Corporate Counsel

How Public Companies Can Minimize Risks Resulting From a Post-COVID-19 Focus on ESG Issues: Part I

While many companies have proclaimed their commitment to environmental, social, and governance issues for years, the pandemic's pervasive effect on American workers, customers, and society has heightened the existing pressure on companies to focus on profit maximization and the creation of tangible shareholder value.

By **Todd G. Cosenza and William J. Stellmach** | May 15, 2020

During the past two months, the COVID-19 pandemic has prompted discussion regarding the proper role of the American corporation. Among these discussions is a renewed focus on environmental, social, and governance ("ESG") issues. While many companies have proclaimed their commitment to ESG issues for years, the pandemic's pervasive effect on American workers, customers, and society has heightened the existing pressure on companies to focus on profit maximization and the creation of tangible shareholder value.

Leo Strine, former Chief Justice of the Delaware Supreme Court, encapsulated this public reckoning in a recent article, in which he opined on the manner in which corporations should respond to the pandemic:

> [T]he corporation's obligations to its workers, its regular contractors, service providers, and lenders, and others with a legal and ethical claim to being paid comes above its duty to stockholders. Corporate leaders have the discretion to use their business judgment to best enable the corporation to weather this unprecedented storm, to honour its duties to those who have made the deepest commitment to the company's success (that is, its employees), and to secure the solvency and long-term health of the business.

Leo Strine, *Remembering What Comes First Is More Important Than Ever*, Moral Money (Mar. 27, 2020).

As companies receive pressure to prioritize employees, customers, and other "stakeholders" over cost management and shareholder value, some investors have pointed to the pandemic as validating their interest in companies which place emphasis on ESG factors. The *Wall Street Journal* recently noted that "the pandemic has demonstrated on a large scale the importance of other factors that are paramount to ESG investors," including "disaster preparedness, continuity planning and employee treatment through benefits such as paid sick leave as companies direct employees to work from home." Kristin Broughton & Maitane Sardon, *Coronavirus Pandemic Could Elevate ESG Factors*, Wall Street Journal (Mar. 25, 2020). And according to one analyst, "ESG equity funds" have "weather[ed] this downturn better than their conventional peers." Jon Hale, *U.S. Sustainable Funds Weathering Coronavirus Correction Better Than Most Funds*, Morningstar (Mar. 4, 2020).

Against this backdrop of a heightened focus on ESG issues, this two-part article addresses the risks that arise for public corporations as a result of a greater focus on ESG and provides guidelines for minimizing these risks, with a particular focus on avoiding potential federal securities law claims. Specifically, Part I discusses securities law claims that may arise from a company's failure to achieve its ESG goals, and the ways in which companies might minimize the risk of these claims. Part II, which is forthcoming, will focus on other securities law claims that may arise from ESG disclosures, as well as additional legal risks associated with ESG.

Securities Law Claims Arising from Failure to Achieve ESG Goals

A company's disclosures regarding ESG issues—for example, its safety standards, environmental consciousness, commitment to international social justice, and intolerance of discrimination and harassment—could expose that company to potential claims by shareholders that such disclosures were false or misleading in light of subsequent news or events which appear to be inconsistent with the disclosures.

Most notably, certain ESG disclosures may invite shareholders to bring claims based on allegations that a company has fallen short of the standards it has touted for itself. For example, multiple shareholder plaintiffs have successfully challenged companies' disclosures regarding safety, particularly where those companies experienced serious safety incidents after making the disclosures at issue. *See, e.g.*, *In re BP PLC Sec. Litig.*, No. 12-cv-1256, 2013 WL 6383968 (S.D. Tex. Dec. 5, 2013) (holding that plaintiffs adequately pled that BP's statements regarding its safety operations management were material misrepresentations in light of the deepwater horizon incident); *Massey Energy Sec. Litig.*, 883 F. Supp. 2d 597 (S.D. W.Va. 2012) (holding, in wake of coal mine fire, that plaintiffs adequately pled Section 10(b) claims challenging energy company's earlier statements regarding safety, including that it was an "industry leader in safety").

Looking forward, there are a number of ESG issues which, if made the subject of corporate disclosures, could give rise to future claims under the securities laws. For example, many companies have expressed an increased dedication to reducing their contributions to climate change. BP—who, like many other energy companies, has faced regulatory enforcement actions from state and local governments regarding carbon emissions—recently committed to achieve carbon neutrality by 2050 "because the world is changing fast, and so are society's expectations of us." Dieter Holger, *BP Agrees to Draft Climate Change Shareholder Resolution*, Wall Street Journal (Mar. 27, 2020). It is conceivable that, as companies strengthen their commitment to this issue in the form of more specific disclosures, they will subject themselves to shareholder claims under the federal securities laws if they seemingly fail to meet their own standards.

Another ESG area in which companies may expose themselves to the risk of such claims is the commitment to international social justice, particularly with respect to labor practices. American corporations face significant pressure to disavow the use of forced or excessively cheap foreign labor. For example, activists are strongly encouraging dozens of prominent American companies to "conduct immediate and thorough human rights due diligence on their factory labour in China," in response to reports that the Chinese government has "facilitated the mass transfer of Uyghur and other ethnic minority citizens from the far west region of Xinjiang to factories across the country." Vicky Xiuzhong Xu et al., *Uyghurs for Sale*, ASPI International Cyber Policy Centre (2020). While it is appealing—both from an ethical viewpoint and for the purpose of attracting ESG-oriented investors—for a company to disavow these practices, companies should be aware of the risk that any such disavowal presents. Especially for retail and technology companies, whose business is often reliant on overseas manufacturing, it is difficult to anticipate whether a company's stated position on these issues will align perfectly with the practices of its affiliates and vendors.

The heightened focus on sexual misconduct, particularly in the workplace, presents another ESG issue giving rise to the risk of shareholder claims. As illustrated by the examples discussed below, claims challenging these types of disclosures have become increasingly common in the "#MeToo" area, but companies can manage the liability risks by drafting appropriately limited disclosures.

Anticipating and Managing ESG Risks

To minimize the risks discussed above, companies should avoid making ESG-related disclosures which are too concrete, absent absolute certainty that such statements will not be challenged as false in the wake of unanticipated news or events. In other words, to the extent that a company wishes to make pronouncements regarding its commitment to ESG issues, these statements should be aspirational and forward-looking, rather than particularized and retroactive. In the context of securities law claims, courts traditionally have found the former category of statements to be "inactionable puffery" on which investors are unlikely to rely. *City of* that general statements about reputation, integrity, and compliance with ethical norms are inactionable 'puffery.'"). For example, federal courts have held that aspirational statements regarding a company's workplace misconduct policy are "far too general and aspirational to invite reasonable reliance." *Construction Laborers Pension Trust for So. Cal v. CBS Corp.*, No. 18-cv-7796 (VEC), 2020 WL 248729, at *8 (S.D.N.Y. Jan. 15, 2020) (holding that statements in company's workplace conduct policy regarding "zero tolerance policy for sexual harassment" were "mere puffery"); *see also In re Liberty Tax, Inc. Securities Litig.*, No. 17-cv-07327, at *5-6 (E.D.N.Y. Jan. 17, 2020) (holding that statements regarding company's workplace conduct policy "were the kind of general positive comments that a reasonable investor would disregard and thus puffery.").

Outside of the context of sexual misconduct, courts have found generic, aspirational disclosures regarding food safety to be inactionable puffery. For example, in *Ong v. Chipotle Mexican Grill Inc.*, the court dismissed shareholder claims after concluding that the company's statements regarding food safety and quality assurance were "either not demonstrably false or inactionable puffery." 294 F. Supp. 3d 199, 232 (S.D.N.Y. 2018). In *Bondali v. Yum! Brands, Inc.*, the Sixth Circuit employed similar reasoning in affirming the dismissal of Section 10(b) claims challenging statements regarding the company's commitment to responsibly sourcing food in light of new food safety problems in company's supply chain. 620 F. App'x 483, (6th Cir. 2015).

Whether in the context of safety, workplace conduct, or the environment, a company should avoid making any ESG disclosures which, effectively, make promises that the company may not be able to keep. In contrast, aspirational, forward-looking statements regarding a company's principles and goals carry much less risk of future liability under the securities laws.

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