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'Greenwashing' is the practice of a company providing information on its environmental, social and corporate governance (ESG) policies, or its products and practices, with the intent to present an environmentally responsible public image that masks harmful business practices. Legislators globally are issuing a spate of new rules and guidance requiring adverse environmental, human rights, or governance issues to be considered, disclosed and even mitigated by companies.

There also is growing pressure from consumers and regulators. Consumers are increasingly seeking out products and services with strong ESG credentials and **reportedly are willing to pay up to a 9% premium** for 'environmentally friendly' products. Unsurprisingly, companies are seeking to leverage this consumer premium in the way that they advertise and market their products and services. However, **a 2021 report published by the UK Competition and Markets Authority** (CMA) found that 40% of green claims made online were potentially misleading. With the increased appetite for regulatory enforcement and ESG-related litigation, the potential risk exposure for companies publishing misleading ESG-related statements is becoming more acute.

Is the European Union set to become a front-runner?

In the EU, the European Commission (EC) has put greenwashing at the front and centre of its agenda. Its aim is two-fold: First, to prevent consumers from being misled by unsubstantiated or inaccurate ESG claims, and second, to require disclosure of ESG data so entities along the value chain can make informed decisions on which materials or products to purchase and to whom they should sell. The required disclosure exercise will no longer be limited to the reporting entity and its group, nor will it be limited to EU companies – **corporates within scope will be required to carry out ESG-focused due diligence**, and report on key aspects of their value chains.

To that end, in March 2022, the **EC put forward a proposal for a directive** that will amend the existing EU rules on Unfair Commercial Practices and Consumer Rights to tighten the rules on green claims. In parallel, the EC is expected in November to present **a proposal that will require companies to substantiate the claims they make** in relation to the environmental footprint of their products and services by using standard methods for quantifying them. The EC believes that these rules will make environmental information more reliable and create a more level playing field.

New rules also are set to enter into force in the EU on mandatory sustainability reporting. The **Corporate Sustainability Reporting Directive** (CSRD), replacing the Non-Financial Reporting Directive, is anticipated for adoption in November. The CSRD will significantly expand sustainability reporting obligations in the EU and will apply to a far broader range of companies than before, including large EU companies (even if they are not listed), non-EU companies that have a subsidiary or branch in the EU, and small and medium-sized enterprises listed on EU regulated markets. Under the new rules, companies will have to report on their impact on sustainability matters and on information necessary to understand how sustainability matters affect the undertaking's development, performance and position. The information must cover the short, medium and long term, and will be specified in the mandatory sustainability reporting standards that the EC will adopt. The **mandatory sustainability reporting standards**, currently **being developed by the European Financial Reporting Advisory Group**, will include environmental matters, such as climate mitigation and adaptation, the circular economy, and use of water and marine resources.

The US clamps down

It is not only in Europe that we are seeing this trend. The US Securities and Exchange Commission (SEC) under Gary Gensler, who was nominated as chair in 2021 by President Joe Biden, has signalled that disciplining corporate ESG disclosure is a top priority. On 21 March 2022, **the SEC released its long-awaited proposed climate change disclosure rules**, with emissions and climate governance and risk disclosure requirements derived largely from the Greenhouse Gas Protocol and the Task Force on Climate-Related Financial Disclosures framework. Expected to be finalised in October 2022, the climate rule, alongside proposed or expected rulemakings on cybersecurity, board diversity and human capital management, is part of a broader trend of moving ESG disclosure out of the 'Wild West' of voluntary reporting and subjecting such disclosure to SEC oversight and standardisation. These rulemakings build upon SEC guidance and comment letter campaigns in recent years that have focused on inadequate disclosure of climate and related risks, as well as discordances between sustainability reports and SEC reporting.

In addition to its emphasis on standardising and improving issuer ESG disclosure, the SEC has focused its rulemaking and enforcement actions on ESG investing. On 30 March 2022, the SEC published a report setting out its enforcement priorities, which included 'greenwashing' in advisory services and investment products. The SEC had already established a Climate and ESG Task Force in 2021 and specifically identified 'ESG investing' as an area to be targeted. Then, on 23 May 2022, the SEC issued its first penalty for activities within the remit of the task force. The agency **reached an agreement with BNY Mellon Investment Adviser** that it would pay a US$1.5 million penalty after accusing it of misstating and omitting information about ESG investment considerations for mutual funds that it managed. These actions were followed by the release of two proposed rule amendments on 25 May 2022 aimed at preventing greenwashing by funds and investment advisers, which, among other changes, would create new requirements around fund names and disclosure requirements related to ESG strategies and goals.

The SEC is investigating a broad range of industries and sectors for their ESG claims. For example:

1. The SEC **filed a complaint against Vale SA**, a Brazilian mining company, for allegedly fraudulent assurances in its sustainability reports and other public filings in relation to the Brumadinho dam, which later collapsed.
2. The SEC is **investigating the asset management division of a leading investment bank** for claims made by some of its ESG-related funds, but no further details are known at this stage.

Is the UK next?

The issue of greenwashing is firmly on the CMA's radar, and its **Annual Plan 2021 to 2022** highlighted the prevention of misleading 'green claims' as one of the regulator's priorities in terms of enforcement. The UK government also announced that **it will grant the CMA enhanced powers to directly enforce consumer law**, including the ability to fine firms up to 10% of their global turnover for breaching consumer protection laws. This may include instances of greenwashing, which are **likely to fall foul of the prohibition on unfair commercial practices** in the Consumer Protection From Unfair Trading Regulations 2008.

The CMA recently launched an investigation into claims made by ASOS, Boohoo and George at Asda to '**get to the bottom of whether the firms' green claims are misleading customers**'. In particular, the CMA will be scrutinising eco-friendly and sustainability claims made by the companies in respect of their fashion products, including clothing, footwear, and accessories. This action follows the **publication of the CMA's Green Claims Code in 2021** and its plans announced in January 2022 to **review environmental claims in the fashion sector**. We understand that the CMA has written to the three companies outlining its concerns and will use its information-gathering powers to obtain evidence to progress its investigation. How the review develops will depend on the CMA's assessment of the evidence before it. Possible outcomes include securing undertakings from the companies to change the way they operate, taking the firms to court to seek enhanced consumer measures (such as payments to consumers to redress any harm) or simply closing the case without further action. (For more guidance on the CMA's Green Claims Code, which provides a framework to help businesses make environmental claims that inform and, importantly, do not mislead consumers, refer to Cooley's **October 2021 Productwise blog post**.)

It is not just the CMA that is taking action in the UK. The **Advertising Standards Authority has been active**, banning several campaigns by companies for the practice of exaggerating the total environmental benefit of their products in a misleading manner. Concurrently, the director of the Serious Fraud Office (SFO), Lisa Osofsky, has **highlighted 'ethical investments' subject to fraud** as a key challenge for prosecutors going forward. In May 2022, the SFO **secured its first ESG-related victory at trial**, with the convictions of two individuals involved in running a fraudulent green investment scheme in Brazil. The agency said that its seven-year investigation uncovered 'an intricate web of money transfers, forged documents and invented identities' used to scam investors 'under the false pretence of environmental protection'. Global Forestry Investments was presented to investors as a secure, well-managed, ethical investment scheme that would help protect the Amazon and support local communities, but the proceeds in fact were being channelled into the two executives' bank accounts.

The UK Financial Conduct Authority (FCA) also has expressed that greenwashing is a growing concern. At the COP26 summit in November 2021, FCA CEO Nikhil Rathi noted that 'greenwashing cannot be allowed to persist'.[1] This comes against a backdrop of a proliferation of rules around ESG-related disclosures to investors, such as the EU's Sustainable Finance Disclosure Regulation, and the FCA's climate-related financial disclosure regime and proposed 'sustainability disclosure requirements', which are expected to be published this year. Stakeholders in this area should monitor these developments closely.

What does this mean for companies?

Ultimately, companies will need to be diligent in ensuring that all ESG-related operational practices match up to any statements made publicly, whether to investors, consumers or other stakeholders. They also could limit the scope of such statements to avoid the risk of facing regulatory action for making bold claims that are not supported by operational reality. Limited disclosures must be carefully drafted so as not to run the risk of being considered omissions of material details and falling foul of the rules in that way. With the growth of whistleblowing, any mismatches between marketing and reality are more likely than ever to be discovered.

One thing is clear: While misleading claims around ESG may have washed with regulators in the past, that is no longer the case. We will continue to see investigations, prosecutions, and possibly convictions for companies and their directors engaging in such claims.

Note

1. FCA speech by CEO Nikhil Rathi, 'A strategy for positive sustainable change', 3 November 2021.

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