BRIEFING

TRAVERS SMITH

ESG litigation risk: developments in the UK

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1 Developing Business & Human Rights Norms and their Impact on UK Businesses with Foreign Subsidiaries

1.1 Soft law human rights frameworks such as the UNGPs and the OECD Guidelines for Multinational Enterprises are relatively well established globally and have been adopted by many businesses as part of the growing ESG agenda. At the same time, there is increasing focus on whether corporate activities are actually compliant with those frameworks. In the UK, this has been driven by the development of transnational tort claims.

1.2 Claimant law firms (and litigation funders) are seeing an opportunity to potentially extend the existing boundaries of tort law, and have explicitly pivoted towards bringing these novel and ambitious claims (commonly referred to as "**ESG claims**"). These claims are founded on two nascent extensions of the tort of negligence, namely (i) parent company liability and (ii) value chain liability.

Parent company liability	Value chain liability
In two recent decisions of the UK Supreme Court (*Vedanta* and *Okpabi*), the Supreme Court held that a parent company could be liable for the negligent acts of a subsidiary in circumstances where a parent (i) "*availed itself of the opportunity to take over, intervene in, control, supervise or advise the management of the relevant operations … of the subsidiary*" or (ii) in published materials "*holds itself out as exercising that degree of supervision and control of its subsidiaries, even if it does not in fact do so*". The Supreme Court noted that in corporate groups, parent companies (or business units within a corporate group) could take *de facto* control of a subsidiary (or a particular business function of a subsidiary) and therefore considered that a parent company could be sued by claimants on the grounds that it (i) stood in place of the subsidiary in practice and (ii) therefore assumed a duty of care that the subsidiary would otherwise hold.	Value chain liability claims are an even more ambitious attempt to extend the tort of negligence. A "value chain" is a reference to a company's activities related to the production of goods/provision of services. This can be a very wide brief, and can include the development of the product or the service, and the use and disposal of the product. It also includes the related activities of established upstream and downstream business relationships. In England, claimants in cases such as *Maran* and *Josiya* have brought negligence claims against UK-domiciled defendants in circumstances where the harm was allegedly (i) suffered downstream from the defendant's value chain and (ii) conducted by a third-party totally unconnected with the UK-domiciled defendant. In both instances, the claimants successfully resisted attempts to strike out the claims on the grounds that the duty of care was too remote.

1.3 In recent years the UK Supreme Court has allowed two parent company liability claims (*Vedanta and Okpabi*) to overcome early procedural hurdles and proceed to trial. This has had a significant impact on other novel transnational claims in lower courts, with judges becoming very reluctant to strike out tenuous claims given the apparent sympathy with which the UK Supreme Court has treated claims that, only a few years ago, would have been deemed unwinnable. Claims have recently been issued against:

- A UK supermarket, whose Thai subsidiary contracted with a third party in Malaysia to produce clothing. The third-party has been accused of enabling modern slavery practices, and the claimants have sued the supermarket on the grounds that it knew (or should have known) about these practices as a third-party "social auditor" checked the factories for health and safety compliance.
- An international trade association that sets standards for the sourcing of gold bullion, on the grounds that it certified that gold ultimately sourced from a mine where police officers had killed two individuals in Tanzania was "responsibly sourced".
- A UK-domiciled shipping agent which, acting on behalf of the owner of a defunct oil-tanker at the end of its working life, sold the vessel to a third party intermediary which sold the vessel to a shipyard in Bangladesh. A worker at the shipyard died while working on the ship, and his family sued the UK-domiciled shipping agent on the grounds that it knew, or should have known, that the vessel would ultimately be sold to a shipping yard that did not have appropriate health and safety practices.

1.4 To be very clear, none of these claims have yet reached trial, and there is still a great deal of uncertainty in this area. Most of the claims issued to date relate to either allegations of human rights abuses or environmental damage (by a subsidiary of a UK-domiciled defendant, or by a third-party further down a UK-domiciled defendant's value chain). These claims have been hard fought by defendants and have generally either settled privately or are progressing very slowly through the court system. Until these claims start to reach trial, and nature of the duty of care alleged by the claimants starts to be scrutinised with reference to detailed factual evidence, the existing uncertainty will remain.

2 Parallel Regulatory Developments

2.1 In addition to the development of transnational tort claims, UK businesses with EU operations should be aware of the European Commission's proposed Corporate Sustainability Due Diligence Directive ("**CS3D**") measures. Under the proposal, entities would be required to identify and prevent, end or mitigate potential and actual environmental and human rights impacts in their supply chain. EU entities with more than 500 employees and a net worldwide turnover of more than EUR 150 million are in scope, though for entities active in high risk sectors (which includes mining), those thresholds are reduced to 250 employees and EUR 40 million (provided at least 50% of turnover is generated in the high risk sector). Non-EU entities are also covered, where they have EUR 150 million of turnover generated in the EU, or EUR 40 million in the EU for those active in high risk sectors (where 50% of net worldwide turnover Is generated in the high risk sector).

2.2 Businesses, both based inside and outside the EU, will also need to report environmental, social and governance impacts of their activities, including those identified under the CSDD, under a related proposal – the Corporate Sustainability Reporting Directive ("**CSRD**"). Reporting will be based on standards currently under development which, according to exposure drafts consulted on earlier this year, could be quite burdensome.

3 Businesses need to consider their Exposure to this Risk

3.1 For business (i) with UK-domiciled holding companies or operations (ii) with foreign subsidiaries (iii) with known legal risk (particularly human rights risk or environmental risk), attention should be given to this developing area of the law.

3.2 These claims are often referred to as "ESG claims" because of their subject matter (i.e. human rights, environmental damage). However what is often overlooked is that businesses that are trying to do the "right" thing (e.g. by addressing human rights risk in their supply chain or by addressing climate change) and attesting (publicly) to their ESG credentials, need to be wary that they may be making themselves easy targets if they make commitments that they fail to live up to.

3.3 Putting ever-increasing amounts of ESG-related information about their businesses and value chains into the public domain will inevitably lead to attempts to hold entities accountable from a number of angles and actors – not just regulators. The volume of corporate ESG-related disclosures has increased substantially over recent years, with notable drivers being TCFD reporting, the EU SFDR and Taxonomy Regulation and the Modern Slavery Act. With the introduction of the CS3D and the CSRD, this will increase yet further. Both in the UK and globally we are seeing activist litigants leveraging both these disclosure laws/regulations and reputational risk in order to pressure high-profile businesses to push their agenda. Organisations should avoid at all costs viewing ESG

disclosures as "soft" statements and approaching them as if they were corporate marketing/PR. These very statements may be used against them in ESG-related litigation, such as parent company liability and value chain liability claims, as well as "greenwashing" actions.

3.4 Irrespective of the sector in which a business operates, one important means of managing ESG-related risk well is through robust and holistic ESG governance, compliance and monitoring systems, and legislation such as CS3D will eventually make it a legal duty to operate in accordance with such a system. The nature of these will differ from business to business, but it is clear that organisations in all sectors need to give thought to how they identify and implement their ESG objectives, and how they manage associated risk. Businesses need to be aware that centralised management of ESG risk across a corporate group may attract allegations of liability at the centre for alleged ESG-related harms, even where those alleged harms are connected to the activities of subsidiaries or even third parties in a commercial value chain. Businesses should consciously assess how they want to balance this risk with their ESG governance and compliance objectives.

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