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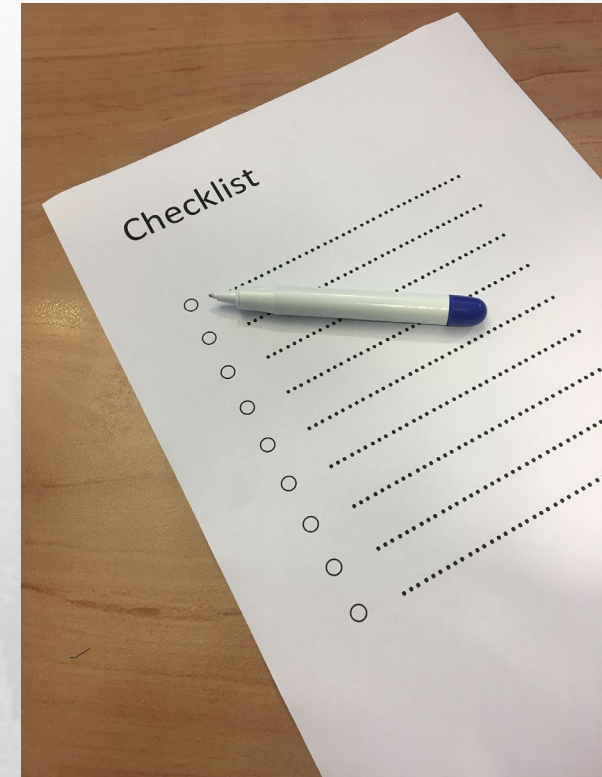
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The Case for and Against Shareholders Litigating ESG Issues



Today's Discussion

- ESG Investing v. ESG Shareholder Litigation
- Hot Topics in ESG Shareholder Litigation
- Successful/Unsuccessful Theories
- Hypotheticals and Discussion



ESG Investing

- Should my plan/fund consider ESG factors when making investment decisions v. strictly maximizing plan assets?
 - Do better ESG practices increase returns to investors?
 - This presentation does not advocate for or against ESG investing



What is ESG Shareholder Litigation?

- Cases brought by shareholders relating in some way to Environmental Social or Governance issues
- Whatever your views on ESG investing, trustees should be aware of ESG shareholder litigation options



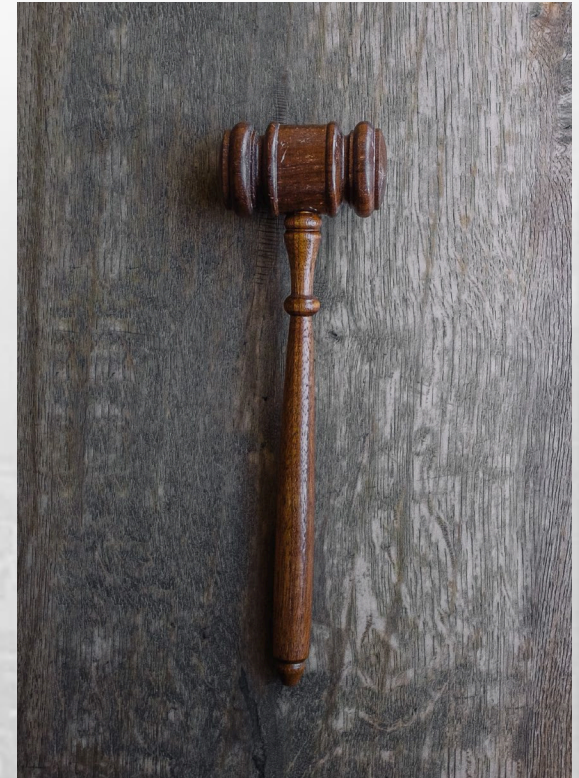
Federal Securities Cases

- Suit against corporation, directors, officers for damages to investors
- Requirements (among others):
 - Materially false or misleading statements and omissions
 - An intent to defraud or recklessness
 - Loss causation: stock price decline in reaction to disclosure of truth
 - Damages: stock, bond or other security



State Shareholder Cases

- Derivative action: Suit on behalf of company against wrongdoer
- Typical fact patterns:
 - Directors or officers engaged in self-dealing, committed fraud, or ignored red flags
 - Recover cost of government fine or civil settlement



Derivative Action

- Requires “demand futility”
 - Board is conflicted and will not impartially consider your demand to take action
- In most cases, a prior demand/action to inspect corporate books and records is recommended or even required



ESG Shareholder Litigation is Not a New Phenomenon

- Shareholder *governance* lawsuits alleging breaches of fiduciary duties have been common for years
- With increased focus on ESG investing decisions, ESG shareholder litigation has taken on a renewed significance



Environmental Shareholder Litigation

- Materially misleading statements or omissions concerning environmental compliance
 - Truth concerning misleading statement is revealed, and stock price declines significantly as a result
- Disclosure of environmental violations leads to fines and costs of cleanup



SEC Guidance

- **March 21, 2022:** SEC released a comprehensive draft climate disclosure rule
 - Companies making long-term climate commitments (primarily CO2 reduction targets) must detail their progress
- **March 29, 2022,** SEC elevated ESG investing to a “significant focus area.”
 - Specifically warned against “greenwashing”



Greenwashing

- Making public statements (ads, SEC filings) designed to:
 - Convey a false impression that a company is more environmentally responsible than it really is
 - in order to induce consumers to purchase products or investors to invest in the company
 - Coal, the “natural” energy source!



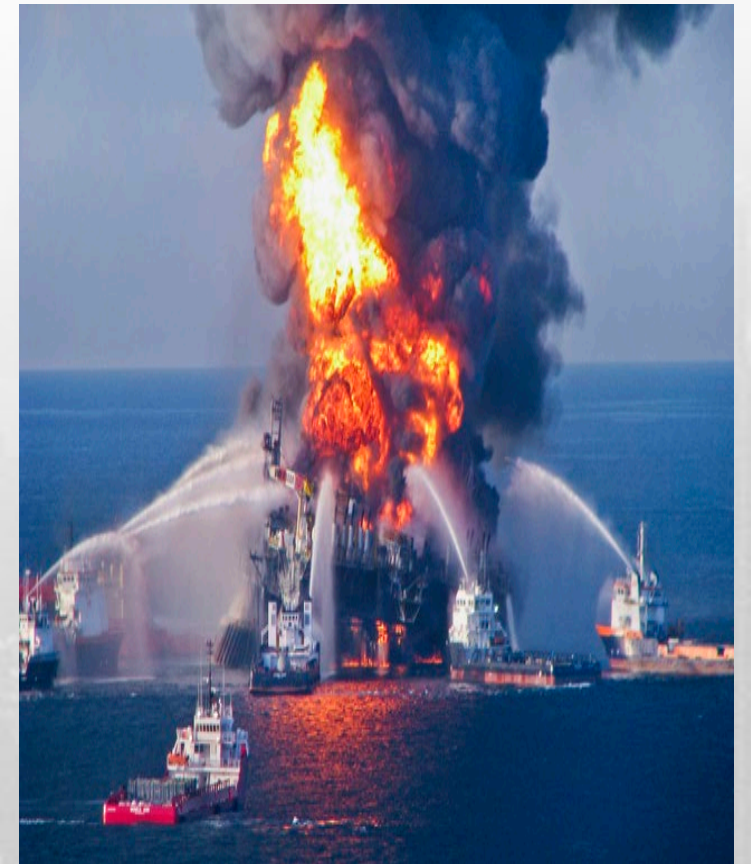
Environmental Litigation Hypothetical

- Company knowingly pollutes river, and when caught, government forces it to clean up the river at great cost



Deepwater Horizon Litigation

- Class and Derivative actions against Transocean (owner) and BP (operator) related to allegedly false statements concerning safety protocols
 - BP: **\$175 million** class settlement
- BP and Transocean were incorporated in foreign countries
 - Derivative cases dismissed because English (BP) and Swiss (Transocean) courts were better forums



Environmental Litigation Hypothetical

- Company states in its SEC filings that its goal is to become carbon neutral, but has taken few steps to do so



New York v. ExxonMobil

- Alleged that ExxonMobil deceived investors by portraying a rosy picture of how it would be able to manage future climate change risk and future regulation
- ExxonMobil allegedly used internal climate change cost projections that differed from publicly-disclosed projections

The ExxonMobil logo is displayed in red text. The word "Exxon" is in a bold, sans-serif font, and "Mobil" is in a similar font but with a distinctive slanted 'i'. The background of the slide features a faded, grayscale image of a city skyline with several skyscrapers.

New York v. ExxonMobil

- Case was dismissed
- New York AG failed to prove that the allegedly false statements were material
 - The court concluded that “no reasonable investor...would make investment decisions on speculative assumption of costs that may be incurred 20+ or 30+ years in the future with respect to unidentified future projects.”

The ExxonMobil logo is displayed in red, featuring the word "Exxon" in a stylized font with a red 'X' and "Mobil" in a bold, sans-serif font.

Massachusetts v. ExxonMobil

- Alleged ExxonMobil “systematically and intentionally ... misled Massachusetts investors and consumers about climate change”
- ExxonMobil was “dishonest with investors about the material climate change-driven risks to its business and with consumers about how its fossil fuel products cause climate change...”

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Massachusetts v. ExxonMobil

- Court found that Mass. AG had adequately alleged ExxonMobil violated Chapter 93A of Mass. General Law by misrepresenting and failing to disclose risks posed by climate change to ExxonMobil's business in its marketing of its securities to Mass. investors and by "greenwashing"
- Unlike NY law, Mass law did not require a showing that investors were deceived or that defendant intended to deceive

The ExxonMobil logo is displayed in red text. The word "Exxon" is in a bold, sans-serif font with a red 'X' that has a white diagonal line through it. The word "Mobil" is in a similar bold, sans-serif font. The background of the slide features a faint, grayscale image of a city skyline with a prominent skyscraper.

Environmental Litigation Hypothetical

- Company conveys false impression that all of its products are produced from 100% recycled material



Social Shareholder Litigation

- Seeks to recover damages for shareholders related to:
 - Sexual misconduct of top executives
 - Failure to meet diversity requirements
 - Company's use of slave labor in its supply chain or otherwise compromising worker safety



Social Litigation Hypothetical

- Company publishes a strict policy for dealing with allegations of sexual misconduct, and publicly states that it complies with the policy in all circumstances
- Company ignores published policy for high earning and valuable employees



21st Century Fox Derivative Case

- FoxNews allegedly turned a blind eye to sexual harassment by Roger Ailes and Bill O'Reilly
- FoxNews paid over **\$30 million** in settlements to accusers, and gave Ailes and O'Reilly huge contract renewals with knowledge of their misconduct



21st Century Fox Derivative Case

- When the truth was revealed, gave Ailes and O'Reilly huge severance packages after firing them
- Fox employees also brought actions alleging racial discrimination
- Derivative litigation recovered **\$90 million** from the Ailes Estate plus governance and compliance enhancements for NewsCorp



CBS Sexual Misconduct Litigation

- CEO Les Moonves stated he had not previously known about sexual misconduct allegations at CBS
 - Allegedly, at the time said, he was actively trying to conceal his own past misconduct
 - When the truth about his actions was revealed, CBS's stock price declined
 - Settlement of class action was recently reached for **\$14.7 million**



Social Litigation Hypothetical

- Company states in its SEC filings that its goal is to achieve management and board diversity, yet lacks diversity of both



Cisco Diversity Litigation

- Derivative action alleging that Cisco had publicly represented itself as a leader in achieving diversity, when it had few African Americans in leadership positions
- Dismissed for technical procedural reasons, not on the merits
- Court did state that “**aspirational assertions**” in company proxy statements are non-actionable because they were neither misleading nor material to investors



Facebook Diversity Litigation

- Derivative action alleging FB's public commitment to diversity was untrue
- Court dismissed litigation
 - “Aspirational assertions” in proxy statements were mere “puffery,” not material, and not actionable
 - FB's statements were not false: 2 of its 9 directors were African American and 4 of the 9 were women
 - Majority of the board was independent



Social Litigation Hypothetical

- Company states it is committed to protecting worker rights and safe workplaces. Company is hiding unsafe working conditions and hiring illegal workers that it pays below minimum wage or uses slave labor in its supply chain



Governance Shareholder Litigation

- Cases alleging breaches of fiduciary duties are most common
- Directors and/or officers put their own interests ahead of the shareholders
 - Conflicted transactions
 - Recover insider trading profits
- Many **Governance** issues will also involve **Environmental** or **Social** issues



Governance Litigation Hypothetical

- Company publicly claims its cybersecurity is “top-notch.” Thereafter, Company is hacked and tens of thousands of its customers have their personal identifying information exposed
 - Data Privacy: In re: First American Financial Corp. Sec. Litigation (MTD Granted)



Governance Litigation Hypothetical

- Company in India with securities publicly traded in the U.S. is found to have violated the FCPA and pays **\$50 million** fine causing stock price to go down significantly
 - Anti-corruption: Petrobras (**\$3 billion** settlement); Odebrecht (MTD denied in substantial part)



Takeaways

- Whatever your opinion on ESG investing, a company's lies or malfeasance may cause your fund to lose money
 - Shareholder class action or derivative litigation may provide the fund and its fiduciaries a way to recover some of their losses



Takeaways

- ESG issues have and will give rise to investor litigation
- Cases have had mixed results
- Before litigating, important to ask questions, such as:
 - What is the strength of the case (*e.g.*, aspirational vs. concrete statements)?
 - Precedent: How does this case compare to other cases that have been brought?
 - Goals of the litigation





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