GREENWASHING

THE NEW DUE DILIGENCE ENVIRONMENT

It has been five years since the Task Force on Climate-related Financial Disclosures (TCFD) published its recommendations. Since then, support for this global initiative – and for company climate and ESG reporting in general – has skyrocketed. Today more than 3,000 organisations in 92 countries with a combined market capitalisation of USD27.2 trillion have signed up as TCFD supporters, and thousands more businesses are also now publishing reports in this area.

As this agenda grows, a sister trend is also emerging: the growing risk of 'greenwashing' claims made against organisations eager to earn their social licence to operate. Following closely behind is a rise in litigation. The London School of Economics' Grantham Research Institute on Climate Change and the Environment announced recently that there are more than 2,000 climate change cases underway around the world, more than double those in 2015.

At a time when organisations around the world are treading a careful line between publishing reports of their ESG progress and straying into the riskier waters of greenwashing, MEttle talked to Lloyd Kavanagh, Senior Partner at MinterEllisonRuddWatts, who is an acknowledged expert on the governance requirements of ESG statements, processes, outcomes and key risks. He shared some of the key risks that surround greenwashing, as well as his insights for business leaders stepping their way through the complexities of this evolving environment.

WHAT IS GREENWASHING, AND WHAT IS DRIVING RISK IN THIS AREA?

The Cambridge English Dictionary defines greenwashing as 'behaviour or activities that make people believe that a company is doing more to protect the environment than it really is'. Kavanagh defines it as 'when the label doesn't match the contents of the tin' from an ESG perspective.

"For me," he says, "greenwashing is when an organisation makes false, misleading, or untrue statements or actions or set of claims about the positive ESG impacts that they or any of their products or services has. This is usually focused on environmental claims, but it can include wider social or governance claims."

Going on to say that ESG statements with no clear achievable programme are becoming high-risk for organisations where adequate internal due diligence is not undertaken, Kavanagh says that he sees two very distinct types of greenwashing.

"Firstly, where deliberate ESG claims are made that the person communicating knows or ought to know are untrue. Fortunately, this is rare, but essentially it's straight-out fraud.

"More commonly however, it's due to well-meaning aspirations at the board or ELT level to address investor or customer concerns, which are not translated into everyday business. The organisation signs up to commitments and policies at a high level, without putting in place the processes to change the fundamental way business is done day-to-day."

This creates potential risk on a growing scale, given the extent of reporting around the world. According to KPMG's 2022 Survey of Sustainability Reporting, based on an analysis of reports and websites from 5,800 companies in 58 countries, territories and jurisdictions, sustainability reporting is growing at pace. Over the past year, 96% of G250 companies reported on sustainability or ESG matters, and TCFD adoption has nearly doubled in two years, going from 37% to 61% among the G250.

Amid this rapid rise in reporting, Kavanagh says that greenwashing risk can be seen in four common situations.

"Firstly, greenhouse gas emissions reduction targets. Organisations are scrambling to meet net zero emissions by 2050. Reduction targets and pathways are capable of genuine intention, but they can be deemed misleading if they are not based on reasonable grounds."

Secondly, he says that the standards for truthful labelling of products and services have risen.

> **"Labelling products as sustainable and green has moved from being broad to now imply a more defined and higher standard of conduct."**
>
> Lloyd Kavanagh, MinterEllisonRuddWatts

He adds that the New Zealand Commerce Commission acknowledges that consumers are increasingly considering the environment when making purchasing decisions and has released a set of claim guidelines governing environmental claims.

"They must be accurate, scientifically sound, and substantiated. The alternative for organisations is severe monetary penalties as well as loss of brand reputation."

Third is what Kavanagh calls Enterprise Branding.

"Consumer protection regulators, and environmental activists are increasingly scrutinising greenwashing in advertising campaigns. Therefore, statements must have evidential backing in a similar way to creating a financial product offering or statement."

Lastly is the topic of disclosure, specifically in financial reports and accompanying narrative, offer documents and, for some, mandatory climate reporting will be required soon.

Kavanagh says that the Financial Markets Authority has recently pointed out that businesses with financial reporting obligations have two reasons to consider the impact that climate risks and opportunities have on their financial statements.

"All entities have existing requirements to assess what impact climate change has on their financial statements."
Lloyd Kavanagh, MinterEllisonRuddWatts

"First, about 200 reporting entities must comply with a mandatory framework for climate-related disclosure (CRD). This is so that they provide investors and other stakeholders with better insights into the climate risks and opportunities impacting those entities. This will apply for reporting periods beginning on or after 1 January 2023.

"Second, all entities – whether or not they are captured by the CRD regime or other mandatory framework – have existing requirements, under current Australian and New Zealand Accounting Standards, to assess what impact climate change has on their financial statements. Most companies will be subject to some degree either to physical impacts or transition impacts, such as changing government rules and market forces as customers and investors move their preferences."

Another factor raising the bar, Kavanagh says, is that two main groups are now focused on holding companies to account.

"Regulators, such as ASIC, and ACCC in Australia, are already active in doing this. Closer to home, both the FMA and Commerce Commission have published guidance to highlight the priority this must be given. These organisations are increasingly scrutinising products and services, and often at the encouragement of the Government.

"Secondly, regimes are also being policed by activist litigants who often have significant backing and funding. Not only do they take cases themselves, but they put pressure on regulators to be more active.

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"This means, for example, that signing up to zero carbon banking initiatives requires you to have a plan and commitment that gives you reasonable grounds to believe you will achieve your aim."

"Given increased political and community scrutiny you must be careful and clear, and not mislead people. This requires a clear approvals process in your business. Claims about products should be run past not just marketing but legal as well."

ESG DUE DILIGENCE

What can organisations do to improve their ESG due diligence and disclosures? Consider the seven points below when approaching ESG due diligence, governance and claims.

ONE

The ESG governance message needs to come from the top. If it's not yet on your agenda, then you're already behind.

TWO

Make reporting and disclosure in this area as important as other risks that are already reported and disclosed.

THREE

Apply the same due diligence processes you would when making non-financial (i.e. ESG) claims as you would to financial claims.

FOUR

Ensure that aspirational policies/claims are underpinned by detailed programmes that show you can reasonably believe that the policies and claims will be achieved – that they are not "pie in the sky".

FIVE

Stand in the shoes of investors and customers to evaluate what they would expect the claim to mean.

SIX

Listen to your customers and people – do they support or criticise your actions in this area? Also consider how they and your suppliers are likely to be affected.

SEVEN

Know your skills or knowledge gaps – if you need more awareness on this topic and the consequences it can have on you and your business, ask your legal team for an education session. Make sure you also have expertise in place as well.

Four key steps that should be on every leadership team's 'to do' list

1. Identify current ESG-related claims made on websites, in press releases and disclosures.
2. Pinpoint your current communications approach and develop what you should consider going forward.
3. If ESG claims have resulted in misleading or confusing customers, consider options for customer redress – and then action.
4. Undertake a risk assessment of existing claims against regulator guidance/principles:
   - Be truthful and accurate
   - Be specific
   - Use plain language
   - Do not exaggerate
   - Make information easy to locate and access
   - Overall impression counts
   - Clearly explain and substantiate your claims

   (e.g. do you have reasonable grounds for a claim? How will you measure and achieve this claim?)