

UPDATE

ESG: Balancing Competing Interests - The Court's Intervention

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Environmental, Social and Governance (ESG) considerations have become standing items on board agendas, with increasing awareness that failure to address these matters poses both a serious financial and reputational business and investment risk.

Gilly Kennedy-Smith and Christa Feltham consider how the Courts have intervened in particular in the 'E' sector, and the impact such intervention may have on your business and investments.

ESG in a Nutshell

ESG is not just a buzzword used to denote a company's commitment to corporate responsibility. They are non-financial standards used to identify material risks and growth opportunities in any business spanning environmental, social and governance matters.

There is an increased emphasis on the preservation of the world's natural capital (water, forests and clear air) and recognition of the services we derive from it (food, climate regulation - **Ecosystem Services**). Increased pressures on this capital i.e. due to climate change and biodiversity loss, are decreasing the ecosystems on which our economies depend, presenting a real risk to business.

This emphasis has not merely arisen as a point of principle to protect our planet, but also in connection with human rights and a businesses' rising operating costs or volatility where it relies on the availability of natural capital (e.g. the food and drink industry) or operates in a location that is exposed to extreme weather conditions (e.g. floods, hurricanes, drought). The pandemic has intensified this discussion, in particular when considering the interconnectedness of sustainability and the financial system.

In response to these pressures, governments, businesses and individuals need to diversify their understanding of ESG and key drivers of policy that will affect them. We discuss below one of the drivers and why increased awareness of these risks and the implementation of good governance is key to the survival of any business.

Court's Intervention

As explained briefly above, natural capital risk can be caused by physical factors (such as climate change – increased drought or extreme weather events), but also changes in policy and legislation. The transition to a low carbon economy has been a hot topic for many years now and is often associated with government policy aimed at holding companies accountable for climate related damage. However, the Courts have started to take steps to hold both government and big corporations accountable, and this can have an impact on the investments we make. The Dutch Courts are leading the way with two landmark judgments *Uragenda*¹ and *Royal Dutch Shell*². Each of these cases are based on the grounds of protecting human

¹ *The State of the Netherlands v Uragenda Foundation*, Judgment (Sup. Ct. Neth. Dec 20. 2019).

² *Milieudefensie et al. v. Royal Dutch Shell plc.* (May 2021).

rights and/or to avoid breaches of international treaties such as the Paris Agreement or domestic legislation such as the Climate Change Act 2008 in England and Wales.

Twenty years ago these judgments would have been unexpected and possibly a controversial intervention by the Courts in policy making. However, they demonstrate a change in approach. Such judgments often result in further legislation and policy to reinforce a government's commitment to addressing the climate crisis, including the introduction of further mechanisms aimed at reducing domestic emissions.

A perhaps less obvious consequence of such judgments is 'spin-off' litigation centred around, for example, the government's intervention in introducing climate action measures giving rise to a cause of action by investors under the 1994 Energy Charter Treaty (ECT). By way of summary – the ECT was enacted to establish a multilateral framework for cross-border cooperation in the energy industry. This cooperation was predominately underpinned by its provisions on investment protection. In response to the climate crisis, certain energy production methods are being phased out, affecting investment longevity. One example is in Uniper, a German energy company that invested in the Maasvlakte 3 coal-fired power plant in 2007. The Netherlands introduced new legislation in 2019, banning the use of coal in the production of electricity. If Maasvlakte does not convert to another fuel by 2030, it must close, causing Uniper to lose its investments.

These are just a few current examples of how a marked change in behaviour is demanding a shift in how we conduct day-to-day business – bringing Environmental, Social and Governance factors to the top of board agenda's due to an increased awareness that a failure to address these concerns as a business, increases the business' financial and reputational risk.

Practical Considerations

Although these may appear abstract and as though they do not impact investors and trustees or beneficiaries of trusts, they are intrinsically linked. By way of example, considering the *Uniper* position, as the owner of the company you will be concerned about significant shareholder exit or penalty if you are unable to convert to a different fuel that is not affected by the coal ban. As an investor, you will want to know what strategy is in place to secure the future of your investment; you will also be affected by the likely immediate fall in share price following the introduction of the coal ban. Equally, if the energy plant formed part of trust property, as a trustee or beneficiary you will have similar concerns and a desire to prevent asset loss.

Therefore, whether you are a director or trustee on a board, an owner of a company that relies on natural capital or is subject to emissions targets, or an individual considering investment, you need to be alive to ESG factors in order to properly understand and account for these risks in your decision making.

How we can help

Mourant's One Firm approach brings expertise across sectors together to help address your needs as a private client or business. Our team is made up of lawyers in our International Trust and Private Client, Corporate and Litigation teams advising on Sustainable Investing and Impact Funds ([find out more here](#)), tax and trust structures as well as a range of cross-border contentious or regulatory matters. If you are interested to hear more about ESG and what it means to Mourant, please click [here](#).

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