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ESG’s Unintended Consequence – Lawsuits

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The Environmental, Social and Governance (“ESG”) movement has existed for over 10 years, but has taken on exponentially greater importance in the corporate, investment and insurance worlds in the last two to three years. With the Biden-Harris administration taking power in 2021, the environment is at the forefront of United States policy as never before, with focuses on climate, environmental justice, and natural disasters. Investors assessing companies’ environmental footprints, offsets, and green practices have a myriad of ways of factoring and scoring companies for their environmental impact with a lens towards determining risk. What we have also seen, however, with the rising importance of ESG in the investment world is ESG’s unintended consequence – lawsuits. This article examines some of the ways that ESG initiatives have come under fire, and ways that ESG may unintentionally create more risk for portfolio companies in the future.

ESG’s Unintended Consequence To Date

There are two primary ways that companies touting ESG initiatives have seen their efforts become the subject of lawsuits in recent years. First, environmentally conscious consumers are watching statements made by companies more than ever before for statements that may not be accurate, and are using the legal system to hold companies accountable. The lawsuit involving Coca-Cola’s “100% recyclable” plastic bottle, which was filed earlier in 2021, is perhaps the most prolific example of this. In the lawsuit, a group of consumers sued Coca-Cola to challenge the “100% recyclable” claim, alleging that the plastic caps and labels on the bottles are, in fact, not recyclable. Plus, the lawsuit alleges, since it is well-recognized that only a certain percentage of the plastic types utilized in the bottles are actually recycled by recycling centers in the United States, 100% of the bottles are in fact not recycled. This lawsuit, coupled with another lawsuit filed against Coca Cola for its “World Without Waste” marketing slogan (which is alleged to be false and misleading), are arguably the most prolific examples of lawsuits that in essence accuse corporations of “greenwashing” that take direct aim at companies and their use of “marketing spin” to project to the public an image of “green” or environmentally conscious corporations.

The impact to Coca-Cola from the above-mentioned lawsuits has, to date, been a modest hit to the company’s stock prices, which over the course of time has rebounded. However, there are examples of environmentally friendly statements made by corporations that turned out to have more a direct and significant impact on investments. Danimer Scientific, Inc. is a corporation that makes polymers, resins, and plastic alternatives that are used in a number of plastic products. Danimer included

biodegradability statements in its marketing and to the SEC (in its SEC Form S-1 registration statement). One Danimer product in particular, Nodax, was touted as being 100% biodegradable within 12-18 weeks after being discarded. Shortly after the statements were made, however, the Wall Street Journal published an article in which various experts cast doubt on the biodegradability statements, stating that a host of factors could contribute to Danimer's Nodax product taking much longer to degrade. Within twenty-four hours, Danimer's stock price fell by 13 percent. Follow-up articles similarly case doubts on Danimer's claims, which resulted in further losses to the company's share prices. Shortly after the losses, a shareholder of Danimer filed a derivative suit against the company's executives and board members, alleging that overstated sustainability claims led to millions of dollars in market capitalization losses.

In the Danimer example, the company's ESG-related statements led to both market capitalization impacts and legal consequences that will have further financial impacts on the company.

ESG's Unintended Consequence – What Does The Future Hold?

Expect that the next two years will see an increasing number of lawsuits brought by both shareholders/investors and consumers. The lawsuits will focus on allegations of greenwashing and will allege things such as misrepresentation, false and misleading advertising or statements, unfair and deceptive trade practices, and securities fraud. While publicly traded companies will be at the center of these lawsuits, privately held companies would be wise not to ignore the examples set in the "first wave" of ESG related lawsuits and learn from the mistakes of other companies.

Privately held companies should also consider the theory of environmental unintended consequences as a whole – i.e., the impact that adapting business practices to become more "green" may actually be setting the company up for future environmental liability issues. As more and more companies look to tout themselves as "green" by investing in solar power, electric vehicle corporate vehicles, and the like, are these companies considering issues that are five, ten, or even twenty years down the road for them that could have major financial consequences from their current actions? For example, solar panels. While touted as saving the planet from carbon emissions, where are the companies disposing of solar panels that age out of their useful life? Even if the panels go to recycling facilities, are those facilities properly disposing of hazardous waste? Are the company or the recycling company taking into consideration that chemicals contained in the solar panels that are today not regulated as hazardous may someday be designated as hazardous and open them up to enormous environmental pollution liabilities for remediation requirements?

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