NORTON ROSE FULBRIGHT

ESG LIABILITIES:

Scope 3 Emissions & Greenwashing or

Be Awake and Be Wary or

Don’t get sucker punched by your customers

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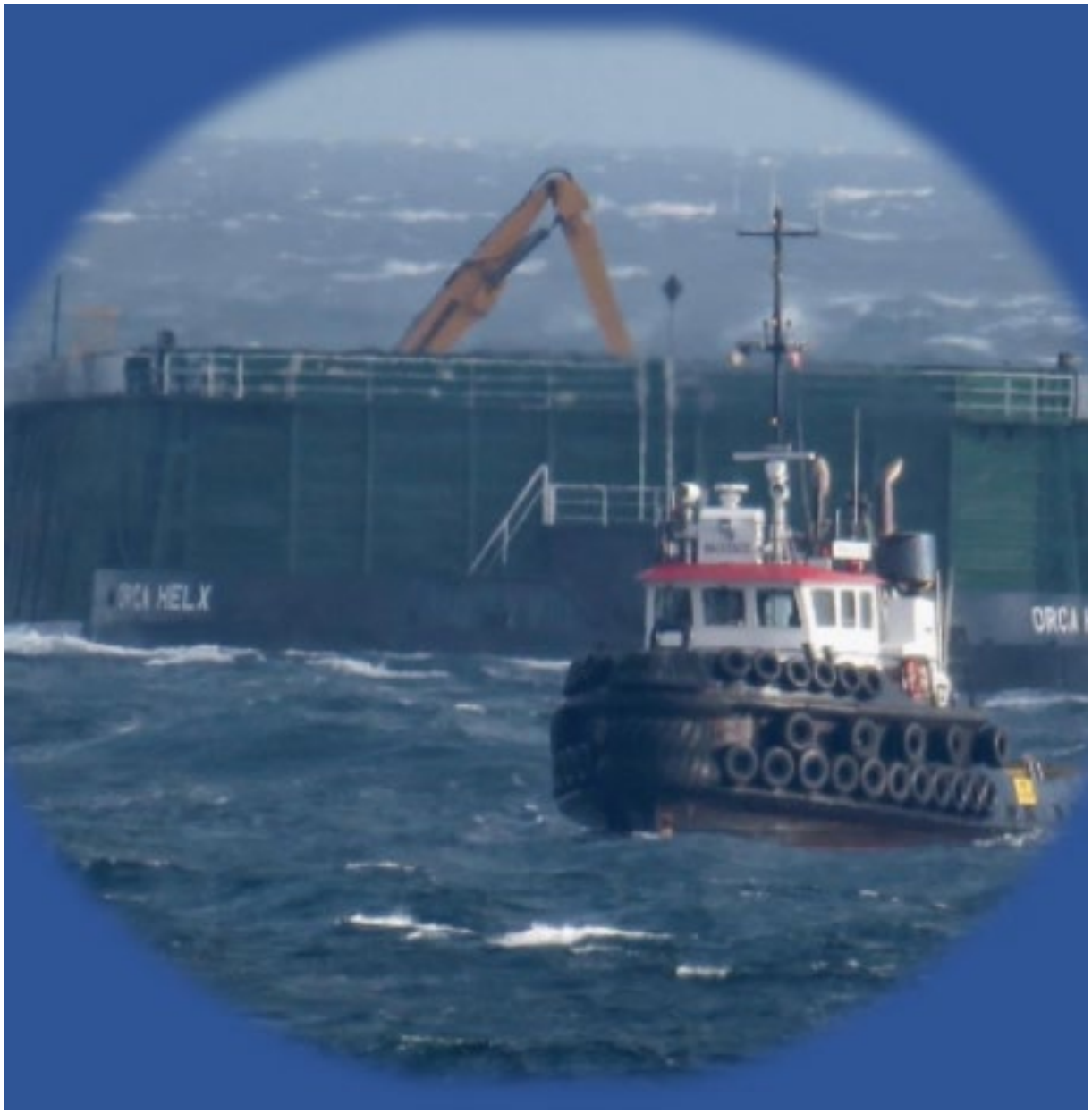
Shelley Chapelski
Partner, Canadian Head of Transport

Norton Rose Fulbright Canada LLP



Agenda

Scope 3 Emissions

- What are Scope 3 Emissions?
- Which of your customers/clients must report on them?
- Why do Ports care about them?
- How is that being downloaded onto the marine industry?

Greenwashing / Woke Washing / Social Washing / Rainbow Washing

- What is greenwashing?
- How are you at risk of greenwashing liabilities?
- What can you do to protect against greenwashing liability exposures?
- What's next in ESG liability exposures to the marine industry?

Scope 1, 2, 3 Emissions: What are they? GHG – Greenhouse Gases

The concepts of Scopes originate from the Greenhouse Gas Protocol, world's most widely used greenhouse gas accounting standard

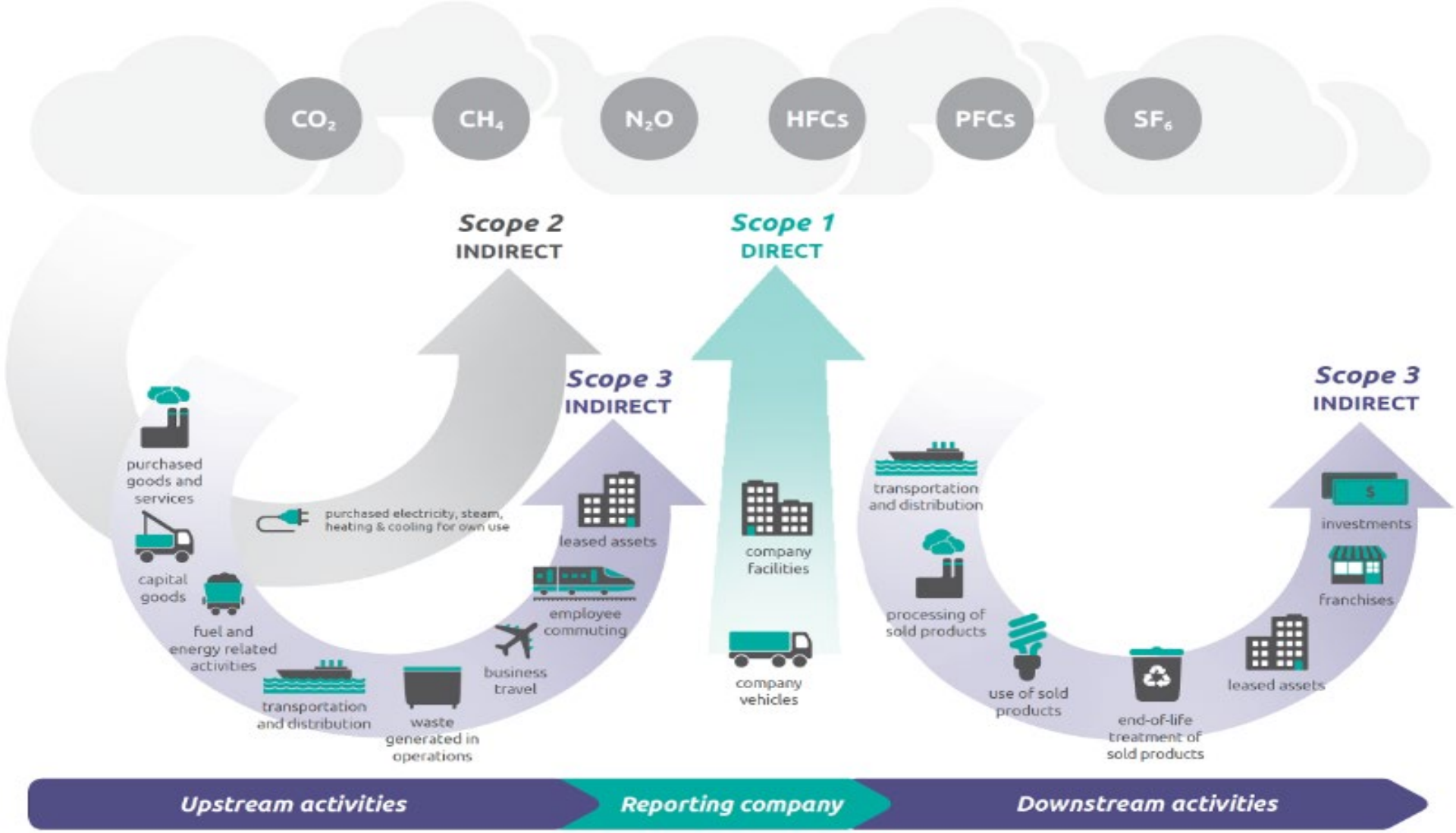
- **Scope 1 GHG emissions -** emissions from sources that an organization owns or controls directly
- **Scope 2 GHG emissions -** emissions that a company causes indirectly and come from where the energy it purchases and uses is produced
- **Scope 3 GHG emissions -** emissions that are not produced by the company itself and are not the result of activities from assets owned or controlled by them, but by those that it is indirectly responsible for up and down its value chain.

  includes all sources not within the scope 1 and 2 boundaries.

  scope 3 emissions for one organization may be the scope 1 or 2 emissions of another organization.

  also referred to as value chain emissions, often represent the majority of an organization's total greenhouse gas emissions – **sometimes as much as 70%**

Scope 3 Emissions: source www.epa.gov



Typical sources of Scope 3 emissions

Examples of scope 3 emissions from your customer's perspective (or your customer's customer's perspective):

- Employee travel and commuting.
- Purchased materials.
- Shipping materials from suppliers.**
- Shipping finished products to customers. **
- Warehousing and distribution at all stages in between sourcing materials and delivering finished goods.**
- Waste disposal and wastewater treatment.**

** potentially marine related

For a company that outsources many aspects of its operations and supply chain activities, scope 3 emissions could easily account for the majority of the company's GHG emissions.

Who is under pressure to report Scope 3 emissions?

All publicly traded companies, resource companies, publicly funded institutions.

Requirements on publicly traded companies to provide annual disclosure on: (i) governance; (ii) strategy; (iii) risk management practices; and (iv) metrics and targets related to climate change risks and opportunities.

Demands for information from shareholders and regulators.

In particular, regulators are trying to impose an obligation to disclose Scope 1, 2 and 3 emissions or reasons for not disclosing such data ("comply or explain why you can't" regime).

An easy excuse to avoid disclosing Scope 3 emissions is that the organization does not have any such data – but that will last as an excuse for only so long. The expectation will be to start collecting it.

Goal posts keep moving with respect to the requirements for Scope 3 disclosures and it varies as amongst Canada, the US, UK, EU and China, but it's coming.

It is not a matter of "if" but "when".

That means the pressure will be on our marine industry, as Scope 3 emitters, to start collecting and providing that data. And to do so in a manner that does not result in liability exposures.

Ports are also a big driver of reducing emissions: Why do Ports Care?

- Ports are in beauty pageants to attract the ships which generate the most lucrative visits.
- Ports perceive that being “green” is a strong driver of business to their ports.
- Ports have wide latitude to impose regulatory regimes unilaterally imposed through tariffs, permits and rules of use and users being “voluntold” to comply.
- Ports are moving towards having carbon management regimes (which is well under development in airports).
- Ports can’t measure any carbon emission gains without base lines.
- Ports can’t establish base lines without data.
- Ports don’t have data without forcing Port users to report their data.
- Whether or not the Port is gunning for data for your own marine operations, it may be seeking Scope 3 data from your customers which means ….. **You.**

Data Collection in the Marine Industry - Challenges

- Ports change their rules of use annually, if not more frequently.
- However, contracts in the marine industry are usually very long tenure to justify the capital investments required.
- Ports can quickly pivot to demand data – but the ability of an organization to force its subcontractors provide data may be lacking from most contracts unless implied.
- This all assumes that it is possible to collect the data in the first place, and reproduce it in a meaningful way, and to do it without crippling costs.
- Potentially another compliance expense without any obvious ($) return.
- When investing in new assets – try to demand as much information in writing as possible about the emissions which may be produced by that asset. May be impossible to get the information later. But know full well that the manufacturer is very unlikely to guarantee any of that data so if it is repeated, always reference the source of the data and caution about its reliability. Don’t assume that the manufacturer will agree to verify or stand behind its emissions data down the road.

What is Greenwashing?

- Making false, misleading, or unsupported environmental claims about a product or service.
- Can take many forms: claims, adjectives, colours, symbols.
- Anything used to create an impression that a product or service is “greener” than it really is.
- Can also include “net zero commitments” by organizations.
- **Greenwashing does not need to be intentional.**
- Woke washing, social washing, rainbow washing are similar themes.

Competition Act: Six Residents Complaint*

- In Canada, any six residents who are the age of majority and are of the view that grounds exist to establish misleading or false advertising or similar complaints under the Competition Act, may apply to the Commissioner of Competition to commence an inquiry.

- The six residents file statutory declarations together with a brief of the alleged violations.

- Upon receiving a six resident complaint, the Commissioner must commence an inquiry (although the Commissioner may discontinue the inquiry once commenced).

- The inquiry is confidential until published.

*(cue the song by White Stripes, “Seven Nation Army”)

Competition Bureau Investigations

IN THE MATTER OF:

An application pursuant to s. 9(1)(b)
of the *Competition Act*, RSC 1985, c C-34
requesting the Commissioner cause an inquiry to be made
into the conduct of Lululemon Athletica Inc.

February 8, 2024

Competition Bureau Investigations - Lululemon

- The complaint is focused on Lululemon's "Be Planet" marketing campaign, launched in 2020. It states that its "products and actions avoid environmental harm and contribute to restoring a healthy planet."
- The NGO behind the complaint to the Competition Bureau, Stand.earth, says that since the campaign's launch, Lululemon's greenhouse gas emissions doubled and that the company uses materials that cannot be effectively recycled, do not biodegrade, and release microplastics in the oceans and waterways.
- In an internal email the company stated that the majority of impact comes from emissions from its broader supply chain.
- From Lululemon's own annual report:

Transportation and Logistics

Transportation and logistics currently comprise approximately 14% of our total carbon footprint.

We are investing in new systems that support more efficient planning processes and optimize inbound transportation to reduce air freight. We intend to shift transportation methods when possible, including from air freight to ocean, truck, or train transportation, and recognize that this is challenging in the current COVID environment.

Competition Bureau Investigations - Lululemon

- On May 6, 2024, the Competition Bureau commenced an investigation under the Competition Act into the alleged deceptive marketing practices of Lululemon.

- A Bureau representative stated: “There is no conclusion of wrongdoing at this time…As the Bureau is obligated by law to conduct its work confidentially, I cannot provide further details on this case at this time.“

- **The filed complaint is seeking a penalty of 3% of Lululemon’s global profits.**

- The penalty is paid to His Majesty, not the complainants – it is not like whistle blower legislation or a class action suit.

Competition Act changes – Private Complaints

Competition Act recently amended to also allow for private complaints.

- Individuals and businesses may now file complaints alleging deceptive marketing practices if they are able to satisfy the Tribunal that it is in the **public interest** to grant them leave to proceed with the complaint.
- "Filing is Winning" – just being granted leave to file the complaint allows a private party to bring attention to the marketing practice
- New civil misleading advertising provision relating to misleading environmental claims.
- Where a representation to the public about a product's benefits in protecting the environment or a product's effects on mitigating environmental or ecological damage caused by climate change is not based on adequate and proper testing, it can be challenged in the same way that other civil misleading performance claims can be challenged.
- Similar to the existing requirement that product performance claims be based on an adequate and proper test.

Competition Act changes – Private Complaints

- Tribunal will be able to impose administrative monetary penalties where it believes this is warranted, these are payable to the government – in other words, from a financial perspective, while successful private litigants may be able to recover some or all of their legal costs, there will be no right to damages.

- Penalties include prohibition orders, restitution orders, and payment of an administrative monetary penalty that is currently the greater of (i) $750,000 or (ii) three times the value of the benefit derived for an individual, or the greater of (i) $10 million or (ii) three times the value of the benefit derived or if that amount cannot be reasonably determined, 3% of the corporation's annual worldwide gross revenue.

- No motivation on a private party to settle because penalty is paid to His Majesty.

Keurig – Competition Act penalties and Class Action suits

- Keurig Canada Inc. - $3 million penalty Competition Bureau arising from concerns about its marketing regarding the recyclability of its single use coffee pods (plus $800,000 paid to a Canadian charity focused on environmental issues).
- *Smith v. Keurig Green Mountain, Inc*. - In February 2022, a US class action against Keurig settled for $10 million.
- The class action alleged, among other things, that Keurig's slogan, "Have your cup and recycle it, too", was misleading as most recycling companies won't accept the pods.
- Copy cat class actions have been filed in Ontario, BC, and in Federal Court.

Greenwashing Exposures?

- Climate change and sustainability are increasingly important to shareholders and consumers.
- What a company says about its climate footprint matters.
- For any company aiming for the common sustainability goal of net-zero emissions by 2050 or sooner, it would be much easier to reach that goal without including scope 3 emissions. However, a company with “net-zero emissions” that omits scope 3 emissions could create a false sense of progress and still be contributing massively to climate change.
- Failure to live up to what you say can result in real legal consequences, including:
  - Competition Bureau Investigations
  - Class Actions
  - Private actions by NGOs
  - Derivative Actions by Shareholders against Officers and/or Directors
  - Scrutiny by Securities Regulators
  - Employee discontent
  - Increasing liability for Directors personally

Other Greenwashing liability exposures

- Securities-related claims have also gaining traction as climate-related risks are being disclosed (or in some cases not disclosed)
- More and more detailed disclosure obligations under securities law
- Regulatory pronouncements and expectations
- Investor activism - securities class action risks – e.g., litigation for failing to adequately protect against climate change and energy transition risks
- Legal obligation of directors to address climate change impacts and position companies to respond to energy transition

Why does the marine supply chain care if its customers are under fire for Greenwashing?

Contracts with customers include warranty and indemnity provisions.

Each party makes promises that certain facts are true (warranties).

And agrees to indemnify the other party if the facts are not true.

It is the generic indemnity provisions typically found in contracts which creates the exposures. Are you unintentionally promising that your ESG information is true and are you unintentionally agreeing to indemnify your customer even if your customer uses that ESG information in a manner you did not anticipate?

Even if the allegations against you are later found to be unsustainable, getting dragged into the fight will be extremely costly in terms of $$, management time and reputational harm.

Try to avoid getting set up for potential warranty breaches relating to ESG matters from the outset.

Don’t assume that the complainant has to prove that your emissions figures are false – you will have to prove that they are accurate.

How to protect yourself?

- Three key questions to ask:
  1. What kind of environmental claims or ESG commitments are you making?
  2. Do you have the data to back up those claims or commitments?
  3. In contracts – are you “warranting” the information or providing an indemnity for anything in the contract which is untrue?

- Managing risk is about being careful about what you say and ensuring that you have data to substantiate your company’s environmental messaging where representations are made.
- Keep your ESG representations simple, keep them verifiable and try to not make them warranties (promises) and **limit the indemnity exposure**.
- Do not give into customer’s demands for specifics unless you have ones you can rely upon.
- Resist providing minimums or maximums or stating absolutes (i.e. the “greenest tugs on the coast”).

How to protect yourself?

- At the end of the day, price still rules. Customers may say otherwise (but perhaps they “exaggerate”).
- However, if two pitches are more or less equivalent to each other, the ESG aspects will probably be the deciding factor. At minimum, the ESG representations will be used as the excuse to choose one over the other.
- Keep it fresh – don’t just recycle the same ESG spiel.
- **To Warrant means to Promise. Don’t make promises you can’t keep or prove.**
- **Try to include a broad Change in Law clause in your contracts so that if the local port starts demanding more information from your operations you might be able to change your pricing to accommodate the cost of compliance.**
- Try to make the Change in Law clause include changes in how regulators interpret policy, not just amendments to statutes and regulations.
- **Learn how to track emissions in your company. If you don’t start now, how will you know if you are improving?**

What's Next in ESG Liabilities?

- Increase in regulation and reporting requirements either being downloaded from customers or directly onto our industry.
- More greenwashing claims.
- "Social Washing" or "Woke Washing" will follow Green Washing

- **Make sure that any ESG claims or statements are clear, accurate and supported by objective evidence.**
- **Keep it simple and verifiable.**
- **Don't make promises (warranties) in contracts that you can't keep or prove and try to avoid providing an indemnity for those promises relating to ESG.**

Questions

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