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## Taking the law into their own hands: how investors are using litigation to achieve ESG impact

The push for better ESG performance could see investors on either side of the courtroom. Sophie Robinson-Tillett looks at the latest developments.

by: [Sophie Robinson-Tillett](#) Jan 27th, 2021

The Chan Zuckerberg Initiative (CZI) was set up by Facebook founder Mark Zuckerberg and his wife Priscilla Chan in 2015 to "build a more inclusive, just, and healthy future for everyone". Its website lays out its focus areas: education, justice, opportunity, science. Its Wikipedia page cites it as being one of the "most well-funded philanthropies in human history". Why? Because Zuckerberg and Chan would give the charity 99% of their Facebook shares – worth some \$45bn at the time of the announcement – over their lifetime.

It sounds like the kind of thing that Swedish public pension fund AP7, which owned more than €200m in shares in the social media titan at the time, would love. As one of the world's most outspoken responsible investors, the SEK740bn (€73bn) fund has building a more inclusive, just and healthy future on its agenda, too. But, as CEO Richard Gröttheim explains: "Zuckerberg made a lot of noise about his philanthropic plans, but he was much quieter about the fact he was going to do it by reclassifying Facebook's shares in a way that would leave minority shareholders like AP7 with less value."

Zuckerberg planned to fulfil his promise to CZI by creating a new share class for Facebook. Gröttheim argues that the consequent share dilution along with the fact the new shares didn't carry voting rights, would have meant shareholders like AP7 would lose some SEK80bn in combined share value. Indeed, 80% of the public stockholders that voted on the proposal, voted against it; but as Zuckerberg is the controlling shareholder, it went through anyway.

"And so we threatened to go to court if he didn't withdraw the plans," says Gröttheim.

AP7 partnered with Amalgamated Bank to lead a class action lawsuit against Facebook, arguing that the move was unacceptable and "terrible from a corporate governance perspective". Shortly before the court date, Facebook shelved the plans.

"It's great that Zuckerberg wants to increase his philanthropy, but he can't do it at the expense of Sweden's pension savers," says Gröttheim. "So we undertook litigation for the

sake of our beneficiaries; but it's also good for other asset owners because it sends a signal to companies that they can't just get away with things – we act like a watchdog.”

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AP7 has been using litigation to push companies on environmental, social and governance issues for nearly 15 years now. In 2019, it sued Google-owner Alphabet over what it argued was an inadequate response to allegations of widespread sexual harassment at the firm – on the basis that the consequent media headlines hurt the share price. The litigation resulted in an out of court settlement that included a commitment by Alphabet to spend \$310m on diversity and inclusion improvements such as the creation of a dedicated committee to properly manage any future sexual harassment issues.

Currently, the pension fund is leading litigation against Qualcomm, a producer of microchips for mobile phones, which it accuses of price fixing.

“We use litigation as an active investment tool, to make companies behave better,” explains Gröttheim. “Often we make decent money out of these cases, which is nice, but not always – the key thing is to create impact that might be hard to achieve using other tools. We still have dialogues with companies, and we vote at annual meetings, but they need to know that we can also go to court if necessary.”

Most of the cases AP7 is involved in are in the US because the country allows ‘no-win-no-fee’ cases – unlike Sweden, for example, where the practice is banned and cases must be funded upfront.

“We’re a government entity, so we can’t go into something that could see us lose money. That means the lawyers take the financial risk in the cases we take on, and we pay them from the settlement money if it’s successful.”

Class actions like this often include thousands of shareholders, and there is what Gröttheim describes as “a problem with free riders” – investors that know they’ll get a pay out from the settlement regardless of whether they play an active role, and therefore leave it to AP7 to handle the case. “Many large investors are also just uncomfortable with this kind of legal action,” he says.

But there is another type of litigation that is gathering steam too; one which could allow investors to use the courts to achieve ESG impact without being a plaintiff themselves.

Aristata is a new investment firm founded by Rob Ryan, former Director of Business Development at environmental law firm Client Earth. It claims to be “the first litigation fund dedicated to driving positive social and environmental change with an attractive financial return”.

The firm plans to raise between £50m and £100m to launch a private equity-style fund this year, focused on financing ‘impact litigation’. So far, it has commitments of £20m from investors including impact specialists Capricorn Investment Group in the US, and George Soros’ Open Society Foundations. Last year, RI reported that J Stern was mulling investment, but Ryan says that it currently isn’t invested.

“We’ve had interest from a real mix of investors – some who have impact as their priority, while others need to put financial returns first but would like impact too,” explains Ryan. “And we’re in advanced stages of talks with a hedge fund that simply wants additional litigation fund exposure.”

For now, Capricorn has extended its £10m investment on a warehouse basis – meaning Aristata can start lining up deals.

“Our first screen when we’re looking for deals is impact,” Ryan explains, pointing to an existing case (which Aristata is not financing) in which 15,000 Indonesian seaweed farmers are suing an Australian oil company for allegedly causing an oil spill that destroyed their livelihoods. “In cases like that, one entity – the seaweed farmers – has significantly less resources than the other – the oil company – and needs private capital to level the playing field in order to seek justice. The benefit for the claimant is obviously compensation, but the case could also persuade oil companies, not just this one, to stop and think ‘it isn’t actually as cheap as we predicted, leaving our oil wells uncapped. Maybe we should cap them in future, as a matter of good business’.”

Ryan and Chief Investment Officer Jack Naylor, who spent 23 years handling litigation for PwC before retiring in 2017, say they are currently considering a range of cases from indigenous rights and gender pay discrimination to oil spills and mining disasters. “We want cases that can have a scalable impact,” says Ryan. “So we are looking for instances where we can create a blueprint for challenging an environmental or social problem that we know is being faced on a wider basis.”

Once a case has passed the impact screen, it is given a “very traditional legal risk and commercial return review”. “We’re suggesting to our investors a conservative 20%+ net IRR [internal rate of return],” says Naylor. “Although many of the cases in our current pipeline sit closer to 30%, which is attractive for an impact product. A traditional litigation

fund would probably be looking for at least 35%, but we can be more flexible because we're also considering the impact.”

'Because the public is so interested in these issues, especially climate change, all the environmental statements being made count as marketing, because they could easily be the reason that someone has chosen you to invest for them' - lawyer Sylvie Gallage-Alwis

Litigation isn't just about investor upside, though. Financial institutions, especially in Europe, are increasingly at risk of being on the wrong end of lawsuits.

The French Government is currently working with think tank 2 Degrees Investing Initiative on a project called the Climate Transparency Hub (CTH) - an effort to consolidate and standardise climate disclosure from French financial institutions, by asking them to upload their climate reports onto a centralised, public platform. In addition to making them easier to find, the platform will also offer comparable information on the climate reports, because experts at France's environmental agency will extract key details - alignment with the TCFD, Article 173 or the EU's new disclosure rules, for example - so they can be easily compared between institutions.

A pilot of the CTH platform will close this week, and the results will be published as part of an official launch in the Spring.

“Like with every tool that makes information public, this initiative will form the grounds for litigation,” says Sylvie Gallage-Alwis, a Partner at Signature Litigation in Paris. “It's the type of information that no one currently has access to, because it's typically about internal decisions for investors and financial institutions. But it will contribute to the scrutiny that's already growing.”

As soon as a financial institution makes a statement about its sustainability objectives – which almost every financial institution now does – it opens itself up to litigation, Gallage-Alwis explains. “You don't have to have a billboard in the street saying you're green, you just have to have it on your website. Because the public is so interested in these issues, especially climate change, all the environmental statements being made count as marketing, because they could easily be the reason that someone has chosen you to invest for them, for example.”

“And as soon as it is marketing, if you don't fulfil it – if you can't provide evidence that it is true – then it could be misrepresentation,” she explains, adding that NGOs are already looking at such statements, and asking investors to back them up. “And even if they can prove it, NGOs are then looking at whether those objectives are properly aligned with, say,



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EU law on climate change. This will get stricter in future, and if investors and companies aren't in step, that could also become a reason for litigation.”

Gallage-Alwis says the focus so far has been on companies – there are eight pending cases like this against corporates in France, including oil company Total – but, she warns, “It’s only a matter of time before the financial sector faces the same challenges”.

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