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# The greenwashing wave hits securities litigation

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Securities litigation comes in all shapes and sizes. And it comes in a new color now as well.

The phenomenon of "greenwashing" is when an entity (such as a company, a product, a process, or an investment fund) is presented as more environmentally friendly, socially impactful, or sustainable than it truly is. Greenwashing can also occur when a company or figure touts the ESG (Environmental, Social, & Governance) benefits of something but fails to also disclose the negative ESG-related consequences of that same thing.

When these types of misleading statements and omissions are made by securities issuers, investor protection can be compromised. While the concept of greenwashing certainly isn't new, we are now starting to see the backlash towards it manifest in securities lawsuits and enforcement actions.

As environmentalism and climate change have become ongoing concerns and the subjects of new laws and regulations, the SEC has anticipated the need for oversight in this area. In March 2021, the SEC announced the creation of its new Climate and ESG Enforcement Task Force.

The task force is responsible for overseeing ESG-related disclosures, investments, and compliance efforts by securities issuers and advisers. (*See* "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues" (SEC.gov)). This year has subsequently seen a flurry of rulemaking and enforcement activity from the SEC pertaining to ESG issues.

In the March release of its 2022 Examination Priorities, for example, the SEC Division of Examinations announced that it would be specifically focusing on "ESG-related advisory services and investment products (e.g., mutual funds, exchange-traded funds (ETFs), and private fund offerings)." This additional layer of scrutiny is designed to ensure that those who manage investment portfolios are making accurate representations regarding the strategies and criteria behind ESG-labelled investments.

Additionally, in March the SEC proposed an extensive new rule that would require registered companies to include detailed climate-related disclosures in their registration statements and periodic reports. (*See* "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (SEC.gov)). Disclosed information would include the company's volume of greenhouse gas emissions; progress updates on any publicly set climate goals; climate-related risks or events that could affect the company's operations (e.g., severe weather or natural disasters); and risk management policies vis-à-vis these risks.

Only a few months later, the SEC released two more rule proposals aimed at combatting greenwashing in ESG investment practices. One rule proposed a set of standard disclosures that must be made by funds and advisers who purport to take ESG factors into consideration when investing. (*See* "Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices" (SEC.gov)).

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The other rule proposed that funds with ESG terminology in their names — words like green, sustainable, ethical, socially responsible, etc. — must "invest at least 80% of their assets in accordance with the investment focus that the fund's name suggests." (*See* "Investment Company Names" (SEC.gov)). Both of these rule proposals are meant to curb the gratuitous use of ESG language when there is insufficient strategy to back up the representations being made.

So what does your average greenwashing suit look like?

That's tough to say. Greenwashing allegations can vary widely, and these types of suits are still in their relative infancy. By way of example, let's look at four greenwashing cases involving different kinds of misrepresentations.

## ESG-focused investment funds

In May 2022, the SEC charged investment firm BNY Mellon with making ESG-related material misstatements and omissions. The SEC order stated that the investments of certain mutual funds that BNY Mellon managed were represented as having undergone an "ESG quality review." However, the order claimed that not all of these investments had actually undergone the review and were therefore being misrepresented to investors in the funds.

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While BNY Mellon neither admitted to nor denied the allegations, the company agreed to pay a $1.5 million penalty and took remedial measures after the fact.

*See In the Matter of BNY Mellon Investment Adviser, Inc.*, SEC Administrative Proceeding File No. 3-20867 (May 23, 2022).

## Environmental hazards and safety

In April 2022, the SEC charged Vale S.A., a publicly traded mining company based in Brazil, with securities fraud. In January 2019, a dam operated by Vale (the Brumadinho dam in Brazil) collapsed and killed 270 people, while also releasing almost 12 million cubic tons of toxic mining waste that polluted the local water supply. The result of this catastrophe was a $4 billion loss in market capitalization for Vale.

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The SEC claimed that Vale knew about the risks pertaining to the compromised integrity of the dam, but knowingly manipulated data and concealed information from dam safety auditors. The SEC charged Vale with making false and misleading statements to its investors concerning the dam's safety and stability.

In a letter to the judge, counsel for Vale has indicated the company's intent to file a motion to dismiss on the grounds that the dam's collapse was not reasonably foreseeable. The company plans to argue that contrary to the SEC's claims, it made all of the necessary disclosures to the proper external parties and that the alleged misstatements and omissions were not material to investors.

*See SEC v. Vale S.A.*, 1:22-cv-02405 (E.D.N.Y. Apr. 28, 2022).

## Sustainability and environmental benefits of a product

Investors filed a class action suit against Danimer Scientific, Inc., a bioplastics company that went public via a business combination with a special purpose acquisition company (SPAC) in 2020. Danimer's primary proprietary product was a plastic substitute called Nodax that the company alleged was 100% biodegradable.

However, an article published in The Wall Street Journal and subsequent reports cast doubt on the accuracy of Danimer's claims about its product. These sources alleged that Danimer's product's ability to completely biodegrade in oceans and landfills had been greatly exaggerated, which in turn caused Danimer's stock price to drop.

Investors accused Danimer of greenwashing by making materially false and misleading statements regarding the environmentally friendly attributes and sustainability of its product.

In a motion to dismiss filed in May of this year, Danimer retorted that its claims of biodegradability applied specifically to its Nodax material and not to any *end products* made with Nodax, such as plastic straws, bottles, or utensils. The company argued that "plaintiffs have alleged nothing that contradicts the certifications and scientific research supporting Danimer's claims."

*See In re Danimer Scientific, Inc. Securities Litigation*, 1:21-cv-02708 (E.D.N.Y. May 14, 2021).

## Business risks of climate change

Another greenwashing suit in the process of being litigated involves a securities fraud class action suit against Exxon Mobil Corp. In an amended complaint filed in Texas in July 2017, shareholders alleged that Exxon made materially false and misleading statements by overstating the value and amount of its proved oil and gas reserves (i.e., petroleum that is "technologically and commercially feasible to recover").

The company later announced that 20% of its proved hydrocarbon reserves would potentially need to be written down. Exxon had also released a public report stating that it used a valuation system that "explicitly accounted for the prospect of policies regulating greenhouse gas emissions" by incorporating a proxy cost of carbon.

However, the suit claims that documents revealed that Exxon's internal accounting numbers differed from what was presented publicly. The suit argued that the omission of this information served to artificially inflate Exxon's stock prices.

*See Ramirez v. Exxon Mobil Corporation et al*, 3:16-cv-03111 (N.D. Tex. Nov 7, 2016).

Exxon filed an original motion to dismiss in 2017 and then two subsequent reconsiderations of its motion to dismiss, the most recent of which cited Exxon's 2019 victory in a similar climate-related securities suit brought by the New York Attorney General. In *People of the State of New York v. Exxon Mobil Corp.*, Docket No. 452044/2018 (N.Y. Sup Ct. Oct 24, 2018), the court determined that the New York Attorney General failed to prove that Exxon's climate disclosures were either misleading or material to investors. Exxon made the argument that the claims in the Texas case mirrored those of the New York case and should therefore be dismissed. However, on March 31 of this year, Exxon's motion for reconsideration was denied.

## Conclusion

As companies are continually pushed to factor ESG considerations into their business operations and investment strategies (whether by law, public pressure, or both), it is likely that the occurrence of greenwashing suits will continue to rise. It remains to be seen what the degree of tolerance from the SEC, shareholders, and the courts will be when companies' claims of "going green" turn out to be only surface-deep.

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