LITIGATION MINUTE: THE "E": ENVIRONMENTAL REGULATION AND ETHOS

ESG IN LITIGATION SERIES: PART ONE OF EIGHT

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WHAT YOU NEED TO KNOW IN A MINUTE OR LESS

Class-action plaintiffs' lawyers increasingly are using changing environmental regulations, new reporting requirements, and companies' voluntary disclosures as the alleged basis for a legal duty when filing wide-ranging putative class actions. These trends are part of the evolving landscape of ESG class actions that have come into sharp focus with a rapidly expanding investment ethos that evaluates investment opportunities through the lens of criteria that are not necessarily quantifiable.

Environmental factors, the "E" in ESG, are typically concerned with calculating the direct and, in some cases, indirect impact of a company on the natural environment, which may include the company's efforts to conserve or improve the natural environment.

Here are two emerging trends in environmental ESG class actions being filed:

Piggybacking on Changing Administrative Estimates

The U.S. Environmental Protection Agency (EPA) undertook the 2014 National Air Toxics Assessment (NATA) as a screening tool to help state, local, and tribal air agencies identify which emission sources they may wish to study further.[1] Despite the EPA's disclaimer that NATA does not estimate any person's individual risk and that NATA should not be used as a definitive means to pinpoint specific risk values or compare risks at local levels or between states,[2] a plethora of putative class-action complaints do just that. Since the EPA released the 2014 NATA results on 22 August 2018, plaintiffs have filed hundreds of lawsuits nationwide (including multiple putative class actions) against defendants in multiple industries.

As the EPA explained, NATA is a screening assessment with uncertainties that vary by location, emission type, and emission source that uses rapidly changing inputs for modeling and perceived health risks. This was quickly borne out in the EPA's 2017 Air Toxics Screening Assessment (AirToxScreen),[3] released 2 March 2022, which estimated risk levels in some locations orders of magnitude lower than NATA only a few years earlier.

Since NATA and AirToxScreen use the EPA's National Emission Inventory (NEI) as a starting point, companies with facilities that have emissions tied into NEI should consider measures to ensure their emissions are as low as reasonably practical and reporting is accurate. For example, increased leak detection and repair (LDAR) testing may reveal that fugitive emissions are lower than estimated and thereby reduce fugitive emissions reporting.

Additional Reporting Requirements on the Horizon

The Securities and Exchange Commission (SEC) created the Climate and ESG Task Force in its Division of Enforcement in March 2021,[4] and the SEC's then-acting chair instructed its Division of Corporate Finance to "enhance its focus on climate-related disclosure in public company filings."[5]

Since then, the SEC has issued a proposed rule on "The Enhancement and Standardization of Climate-Related Disclosures for Investors"[6] "intended to enhance and standardize climate-related disclosures to address these investor needs," in part because "many issuers currently seek to provide this information, but current disclosure practices are fragmented and inconsistent."[7]

Further, the SEC on 25 May 2022 proposed amendments to existing rules and reporting forms that, if adopted, would modify ESG-related disclosure requirements that apply to all investment companies and business development companies registered under the Investment Company Act of 1940 (as amended), investment advisers registered under the Investment Advisers Act of 1940 (as amended), and certain advisers exempt from regulation.[8]

If these proposed disclosure requirements become effective, the current trend of securities class actions based on sustainability disclosures is likely to accelerate its pace. Over the past decade, consumer and investor plaintiffs have focused on companies' voluntary sustainability disclosures. With these additional disclosure requirements on the horizon, it is increasingly critical for a company's disclosures to be complete and accurate. Companies should assess their processes for gathering information pertinent to disclosures and ensure those processes are prepared to meet the proposed disclosure requirements in case they become effective.

FOOTNOTES

[1] *See* U.S. Env't Prot. Agency, *National Air Toxics Assessment*, https://www.epa.gov/national-air-toxics-assessment/2014-nata-assessment-results

[2] *See* U.S. ENV'T PROT. AGENCY, 2014 NATIONAL AIR TOXICS ASSESSMENT: FACT SHEET, https://www.epa.gov/sites/default/files/2018-08/documents/2014_nata_overview_fact_sheet.pdf

[3] *See* U.S. Env't Prot. Agency, *Air Toxics Screening Assessment*, https://www.epa.gov/AirToxScreen

[4] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (4 March 2021), https://www.sec.gov/news/press-release/2021-42

[5] *See* U.S. Sec. & Exch. Comm'n, *Statement on the Review of Climate-Related Disclosure* (24 February 2021), https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure

[6] *See* U.S. SEC. & EXCH. COMM'N, THE ENHANCEMENT AND STANDARDIZATION OF CLIMATE-RELATED DISCLOSURES FOR INVESTORS, https://www.sec.gov/rules/proposed/2022/33-11042.pdf

[7] Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (21 March 2022), https://www.sec.gov/news/press-release/2022-46

[8] For more on the SEC's 25 May 2022 proposed rule on ESG disclosures by investment managers and investment funds, see this U.S. Asset Management and Investment Funds Alert published by our colleagues: SEC Takes First Step Toward Standardized ESG Disclosures for Funds and Investment Advisers.

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