

ALERT

SEC's First ESG Enforcement Action Is Latest Move In Agency's ESG Efforts

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As we expected to see in 2022, the U.S. Securities and Exchange Commission (SEC) is continuing an aggressive push in policing Environmental, Social, and Governance (ESG) related matters. In just the first few months of this year, the SEC has already brought a case it hails as its first major ESG enforcement action, *Securities & Exchange Commission v. Vale S.A.*, 1:22-cv-02405 (E.D.N.Y.). In addition, the Commission proposed a new climate disclosure rule. All signs point to the SEC moving full steam ahead on ESG cases.

SEC Brings First ESG Enforcement Action: SEC v. Vale S.A.

Exactly one year from the formation of the ESG Task Force, on April 28th, the SEC brought its first ESG-related enforcement action. In its 285-paragraph complaint, the SEC charged Vale S.A. (Vale), a Brazilian iron ore producer, in the U.S. District Court for the Eastern District of New York with securities fraud.^[1] The SEC alleges that Vale made false and misleading statements related to the safety and stability of dams holding toxic waste by-products of its mining operations. But the SEC's complaint deserves more context: It comes nearly two years after private plaintiffs filed a similar securities fraud class action against Vale and its senior executives.^[2]

Both actions arise out the 2019 collapse of Vale's Brumadinho dam. On January 25, 2019, the Brumadinho dam at Vale's iron ore mine in Córrego do Feijão, Brazil failed and allegedly killed 270 individuals and caused significant environmental damage. The complaints further allege that following the collapse, the value of the Vale's stock declined significantly. The SEC Complaint specifically alleges that Vale's market capitalization declined by over \$4 billion, its American Depository Shares lost more than 25% of their value, and that Vale's

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corporate credit rating was downgraded to junk status.

Each complaint relies heavily on Vale's reaction to an earlier dam failure. In 2015, Vale's Mariana dam collapsed, allegedly killing 19 individuals and polluting the surrounding environment. As a result, Vale was required to evaluate its other dams, including the Brumadinho dam, disclose any safety issues, and conduct a number of audits. Most importantly, in the aftermath of the Mariana dam collapse, Vale allegedly vowed publicly to prevent another disaster and committed itself to sustainability and safety. These and later pronouncements about safety and sustainability made in Vale's Annual Reports, Sustainability Reports, and Form 6-Ks permeate both complaints.

Because the class action complaint preceded the SEC's case, the SEC has had the benefit of observing and learning from two-years of private litigation. Perhaps most illuminating for the SEC was Vale's unsuccessful motion to dismiss.^[3] In its Memorandum and Order^[4] denying the motion, the court held that while Vale's statements about safety and sustainability were "generic" and unactionable to the extent they were purely aspirational, by "repeatedly" emphasizing its commitment to these priorities, Vale "put the topic at issue" such that, as a matter of law, the statements could be material to investors.^[5] In reaching this conclusion, the court explained that "certain statements, 'viewed in isolation, may be mere puffery,'" but "when the statements are 'made repeatedly in an effort to reassure the investing public' about matters particularly important to the company and investors, those statements may become material to investors."^[6] The court also held that omissions from Vale's Sustainability Reports and Form 6-Ks were misleading. Specifically, it concluded: "Vale's omission of alleged facts suggesting that there were known issues with dams and that [Stability Condition Statements] were unduly influenced and certified for dams with insufficient factors of safety obviously paint an incomplete and misleading picture about the stability of Vale dams."^[7] Vale's motion for reconsideration was denied.

With the benefit of the court's decision, the SEC now claims that Vale's "concealment of the true condition of the Brumadinho and other tailings dams caused Vale's sustainability reports, periodic filings, and other [ESG] disclosures to be materially false and misleading."^[8] Notably, the SEC alleges that several statements made about the number and quality of audits in Vale's 2016 and 2017 Sustainability Reports were "false and misleading," because "[b]y emphasizing 'external audits' and 'responsible auditors,' Vale falsely conveyed the message that the audit process had integrity and was independent."^[9] The SEC also takes issue with numerous similar statements in Vale's SEC filings related to its compliance with environmental regulations.

Upon the filing of the SEC's lawsuit, Vale issued a statement that it "denies the SEC's allegations, including the allegation that its disclosures violated U.S. law, and will vigorously defend this case."^[10]

SEC Proposes Rule on Climate Risk Disclosures

Additionally, as the SEC promised last year, on March 21, 2022, the SEC issued a proposed rule^[11] for enhancing and standardizing climate-related disclosures provided by public companies. Simultaneous with the SEC's proposal, Chairman Gary Gensler stated, "[t]oday, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant

financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions.”^[12]

Under the proposed rule, a registrant would be required to provide the following disclosures:

- Climate-related risks that are reasonably likely to have a material impact on a public company's business, results of operations, or financial condition;
- Greenhouse gas emissions associated with a public company; and
- Climate-related financial metrics to be included in audited financial statements.

The deadline for comments on the proposed rule was recently extended from May 20, 2022 to June 17, 2022 after vociferous objection to the shortened comment period for such consequential regulation.^[13]

Notable political voices have already come out in opposition. Senator Joe Manchin (R-WV) sharply criticized the SEC's rule in an April 4th public letter to Chairman Gensler.^[14] He expressed “deep[] concern[] that the proposed rule has the potential to run counter to the SEC's long-standing commitment to its mission by adding undue burdens on companies, while simultaneously sending a signal of opposition to the all-of-the-above energy policy that is critical to our country right now.”^[15] Senator Manchin also called into question the necessity and utility of the rule, pointing out that many companies already publish sustainability reports, and accused the SEC of crafting a rule that “aims to solve a problem that does not exist.”^[16] Unsurprisingly, Senator Manchin also highlighted that he believed “the most concerning piece” of the rule to be that it appears to “target[] . . . our nation's fossil fuel companies.”^[17] Likewise, West Virginia Attorney General Patrick Morrisey has threatened to sue, claiming that the rule is unconstitutional.^[18]

SEC Commissioner Hester M. Peirce—the lone vote against the proposed rule—has also voiced her concern.^[19] In a statement entitled “We are Not the Securities and Environment Commission - At Least Not Yet,” Peirce offered her critique. She said: “We are here laying the cornerstone of a new disclosure framework that will eventually rival our existing securities disclosure framework in magnitude and cost and probably outpace it in complexity. The building project upon which we are embarking will consume our attention and enrich many, as any massive building project does. The placard at the door of this hulking green structure will trumpet our revised mission: 'protection of stakeholders, facilitating the growth of the climate-industrial complex, and fostering unfair, disorderly, and inefficient markets.' This new edifice will cast a long shadow on investors, the economy, and this agency.”^[20]

Examinations Names ESG as 2022 Priority

Like last year, the Division of Examinations included ESG in its 2022 Examinations Priorities.^[21] It specified that there is a high risk of greenwashing that could result in investors being misled. Accordingly, the Division of Examinations “will continue to focus on ESG-related advisory services and investment products.”^[22] Typically, these reviews will center on whether registered investment advisers and funds are:

- “Accurately disclosing their ESG investing approaches and have adopted and implemented policies, procedures, and practices designed to prevent violations of the federal securities laws in connection with their ESG-related disclosures, including review of their portfolio management processes and practices”;
- “Voting client securities in accordance with proxy voting policies and procedures and whether the votes align with their ESG-related disclosures and mandates”; or
- “Overstating or misrepresenting the ESG factors considered or incorporated into portfolio selection (e. g., greenwashing), such as in their performance advertising and marketing.”^[23]

Notable Leadership Changes

Recently, the SEC’s head of the ESG Task Force, Kelly Gibson, departed for private practice. In her place, the SEC has appointed Sanjay Wadhwa, Deputy Director of the Division of Enforcement. In addition to serving as Deputy Director of Enforcement, Wadhwa has had various prior roles, including various leadership positions in the SEC’s Market Abuse Unit as well as the New York Regional Office. It is fair to say that having placed first Ms. Gibson, and now Mr. Wadhwa, in charge of the ESG Task Force, the current Commission intends to demonstrate that ESG is a very serious priority.

Predictions and Takeaways

Corporations need to be extremely vigilant in monitoring the accuracy of any and all public statements related to ESG and should take a liberal view of what in fact constitutes ESG. The *Vale* case demonstrates that the SEC is willing to look beyond filings to underlying reports and statements to bring a case. Further, material omissions are just as problematic as affirmative representations. Not only should companies make sure what they are saying regarding ESG is accurate, but they should make sure what they *are not* saying is not misleading. Public statements should be realistic, accurate, and fulsome. Additionally, corporations subject to ongoing or past private securities litigation with any sort of connection to ESG should evaluate whether the litigation will now attract the SEC’s attention or affect the SEC’s litigation strategy.

It is without question that the SEC’s campaign on ESG will continue. As more enforcement cases are filed, companies will be able to better define the contours—or lack thereof—of the Commission’s ESG expectations. In the interim, companies need to assess their ESG posture and public statements holistically to make sure aspirational goals do not become the basis for fraud allegations if they are not met.

[1] Complaint, *Securities & Exchange Commission v. Vale S.A.*, 1:22-cv-02405 (E.D.N.Y. filed Apr. 28, 2022), ECF No. 1, <https://www.sec.gov/litigation/complaints/2022/comp-pr2022-72.pdf>.

[2] Amended Complaint, *In re Vale S.A. Securities Litigation*, 1:19-cv-00526 (E.D.N.Y. filed Oct. 25, 2019), ECF No. 47.

[3] Mot. to Dismiss, *In re Vale S.A. Securities Litigation*, 1:19-cv-00526 (E.D.N.Y. filed Feb. 21, 2020), ECF No. 63.

[4] Mem. & Order, *In re Vale S.A. Securities Litigation*, 1:19-cv-00526 (E.D.N.Y. filed May 20, 2022), ECF No. 74.

[5] *Id.* at 22.

[6] *Id.* at 21-22.

[7] *Id.* at 26.

[8] Complaint, *Securities & Exchange Commission v. Vale S.A.*, 1:22-cv-02405 (E.D.N.Y. filed Apr. 28, 2022), ECF No. 1, ¶ 16.

[9] *Id.* at ¶¶ 231-32, 237-239.

[10] Vale, Vale informs about the United States Securities and Exchange Commission ("SEC") (Apr. 28, 2022), http://saladeimprensa.vale.com/en/Paginas/Articles.aspx?r=Vale_informs_about_the_United_States_Securities_and_Exchange_Commission_%E2%80%9CSEC%E2%80%9D_%E2%80%9CFinance&rID=1570&sID=5.

[11] *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Proposed Rule, 87 Fed. Reg. 21334 (April 11, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf>.

[12] Press Release, SEC, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2022), <https://www.sec.gov/news/press-release/2022-46>.

[13] Press Release, SEC, SEC Extends Comment Period for Proposed Rules on Climate-Related Disclosures, Reopens Comment Periods for Proposed Rules Regarding Private Fund Advisers and Regulation ATS (May 9, 2022), <https://www.sec.gov/news/press-release/2022-82>.

[14] Letter from Joe Manchin III, United States Senator, to Gary Gensler, Chairman, SEC, (Apr. 4, 2022), <https://www.manchin.senate.gov/imo/media/doc/SEC%20ClimateDisclosure%20Letter.pdf?cb>.

[15] *Id.* at 1.

[16] *Id.*

[17] *Id.*

[18] Letter from Patrick Morrissey, West Virginia Attorney General, to The Honorable Allison Herren Lee, Acting Chair, SEC (Mar. 25, 2021), <https://ago.wv.gov/Documents/Letter%20to%20Acting%20Chair%20Lee.pdf>.

[19] Statement, Commissioner Hester M. Peirce, SEC, We are Not the Securities and Environment Commission - At Least Not Yet (Mar. 21, 2022), <https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321>.

[20] *Id.*

[21] *2022 Examination Priorities, Division of Examinations*, SEC (Mar. 30, 2022), <https://www.sec.gov/files/2022-exam-priorities.pdf>.

[22] *Id.* at 13.

[23] *Id.*