

# Looking to the horizon – the pitfalls on the path to net zero

## Climate change-related disputes

If it is not already upon us, a ‘perfect storm’ is developing on the horizon, bringing a wave of climate change-related disputes, super-charged by the £2Bn of cash held by the UK’s litigation funders, and compounded by recent legal judgments, developments in the UK’s class action regime and changes in attitudes across society.

### Net zero

Most nations around the world have made some form of commitment to reduce carbon dioxide emissions. The reality, highlighted in a recent report by the International Energy Agency (IEA), ‘*Net Zero by 2050 – A Roadmap for the Global Energy Sector*’ (May 2021), is that there either needs to be a vastly increased divestment from carbon fuels around the world and reinvestment in clean-energy sources (which means R&D and increased focus on, and investment in, innovation) or those nations will not meet their climate change goals. The IEA report states that energy groups need to stop all new oil and gas exploration projects from this year if global warming is to be kept in check.

### Investors prepared for climate activism

FTI Consulting has researched 250 global institutional investors<sup>1</sup> representing over \$10 trillion in assets under management. More than one-third (41%) of respondents expect Environmental, Social and Governance ‘ESG’ related disclosures and regulation to bring about claims backed

by litigation funding. This sentiment is expressed more strongly by investors in North America (48%) compared to investors in Europe (29%).

### Walking the walk

The litigation risk, in part, revolves around the tension and inconsistencies between *actions* and *statements* (or disclosures) also known as ‘greenwashing’ and impacts governments, as well as corporates, and not just those working in the extractive sectors. While most climate change-related litigation has been in the US, we are seeing activity in the EU as well. Recent notable cases in the EU include [legal action taken against the Belgian Central Bank](#) by climate activists who allege that the bank is directing funding to sectors that are causing the climate crisis, and has thereby breached environmental and human rights laws. In the UK, a group of climate activists have [launched a legal action](#) intended to challenge the UK government’s support for maximising the economic recovery from the North Sea oil and gas production.

1 FTI Consulting survey of global institutional investors, March 2021, n= 250 with total AUM of \$10tn+

## Extended duties of care

Beyond the extractive sectors, we expect to see an increase in what are known as S.172 claims against directors. Under S. 172 of the UK's Companies Act 2006, directors have a duty to consider the environmental impact of their business operations. Companies are also required to make an annual s.172 disclosure, setting out how their directors have had regard to the likely consequences of any decision in the long term, and the impact of the company's operations on the community and the environment. Where there is a divergence between statements and actions, there is a risk that campaign groups and activist investors may bring claims against both the corporate and the directors; this risk extends beyond issues around climate change, but also in relation to other societal considerations. And the claimants' main motivation in these cases may not be to seek redress or financial compensation but to affect public policy and behavioural change.

## Legislative changes

On the legislative side, as part of a raft of Directives to be passed in the EU relating to sustainable finance and the wider Environmental, Social and Governance agenda, we expect the EU to bring in the *EU Directive on Mandatory Human Rights, Environmental and Good Governance Due Diligence* ('EU Directive')<sup>2</sup>. This will make it mandatory for all businesses - regardless of size or sector - to conduct adequate supply chain due diligence in relation to human rights, environmental and governance risks. The level of due diligence will need to cover the whole value chain, including direct and indirect business relationships, both upstream and downstream. The EU Directive will bind both companies established in the EU, as well as those established outside the EU, who have access to the EU internal market.

The Taskforce and Climate-Related Financial Disclosures (TCFD) was created in 2015 by the Financial Stability Board (FSB) to develop consistent climate-related financial risk disclosures for use by companies, banks and investors across the G20. In the UK, the government has committed to be the first G20 country to make the voluntary TCFD-aligned climate-related financial risk disclosures mandatory in the UK by 2025. In addition, while narrower than the EU Directive, we expect to see steps taken by the UK legislature to bolster the Modern Slavery Act 2015, to make the due diligence provisions mandatory. We would not discount the

possibility of the UK government going further to expand the supply chain due diligence requirements to encompass risks to the environment and wider society.

## Looking ahead

As the Belgian Central Bank case illustrates, there is growing pressure on large banks, pension and investment funds and insurance companies to stop funding, investing in or underwriting businesses involved in operations that are harmful to the environment. An example of the increasing impact this will have is a recent case in Australia, where BMD Group, a mining contractor, had to [appeal to the Australian government for insurance](#) after they were unable to secure insurance for a controversial coal mine project due to environmental concerns.

Until now climate change-related legal cases have been against governments (by way of some form of application for Judicial Review) and against extractive companies, often focused on negligence, nuisance and fraud. This trend will continue, with recent judgments in the UK (*Lungowe v Vedanta Resources Plc*, and *Okpabi v Royal Dutch Shell Plc*) establishing that a UK headquartered parent company may owe a duty of care to injured third parties for the actions of a foreign subsidiary. Litigation funders are already investing in these types of cases, and while not every case will appeal to the funders due to the economics and diverging motivations of the claimants, we may see further instances of litigation funded environmental claims being brought in the UK Courts.

*Based on FTI Consulting's research of 250 global institutional investors, 38% of European institutional investors expect to see environmental harm cases backed by litigation funding<sup>3</sup>.*

As mentioned above, there is also likely to be an increase in actions taken against directors of companies operating outside of the extractive sector, based on inconsistencies between their corporate disclosures and the actions of those corporates. This may take several forms, but we expect to see an increase in climate change-related claims and group litigation brought by activist investors under Section 90A of the Financial Services and Markets Act 2000 (FSMA). FSMA 90A gives investors a right to sue

<sup>2</sup> [https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073\\_EN.html#title2](https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html#title2)

<sup>3</sup> FTI Consulting survey of global institutional investors, March 2021, n= 250 with total AUM of \$10tn+

a public company that publishes misleading information to the market. Where activist groups suspect a company of greenwashing (either based on their own research or a regulatory finding), they may buy shares in the target company, and then launch a media campaign highlighting their grievances, alleging greenwashing. The plan would be to drive the target company's share price down and then initiate legal proceedings against the company to recover the losses. With access to crowdfunding, and with the main motivation of the climate activists being to affect change in behaviour rather than to recover losses or seek financial compensation, the legal and reputational risks of climate activist litigation are considerable.

The path to meeting net zero goals is a walk that the international community needs to take, but it is not going to be straightforward and there are many pitfalls along the way.

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