

Fifty Shades of Green? ESG Pressure vs the Risk of Greenwashing

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The current pressure on companies to be “green” is unprecedented. It is the natural result of the world becoming more focused on the risk of climate change and the need for a successful transition to cleaner energy. This pressure has led to many companies making public statements about their green credentials, often to allay the concerns of consumers or investors. However, increased regulation has introduced new risks and compliance burdens, all designed to ensure that such statements are not misleading.

What Is Greenwashing?

Greenwashing refers to a practice by which a company makes inaccurate or misleading claims about its business or products in order to improve their environmental or social credentials. Such claims are traditionally made in advertising or marketing promotions. However, they are increasingly appearing in annual reports, investor documents and contractual agreements.

What Are the Regulatory and Legal Risks of Greenwashing?

Those operating in the UK need to be aware of the UK legal and regulatory regime which could catch and penalize greenwashing. Thus far, the main targets have been misleading advertising and marketing (with enforcement action being taken by the Advertising Standards Authority and the Competition and Markets Authority). However, new UK legislation arguably creates strict or near-strict liability for companies and directors of companies that engage in greenwashing activities. This includes statutes targeting fraud and false accounting. In addition, the new strict liability offence for failing to prevent fraud

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introduced by the Economic Crime and Corporate Transparency Act 2023 paves the way for corporate liability for greenwashing, much as the Bribery Act 2010 did for bribery. It creates an offence for corporates who fail to prevent fraud by their employees, agents and other associated persons.

Greenwashing allegations have already become a focus for a number of NGOs and climate activist organizations. Given greater ESG awareness, it is likely only a matter of time before prosecutors, whether government or private, begin to bring cases against organizations and groups engaged in activity that they see as greenwashing.

Greenwashing can also give rise to civil litigation risk. There are a wide range of potential civil actions that can be brought by shareholders, customers and other interested parties. These include derivative actions under the Companies Act 2006 and claims under Financial Services and Markets Act 2000. While in its early days, it is clear this is a developing area.

The penalties for failure to comply with the regulatory and legal regime in the UK can be significant. However, as with other forms of compliance and financial crime, much of the penalty is in the process of being investigated and/or prosecuted, even if a conviction is not subsequently secured.

What Are the Other Risks Associated With Greenwashing?

Driven by the pressure to be 'green' and to achieve competitive advantage, many companies position their products or themselves as sustainable. Should the consumer trust them all? Many organizations set ambitious sustainability targets that often fall short of what is required, are not fit for purpose, or cannot be met. The lack of consensus as to what constitutes 'green standards' or 'sustainable' is often defined by third-party verification or certification bodies, which means that it can be difficult for companies and consumers alike to distinguish greenwashing claims, without a clear global standard or knowledge behind the label.

Consumer trust, often earned over periods of many years may easily break down after an incident of greenwashing, impacting companies' revenue, reputation and operations, potentially causing substantial damage to companies' bottom-lines.

It is not only greenwashing that companies must manage, but 'greenwashing' and 'greenhushing' as well.

In some cases, organizations will choose not to publicize their ESG credentials at all (greenhushing) for fear of making claims they cannot substantiate, or being penalized by investors who might consider ESG to undermine profit. While silence on sustainability matters might reduce the risk for corporate

liability, it can also increase the reputational risk if there is a lack of transparency.

Companies may also unknowingly or unwillingly set unrealistic targets or make unfounded public statements about their intent to improve their sustainability profile (greenwashing). They may overpromise and underdeliver by greenwashing, perhaps hoping to meet specific sustainability credentials however lacking the internal resources, capability, budget or will to do so. There are cases where this is particularly challenging for those SMEs that may not be able to afford to pay for advice, or for annual certification fees to validate their ESG claims. However, this should not stop any company looking to achieve better sustainability outcomes and communicating their progress honestly and openly. There is publicly available government guidance, which is free to everyone, which helps companies to avoid making unsubstantiated or misleading claims.

How Do We Find the Right Balance?

It may be quite easily concluded that between greenwashing, greenwishing and greenhushing, making material progress on ESG issues and communicating on this effectively is an ever-complicated minefield. However, being transparent about a company's current state and progress on their sustainability efforts has never been more crucial.

The perceived complexities should not deter efforts. However, organizations could mitigate the risks by seeking suppliers that have evidence based ESG credentials for their value chains. It is true that this may sometimes incur initial capex outlays, or higher operational costs. However, this initial expenditure could be dwarfed by the risks to revenue, operations and reputation that may result from misleading ESG strategies.

There is no one-size-fits-all approach. Companies must find the appropriate balance for them by continuing to evaluate their sustainability initiatives, conducting external due diligence and integrating ESG into their risk frameworks. Companies that do so will have the confidence to communicate their substantiated claims with clarity and are more likely to benefit in the long run.

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