Greenwashing: Brief Considerations

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Abstract:
Greenwashing cannot only trigger an obligation to compensate but will also inevitably affect the corporate entity's reputation. Therefore, we must keep in mind both the regulatory requirements in this matter and the possible ways of implementing possible liability, in order to safeguard the position of companies. In doing so, we are also aware of consumer and investor protection mechanisms.

1. Introduction

Throughout the years, there has been an increasing focus on ESG (Environmental, Social, and Governance) factors in the corporate strategy of several companies. Despite the potential short-term impact on profit maximization, major corporations have realized that, in the medium and long term, the financial returns may outweigh short-term losses.

In fact, the public in general, influenced by awareness campaigns, is becoming increasingly conscious of the need for sustainability at various levels. This has led to a growing demand for socially responsible investments due to the pressure imposed by consumer demand. In terms of competitiveness, large companies tend to adopt measures to avoid negative environmental impacts and show concern for social issues, whether related to their workforce or not, to remain competitive. While it is true that initially considering ESG factors may lead to decreased profits, it is equally certain that not integrating those factors into the corporate strategy can have negative consequences. Promoting ESG factors at the corporate level can lead to an enhanced reputation and, consequently, an increased market competitiveness and profitability. This is why major companies have shown a particular concern for showcasing their efforts in ensuring sustainability across several dimensions, including environmental aspects, and highlighting their green credentials.

Likewise, the European legislator has been particularly concerned about the introduction of ESG factors into companies' business strategies. The European Parliament's Resolution of 10th of March, 2021, which contains recommendations to the Commission on corporate due diligence and corporate responsibility (2020/2129(INL)), considers that ‘the European Union must urgently adopt binding requirements for companies to identify, assess, prevent, cease, mitigate, monitor, report, justify, resolve, and remedy the potential and/or actual adverse effects of their value chains on human rights, the environment, and good governance'. It also specifies that 'Member States must ensure that they have a liability regime under which companies can, under national law, be held liable and provide redress for any harm caused by potential or actual adverse effects on human rights, the environment, or good governance resulting from acts or omissions'.

Particularly important is also the proposal for a Directive of the European Parliament and the Council on Corporate Sustainability Due Diligence (Directive 2022/0051(COD)), adopted by the Commission on 24th February, 2022. According to Article 22, 'Member States must ensure that companies are liable for damages if: a) they have not fulfilled the obligations laid down in Articles 7 and 8, and b) that the failure has led to an adverse effect that should have been identified, prevented, mitigated, ceased, or minimized by appropriate measures provided for in Articles 7 and 8, resulting in harm'. However, if a company has taken the measures specified in Article 7(2)(b), Article 7(4) or Article 8(3)(c) and Article 8(5) it is not liable for damages caused by an adverse effect resulting from the activities of an indirect business partner with whom it has a business relationship unless, given the circumstances of the case, it is not reasonable to expect that the measures effectively taken, particularly with regard to compliance checks, are adequate to prevent, mitigate, cease, or minimize the extent of the adverse effect. This liability does not affect the civil liability of its subsidiaries or any direct and indirect business partners in the value chain. This means that, while it is necessarily mediated by human behaviour, the primary responsibility rests with the company, as it is bound to adopt 'appropriate measures to identify potential and/or actual adverse effects on human rights and the environment in its own operations or those of its subsidiaries, and, when related to its value chains, its business relationships' and to take 'appropriate measures to prevent, or, if prevention is not possible or not immediately possible, to adequately mitigate potential adverse effects on human rights and the environment that have been or should have been identified in accordance with Article 6'.

The General Guideline of the Counsel of 30th November, 2022, profoundly changed the Article 22 that we referred to, 'in order to ensure legal clarity and security for companies and to avoid unreasonable interference in the civil liability systems of Member States'. Therefore, the company can be held liable for the harm caused to an individual or legal entity only if it 'deliberately or negligently fails to fulfil the obligations set out in Articles 7 and 8 when the right, prohibition, or obligation listed in Annex I is intended to protect the individual or legal entity; and, as a result of the failure referred to in point (a), the legal interests protected by the individual or legal entity in the scope of the law have been affected'. There is no liability when the damages have been caused solely by business partners in their own chain of activities. According to the provision 27 of the General Guideline, four conditions must be met for a company to be considered liable. Namely, 'damage to an individual or legal entity, a breach of duty, a causal link between the damage and the breach of duty and a non-performance (with intent or negligence)'. The formula is not ideal: first, it is not clear which is the difference between a breach of duty and a non-performance, and it seems that the fault is linked to the non-performance, which is not a recommendable solution and has no support in European liability doctrine. However, regarding compensation, Article 22 not only avoids these internal contradictions in the system, but also provides important clues for the densification of liability. It can be argued that liability arises whenever there is a violation of a protection provision or a duty specified in the Directive, accompanied by a violation of the rights or interests of an individual or legal entity (implying a transition from collective to individual protection); there is fault (intent or negligence); there is a damage, and a causal link is established. Regarding the latter, it is required that the neglected duty is intended to protect the individual or legal entity and that the damage inflicted on their rights or interests, included in the scope of protection of such rights, has been caused by the breach of duty, seeming to indicate in a positive sense, in accordance with what appears to be the best dogmatic position on the subject matter, a normative determination of causality that departs from the cause-and-effect logic. If all these prerequisites are met, the harmed party is entitled to full compensation, although, without any right regarding punitive damages. The civil liability of a company does not affect the civil liability of its subsidiaries or any direct and indirect business partners in the company's chain of activities.

At the same time, Articles 25 and 26 were dismissed. Articles 25 and 26 established a duty of diligence for administrators and required them to create and supervise actions regarding the subject matter and adapt the business strategy to take into consideration any identified negative effects. Nevertheless, considering Article 64 of the Portuguese Companies Code (PCC), in conjunction with Article 72 PCC, and the need to consider the long-term sustainability of the company, it becomes defendable that, in conjunction with the legal entity, the company administration itself may be held liable, potentially even prior to the legal entity.[1]

Accordingly, active efforts are being made, through the imposition of diligence duties, to enable liability of legal entities, ensuring that the consideration of ESG factors is mandatory at the corporate governance level of companies.

The intention behind the rules that impose specific information duties is different, aiming to ensure the effective understanding of the risks that a company's activities pose to the environment and to identify how such risks impact the company's value in a given financial period. These mechanisms are designed to protect investors and consumers. It is primarily for this purpose that the practice of greenwashing is thought to be prohibited.

2. Greenwashing

The term greenwashing refers to the practice of concealing the negative environmental impact of an activity, company, or product, or promoting ecological characteristics that do not exist. In other words, greenwashing involves deceptive or false communication of environmentally friendly practices

[1] See Ana Filipa Morais Antunes, 'ESG, racionalidade empresarial e novos contenciosos' (2022) Revista de Direito Comercial 2009 ff. <https://www.revistadedireitocomercial.com/esg-racionalidade-empresarial-e-novos-contenciosos> accessed 8 February 2024.

with the goal of improving the public image of a company, brand, or product, often to attract environmentally-conscious consumers.

Greenwashing can also be observed in the marketing of financial products that are presented as financial instruments issued by entities that claim to carry out projects with a positive environmental impact but ultimately do not really have such characteristics.

At this level, it seems essential to consider the necessary coordination between the recent European requirements regarding information duties and consumer protection with the traditional doctrinal frameworks in private law.

2.1. Information Duties

European entities impose information duties in order to enable investors and consumers to adequately assess risk, to increase market confidence and to safeguard essential values.

The Directive 2014/95/EU, transposed into our legal system by Decree-Law no. 89/2017, with the amendments introduced by Law no. 58/2020, of 31st August, requires Portuguese public interest companies with more than 500 employees and large publicly traded companies to annually report on policies, practices, and indicators related to environmental, social, and worker-related issues, gender equality, non-discrimination, respect for human rights, and combating bribery attempts, both within their business operations and, if relevant, within their value chain[2], with obvious consequences for their financing and investment policies.

More recently, the CSRD (Corporate Sustainability Reporting Directive)[3] reinforces the existing rules on non-financial information disclosure, which had been added to the accounting directive by the Non-Financial Information Disclosure Directive, establishing stricter requirements for notification. As a result, large companies and publicly traded SMEs are now required to provide information on sustainability issues, such as environmental rights, social rights, human rights, and governance factors.

Both large companies and small and medium-sized enterprises, except micro-enterprises, that are entities of public interest, must include in their management report the necessary information to understand the company's impact on sustainability issues, as well as the information required to understand how sustainability issues affect the company's evolution, performance, and position. The requirements for sustainability information disclosure will apply to large entities of public interest, large companies, parent companies of large dimension groups, and small and medium-sized enterprises listed on regulated markets in the European Union.

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[2] Banco de Portugal, 'Guia ESG' (2018) 4-5 <https://www.bcsdportugal.org/wp-content/uploads/2018/03/Guia-ESG.pdf> accessed 8 February 2024.

[3] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/ 34/EU with regard to corporate sustainability reporting OJ L 322/15.

From an objective point of view, it is important to emphasize that non-financial statements are now included in audit reports, and auditors must provide an opinion on compliance with European requirements. Additionally, various climate-related requirements are highlighted, requiring the definition and presentation of action plans and targets to reduce negative impacts, as well as a requirement to report on all its value chain activities. This means that companies will need to monitor information beyond their own organization, also considering their value chain business partners.

Regulation (EU) 2019/2088 of the European Parliament and the Council (amended by Regulation (EU) 2020/852 of the European Parliament and the Council, of the 18th June of 2020, on the establishment of a framework for promoting sustainable investment), related to the disclosure of sustainability-related information in the financial services sector, also stipulates that market participants must publish on their websites information regarding their policies for integrating sustainability risks into their investment decision-making process. Financial advisors must also publish information on their websites regarding their policies for integrating sustainability risks into their investment advisory or insurance advisory services.

According to Article 4, market players must also publish, in an up-to-date manner, in their websites, if they take into account the major adverse impacts of investment decisions on sustainability factors, a statutory statement on their due diligence policies regarding these impacts, taking into account the size, nature, and scale of their activities and the types of financial products they offer.

If they do not take into account the adverse impacts of investment decisions on sustainability factors, they must provide clear reasons for doing so, including, if applicable, information on whether and when they intend to consider these adverse impacts.

From the 30th of June of 2021, market participants in the financial sector which, as of the closing date of their balance sheet, exceed the criterion of an average of 500 employees during the financial year must publish on their website a statement regarding their due diligence policies regarding the major adverse impacts of investment decisions on sustainability factors. From that date, financial market participants which are parent companies of large groups and exceed the criterion of an average of 500 employees during the financial year at the closing date of the group's consolidated financial statements must also publish and update statutory statements on their websites regarding their due diligence policies concerning the major adverse impacts of investment decisions on sustainability factors.

Similar transparency obligations apply also to financial advisors. Specifically, they must provide information on whether, given the size, nature of their activities, and the types of financial products they advise on, they take into account the major adverse impacts on sustainability factors in performing their investment advisory services. If they do not, they must provide reasons for not doing so.

Transparency also extends to remuneration policies, as per Article 5, and to the marketing of financial products. This solution is understandable for two major reasons: first, to ensure informed decision-making by investors seeking to avoid unsustainable investments, and second, to prevent greenwashing activities, which is the unfair competition practice of marketing a financial product as sustainable when basic environmental standards are not met.[4] Additionally, it seeks to increase market confidence, contributing to the promotion of a sustainability agenda.

Information duties also apply to financial products themselves. According to Article 6 of Regulation (EU) 2019/2088, market participants must, among various pre-contractual information, describe how sustainability risks are integrated into their investment decisions and indicate the results of the assessment of potential impacts of sustainability risks on the performance of the financial products they offer. It was also envisaged that whenever market participants considered sustainability risks to be irrelevant, they would explain the reasons for this understanding clearly and concisely. Financial advisors, in turn, must include, in their pre-contractual information disclosure, information on how sustainability risks are integrated into their investment advisory or insurance advisory services and the results of the assessment of potential impacts of sustainability risks on the performance of the financial products they advise about. Similarly, if financial advisors consider sustainability risks to be irrelevant, they should explain the reason.

Furthermore, whenever a financial product promotes environmental and/or social characteristics, the disclosed information should indicate how such characteristics are achieved. The information must comply with the requirements of Article 9 if a financial product aims for sustainable investments and a reference benchmark has been designated.

With the amendments introduced by Regulation (EU) 2020/852, the regulation goes further. Firstly, the European Supervisory Authorities are tasked with jointly developing technical regulatory standards to specify the content and presentation of information in more detail, following the principle of 'not significantly harming'. In addition, it requires that the information provided at the time of marketing a financial product (or some financial products) includes some of the indications referred to in the mentioned Regulation of 2020 (particularly in Articles 5 and 6), making the disclosure more detailed.

In this regard, whenever a financial product aims for sustainable investments and a reference benchmark has been designated, involving an economic activity that contributes to an environmental goal, information concerning the environmental goal must be provided, as well as information concerning the contribution of the economic activity for that goal and information on how the underlying investments in the financial product can finance economic activities that are environmentally sustainable.

Secondly, because a standardization of criteria may be essential for the evaluation of the provided information, Regulation (EU) 2020/852 establishes criteria for determining whether an economic

[4] *Considerandum* 11 of the Regulation (EU) 2020/852, of the European Parliament and of the Council of June 18, 2020, on the establishment of a regime for the promotion of sustainable investment OJ L 198/13.

activity can be qualified as environmentally sustainable, to assess in which extent an investment is environmentally sustainable.

According to Article 3, an economic activity is environmentally sustainable if it substantially contributes to one or more environmental objectives, including mitigating climate change, adapting to climate change, sustainable use and protection of water and maritime resources, transitioning to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems, and does not significantly harm any of these objectives; if it is carried out in accordance with the procedures to be applied by the company conducting an economic activity with the aim of aligning such procedures with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights established in the eight fundamental conventions identified in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights; and if it satisfies the technical assessment criteria established by the Commission.

These criteria are applied to determine whether an economic activity qualifies as environmentally sustainable and are also applicable to issuers of financial products or corporate bonds that are offered as environmentally sustainable.

However, we must analyse it deeper. In fact, if the information duties considered so far are particularly relevant to recommend the abstention from investing in financially objectionable products (negative screening), or to recommend investment in financial instruments issued by entities that propose to carry out projects with a positive impact in environmental, social, or corporate governance terms (impact investment), that is, to assure investment in projects that prioritize ESG factors, financial markets show us that it is possible to go further by linking the securities value itself to the realization of an environmentally sustainable project. Specific bonds emerge, such as green bonds, as well as social bonds and blue bonds.

Taking this into consideration, the European legislator intervened, adopting in October 2023 the Green Bonds Regulation - Regulation of the European Parliament and of the Council on European Green Bonds and optional disclosure of information regarding bonds marketed as environmentally sustainable and bonds linked to sustainability. This regulation aims to establish uniform requirements for issuers who intend to use the designation 'European Green Bonds'.

In Article 2, the regulation establishes an important distinction between bonds marketed as environmentally sustainable, i.e., bonds whose issuer assures investors through their pre-contractual information that bond revenues are used in economic activities contributing to an environmentally positive objective; and bonds linked to sustainability, meaning bonds whose financial or structural characteristics vary depending on whether the issuer achieves predefined environmental sustainability goals. Accordingly, the Regulation imposes significant duties of transparency and information.

Firstly, it is required that the issuer, in addition to preparing the prospectus, completes a form regarding the issuance of green bonds, which must be subject to a favourable opinion from a third party, issues annual reports regarding the allocation of European green bond revenues to economic activities aligned with environmental sustainability; and publishes an impact report describing the environmental impact of using its revenues after the full allocation of revenues.

These duties, enshrined in Articles 8, 11, and 12 of the Regulation, are subject to assessment by external auditors, both before and after the issuance of green bonds, which are also subject to registration and supervision by ESMA.

Supervisory and investigation powers are also conferred to competent national authorities, which may start to demand the provision of information or the publication of information sheets, reviews and assessments, annual reports regarding the allocation of revenues, or impact reports.

Accordingly, the rules are strengthened to combat the risks of greenwashing, while also providing for voluntary disclosure requirements regarding other environmentally sustainable obligations and sustainability-linked obligations issued by the EU.

By reinforcing information duties, an environment of increased confidence is created, allowing for increased capital flows into environmentally sustainable projects. However, at the same time, rights of investors are strengthened, enabling them to invoke these rules to demand compensation in case of misinformation, without completely eliminating the risk of breach of the environmentally sustainable project upon which the obligation may structurally depend. Note that the triggered liability is both pre-contractual and non-contractual, given the nature of legal provisions protecting third-party interests that may be recognized in these norms. Ultimately, in the event of non-compliance with environmentally sustainable projects post-obligation subscription, contractual liability may be invoked.

Additional issues may be raised regarding the responsibility of financial intermediaries, as well as the potential responsibility of external auditors.

2.2. Remedies

Regardless of the sanctions that various legal systems may establish for the violation of the specified information obligations, it becomes clear that there can be consequences in terms of specific and individual private relationships that may be established.

Among such consequences is the possibility of potential invalidity of the legal transaction for the acquisition of securities that, contrarily to the information that has been provided, violate ESG (Environmental, Social, and Governance) criteria.

Mistake or deceit regimes may come into play, depending on the circumstances of the case and the specific problematic structure in question. In a necessarily simplified manner, we can suggest that the investor's decision to invest may have been influenced by a particular environmental or social concern. An incorrect representation of the reality regarding the positive environmental or social impact of the investment or the absence of a negative social, human, or environmental impact can be considered as a relevant mistake. If such mistake is essential and concerns a circumstance that both parties regarded as an essential condition to the contract, such that it may have even determined a different return on investment and a different interest rate on the bond, the bond subscription can be annulled under Article 252(2) of the Portuguese Civil Code. If the financial return depends on the success of the sustainable project underlying the investment, as in the case of impact investment, then the error is an error regarding the object, leading to the annullability of the transaction under Articles 251 and 247 of the Civil Code. In the case of an inaccurate representation of the green qualities of the issuer, the mistake may rest on the recipient, and the regime of Article 247 of the Civil Code is also appliable, by reference to Article 251 of the Civil Code.

When there is a deliberate omission of information that must be provided, that can potentially constitute a case of omissive fraud/deceit. This will be a fraud by the part of the recipient, in the case of the acquisition of bonds (or other securities) in the primary market, depending on the subscription scheme. In this context, we can say that negligent omission of information that is required by law can be equivalent, for the relevant purposes, to deceit. In the case of omission of information by the broker, the terms of the problem have to be considered in other way.

A claim for damages based on pre-contractual liability may arise in cases of contract invalidity. It is also possible to establish extracontractual liability. For that purpose, it would be necessary to qualify the rules that establish the information obligations mentioned above as legal provisions protecting third-party interests, the violation of which can establish liability under Article 483 of the Portuguese Civil Code, like what appears to result from some German jurisprudential decisions referring to § 823 II BGB. Furthermore, there is the possibility of liability regarding the prospectus.

But greenwashing can occur outside the marketing of financial instruments. This might involve, for example, claiming certain environmentally friendly characteristics of a product when they do not actually exist. In such a scenario, various legal frameworks are abstractly relevant to assess the legal significance of the case.

Firstly, it may involve a lack of conformity of the product with the contents of the contract. In such cases, the legal regime of Decree-Law no. 84/2021, dated 18th of October, which establishes consumer rights in the purchase and sale of goods, contents and digital services may be invoked.

It is also relevant to consider the possibility of invoking the regime of the vices of the declaration of intent, as we discussed regarding the acquisition of financial instruments. This raises a specific question about the relationship between will vices, redhibitory vices, and the recent principle of conformity of goods with the content of the contract.

In addition, a violation of the right to information, as required in Article 8 of Law no. 24/96, could be at issue, with consequences in terms of compensation, even in the field of financial investments, as long as we can qualify the investor as a consumer.

Furthermore, the EU legislator considered that making an environmental claim, understood as ‘any message or representation that is not mandatory under EU or national law, including textual, pictorial, graphic, or symbolic representation, in any form, including labels, trademarks, company names, or product names, in the context of commercial communication, declaring or implying that a product or professional has a positive or nil impact on the environment or is less harmful to the environment than other products or professionals, respectively, or has improved its impact over time,’ without clear, objective, and verifiable commitments and targets and without an independent monitoring system, should be considered a deceptive commercial practice under Article 6(2)(d) of Directive 2005/29/CE, according to the Proposal for a Directive of the European Parliament and of the Council, amending Directives 2005/29/CE and 2011/83/UE, regarding empowering consumers for ecological transition through better protection against unfair practices and better information.[5]

On the other hand, Annex I of Directive 2005/29/CE is amended to include misleading commercial practices which are in all circumstances considered unfair, such as the display of a sustainability seal that is not based on a certification scheme or is not established by public authorities; the generic environmental claims for which the trader cannot demonstrate excellent recognized and relevant environmental performance; and the environmental claims about the entire product when it concerns only a specific aspect of the product.

If the proposed directive is approved and subsequently transposed into our legal system, the verification of such deceptive action could lead to civil liability under general terms, as specified in Article 14(3) of Decree-Law no. 57/2008. To establish such liability, it would be crucial to qualify the relevant rules as legal provisions protecting third-party interests and to identify concrete provable inflicted harm.

From a consumer's perspective, the Proposal for a Directive of the European Parliament and of the Council on the substantiation and communication of explicit environmental claims (Green Claims Directive)[6] is equally important. This directive establishes minimum requirements for substantiating and communicating voluntary environmental claims and environmental labelling in business-to-consumer practices. It ensures that the verification of explicit environmental claims is based on an evaluation that meets the established minimum criteria, preventing such claims from being deceptive. It also sets additional requirements for comparative claims, i.e., claims that state or imply that a product has fewer or more environmental impacts or performs better or worse in terms of environmentally relevant aspects than other products. Additional requirements are also established for environmental labelling, which should be considered complementary to the requirements set out in the proposal for empowering consumers for ecological transition.

In this context, Directive (EU) 2020/1828 on collective actions is also important. This directive, which aims to enable consumers to protect their collective interests in the EU through collective actions

[5] COM(2022) 143 final, 2022/0092 (COD).

[6] COM(2023) 166 final, 2023/0085(COD).

proposed by representative entities on behalf of groups of consumers to obtain injunctive measures, i.e., to put an end to unlawful practices or demand remedial measures, has been transposed to the Portuguese legal order by Decree-Law nº114-A/2023, which provides for the possibility of a compensation class action.

3. Conclusion

In the near future, numerous mechanisms are expected to ensure, with a clear concern for sustainability factors, the position of investors and consumers with environmental concerns. At the same time, there are increased risks for companies that cannot be ignored, potentially leading to hypotheses of civil liability. Greenwashing cannot only trigger an obligation to compensate, but will also inevitably affect the corporate entity's reputation, a more than enough reason for such practice to be avoided.