KEY POINTS

- The wave of ESG-related claims in the context of financial services began in 2017 and the number of cases has steadily increased during that time. Cases are almost always brought for strategic reasons, to force a wider change in corporate policy or regulation.
- Cases tend to focus on the disclosure of climate risks, allegations of greenwashing, investment decisions, and the types of clients being financed (and their links to climate change or biodiversity impacts).
- During 2023 there has been a high number of court dismissals, particularly in the UK, and taken together, they suggest that courts will continue to evaluate cases carefully on their legal merits (not policy aims).

Feature

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ESG litigation in the context of financial services: a global gear change?

This article examines the way that ESG-related cases in the context of financial services have evolved over the past few years, and the themes emerging from the high number of court dismissals during 2023, which indicates that legal merits continue to be the prevalent factor.

INTRODUCTION

The recent wave of ESG-related claims in the context of financial services began in 2017, and the number of those claims has increased steadily since that time. This has coincided with a period of intense investor and regulator scrutiny of ESG-related matters, together with the introduction of a significant amount of ESG-related financial regulation, which has all served to increase attention on ESG-related claims.

Most ESG-related claims in the context of financial services focus on climate risk, and tend to concern whether those risks have been disclosed adequately, allegations of greenwashing or how those risks have been taken into account in investment decisions (although there is of course overlap between categories). There are also cases beginning to be brought concerning the types of projects and clients being financed in both a climate and a biodiversity context. This article examines the way that ESG-related cases in the context of financial services have evolved over the past few years, and the themes emerging from the high number of court dismissals during 2023, which indicates that legal merits continue to be the prevalent factor.

GENERAL DYNAMICS OF CLAIMS

To date, almost all of the cases in this area have been brought for strategic reasons, rather than to obtain compensation for loss – claimants appreciate the influence that financial institutions and regulators have over companies in the real economy and bring claims against them with the purpose of forcing a wider change in policy or regulation. This means that many cases are discontinued or settled when those policy ambitions are perceived to be achieved.

For example, in April 2021 the NGO ClientEarth initiated proceedings against Belgium's central bank, alleging that it had breached environmental and human rights laws when implementing the European Central Bank's (ECB's) corporate sector purchase programme by disproportionately investing in greenhouse gas-intensive sectors. Alongside the claim, ClientEarth made representations to the ECB about the way in which it should incorporate climate change into its monetary policy. The claim was dismissed, and while ClientEarth did appeal, the appeal was withdrawn in November 2022, with ClientEarth pointing to the ECB's recent changes to its monetary policy.

Claimants in this area are creative in the various ways that claims are brought, and the specific mechanisms used range from statutory claims concerning shareholder or beneficiary rights and misrepresentation under securities legislation to derivative claims and judicial reviews of financial regulators and government export agencies. Two recent claims which are particularly interesting for financial institutions are based on the French law of vigilance, which requires large companies in France to identify and prevent environmental and human rights risks.

Increasingly, strategic claimants are also naming senior representatives of the relevant institution in the claim as a way of highlighting their personal accountability (even if the claims against those senior representatives are not viable).

DISCLOSURE OF CLIMATE-RELATED RISKS

Early cases focused on whether disclosures made

When they were first brought, cases in this category tended to focus on whether institutions had made disclosures of climate-related risks, with the intention of establishing that climate-related risks were significant financial risks and that they needed to be considered and disclosed in the same way as other financial risks.

For example, in 2018 a member of a superannuation fund, Mr McVeigh, brought a claim in Australia against the REST fund's trustees, alleging, among other things, that they had breached their information duties to him by failing to provide him with information about the fund's exposure to climate change.

Similarly, in 2020, a bondholder, Ms O'Donnell, brought a claim against the Australian government and two of its senior representatives for non-disclosure of various climate-related financial risks in the published documents about its exchange-traded bonds, which Ms O'Donnell said meant that the bonds were a riskier investment than advertised. Ms O'Donnell defended a strike out application in 2021

([2021] FCA 1223), and the case proceeded on the question of whether the government's failure to disclose the risks of climate change constituted misleading and deceptive conduct under the Australian Securities and Investments Commission Act 2001 (although the Federal Court of Australia did not allow claims against the individual government representatives to proceed).

Both cases have now settled. *McVeigh v REST* settled in 2020, with REST publishing a statement acknowledging that climate change posed a direct, material and current risk to the fund. In that statement, it also indicated that it would take steps to consider and disclose those climate change risks in the future.

O'Donnell v Commonwealth of Australia settled this year. Given that the claim was brought as a representative action, the settlement required court approval. Interestingly, in giving that approval (and considering whether the settlement was appropriate for the benefit of other absent group members), the court concluded that Ms O'Donnell faced a real risk that the claim would not succeed on liability. Justice Murphy indicated that in his view it would be unlikely to be as difficult as the Commonwealth thought for Ms O'Donnell to establish that climate change would give rise to real systemic risks for the Commonwealth. However, he considered that it would be likely to be complex and difficult to establish that these impacts would go as far as causing a country like Australia to be unable to perform its obligations in relation to its government bonds ([2023] FCA 1227). In some ways his comments demonstrate how far the judicial recognition of climate change risks has come; he described climate change risks as "real, but until more recently, underacknowledged" and specifically referenced scientific evidence heard in other Australian cases concerning the risks of climate change. However, they also demonstrate the difficulties of charting the impacts of climate change precisely enough to form the basis of a successful claim.

The terms of the settlement itself required the Australian government to publish a statement acknowledging that climate change is a systemic risk to the Australian economy and that the economic and climatic changes will have fiscal impacts (although the statement noted that the precise impacts of these changes is uncertain). The statement also details how the Australian government is now responding to climate change, and concludes with the undertaking that:

> "The Commonwealth will continue to engage with asset owners and relevant stakeholders to ensure that investors are informed as to the Commonwealth's policy settings and actions in relation to the risks and opportunities posed by climate change."

In the meantime, requirements to disclose climate-related financial risks have been introduced in many jurisdictions – including in Australia, which may have contributed to the claimants' willingness to settle, if they considered that the purpose of the litigation had effectively been achieved.

Shift to quality of disclosures

Cases brought more recently have turned to the quality of the disclosures made. For example, in February this year, ClientEarth applied for permission to bring an application for judicial review against the Financial Conduct Authority (FCA) in the UK, alleging that the FCA had approved an energy company's prospectus unlawfully as the prospectus did not adequately disclose the climate-related risks it faced. Although the prospectus acknowledged that climate change may have a material adverse effect on the hydrocarbon industry, ClientEarth's case was that the company's description of climate-related risks was too general and failed to explain the potential impact of the company aligning with important sustainability objectives, which it said was a breach of the Prospectus Regulation and prevented investors from making an informed assessment of the company's financial position. ClientEarth's claim was brought in the context of the amendments it had suggested to the UK's Listing Rules.

The English High Court refused ClientEarth permission (High Court, CO/504/2023, unreported). In his written reasons, given in April this year, Sir Ross Cranston held that it was not arguable that the FCA had misdirected itself in law as to whether the requirements on risk factors in the Prospectus Regulation had been met, and that the decision was not irrational either. He noted that the FCA has a considerable margin of discretion in this area, and that coupled with its expertise, the irrationality standard was particularly difficult to surmount.

Most recently, in July this year, a case was filed against Export Finance Australia (EFA) and Northern Australia Infrastructure Facility (NAIF) seeking to compel them to disclose the full environmental impact of the fossil fuel projects they subsidise. The claim alleges breaches of certain disclosure requirements in the Australian Environment Protection and Biodiversity Conservation Act 1999 (and it specifically names the Chairs of EFA and NAIF as representatives for their respective boards).

While earlier cases concerning the fact of disclosure could be largely considered to be successful given the outcome of the settlements, it seems likely that cases concerning the extent and quality of disclosures will be much more difficult to prosecute.

GREENWASHING

Allegations of greenwashing, or that a firm has misled customers, investors or the general public about its climate credentials, business strategy or aspects of a product or service are a key focus for claimants in this area. In some cases, the alleged greenwashing arises because of ambiguity in the way that an ordinary customer or investor would interpret a particular statement. Most cases to date concern the way that ESG funds are marketed. For example, in Germany, the consumer organisation Verbraucherzentrale Baden-Württemberg (VBW) brought a case against DWS alleging that it had misrepresented the way that an exclusion in its Climate Tech Fund operated (which settled immediately before trial in March

2023), and another against Commerz Real in relation to the claim that its impact fund achieves "measurable ecological impact". VBW's case against DWS followed the well-publicised regulatory investigation, and there have also been a number of regulatory enforcement cases on this topic in the US and Australia.

Other allegations of greenwashing arise because claimants have identified what they believe is an inconsistency between the public strategy or statements made by a firm and what it is doing in practice. For example, in *Abraham v Commonwealth Bank of Australia*, a shareholder applied for disclosure of documents (including documents and correspondence created at board level) demonstrating how the bank had made its decision to enter certain oil, gas and coal projects. The implication was that the bank's financing of these projects was not consistent with its environmental and social policy, which only allowed it to provide banking and financing activity "to new oil, gas or metallurgical coal projects if supported by an assessment of the environmental, social and economic impacts […], and if in line with the goals of the Paris Agreement". The application for disclosure was ultimately agreed by consent, and it remains to be seen whether a substantive claim will be brought.

Overall, it seems that claims in this category will continue to be brought, given the particular focus from action groups and investors, and the increasing level of detail required from firms in their climate disclosures (which can be used as the basis for a claim).

DISCRETION AVAILABLE IN INVESTMENT DECISIONS

Cases in this context originally concerned whether trustees of pension funds, for example, should take account of climate-related financial risks to comply with their fiduciary duties (for example, the *McVeigh v REST* case mentioned above), and that has now shifted so that cases are considering how much discretion trustees have in their approach to navigating around climate-related risks and in pursuing sustainability-related objectives.

In *Butler-Sloss v Charity Commission* ([2022] EWHC 974 (Ch)), the trustees of two environmental charities sought declarations from the English High Court that they were permitted to implement an investment policy that sought to align with the Paris Agreement and prohibited investments in certain sectors. The court ruled in their favour, holding that on the facts of this case the trustees were required to conduct a balancing act between maximising financial returns and pursuing other objectives and that the trustees had properly conducted this exercise.

In *McGaughey v Universities Superannuation Scheme Limited*, two members of a UK pension scheme sought to bring "multiple derivative" claims against the scheme's corporate trustee, alleging that it had breached its directors' duties to promote the success of the company by (among other matters) allowing the scheme to invest in fossil fuels. The trustee argued that it had in fact considered the sustainability of its investments and that it did not consider divestment to be an appropriate way to achieve net zero. The English High Court held that the claimants had failed to prove standing or loss but even if they had done, the trustee had not committed a deliberate or dishonest breach of duty ([2022] EWHC 1233 (Ch)). In July this year, the Court of Appeal upheld that decision ([2023] EWCA Civ 873).

In her judgment, Justice Asplin noted that there was no suggestion that the trustees of the scheme had acted in bad faith or done anything other than act in the best interests of the corporate trustee and the scheme, having taken proper advice. The corporate trustee was under a specific duty to exercise its investment powers in a manner calculated to ensure the security, quality, liquidity and profitability of the investments as a whole, and to ensure that the assets were properly diversified. The evidence was that the trustee had complied with those requirements. Justice Asplin went even further and described the claim as an "attempt to challenge the management and investment decisions of [the corporate trustee] without any ground upon which to do so" and concluded that there was nothing in the pleadings or the evidence which suggested that it had exercised its powers in an improper fashion.

Her comments suggest that the UK judiciary has little patience for claims which are directed at forcing policy change but which do not fulfil the legal requirements, and also demonstrate the English courts' general reluctance to interfere in properly made business decisions. They also echo Mr Justice Trower's comments recently (albeit outside a financial services context) in the much-publicised *ClientEarth v Shell* ([2023] EWHC 1897 (Ch)) that it is a well-established principle that directors (acting in good faith) can determine how to promote the success of a company for the benefit of its members, and that good faith, and not irrationality is the touchstone.

TYPES OF PROJECTS AND CLIENTS BEING FINANCED IN RELATION TO CLIMATE AND BIODIVERSITY

Claimants are also beginning to bring claims concerning the type of projects and clients an institution finances or supports in other ways (such as in a capital markets context, for example).

In *Friends of the Earth v UK Export Finance* (*UKEF*), Friends of the Earth applied to the English courts for judicial review of UKEF's decision to finance a natural gas project in Mozambique, for allegedly being incompatible with the Paris Agreement and for failing to quantify the Scope 3 emissions for the project. UKEF had made its investment decision on the basis that the project would help Mozambique transition away from more damaging fossil fuels. The Court of Appeal rejected Friends of the Earth's application, finding that UKEF was required only to hold a "tenable" view that the decision was compatible with the Paris Agreement (which it had) and that the non-quantification of Scope 3 emissions did not render the decision irrational.

Separately, in February 2023 a group of NGOs brought a case against BNPP in Paris in an effort to stop BNPP supporting new oil and gas projects by arguing that BNP Paribas has failed to comply with the French duty of vigilance law. The NGOs

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have detailed various alleged violations of the law of vigilance in their claim, including, in particular, a claim that the plan does not include the commitment to cease all financing and investments that support the expansion of fossil fuels, which they say is necessary to comply with the law on the duty of vigilance.

Claims have also started to focus on institutions' support of companies which are linked to biodiversity and human rights risks. This year, the NGOs *Comissão Pastoral da Terra and Notre Affaire à Tous* brought a separate claim against BNPP under the French duty of vigilance alleging that the bank's plan to identify and prevent human rights risks is inadequate as (among other reasons) it provides financial services without adequate due diligence into the corporations it supports. In this regard, the NGOs highlight BNPP's services to a meat-packing company, Marfrig. It is alleged that suppliers to Marfrig engaged in severe deforestation of the Amazon, seizing of indigenous lands and forced labour. The NGOs say that BNP Paribas should take steps to ensure that its clients' supply chains do not contribute to these harms, including by establishing a reporting and alert system for third parties who are or may be affected by negative impacts caused by BNPP's customers and activities.

The importance of biodiversity and nature risks is likely to continue to rise up the corporate agenda; this year the TaskForce on Nature-related Financial Disclosures released its inaugural disclosure recommendations, and further attention from investors, regulators and potential claimants will inevitably follow.

CONCLUSIONS

It seems that ESG litigation in the context of financial services is at a critical point. While claimants are continuing to bring strategic cases aimed at changing policy, often in creative ways, they still face difficult legal hurdles on crucial matters such as establishing legal standing, causation and loss, and the courts, particularly in the UK, have in their decisions this year, held a firm line. It could in fact be described as a gear change – a wave of litigation has been brought highlighting the importance of the financial sector's part to play in ensuring an orderly transition to net zero – it seems that the judiciary is maintaining a firm line on the legal merits of claims, irrespective of the policy objectives being advanced by claimants. Whether claimants will rise to the challenge and bring claims which are allowed to proceed beyond their early stages remains to be seen. ■

Further Reading:

- The fiduciary's divestment dilemma: ESG and the age of climate change (2023) 9 JIBFL 612.
- Seeing the world differently: litigaton arising from ESG-related disclosure (2022) 3 JIBFL 150.
- Lexis+® UK: Financial Services: Preparedness for climate/ESG-related enforcement and litigation in the financial sector.