect human rights. The idea is that by carrying out systematic due diligence to identify the risks its operations might present of causing or contributing to human rights abuses, a business can then take steps to eliminate those risks.

Until recently, States have tended to be supportive of this, but have largely stopped short of imposing mandatory environmental and human rights due diligence legal obligations on business. For instance, in the UK, the Modern Slavery Act (MSA) provides for mandatory reporting by businesses over a certain size of what steps they have taken to remove modern slavery from their supply chains, which is intended to prompt human rights due diligence, but a business can simply say "we have done nothing."

The theory behind the MSA and similar pieces of legislation was that reporting obligations would be enough to bring about better practices. Businesses would not want to report that they do nothing to avoid human rights abuses, and civil society would play a role in shining a light on businesses which don't report progress. "But that has not proved to be very effective, which has strengthened the call by NGOs and a variety of governments around the world for businesses to be placed under a legal obligation to carry our mandatory human rights due diligence, and that's recently gained traction," says Leese.

At an international level, this has taken the form of the creation of a UN intergovernmental working group mandated to produce the text of a binding international treaty. This began in 2014 and will not end any time soon, but the recently released second revised draft includes detailed provisions on mandatory human rights due diligence.

There are a number of other examples in Europe of mandatory human rights due diligence legislation. Perhaps the best known is the landmark Duty of Vigilance Law in France, which came into effect in March 2017. This imposes due diligence requirements on large French companies, their subsidiaries and entities within their supply chain, and covers environmental as well as human rights risks.

Companies subject to this law have to draw up a "vigilance plan", which must be implemented "in an effective manner." The vigilance plan must include:

- a risk mapping;
- assessment procedures;
- risk mitigation actions;

- an alert or reporting mechanism; and
- a monitoring mechanism to evaluate the effectiveness of measures taken under the plan.

In addition to establishing and implementing a vigilance plan, the Law also requires companies to publish their plan and a report on its effective implementation.

Importantly, the Law provides that any interested party can formally demand that a company complies with the obligations under this Law and take court action if that demand is not met.

"There are other initiatives around Europe, including in Germany, Switzerland and Norway, but the Dutch and French examples, I think, show us that very different approaches are developing, from ones focused on very specific issues, such as child labour, through to the wide-ranging approach taken in France," says Leese.

There is a risk that this could lead to a patchwork of legislation across Europe; however, in April 2020, the European Commissioner for Justice, Didier Reynders, announced plans for a legislative initiative to introduce EU-wide mandatory due diligence requirements next year for businesses to respect human rights and prevent environmental harm across their global supply chains.

This is being pitched as part of the EU's Covid-19 recovery package. In his announcement, the Commissioner said that "the Covid-19 crisis powerfully exposes the vulnerabilities of our economy and of unregulated global supply chains," suggesting that the action we take in response "will determine the sustainability of our economy, society and planet."

"As you would expect, this has been welcomed by NGOs and other campaigners, but the reaction of business has not been uniform. Some businesses are, of course, concerned by the costs of compliance and the litigation risk, but others note that it may be better to have a level playing field across Europe than face a patchwork of national legislation. For instance, on 2 September, 26 companies, many of them household names, signed a declaration of support for the EU's plans for mandatory due diligence," Leese explains.

These companies said: "Mandatory legislation can contribute to a competitive level playing field, increase legal certainty about the standards expected from companies to respect human rights and the environment, clarify legal consequences for when responsibilities are not met" and also that "EU-wide cross-sectoral legislation, reflecting national developments and with clear accountability, should harmonise… expectations towards companies."

Some companies may be concerned that these types of obligations will expose their business to litigation risk as well as compliance costs. Leese says: "It's certainly a valid concern. For example, in a case brought under the French Vigilance Law against Total, which focused on Total's exploration for oil in Uganda, and the adequacy of Total's Vigilance Plan, key points to note are, firstly, that the legislation essentially places under scrutiny the activities of foreign subsidiaries of a French parent company. And secondly, damages can be awarded if harm can be shown to have arisen as a result of a business's failure to comply with the Law."

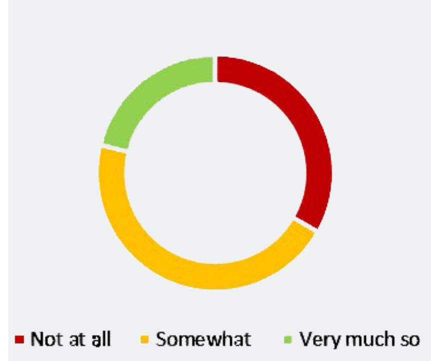
He adds that other proposed legislation, though, such as that under consideration in Switzerland, would work in different ways but could essentially make parent companies liable for human rights and environmental harm caused by their subsidiaries, wherever those subsidiaries are based, but then providing the parent with a defence to liability if it can demonstrate that it carried out proper human rights and environmental due diligence.

"This approach essentially heightens litigation risk substantially, in that it potentially does away with the principal hurdles that potential claimants have faced to date in bringing claims against parent companies, which is of course that the corporate veil doctrine means a parent is not generally liable for the actions of its subsidiary," Leese says.

Another consequence of placing liability on parents is that claims in respect of alleged harm caused by foreign

subsidiaries can be brought in the domicile of the parent, and so giving rise to the prospect of more claims being brought in Europe.

During a recent webinar with clients we asked the following question: To what extent do you feel confident that you and your organisation have enough insights into the legal developments around Human Rights



Developments in diversity and inclusion

"Boards have been very proactive and have approached these topics not as a compliance issue, but have instead identified these topics as having a significant impact on the culture of their companies," he says.

However, it is not always straightforward. Boards may want the relevant data in their organisations on, for example, diversity and LGBT+ in order to use it as a basis for policymaking. But there is a significant amount of tension between the wish to collect and use such data and the legal ability to do so, given GDPR and other privacy constraints. By way of example, Clifford Chance has advised a leading international bank on whether it is lawful to collect and use data relating to sexual orientation and/or the transgender status of its employees, contractors and/or job applicants in 22 countries.

Boards are also imposing targets on gender diversity, in particular, at certain levels within their businesses (e.g. top 100). Or insisting that, for every job application at a certain level, there is a choice between a male and a female candidate. "These kinds of measures can easily result in the creation of preference policies, which may result in inequality; so, there are many sensitivities, from a legal perspective, to be aware of and to consider," Van De Bult adds.

Sexual intimidation has always been a topic Clifford Chance has advised on in the employment practice, but with the MeToo movement, these issues have now become much more visible and have been brought to the attention of senior management levels in businesses. There has been a shift from a reactive approach towards proactively addressing MeToo and harassment issues led by boards.

"By way of example, we have advised one of the largest tech investors in the world on the design and international implementation of a global anti-harassment policy," he says. "The difficulty with such a global policy is that cultural differences play an important role: what is normal and acceptable in one country may be offensive in another country. That is why the local implementation of such policies is essential. Two board members were actively involved in the design of this policy as well as in the preparation of the training materials provided to employees in many different locations across the globe. The training sessions were subsequently led by one of our lawyers or local partners, together with the in-house legal team."

The impact of Covid-19

Covid-19 has brought an additional layer of social, governance and business continuity issues for employers. There has been a huge focus on employee health and safety, working from home and "return to work" arrangements. In several European countries, there is already existing legislation on employee rights in relation to working from home, or such legislation is now being developed. "If the current situation in which employees are working for a significant part of the week from home becomes more permanent, this will have a massive impact on employee relations and policy, says Van De Bult.

There will be many employee considerations regarding a safe working environment; employers' responsibilities and liabilities; monitoring and supervision; organising teams; a shift in employment terms; and employees' entitlements and

We are seeing many developments in relation to diversity, including gender diversity, LGBT, MeToo and, more recently, Black Lives Matter (BLM). These issues have been high on the agenda of many companies at boardroom level.

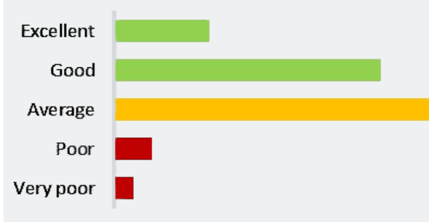
—**FLORIS VAN DE BULT**
PARTNER

acquired rights while working from home. In many continental European jurisdictions, labour unions, works councils and health and safety committees will be important counterparts or partners in adjusting to this new reality.

"From a legal perspective, it is key that boards take a proactive approach by implementing policies on diversity, inclusion and anti-harassment and put in place easily accessible measures to process complaints and initiate investigations adequately. Without proper policies, companies enter a legal minefield of liabilities in relation to an alleged perpetrator and an alleged victim," he explains.

This adds a new dimension to existing policies; companies must start thinking about what policies need to be amended and what policies will need to be developed. These policies must not only address employment law issues, such as a safe workplace, but also tax issues (e.g. certain tax-free allowances) and regulatory issues (e.g. supervision in a regulatory environment, such as a bank or an investment firm).

During a recent webinar with clients we asked the following question: To what extent do you feel your company's ESG employment policies have adapted to the challenges posed by Covid-19?



The rise of ESG ratings

ESG ratings are an increasingly popular way of assessing the performance of companies across a range of non-financial factors. However, sometimes it is not clear what the criteria for these ratings are. In a recent case in Germany, ISRA Vision, a manufacturer of software and systems for image processing and robotics, received a request from the US proxy advisory firm Institutional Shareholder Services (ISS), which provides ESG ratings, to participate in a sustainability review. ISRA Vision had apparently thought the request was a scam and did not participate. Based on publicly available material, ISRA Vision was then given the worst rating possible, a D minus. ISRA Vision then sought an injunction in the Munich courts. ISRA Vision was successful: the rating was prevented from being issued. While the full text of the decision is not publicly available, it is understood that the Court found that the mere lack of information did not justify a bad rating. The Court also found fault in ISS's criteria, as these did not match the specific business of the company.

"What this case underlines, I think, is the growing relevance of ESG ratings and the fact that this whole area of business is still in its infancy," says Moritz Keller.

There is a linkage between ESG ratings and access to capital. ESG can affect the cost of capital by affecting a credit rating in certain circumstances where the ESG factor can be said to affect the creditworthiness of the business. "But note that the European Securities and Markets Authority published guidance last year stating that, where a change of credit rating or outlook has been driven by ESG factors, the Credit Rating Agency needs to disclose detail on how they made that assessment," says Roger Leese.

ESG ratings themselves can affect access to capital and cost of capital through the basic laws of supply and demand: so, a strong rating increases investor demand and, in theory, lowers the cost of that capital. "However, whilst we do know that ESG factors are now commonly in the mix, they are just one aspect of the investment decision-making process. And also, there is significant scepticism as regards the reliability of ESG ratings. Even the World Business Council for Sustainable Development is quoted as describing them as a bit of a zoo," he says.

Green bonds are a good example of potential indirect linkage. In simple terms, bonds are labelled green by reference to the promised use of proceeds, but investors are nevertheless generally interested in the business's ESG ratings

as they are wary of accusations of greenwashing if they invest in a green bond in a company that otherwise has a poor ESG rating. There is also some evidence that green/social/sustainable bonds benefit from better pricing (a so-called "greenium").

What should businesses consider?

It is clear that ESG issues present a range of risks and it is crucial that businesses take a number of steps, including:

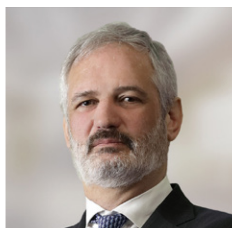
- Get ahead on human rights and environmental due diligence. It is not an easy process to manage within a business of any size.
- Take a look at your business through a "climate change lens" and try to identify potential exposure to climate change disputes.
- Make sure you have the right policies in place and that these become part of your DNA. Arrange for proper implementation, awareness and periodically refresh sessions.

ESG also offers a range of business opportunities, including:

- Channel successful management of environmental and social issues into lower cost of capital.
- There are also opportunities for different sectors. For example, are there opportunities for insurance companies to create bespoke products and perhaps also reflect a company's compliance in setting premiums?
- Climate change is not only a driver of societal change, but also provides a multitude of investment opportunities. There is huge interest in green investments of all sorts.
- Being at the forefront of ESG developments may result in the creation of a stronger corporate culture and will help in becoming an employer optimally placed to win the war on talent.

CONTACTS

Angela McEwan
Partner
Amsterdam
T: +31 20 711 9142
E: angela.mcewan@
cliffordchance.com



Charles Adams
Managing Partner CE
Milan
T: +39 02 8063 4544
E: charles.adams@
cliffordchance.com

Roger Leese
Partner
London
T: +44 207 006 8710
E: roger.leese@
cliffordchance.com

Dr. Moritz Keller
Partner
Frankfurt
T: +49 69 7199 1460
E: moritz.keller@
cliffordchance.com

Floris van de Bult
Partner
Amsterdam
T: +31 20 711 9158
E: floris.vandebult@
cliffordchance.com

C L I F F O R D

C H A N C E

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance 2020

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.

2009-001100