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GREEN OR GREY: REGULATORS TARGET GREENWASHING, MISLEADING ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CLAIMS

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Environmental, social and governance ("**ESG**") practices have become a top priority for companies and stakeholders in today's world. ESG encompasses a wide variety of different subject matters including, among others, environmental, ethics, human rights, corporate social responsibility, diversity, equity and inclusion.

This Bulletin provides a brief overview of current issues relating to ESG-related claims. McMillan is publishing a series of Bulletins providing additional insight into ESG-related issues. McMillan previously released a summary of ESG-related trends in 2021.[1] If you would like more information about these developments or would like a more detailed presentation on how ESG regulation may affect your business please reach out to any of the authors, or your usual McMillan contact.

Misleading ESG Claims

Consumers are motivated to support companies or entrepreneurs whose products and services are "environmentally-friendly", "green", "sustainable", or otherwise promote positive ESG impacts. Accordingly, businesses are incentivized to invest in ESG initiatives.

ESG attributes of a business appeal to investors, consumers and other stakeholders – and can be promoted through, for example, trademarks, slogans, green symbols, marketing practices or performance claims. However, false and misleading claims can expose a business to a myriad of legal, financial and reputational risks. The potential for director and officer (D&O) regulatory liability for failure to make adequate climate change risk disclosure together with increasingly extreme weather events have served to increase the pressure on businesses to make such claims.

"**Greenwashing**" occurs when a business's disclosure, branding or marketing intentionally or inadvertently contains false or misleading environmental/sustainability information, such as claiming a product or company is "green" or "clean", overstating environmental credentials, mischaracterizing an environmental initiative or understating emissions. Greenwashing also includes attempts to capitalize on the good will of a positive

environmental image while failing to take into account or to disclose negative environmental practices in, for example, its overseas supply chain.

As greenwashing and false ESG claims continue to make headlines, businesses are facing increased regulatory oversight, government enforcement and civil litigation. This is not surprising given the myriad of ESG related claims being made, the lack of consensus on what the classification really means or should mean, and the absence of consistently accepted verification and certification systems. What makes for a good net zero carbon emissions pledge, for example? And who gets to determine it? So far, carbon-offsets are the most common subject matter of "greenwashing". Is the particular carbon offset being touted of real net benefit or does it amount to just a shuffling of the cards?

In this context businesses are left to navigate multiple regulatory regimes to ensure compliance while trying to remain positive in the market on their ESG initiatives. The risk of overzealousness, however, is real: greenwashing may result in substantial penalties and significant reputational harm to a wide range of types of businesses, including reporting issuers (public companies), investment funds and private corporations.

Securities Regulation

Securities regulators across Canada are closely monitoring the marketing and compliance disclosure practices related to the ESG-related investment activities, including portfolio managers, investment fund managers, and exempt market dealers. The review comes amidst concerns that a fund's disclosure or marketing intentionally or inadvertently may mislead investors about the ESG-related aspects of the fund.

In January 2022, the Canadian Securities Administrator (the "**CSA**") published a staff notice which provides guidance on the disclosure practices of investment funds as they relate to ESG.[2] This came after the CSA uncovered that over half of the funds reviewed lacked detailed disclosure in their investment strategies as they related to ESG, and a fifth of the funds reviewed had portfolio holdings that appeared to be inconsistent with the fund's name, investment objectives or investment strategies.

We expect securities regulators will closely monitor ESG claims, particularly in public disclosure.

Competition Regulation

The issue of greenwashing is increasingly becoming a priority of the Canadian Competition Bureau. In 2022, the Bureau has issued warnings to the public and has publicly commenced investigations related to greenwashing, has issued substantial fines against companies engaged in greenwashing, and hosted the Competition and Green Growth Summit in September 2022 to examine the interaction between competition law and policy and sustainability.

We expect that the Bureau will continue to expand its investigations into, and enforcement against, companies believed to be engaged in misleading ESG claims.

US and European Regulation

In the United States, the Securities Exchange Commission ("**SEC**") is similarly increasing ESG regulation. The SEC announced a proposal requiring disclosure of certain climate-related information in public filings.[3] In March 2021 the SEC launched the Climate and ESG Task Force to identify ESG-related misconduct.[4] The Task Force has filed five enforcement actions related to ESG in 2022 alone.

On September 15, 2022, the U.S. Congressional Committee on Oversight and Reform held a hearing to examine climate change statements made by Exxon, Chevron, BP and Shell. The hearing is part of the Committee's investigation into "the fossil fuel industry's long-running campaign to spread disinformation about climate change and greenwash its role in causing global warming."[5]

The European Commission is in the process of considering and implementing several proposals to require corporate disclosure of ESG information and to protect consumers from misleading ESG claims. The proposals include mandatory reporting, requirements to substantiate claims, and restrictions on certain types of ESG advertising.

Earlier this year, Germany's financial regulator and the SEC launched probes into greenwashing claims made by DWS, Germany's largest fund manager.

Consumer Protection

Canada's consumer protection laws may also be implicated by ESG claims. Generally consumer protection in Canada is governed by provincial and territorial laws, but the federal *Consumer Packaging and Labelling Act* and regulations also have a consumer protection objective by protecting consumers from false or misleading representations.

When consumers have been deceived or misled, they may be able to seek recourse against the business, which could include a cancellation of the transaction or recovery of any payments made. The business may be subject to enforcement action, including administrative orders, fines and undertakings, or cancellation of its license (where it is operating a business licensed under applicable consumer protection law).

Private Disputes & Litigation

In addition to the actions taken by regulators, there has been a rise in civil ESG disputes. Companies may have proxy contest and shareholder activism risks if they do not adequately address ESG issues or if they make misleading ESG claims.

Businesses could also face civil lawsuits brought under Canada's competition, securities or consumer protection legislation. We expect greenwashing and ESR-related lawsuits will rise in Canada, including class actions, shareholder activism and D&O litigation.

What does this mean for companies?

Businesses can continue to advertise and promote their ESG attributes but, as always, marketing and disclosure should be true and not misleading.

Given the heightened sensitivity around ESG claims, businesses need to be particularly diligent to ensure that all ESG-related statements and practices are true and verifiable, have a sound basis and are consistent with the business' other public disclosures and representations. ESG claims should be carefully scrutinized before publication, including in particular claims made in public disclosure, press releases, marketing materials and packaging.

We expect we will continue to see regulatory investigations, enforcement action and litigation relating to ESG claims in Canada.

Key Takeaways

Akin to calorie disclosure in food or the health benefits of a variety of consumer products, ESG claims seek to reflect a company's value proposition and are designed to positively influence the buyer or consumer. Accordingly, such disclosure should be made with care:

- **Do not** make ESG related claims indiscriminately or selectively across a product line;
- **Establish and enforce** an internal policy on ESG claims including how such claims are to be made and who will be responsible and accountable for them;
- **Adopt and apply** well established terms (not buzz words) and definitions of key concepts such as "sustainability";
- **Ensure** that your ESG claims (in whatever form including in the images used) are clear, true, accurate, balanced, substantiated and verifiable;
- **Do not** make broad representations that products, services, supply chains or partners are "green", "sustainable", "eco-friendly", "socially impactful" etc., without being able to back them up with accurate and fulsome explanations;
- **Consider** independent external accountability and transparency frameworks such as the B Corp certification;
- **Keep up to date** on the current guidelines on regulatory guidance with respect to ESG-related claims and be prepared for further regulatory changes;

- **Review** ESG-related disclosure practices published by your related regulatory body; and
- **Audit** ESG performance, regulatory compliance and disclosure practices, and address any gaps.

[1] ESG in Canada: What We Learned in 2021 and Looking Ahead to 2022
[2] CSA Staff Notice 81-334 - ESG-Related Investment Fund Disclosure
[3] Press Release - SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors
[4] Spotlight on Enforcement Task Force Focused on Climate and ESG Issues
[5] [Fueling the Climate Crisis: Examining Big Oil's Prices, Profits, and Pledges

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.