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ESG Challenges for Corporations— Litigation Trends

Corporations face pressure from state regulators, shareholders, and those with retirement investment accounts as they incorporate ESG principles into their procedures and actions. In some states, regulators seek to limit ESG efforts, claiming they violate antitrust rules or create discrimination in the workplace.

Increasingly, shareholder actions challenge corporations that fail to comply with their own ESG policies and procedures. Most of the earlier cases of this nature involved “greenwashing,” which Vega Economics covered last year.¹ Greenwashing involves a corporation’s misrepresentation of products or practices as environmentally responsible or healthy or the company’s failure to meet stated environmental or health goals. Plaintiffs continue to file these suits.²

Recent litigation focuses increasingly on social and governance policies that companies have chosen to—or have elected not to—adopt. Many seek to force corporations to divulge the information that will help their ESG-based lawsuits survive motions to dismiss. And some litigation challenges, under the federal Employee Retirement Income Security Act, companies that consider ESG principles in choosing which stocks to include in employee retirement investment programs.

As these companies are pulled in multiple directions, they are finding it increasingly difficult to ‘thread the needle.’ In this article, Vega Economics reviews examples of the recent litigation involving corporate ESG-related issues.

¹ See “Detecting and Navigating Greenwashing Claims.” *Vega Economics*.

<https://vegaeconomics.com/detecting-and-navigating-greenwashing-claims> (accessed August 22, 2023).

² See, e.g., *Fagen v. Enviva Inc.*, No. DKC 22-2844 (D. Md. Jan. 31, 2023) (wood pellet producer alleged to have greenwashed its wood procurement); *Rosencrants v. Danimer Scientific, Inc.*, No. 1:21-cv-02708 (E.D.N.Y. May 14, 2021) (company’s plastic substitute allegedly not 100% biodegradable, as claimed).

<https://climatecasechart.com/case/rosencrants-v-danimer-scientific-inc/> (accessed August 25, 2023); *In re: Peabody Energy Corp. Securities Litigation*, No. 1:20-cv-08024-PKC (S.D.N.Y. March 19, 2021) (coal-mining company’s public statements regarding its commitment to safety alleged to be false as evidenced by a fire that led to the mine’s closure for a year). <https://www.strategicclaims.net/peabody/> (accessed August 25, 2023). See also, *In re: Peabody Energy Corp. Securities Litigation*, No. 1:20-cv-08024-PKC (S.D.N.Y. March 19, 2021) (final order and judgment dated February 7, 2023).

<https://www.strategicclaims.net/peabody/> (accessed August 25, 2023).

Litigation Involving Employee Retirement Investment

A class action suit was recently filed against Fidelity Investments Institutional, American Airlines, Inc., and others.³ The plaintiffs in this class claim that incorporating ESG factors into 401(k) plans violates the Employee Retirement Income Security Act (ERISA).⁴ The plaintiffs assert that the defendants breached their fiduciary obligations to American Airlines employees because incorporating ESG principles into investment decisions fails to maximize the benefits to retirement plan participants.⁵ ERISA provides that fund managers must act “solely in the interest of participants and beneficiaries and...for the exclusive purpose of providing benefits to participants and their beneficiaries.”⁶

This case touches on the same issues raised in March of this year when the U.S. Senate passed legislation to overturn a U.S. Department of Labor rule permitting retirement plan managers to consider ESG factors in choosing which stocks to include in their portfolios. President Biden vetoed the bill⁷ but the efforts did not end there.

Convinced that the Department of Labor rule violates ERISA by undermining retirement savings protections, twenty-five attorneys general sued the Department of Labor⁸ under the Administrative Procedure Act⁹ and ERISA.¹⁰ Florida joined in this action but also passed its own law requiring that “all investment decisions must be driven solely by pecuniary factors and may not sacrifice investment returns to promote factors like ESG and extending these requirements to all state and local funds.”¹¹

A Shareholder Suit for Economic Loss Attributed to the Adoption of ESG Considerations

Target’s recent corporate decision to sell LGBTQ Pride-related products, including women’s one-piece “tuck-friendly” bathing suits, triggered a backlash and boycott among some conservative

³ *Spence v. American Airlines, Inc.*, No. 4:23-cv-00552 (N.D. Tex. June 1, 2023).

<https://storage.courtlistener.com/recap/gov.uscourts.txnd.377577/gov.uscourts.txnd.377577.1.0.pdf> (accessed August 18, 2023).

⁴ 29 U.S.C. § 1001 *et seq.*

⁵ *Id.* at 2.

⁶ 29 U.S.C. §§ 1104(a)(1), 1104 (a)(1)(A).

⁷ “Biden uses first veto to defend rule on ESG investing.” *Reuters*.

[https://www.reuters.com/business/sustainable-business/biden-vetoes-resolution-block-labor-dept-rule-esg-investing-2023-03-20/#:~:text=WASHINGTON%2C%20March%20%20\(Reuters\),first%20veto%20of%20his%20presidency](https://www.reuters.com/business/sustainable-business/biden-vetoes-resolution-block-labor-dept-rule-esg-investing-2023-03-20/#:~:text=WASHINGTON%2C%20March%20%20(Reuters),first%20veto%20of%20his%20presidency) (accessed August 18, 2023).

⁸ *Utah v. Walsh*, No. 2:23-cv-00016-Z (N.D. Tex. January 26, 2023),

https://www.texasattorneygeneral.gov/sites/default/files/images/press/2023.01.26_1%20Complaint.pdf (accessed August 18, 2023).

⁹ 5 U.S.C. § 500 *et seq.*

¹⁰ 29 U.S.C. § 1001 *et seq.*

¹¹ “Governor Ron DeSantis Signs Legislation to Protect Floridians’ Financial Future and Economic Liberty.” *Ron Desantis, 46th Governor of Florida* (May 2, 2023). <https://www.flgov.com/2023/05/02/governor-ron-desantis-signs-legislation-to-protect-floridians-financial-future-economic-liberty/> (accessed August 18, 2023).

groups. Recently, Target announced that, as a result, its second quarter sales were 5.4 percent lower than earnings in the same quarter last year. The company also announced it was reducing its earnings forecast for the next year.¹²

On August 8, 2023, America First Legal filed suit against the company¹³ on behalf of a shareholder alleging several violations of the Securities and Exchange Act including Section 14(a) of the Act, Rule 14a-9, Section 10(b) of the Act and Rule 10b-5. Section 14(a) essentially requires proxy statements to be free of false or misleading material statements or omissions of material facts.¹⁴

The complaint alleges that Target issued false and misleading statements that presented a “classic middle-class brand” while, behind the facade, the Board and management put the company’s financial and reputational capital at risk by pursuing ESG and DEI mandates.¹⁵

Part of that risk, the complaint claims, was “Target’s now infamous children-and-family-themed LGBT-“Pride” marketing and sales campaign—which embroiled Target in the culture war and caused Target to experience the biggest stock decline in the company’s history, costing investors billions.”¹⁶ The complaint further alleges that the Target Board, in its 2022 and 2023 annual proxy statements, assured investors it was guarding against any ESG/DEI-based risks but, in fact, was only protecting against the risk of failing to achieve those ESG and DEI goals.¹⁷

Shareholders Suing to Force Corporations to Comply with Company ESG Policies

Many shareholders want the corporations they invest in to establish and follow ESG mandates and readily sue companies that fail to meet these expectations. But maintaining such suits is not easy.

The Northern District of California has rejected attempts to sue corporations for failure to comply with stated ESG objectives. For example, a plaintiff filed a shareholder derivative suit against Facebook and members of the Board of Directors and executive team¹⁸ claiming, among other things, that the company failed to comply with its own public proxy statements regarding its commitment to diversity in violation of § 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a), and SEC Rule 14a-9, 17 C.F.R. § 240.14a-9.¹⁹

The plaintiff claimed that, despite the company’s statements in its 2019 and 2020 proxy statements regarding diversity and inclusion, Facebook lacked diversity in the boardroom, in

¹² “Target’s Sales Hit by Pride Month Merchandise Backlash.” *New York Times*. <https://www.nytimes.com/2023/08/16/business/target-sales-pride-backlash.html> (accessed August 18, 2023).

¹³ *Craig v. Target Corporation, et al.*, No. 2:23-cv-00599 (M.D. Fla. August 8, 2023), https://media.aflegal.org/wp-content/uploads/2023/08/08204301/Complaint-filed-stamped-copy.pdf?_ga=2.128465029.809844329.1691535885-688144585.1691535885 (accessed August 18, 2023).

¹⁴ *Lee v. Frost*, No. 21-20885-CIV-ALTONAGA/Torres (S.D. Fla. August 31, 2021) at 9 (citing *In re The Home Depot, Inc. S’holder Derivative Litig.*, 223 F.Supp.3d 1317, 1329 (N.D.Ga. 2016)).

¹⁵ *Id.* at 3, ¶ 4.

¹⁶ *Id.* at 3, ¶ 5.

¹⁷ *Id.* at 5, ¶ 15.

¹⁸ *Ocegueda ex rel. Facebook v. Zuckerberg*, 526 F. Supp. 3d 637 (N.D. Cal. 2021).

¹⁹ *Id.* at 641.

senior management, and in the workplace.²⁰ The plaintiff claimed the company's proxy statements were materially false and essentially amounted to fraud.²¹

The Court found that the plaintiff failed to identify any materially false misleading statements²² and that the diversity goals stated in the proxy statements were merely puffery or aspirational and therefore not actionable.²³ Moreover, the plaintiff failed to allege any widespread unlawful activity and did not allege that the proxies were causally linked to a loss.²⁴

In an earlier action, the Southern District of Florida dismissed a shareholder derivative suit against board members of OPKO, a Miami-based diagnostics and healthcare company.²⁵ The plaintiffs alleged that, notwithstanding OPKO's public commitment to "a healthy work place," the company failed to hire any black, Latinx, or other underrepresented minorities to the Board or executive management team.²⁶ The Plaintiff alleged, among other things, that the defendants violated Section 14(a) of the Securities Exchange Act.²⁷

The plaintiffs claimed the Board failed to follow its Code of Conduct which stated that "discrimination is not tolerated." The Court found the plaintiffs failed to plead particularized facts showing the statements were materially false or misleading but, rather, simply offered conclusions that the company failed to follow its Code of Conduct. In fact, the plaintiffs admitted the Code expressly stated that hiring decisions would not be based on race or color.²⁸ Courts have regularly held that corporate statements regarding diversity commitment are "unactionable puffery" or aspirational statements²⁹ and the Court found that the plaintiffs had failed to tie their claims to any cause of loss.³⁰

In a similar action, Becky Kiger and Heather Nelson filed derivative suits against various Qualcomm directors, alleging those directors permitted unlawful and discriminatory practices at the company, thereby breaching their fiduciary duties as well as Section 14(a) of the Securities Exchange Act. They claimed this exposed Qualcomm to risk.³¹ The Court dismissed the action for failure to identify any false or misleading statement contained in the proxies in question.³²

²⁰ *Id.* at 642.

²¹ *Id.* at 650-51.

²² *Id.* at 651.

²³ *Id.* at 651 (citations omitted).

²⁴ *Id.*

²⁵ *Lee v. Frost*, No. 21-20885-CIV-ALTONAGA/Torres (S.D. Fla. August 31, 2021).

²⁶ *Id.*

²⁷ *Id.* at 9.

²⁸ *Id.* at 10.

²⁹ *Id.* (citations omitted).

³⁰ *Id.*

³¹ *Kiger v. Mollenkopf*, Civ. No. 21-409-RGA (D. Del. November 15, 2021).

³² *Id.* at 9 (dismissing without prejudice).

Suits for Books and Records

Because the Kiger case against Qualcomm was dismissed without prejudice to refile, Ms. Kiger reportedly elected to pursue a Section 220 action.³³ If successful, Section 220 of the Delaware General Corporation Law would allow the plaintiff to obtain internal corporate documents that can be used to craft a complaint with more particularity so that it has a better chance of avoiding dismissal.

Earlier this year, in the Northern District of California, several plaintiffs brought shareholder derivative actions alleging that officers of Wells Fargo conducted fake interviews, thereby violating the company's hiring policy of promoting diversity.³⁴ Various parties sought to intervene including Amy Cook, who also filed a Section 220 action for a "books and records" inspection.³⁵ The Section 220 action has not yet been resolved.

A Section 220 request offers no guarantees. The Delaware Court of Chancery recently rejected a plaintiff's books and records action against The Walt Disney Company.³⁶

Disney had taken no position on certain Florida education legislation. When the bill passed, pro-LGBTQ company employees challenged Disney's silence, prompting the directors to hold an internal meeting on how to handle "political engagements and communications."³⁷ At the annual shareholder meeting, the company announced it would take a more public stand against such laws.³⁸ When Disney carried out its promise of activism, the state dissolved the special tax district encompassing Disneyworld that had afforded the company significant financial benefits and autonomy.³⁹

The plaintiff sued to obtain internal documentation regarding how and why the company had changed its position, but the Court found it to be an improper purpose⁴⁰ for inspecting the books and records. The Court entered judgment for Disney because, under Delaware law, directors enjoy substantial discretion in decision making and are empowered to weigh whether or not to incorporate social and political issues in that decision making.⁴¹

The Future of ESG Litigation

These cases are a few examples of how ESG-related litigation is expanding, a trend Vega expects to continue. Shareholders are divided—some want to invest in companies that value ESG principles. Others, however, want to hold corporations to traditional fiduciary obligations. Further,

³³ See Pappas, Leslie A., "Qualcomm Investor Sues In Del. For Docs On Board Diversity." *Law360* (March 11, 2022) <https://www.law360.com/articles/1473045> (accessed August 24, 2023).

³⁴ *In re Wells Fargo & Company Hiring Practices Derivative Litigation*, Nos. 22-cv-05173-TLT and 23-cv-01168-TLT (N.D. Cal. July 13, 2023).

³⁵ *Id.* at 5.

³⁶ *Simeone v. The Walt Disney Company*, C. A. 2022-1120-LWW (Del. Ch. Ct. Jun 27, 2023).

³⁷ *Id.* at 6.

³⁸ *Id.* at 7.

³⁹ *Id.*

⁴⁰ *Id.* at 19 (citations omitted).

⁴¹ *Id.* at 3.

state attorneys general are likely to become more involved, bringing a variety of suits challenging the incorporation of ESG principles in corporate governance.

Vega Economics offers expertise in ESG litigation and expert support in various areas, such as deceptive business practices, human rights violations in the supply chain, climate change litigation, and shareholder claims against companies for misstatements and omissions.

For additional inquiries please contact experts@vegaeconomics.com.