AGENDA

OPINION

Empty ESG Promises: Investor Recourse for Moral Harms

By David S. Flugman, Joshua Margolin, Samuel Breidbart, Denae Kassotis

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Investors increasingly call upon companies to provide information about their environmental, social, and governance (ESG) practices.

In providing such information, companies are subject to federal and state securities law. If a company misrepresents or omits information about its ESG practices, causing its stock value to drop, it may be liable under such laws, just as if other information was misrepresented or omitted causing a decline.

But what if a company misrepresents its ESG practices and a drop in its stock value cannot be tied to ESG misrepresentations? Or what if its stock value *does not* drop but the market is illiquid? It is easy to imagine that a company which makes certain representations about its sustainability practices, but which is not actually making investments necessary to reduce its carbon footprint, may end up being more profitable.

David S. Flugman, Partner
David Flugman has successfully represented clients in a wide array of matters in federal and state courts and arbitral panels across the United States and in cross-border litigations.

Joshua Margolin, Partner
Joshua Margolin has litigated, arbitrated and mediated matters involving complex financial products, securities fraud, corporate governance, and mergers, and has guided clients through investigations.

Samuel Breidbart
Samuel Breidbart is an associate at Selendy Gay Elsberg.

Denae Kassotis
Denae Kassotis is an associate at Selendy Gay Elsberg.

Should shareholders be able to bring a claim against a company for its allegedly misleading representations, despite the fact that such misrepresentations cannot be tied to economic losses?

Perhaps these investors have sustained no economic harm, but for investors for whom sustainability is a guiding principle, a company's ESG misrepresentations amount to a different harm: what can be called a "moral harm," where investors are misled into violating their normative preferences with their investments.

What can be done for investors in this predicament? Do securities laws provide remedies for those who believed they were investing in environmentally responsible companies, only to learn they were duped?

Blue Sky Laws

State law provides one pathway to relief for aggrieved investors against an issuer. In several states, "Blue Sky" laws — statutes shielding investors from fraudulent behavior — offer causes of action for rescission (when the issuer repurchases the investors' securities) even to investors who suffer no economic loss. Blue Sky laws vary regarding what elements must be pled, but their protections are the same: a right to sue issuers who misrepresent or omit information in connection with an issuance.

Rescission is the proper remedy for moral harm under the Blue Sky laws because it restores investors and issuers to the positions they occupied before the sale of the security. Unlike traditional damages, rescission is not tied to the level of economic loss an investor endured, and provides a remedy even where a stock may have not dropped in value and may be illiquid.

Rescission in this context is available under nearly every state's Blue Sky laws (New York being a notable exception). Courts in several states (such as Florida and Massachusetts) appear particularly solicitous of actions for rescission even when there is no economic loss.

For example, an aggrieved stockholder could bring a claim under the Massachusetts Uniform Securities Act by proving that (1) a misrepresentation or omission occurred in connection with an offering or sale in Massachusetts, (2) the investor did not know about the misrepresentation or omission, and (3) the issuer knew or should have known about it. At no point would the investor need to allege that they relied on the misrepresentation in making their purchase, or that they suffered economic loss.

Whether such a claim is likely to succeed is hard to assess because of its novelty. And even where rescission is available, courts may stress that certain misrepresentations about sustainable practices that do not lead to economic loss are insufficiently "material" to an investor's decision to invest to form the basis of a claim.

Federal Law

Morally harmed investors may also turn to Section 12 of the Securities and Exchange Act, which allows an investor to rescind a transaction by showing that a prospectus (or oral communication) contained a material misstatement or omission, and that they were unaware of the truth when they purchased the security.

Under the relevant provisions of Section 12, an investor *must* demonstrate that the misinformation or omission was material. But again, whether courts will consider ESG representations untethered from a company's finances to be "material" remains an open question.

While federal courts have not considered the issue, the SEC recognizes that the definition of materiality is "evolving" given investors' increasing interest in ESG. One study confirms that investors are more likely to engage companies on sustainability issues than on financial results or corporate strategy. But this same study indicates that ESG representations matter to investors *because* a company's ESG compliance tends to impact its bottom line.

Will courts conclude that a statement is material if it does not affect the investment financially? Although Section 12 requires no showing of economic loss, the absence of economic injury may be relevant — or even necessary — to materiality. What position courts take remains to be seen.

Conclusion

What is certain, however, is that courts will face a morally harmed investor sooner rather than later, as investors become increasingly concerned with their acquiescence to, or facilitation of, companies' poor ESG practices.

If investors are led to believe that their investments are helping the world, when they are actually making matters worse, they suffer a real (albeit intangible) injury. As described here, investors may seek relief through litigation under state and federal securities laws.

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