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A WORD ON TAKING CSR TO COURT

TAKING CSR TO COURT: HOW DOES THIS AFFECT COMPANIES AND INVESTORS?

Due diligence litigation against large companies has grabbed headlines in recent years, showing how Corporate Social Responsibility (CSR) has now become a matter for the courts. Valérie Demeure, Head of ESG Research at Ofi Invest Asset Management, provides some insight into the latest CSR trends and their impact on portfolio management.

CSR was initially voluntary and based on benchmark international legal doctrines[1] but was not binding.

However, the signing of the Paris Agreement in 2015 signalled a collective awareness of the need to act and to go further in addressing climate challenges and sustainability, so that the environmental transition would also be a socially fair transition. This has led to the strengthening of regulatory and legislative frameworks, as well as legal recourse.

Strengthening the CSR legislative framework: from soft law to hard law

France established an initial framework with its March 2017 adoption of a **due diligence law**[2] requiring that large French companies set up plans to identify and prevent risks to fundamental human rights, serious bodily or environmental damage, or health risks from the actions of the companies or their sub-contractors. The due diligence law introduced a provision incurring the civil liability of those companies in the event that such risks are borne out. In Germany, a very similar law was passed in 2023 but provides for only a system of administrative sanctions against companies.

At the European level, the legislative arsenal has also been strengthened around the Green Deal, which addresses 2050 carbon-neutrality objectives. Recently adopted texts include the green taxonomy; the Corporate Sustainability Reporting Directive (CSRD), which aims to make companies' extra-financial reporting more standardised and reliable; and the Sustainable Finance Disclosure Regulation (SFDR), which deals with financial products. These texts target greater transparency from companies and financiers. They come with a system of inspections, but no sanctions.

This is not the case of other European texts, such as the European due diligence directive[3], which provides for a system of administrative sanctions, including fines of as much as 5% of a company's net worldwide revenues and civil liability charges with possible indemnities paid to victims of adverse impacts. Regulations on forced labour and on banning the sale or export from Europe of products that have contributed to deforestation or the worsening of forests. also come with a system of inspections, customs ones in particular, and sanctions that include fines, among other things.

And, lastly, companies' criminal liability may also be incurred. This is the case of the Environmental Crime Directive passed in March 2024, which provides for a list of criminal infractions and recognises the crime of ecocide[4].

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*[1] Companies' voluntary CSR actions were initially based on benchmark frameworks such as the **OECD Guidelines for Multinational Enterprises**, the **United Nations Global Compact**, the **UN Guiding Principles on Business and Human Rights** and the **fundamental conventions of the International Labor Organization.***

[2] Law n°2017-399 on due diligence by parent companies and client companies.

[3] The Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the European Council in May 2024.

[4] Individuals guilty of environmental crimes causing the death of a person are punishable by prison terms of up to 10 years and eight years for "qualified infractions" equivalent to an ecocide, and five years for the others. They are also required to repair the damage caused to the environment. Companies are subject to fines amounting to as much as 5% of their global annual revenues or 40 million euros.

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More and more civil litigation against companies

As a result of these legislative and regulatory standards, litigation against companies has become increasingly common in recent years, mainly from non-governmental organisations.

In France, major groups, such a La Poste, Casino, Yves Rocher, Carrefour, Auchan, Danone and TotalEnergies* have been sued for failing in their due diligence obligations. There are various grievances behind these alleged failings, including undocumented workers in their subcontracting chain, hindering of trade-union freedoms, contributing to deforestation, failing to take action against plastic pollution, a controversial oil pipeline in Uganda due to its environmental impacts, harming local communities, etc.

But beyond these cases of litigation and the strong media echo they triggered, the judicial outlines of due diligence must be better drawn, and a dedicated courtroom was established in early 2024 at the Paris Court of Appeal to hear these cases[5].

How does all this affect investors?

In accordance with sustainable investment principles, investors must consider long-term investment factors, and in particular, environmental, social and governance (ESG) ones. This is indeed part of their fiduciary responsibility[6]. In addition to taking ESG factors into account, European regulations, SFDR in particular, require that investors be transparent in integrating these ESG factors and in considering negative sustainability impacts. This obligation of transparency is found in France with the Energy-Climate Law, under which investors report on these factors, as well as on their climate strategy and their strategy for combatting depletion of biodiversity.

Changes in corporate sustainability regulations and the increase in litigation that has come with them have had an impact on investment research and the resulting portfolio management choices.

These changes are reflected in companies' ESG ratings and the monitoring of controversies that they face, as well as in a review of their ability to manage the risks that have been identified and to take remediation measures if their management practices come up short. In addition to this risk management component, investors may also exercise the two levers of shareholder engagement actionnarial and voting to urge companies to make progress in tackling sustainability factors. Such levers may be activated individually or collectively via investor coalitions, in order to call out issuers on very precise matters, such as their climate strategies, by submitting "say-on-climate" resolutions, for example, or on other thematics, such as human rights, plastic pollution, deforestation, and others.

Financial sector activities and the social and environmental impacts of investments and financing are also reviewed by non-governmental organisations. Each year, NGOs conduct campaigns and publish reports on climate[7] and societal[8], thematics arising from investments and project financing[9], which constitute a true reputational risk.

There is also some legal risk. In February 2023, BNP Paribas* was sued by Friends of the Earth, France, Notre Affaire à Tous and Oxfam France for failing to comply with its climate due diligence obligations[10]. This was a first, but probably not the last, of a series highlighting the civil liability of all actors in combatting adverse sustainability impacts.

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What is CSRD?[11]

Applicable since 1 January 2024, the European Corporate Sustainability Reporting Directive (CSRD) establishes new extra-financial reporting standards and obligations. The CSRD covers large companies and listed small and mid caps.

The purpose of CSRD is to encourage companies to be more transparent in their sustainable development actions.

*Companies are mentioned only for informational purposes, not as an offer to sell, nor as a solicitation to buy, financial securities

(5) https://www.cours-appel.justice.fr/paris/creation-dune-chambre-des-contentieux-emergents-devoir-de-vigilance-et-responsabilite

(6) https://www.unpri.org/download?ac=10965

(7) See, for example, the report "Banking on Climate Chaos, 2024" https://www.banktrack.org/download/banking_on_climate_chaos_2024/bocc_2024_vf1.pdf

(8) See, for example: https://www.banktrack.org/download/actions_speak_louder_2024_update_on_bank_responses_to_human_rights_violations/actions_speak_louder_2024_aw_opt.pdf

(9) See, for example, the recent reports of Reclaim Finance: https://reclaimfinance.org/site/2024/05/27/banques-et-chaos-climatique-le-soutien-au-charbon-metallurgique-en-hausse or https://reclaimfinance.org/site/2024/06/13/piege-energetique-en-europe-les-banques-soutiennent-le-gaz-fossile-avec-stade-lng/

(10) https://www.lemonde.fr/planete/article/2023/02/23/bnp-paribas-premiere-banque-assignee-en-justice-pour-son-financement-des-energies-fossiles_6162941_3244.html

(11) https://entreprendre.service-public.fr/actualites/A16970

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Their extra-financial reporting deals with ESG (environmental, social and governance) **data,** including:
- environmental factors: climate change mitigation and adaptation, biodiversity, use of resources, etc.
- social factors: equal opportunity, working conditions, and upholding human rights and fundamental freedoms, etc.
- governance factors: role of administrative bodies, lobbying, and managing relations with business partners

Information disclosed by the company must be certified by an external auditor or an accredited independent third-party organisation.

What is SFDR?

The European Sustainable Finance Disclosure Regulation (SFDR) aims to promote sustainability in Europe's financial sector.

Under SFDR, companies that distribute or provide advice on financial products in the European Union are subject to obligations of transparency on extra-financial or **ESG (Environmental, social and governance)**, criteria, particularly to facilitate comparisons between financial products.

Portfolio management companies must use the following classifications in providing investors with clear and comparable information on the sustainability of their investments.

Three categories of financial products are defined by the SFDR, based on their contribution to sustainability:
- "Article 9" investments, which have a sustainable investment objective.
- "Article 8" investments, which promote social and/or environmental objectives.
- "Article 6" investments, which do not integrate any kind of sustainability into their investment processes. This includes all investments that are neither "Article 8", nor "Article 9".

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