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ESG Disclosures and Litigation: A Pennsylvania Case Example

This article highlights potential litigation risks associated with ESG-related statements, a Pennsylvania litigation case example, and ways to mitigate ESG litigation risk.

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Investors and consumers are demanding corporations provide environmental, social and governance (ESG) information. With the increased information sharing potentially comes increased litigation exposure. This article highlights potential litigation risks associated with ESG-related statements, a Pennsylvania litigation case example, and ways to mitigate ESG litigation risk.

Potential Causes of Action

Litigation concerning ESG statements arise primarily under consumer protection and anti-fraud statutes. The SEC has emphasized its plans for rulemaking and its focus on ESG-related disclosures, particularly with respect to climate risk. Federal and state governments have filed climate change nuisance lawsuits seeking to hold corporations liable for alleged false or misleading statements regarding the impact of the corporation's business operations on climate change. Securities fraud litigation under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 provide instructive examples of how ESG-related disclosures may be subject to close scrutiny after an adverse event impacts stock prices.

Elements of a Securities Fraud Claim

It is a violation of the Exchange Act and accompanying rules to "make any untrue statement of material fact or to omit to state a material fact … in connection with the purchase or sale of any security." See 17 C.F.R. Section 240.10b-5 (Rule 10-b5). To establish a securities fraud claim under Rule 10b-5, the plaintiff must show "a material misrepresentation (or omission); scienter, i.e., a wrongful state of mind; a connection with the purchase or sale of a security; reliance [on the material misrepresentation]; economic loss; and … a causal connection between the material misrepresentation and the loss." See *In re Aetna Securities Litigation*, 617 F.3d 272, 277 (3d Cir. 2010). Although all elements must be satisfied, motions to dismiss most often focus on the first and second elements because there is a "heightened pleading standard" for those elements. The complaint must specify each misleading statement, the reasons why the statement is misleading, and facts in support. See *Williams v. Globus Medical*, 869 F.3d 235, 240 (3d Cir. 2017). Additionally, for each act or omission, the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." A safe harbor provision, however, under the Private Securities Litigation Reform Act (PSLRA) renders "inactionable" certain "forward-looking statements." Forward-looking statements must be accompanied by "meaningful cautionary language."

As a result of the heightened pleading standard (under Federal Rule of Civil Procedure 9(b) and the PSLRA), defendants frequently move to dismiss at least some of the allegations, resulting in a detailed review of each allegation. This close review of allegations highlight practical considerations for companies providing ESG-related information.

Case Example

This year, the U.S. District Court for the Eastern District of Pennsylvania reviewed securities fraud allegations relating to environmental health and safety disclosures. See *Allegheny County Employee Retirement System v. Energy Transfer*, No. 20-cv-200, (E.D. Pa. April 6, 2021). In *Allegheny County*, shareholders alleged false and misleading statements about environmental compliance and safety related to the construction of three natural gas pipelines in Pennsylvania. The shareholders contended the value of stock dropped when the truth about operations was slowly revealed to investors through corrective disclosures.

The court reviewed almost sixty allegedly actionable misstatements to determine which statements survived the motion to dismiss. We will review two examples in which defendants purportedly made statements to investors regarding the company's commitment to safety and environmental regulatory compliance.

Example No. 1: "It is out priority to maintain and operate our assets to the highest safety standards, not just because it makes good business sense, but because it is the right thing to do."

Here, the court found the subject of safety was material because defendants affirmatively touted their commitment to and prioritization of safety in investor phone calls and press releases. The statement survived dismissal because it was material and plaintiffs plausibly alleged the "stated prioritization was false based on the flouting of regulations and consequent environmental disasters." Other federal courts, including the Eastern District of New York, have similarly held that while some statements in isolation may be mere "puffery," when the statements are repeated in a way to provide assurance to the public about a company's operations, the statements may be considered material to investors.

This finding emphasizes that if a company makes repeated statements on a certain subject like environmental compliance, sustainability, or safety, a court may find the topic is material, at least to survive a motion to dismiss. That means, it is crucial for the company representative responsible for making

statements to the public about environmental compliance and safety to be aware of the company's compliance history to ensure the data backs up the claim.

Example No. 2: The company's construction and engineering groups remain "very focused on safely and responsibly bringing projects into service."

In comparison, the court dismissed this statement, finding it was too vague to be possibly measured by a reasonable investor, and therefore, immaterial as a matter of law. One could argue the two statements are not all that different, yet the court drew a distinction on materiality. Similarly, other statements in the complaint that were accompanied by meaningful cautionary language were also dismissed. (Even if a statement is material, the other elements must be satisfied, including scienter. Here, the court made separate findings about allegations of scienter for the individual defendants and the corporate defendant).

Risk Mitigation Strategies

Companies seeking to provide ESG-related information should consider providing aspirational statements, identifying the company's goals, while avoiding statements that can be proven false. Forward-looking ESG statements should be accompanied by appropriate cautionary language, "identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." As the court noted in *Allegheny County*, vague or boilerplate disclaimers may not suffice as cautionary language—"the language 'must be substantive and tailored to the specific future projections, estimates or opinions … ."

Internal coordination is key to navigating ESG disclosures because even statements in corporate social responsibility reports or press releases have been called into question. (And, the SEC's recent sample letter to companies regarding climate change disclosures suggests companies may be asked to explain differences between more expansive climate-related information provided in corporate social responsibility reports and more limited information provided in SEC filings). All statements or disclosures should be fact-checked, including information provided in corporate social responsibility reports, to ensure there is data to support any statements that are capable of being proven false. Although ESG has taken different forms over the years, the topic is here to stay and internal coordination and auditing will assist companies in mitigating associated litigation risk.

About the Author:

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