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# ESG-Related Risks Worldwide: Equipping Your Organization to Face Regulators' Enhanced Arsenals

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# Setting the Scene



# The Growth of ESG

- Multiple contributory factors:
  - Active civil society.
  - Increased scrutiny and media coverage.
  - Series of high-profile corporate collapses.
  - Series of high-profile corporate scandals re supply chains etc.
  - Judicial willingness to allow ESG-related litigation.



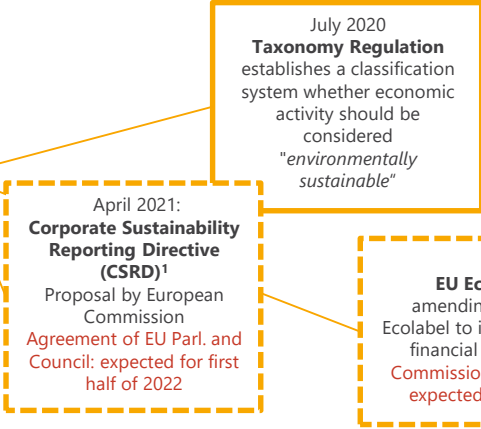
# Focus EU: Network of Sustainability Regulations on EU Level (Snapshot)



**Renewed sustainable finance strategy and implementation of the action plan on financing sustainable growth**

**Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains**

**EU CSDD**



*"The European Green Deal is our new growth strategy. It will help us cut emissions while creating jobs."*

*Ursula von der Leyen, President of the European Commission*



# Global Focus on Supply Chain Sustainability



**CSR & ESG:** Avoidance of (reputational) damage; impact of the company on the environment (CO2 footprint, etc.)

**Supply Chain Laws:** Liability for risk - **fine without damage!**



Global trend; German Supply Chain Law most extensive benchmark



**Align & Leverage:**  
Comprehensive ESG risk management



Do the Right Thing

# Focus on Germany and EU: Supply Chain Due Diligence Regulation



## German SCDDA



1/1/2023 > 3000 Employees

1/1/2024 > 1000 Employees

All suppliers of the addressees indirectly affected (Supplier DD)

## European Proposal for Directive on Corporate Sustainability DD



> 500 Employees € > 150 million worldwide

> 250 Employees € > 40 million 50% of turnover in "high-risk sector"



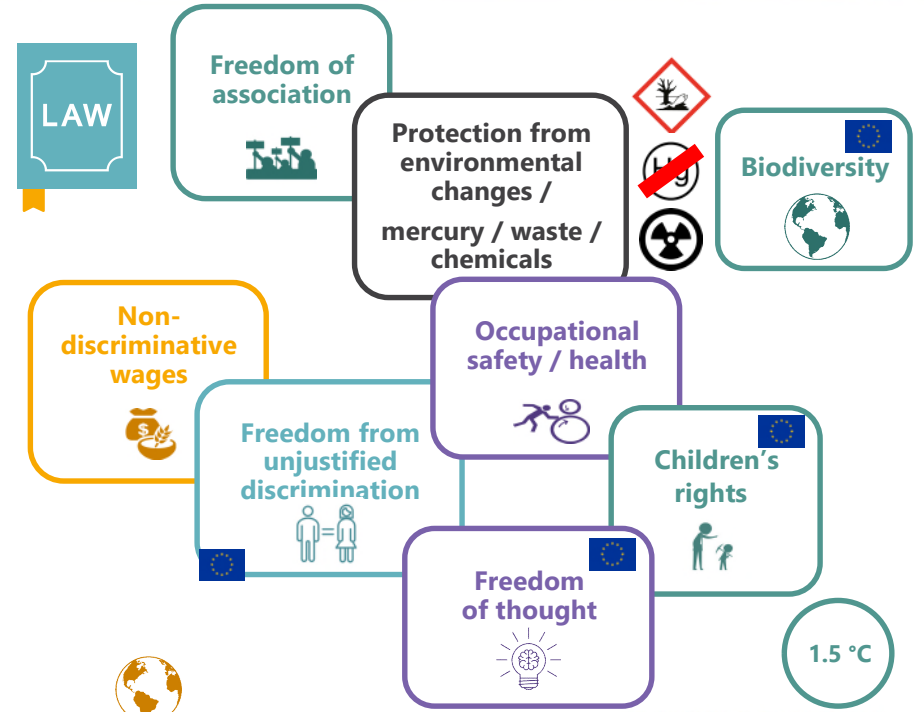
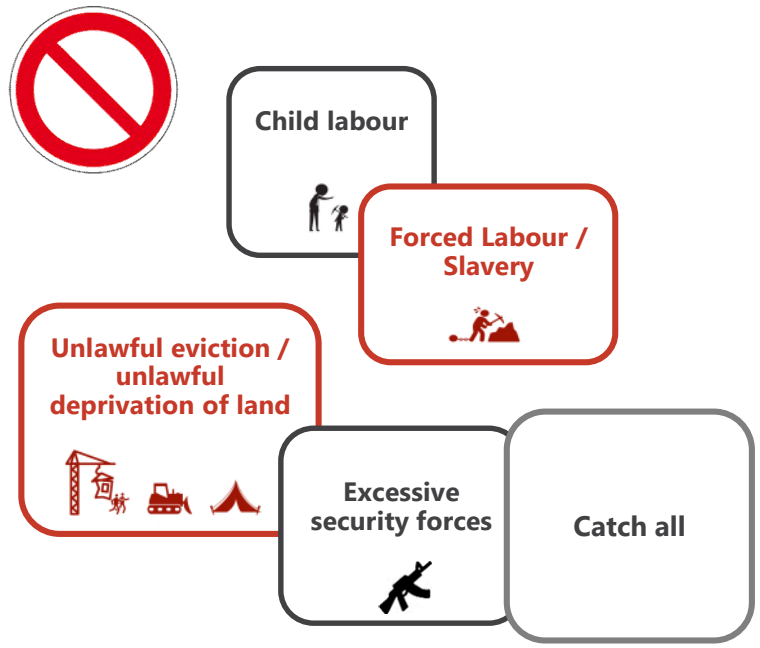
€ > 150 million in EU

€ > 40 - 150 million in EU 50% of worldwide turnover in "high-risk sector"

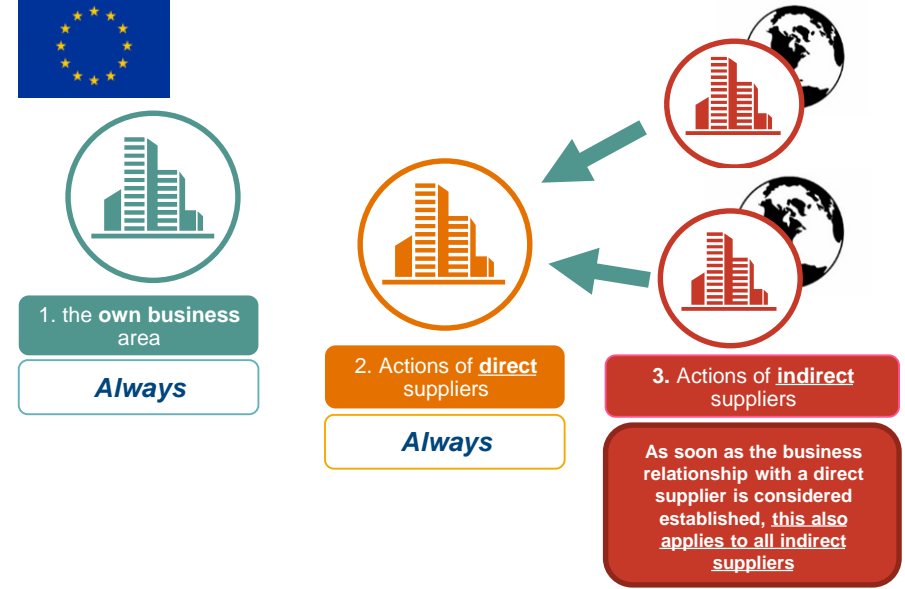
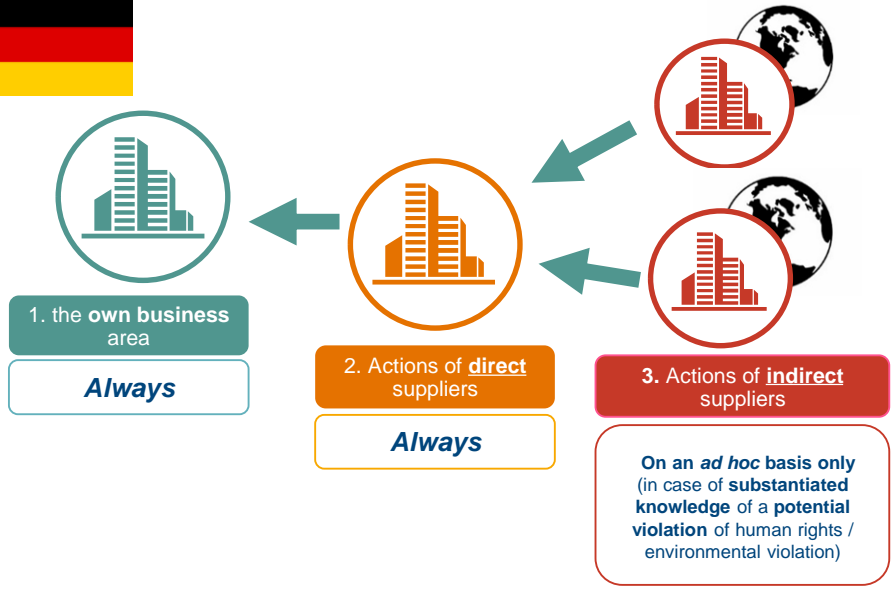




# Focus on Germany and EU: Protected Rights = Human Rights & Environmental Aspects

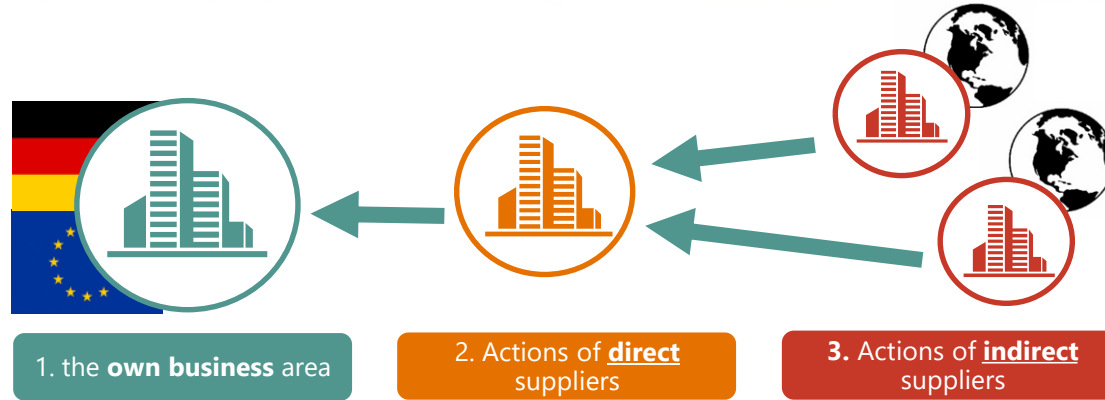


# Focus on Germany and EU: Where Does The Regulation Apply?





# Focus on Germany and EU: Tiered Due Diligence Obligations



## Appropriateness of due diligence obligation

### Key factors:

Nature & scope of  
business

Potential influence on  
supplier

Severity, reversibility,  
likelihood of violation

Factors contributing to  
the cause of violation

# Focus on Germany and EU: Reporting and Documentation Requirements



**Implement whistleblower system re supply chain DD issues**



**Document and keep records for 7 years**



**Reports to be published annually and submitted to authorities  
(Sustainability Report 2.0)**

# Focus on Germany and EU: Sanctions



Intentional violation

Negligent violation



## For intentional breach

- **On individuals:** up to EUR 800,000 (increased tenfold for companies)
- **On companies (with turnover > EUR 400 million):** up to 2% of average worldwide annual group turnover

*Amount divided by 2 for negligent breach*

- For up to 3 years – until full clearance
- Prerequisite: legally binding imposition of a fine of at least EUR 175,000



Member States shall base monetary sanctions on company's turnover



Sanction decisions to be published ("naming and shaming")



Civil liability

# Focus on Germany: Recent ESG Related Enforcement Action and Litigation



Enforcement of SCDDA



Climate litigation



VS.

**RWE**

**GREENPEACE**

VS.



# Focus on Germany and EU: What's Next?



- 1.1.2023: German Supply Chain Due Diligence Act enters into force for larger companies
- 1.1.2024: SCDDA applicable to smaller companies
- EU Proposal for Corporate Sustainability Due Diligence Directive is going to EU Parliament and the Council for approval. Once adopted, Member States will have 2 years to transpose the Directive into national law.

# Focus on the UK: The Emerging Framework

- **Global factors** (and **EU developments** in particular) are relevant to the UK also.
- UK Government's "**Greening Finance – A Roadmap to Sustainable Investing**"
  - Sets out Government plan to "green" the financial system and align it with UK's "*world leading net-zero commitment*"
  - TCFD-aligned disclosures becoming mandatory
    - Sustainability Disclosure Requirements (**SDRs**)
- Significant legislative and other provisions
  - *Companies Act 2006*
  - *Modern Slavery Act 2015*
  - *UK Corporate Governance Code 2018*



# Focus on the UK: What is Coming Next?

- *Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022*
- *Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022*
- Mandatory **diversity and inclusion** reporting requirements
- Continued move towards alignment with sustainability disclosure requirements
- Regulatory drive will continue
  - FCA Position Papers, Policy Statements, and “Dear Chair” letter
  - PRA “Dear CEO” letters

# Focus on the UK: Enforcement Developments

- Move towards mandatory disclosures
  - Focus on objective criteria
  - BUT difficulties of objective measurement
- Regulatory bodies increasingly focused on ESG-related reporting and compliance:
  - **ASA** targeting financial institutions
  - **CMA** activity – powers to levy fines for breaches of consumer protection rules
  - **FCA** focus on **greenwashing**



# Focus on the UK: Litigation Exposures

- Public scrutiny of **greenwashing** is intensifying.
- Potential favoured jurisdiction for **strategic litigation**.
- Focus on **directors**
  - Adequately taking account of climate change risks?
  - Acting in shareholders' best interests?
  - Breaches of fiduciary duty (**Better Business Act campaign**)
- **Securities claims** based on sections 90 and 90A of FSMA.



# Focus on the US: The Growth of ESG

- All global factors already discussed apply:
  - Money flowing to ESG
  - Series of high profile corporate scandals
  - Stakeholders, boardroom and investors, taking notice
  - Particular focus on public companies and financial institutions
  - Judicial willingness to allow ESG-related litigation
- **Global factors** are relevant to the US also
  - SEC teams with BaFin to investigate misstatements of Green-labelled products
  - Study that 60 of 94 ESG funds filed to adhere to principals of ESG investing
- US SEC leading the way



# Focus on the US: The Emerging Framework

- US SEC's Proposed Rules to Enhance and Standardize Climate-Related Disclosures for Investors
  - March 21, 2022: Must disclose information about climate-related risks reasonably likely to have a material impact on business
  - Climate related financial statement metrics in audited financials
    - Governance
    - Material impact over short, medium and long term
    - Affect on strategy, business model, and outlook
    - Impact of severe weather on consolidated financial statements, estimates and assumptions
- Request for responses: Largest response in recent SEC history

# Focus on the US: SEC Response



- March 3, 2021:
  - OCIE exam priorities includes ESG
  - Creation of Enforcement Task Force Focused Exclusively on Climate and ESG Issues
    - 22 dedicated members
    - Reviewing for material gaps or misstatements in issuers' disclosures and investment
    - ESG related misconduct
- May 24, 2022
  - Task force brings first action



# Focus on the US: What is Coming Next?

- Codified Securities Rules requiring climate related disclosure
  - Continued refinement of rules and requirements
- Increase in enforcement investigations and actions
  - 22 people need to be justified
  - New rules mean unclear requirements and potential foot-faults, along with the uncovering of real issues
- SEC making a statement
  - Increases in disgorgement and penalties, along with an emboldened staff

# Focus on the US: Enforcement Developments

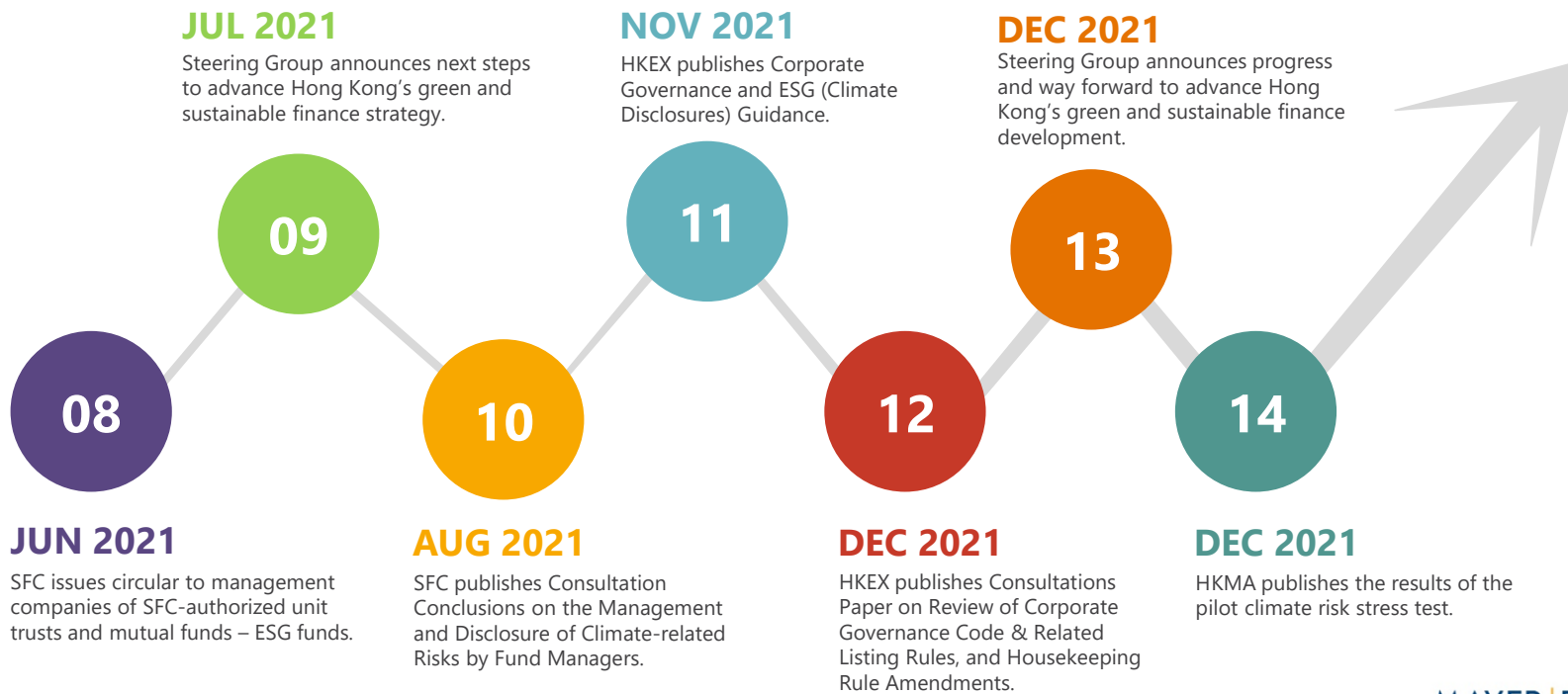


- April 28, 2022: Vale
  - The SEC’s Climate and ESG Task Force Charges Vale S.A. With Securities Fraud in ESG related collapse of Brumadinho dam
    - The SEC's complaint against Vale concerns allegedly false and misleading statements made prior to and immediately after the collapse of the dam
  - Highlights the SEC’s increasing scrutiny of alleged misstatements regarding ESG claims
- May 24, 2022: ESG Task Force settlement
  - ESG Enforcement Task Force brings first settled enforcement action
    - Misstatements and Omissions regarding ESG considerations for mutual funds
    - All funds had ESG quality review: Apparently not entirely accurate
    - Settled case: \$1.5 million penalty

# Focus on Hong Kong: The Emerging Framework



# Focus on Hong Kong: The Emerging Framework



# Focus on Hong Kong: The Emerging Framework



- Hong Kong has advanced its ESG agenda by regulatory measures and guidance in relation to climate risk rather than by legislation
- The SFC's Fund Manager Code of Conduct has been amended to introduce requirements on the management and disclosure of climate-related risks
- Depending on AUM, fund managers need to comply with these requirements by August or November 2022

# Focus on Hong Kong: The Emerging Framework



- The SEHK published Guidance on Climate Disclosures to assist Hong Kong listed companies with the Task Force on Climate-related Financial Disclosures recommendations
- The HKMA is consulting about guidelines on climate-related risks by banks



# Focus on Hong Kong: What Is Coming Next?



- At this stage in Hong Kong's ESG evolution, the risk of regulatory action appears more likely than the risk of litigation
- The SFC has extensive powers of investigation and enforcement powers under the Securities and Futures Ordinance. Will it use these powers to:
  - enforce the new FMCC requirements against fund managers?
  - challenge inadequate climate-related disclosures by Hong Kong listed companies?

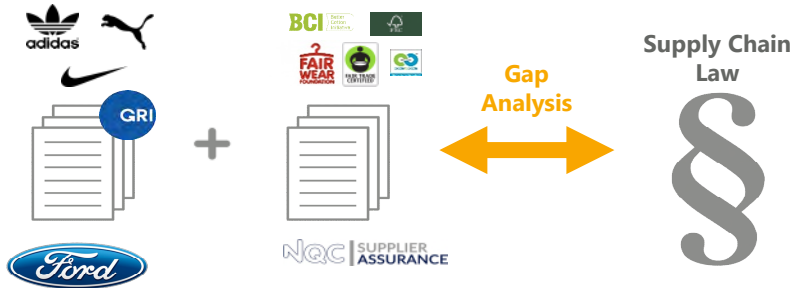
# What Should Companies Be Doing?



- The risks of inaction
  - Reputational risk
  - Counterparty / credit risks
  - Physical risks
  - Transition risks (e.g., “stranded assets”)
- Familiarity, and compliance, with the rapidly evolving legislative and regulatory framework
- Focused working groups for ESG issues and disclosures
- Identify and cure gaps between what is “said” and what is “done”

# Example: Gap Analysis German SCDDA

## GAP Analysis



## Typical findings



Company is a good corporate ESG citizen



But the Supply Chain Law requires more: a *comprehensive* risk management system and, in particular, extensive **documentation**.



Internal processes do not comprehensively cover own business area  
Responsibilities and reporting are unclear  
Communication / documentation is insufficient  
**Risk analysis is incomplete**



# Heading Off Potential ESG Issues

- Focus on **directors**
  - Adequately taking account of climate change risks?
  - Acting in shareholders' best interests?
- Disclosures and public statements – accuracy is essential
- Examine **supply** and **value chain issues** and requirements to ensure best practice

# Example: ESG Risk Management under German SCDDA

## Level 1

### Risk Management (mandatory)

- **Risk analysis** (at least annually + for new business fields / products)
- Designate responsibilities (**Human Rights Officer**)
- Adopt a **policy statement** on human rights strategy
- Comprehensive **supplier DD**
- Implement a **Whistleblowing system**
- **Code of conduct** describing rules and principles for employees and subsidiaries



## Level 2

### Risk identified

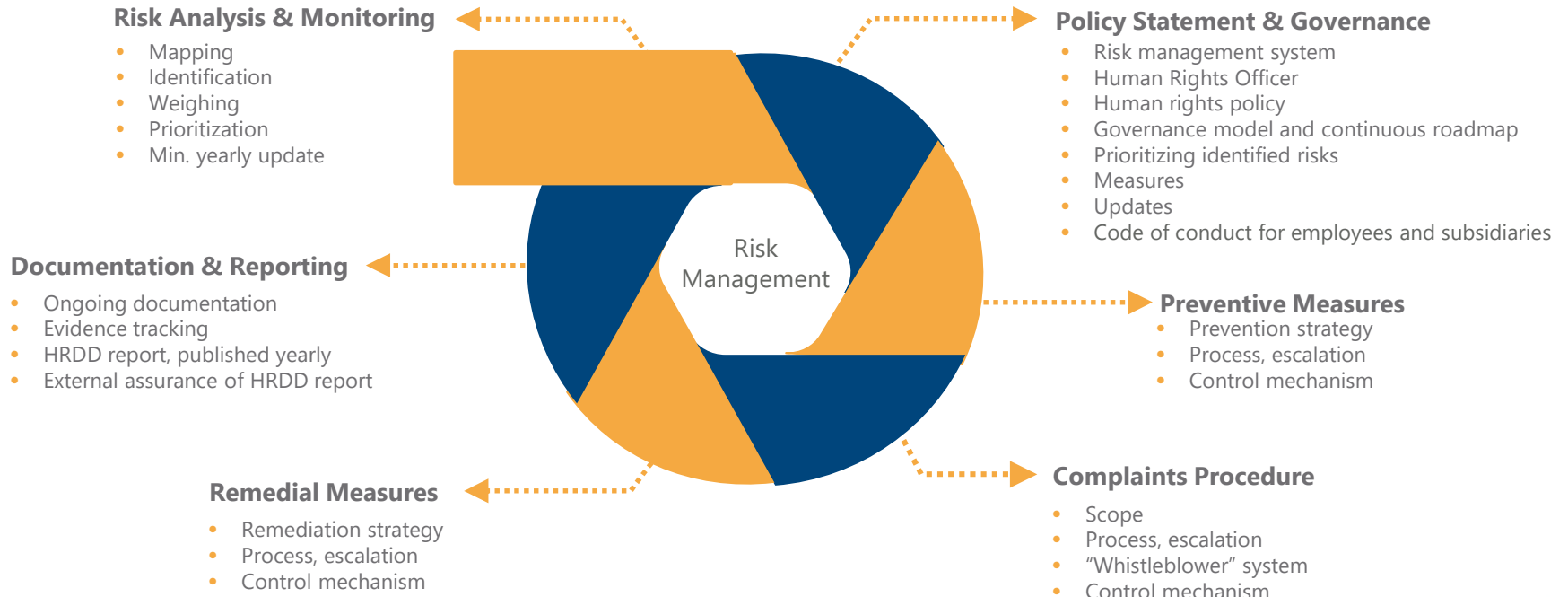
- Appropriate **preventive measures**
- Implement HR Policy
  - Purchase strategy & supplier code / contract design
  - Training (internal and external)
  - Monitoring & audits

## Level 3

### Violation identified

- Immediate appropriate **corrective measures**
- **Ultima Ratio:** Termination of relationship with supplier

# ESG Risk Management & Compliance







# Litigation Risks and Considerations

- Consider and understand its nature and distinctions from “conventional” litigation
  - Nature of plaintiffs / claimants and other stakeholders (e.g., funders)
  - Relief sought
- Engagement and collaboration with stakeholders at an early stage?
  - Consider out-of-court solutions
    - Reputational issues associated with defence strategy
    - National Contact Points and Operational Level Grievance Mechanisms

# Speaker Biographies



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Alan Linning is a partner of Mayer Brown and a member of the firm's Litigation and Dispute Resolution practice. He has over 30 years of experience in commercial litigation and disputes with a focus on financial services regulatory matters and investigations. With the extensive experience gained from his roles in the finance sector as well as with the Hong Kong regulators, Alan is well placed to provide strategic advice and assistance to clients on both contentious and non-contentious regulatory matters including civil and criminal investigations and litigation, compliance issues and regulatory policy. Alan is listed as a leading litigation and dispute resolution and financial services regulatory lawyer by Chambers Global, Chambers Asia Pacific, Legal 500 Asia Pacific and IFLR 1000. He is recognised as an "experienced pair of hands and easy man to work with." (Chambers Asia Pacific 2019).



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James Whitaker is a partner in the Litigation & Dispute Resolution practice of the London office, where he acts in complex commercial disputes. James is dual-qualified in England and Wales, and California.

James is a founding member of, and co-leads, Mayer Brown's global Environmental, Social and Governance (ESG) Product Group, and much of his work is focused on the emerging ESG landscape, and associated risks.

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Richard M. Rosenfeld is co-lead of Mayer Brown's US Securities Litigation & Enforcement practice. Richard regularly counsels and represents financial services firms, corporations, funds, directors and their committees, officers and employees in securities related business, regulatory and compliance issues. Richard uses his more than two decades of experience in the securities field, including more than a decade in increasingly senior government regulatory and enforcement positions, to defend SEC, CFTC, FINRA, DOJ, CME and other securities-related investigations. He leads internal investigations, often advising clients on ESG related preventive compliance and remedial measures before and after securities-related issues arise. Richard's capabilities and experiences were referenced in Global Investigations Review's "Just Anti-Corruption" publication, which listed Mayer Brown as a "Highly Recommended" firm for FCPA compliance and investigations counseling.



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Dr. Johannes Weichbrodt is a partner in the Düsseldorf office of Mayer Brown's Antitrust and White Collar Defense & Compliance practices. Johannes advises on all aspects of European and German antitrust and competition law and helps clients with all kinds of compliance issues. He focusses on cross-border internal investigations and compliance programs, including in Asia and in Latin America. His litigation experience includes proceedings before the German courts as well as the European Court of Justice.

Johannes has a particular focus on ESG and CSR compliance work and has published in and been interviewed by leading German and international newspapers on the subject. Currently, he is guiding several clients in implementing measures to meet the obligations under the German Supply Chain Due Diligence Act.



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