

# Green Policies: Understanding and Addressing Compliance Risks

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Increased energy costs and growing awareness about climate change have pushed "green issues" into corporate boardrooms. Regulatory, shareholder, employee and customer concerns about corporate environmental accountability, in addition to emerging climate change and energy regulations, have made "green" policies a common element of business strategic planning. The recently released Global Green 100 list includes the many Fortune 500 companies that have adopted and implemented board-level green corporate policies and governance commitments for sustainable and energy-efficient practices.<sup>1</sup> Indeed, organizations across the economic spectrum (including this law firm) have adopted or are adopting green policies (also called sustainability policies). These policies provide standards for environmental responsibility and sustainability initiatives.

Green policies offer organizations many benefits, including enhancement of public image, increase in marketability, reduction of operating costs, and improvement in employee morale. However, adopting green policies may impose risks on your organization if the policies are not properly followed or false or misleading statements are made about those policies. This article will address some of these risks and provide practical tips to manage those risks and to make your organization's green policies work for you.

## *FALSE ADVERTISING RISKS*

In an age of environmental consciousness, businesses may be held liable for false statements about their eco-friendly company policies or products.

### *JUDICIAL DECISIONS RELATING TO STATEMENTS ABOUT ECO-FRIENDLY CORPORATE POLICIES*

The U.S. Supreme Court in 2003 addressed alleged false advertising of corporate policies in *Nike, Inc. v. Kasky*,<sup>2</sup> in which the court was asked to decide whether Nike was liable for false advertising when the company released allegedly false statements about working conditions in the Asian factories that produced its products. Beginning in 1996, Nike had been "besieged with a series of allegations that it was mistreating and underpaying workers at foreign facilities."<sup>3</sup> In response, Nike mounted a public relations campaign, sending out press releases, letters to editors of various newspapers, and letters to university presidents and athletic directors disputing the allegations and describing the foreign working conditions positively. Nike was later sued by Mark Kasky (a California resident) on behalf of the general California public for the alleged misrepresentation in Nike's public relations

campaign.<sup>4</sup> Mr. Kasky claimed Nike's statements about the factory working conditions were false and had been made by Nike to "maintain and/or increase its sales."<sup>5</sup>

The key issue was the distinction between "commercial" speech (which may be reasonably regulated to protect the public) and constitutionally protected "free" speech (which may be regulated only to serve a compelling state need and in the least restrictive manner possible). Following trial, the California Supreme Court ruled that Nike had engaged in commercial speech and that Nike's statements violated the California laws prohibiting deceptive advertising. The U.S. Supreme Court dismissed Nike's subsequent appeal on procedural grounds.<sup>6</sup> In so doing, however, the court observed that the distinction between commercial and noncommercial speech by corporations was a difficult issue and one of great public importance.<sup>7</sup> The court nevertheless declined to decide whether a corporation's allegedly false misstatements about its own corporate policies were entitled to constitutional protections, leaving that issue to be decided through litigation in the lower courts.

Although the *Nike* Court focused on allegedly false statements about Nike's corporate labor policies, the decision suggests that advertisements and public disclosures about green policies and practices may well be subject to regulation under federal and state law.

#### *FTC GREEN GUIDES RELATING TO STATEMENTS ABOUT ECO-FRIENDLY PRODUCTS*

Since 1996, the Federal Trade Commission ("FTC"), through its Guides for the Use of Environmental Marketing Claims ("Green Guides"),<sup>8</sup> has monitored advertising claims about eco-friendly products. In 2007 the agency began updating the Green Guides to address new environmental terms and new commodity markets—such as those for renewable energy credits or carbon credits. The Green Guides provide guidance for the use in consumer advertising of specific terms like "sustainability" and "renewability," and also address "greenwashing,"—a term coined generally to describe the act of misleading consumers regarding the environmental practices of a company or the environmental benefits of a product or service.<sup>9</sup> With respect to all environmental claims, the Green Guides impose on product makers the obligation to obtain scientifically valid information supporting the claims before making them.

The FTC has authority to charge a company under the Federal Trade Commission Act for making false or unsubstantiated "green" claims.<sup>10</sup> Sanctions for false advertising include agency orders requiring companies to (a) refund (in full or in part) monies paid by consumers who bought falsely advertised products; (b) cease running advertisements making false claims; (c) issue corrective advertisements to offset the harms caused by earlier false advertising; and (d) submit periodic reports to the FTC to substantiate new advertising claims.

The FTC has not hesitated to use its authority to challenge false green marketing claims. Recently, the agency sued Kmart Corp., claiming that it had made false and unsubstantiated claims that its private-label paper products were biodegradable. Contrary to the consumer's reasonable interpretation of "biodegradable," the agency

claimed that Kmart's paper products "will not completely break down and return to nature, *i.e.*, decompose into elements found in nature within a reasonably short period of time, because a substantial majority of total municipal solid waste is disposed of by methods that do not present conditions that would allow for [Kmart's] paper plates to completely break down." Kmart settled the case by agreeing to stop making biodegradable claims.<sup>11</sup> On August 11, 2009, the FTC similarly announced a settlement with three sellers of clothing and other textile products charged with deceptively labeling and advertising these items as made of bamboo fiber, when they were instead made of rayon, and with making false claims about use of environmentally friendly processes and about the products being biodegradable.<sup>12</sup>

#### *LANHAM ACT REGARDING FALSE OR MISLEADING ADVERTISING*

A separate U.S. statute, the Lanham Act, bans false or misleading representations in advertising of goods, services or commercial activities. Private lawsuits under Section 43(a) of the Lanham Act are a risk where a market competitor believes another marketer's green claims are deceptive.<sup>13</sup> This law has not yet been applied in court to a claim of environmental advertising, but its broad scope may make it a tool to address greenwashing. The Lanham Act provides no cause of action to consumers; only business competitors have private enforcement standing under the statute.<sup>14</sup>

#### *STATE LAW REGULATION*

At the state level, deceptive or misleading advertisements can be challenged by consumers (or state attorneys general acting on behalf of consumers) under consumer protection statutes that address false advertising, consumer fraud, or unfair business practices. Some states (*e.g.*, California, Indiana, Delaware and Texas) have adopted specific laws governing environmental marketing claims—a trend that is likely to continue as environmental marketing evolves.

#### *INDUSTRY REGULATION*

The National Advertising Division ("NAD") of the Council of Better Business Bureaus has provided an alternative to enforcement under the Green Guides or state advertising laws. Investigations can be initiated by NAD or by competitors. The NAD process is voluntary; however, NAD may refer matters to federal or state agencies for enforcement. Like the FTC, NAD has been aggressive about false advertising regarding green products. Earlier this year NAD forced GP Plastics to stop claiming that its PolyGreen plastic newspaper bags were "100 percent oxo-biodegradable" and "recyclable."<sup>15</sup>

#### *INTERNATIONAL REGULATION*

Companies that market products or services outside the United States must also consider international regulations regarding environmental marketing. For example, the European Union has adopted voluntary labeling programs, Scandinavian countries have adopted mandatory guidelines (similar to the FTC's Green Guides)

and the United Kingdom has established an independent body (the Advertising Standards Authority ("ASA")) to assess and resolve deceptive advertising disputes. ASA has ruled within the past two years against companies, such as Shell International Ltd. and Lexus (GB) Ltd., over their green advertising claims.<sup>16</sup>

### *SHAREHOLDER-RELATED RISKS*

In recent years, corporate social and environmental practices have attracted increased attention from shareholders of public companies. According to RiskMetrics, a leading provider of corporate governance services to institutional investors, more than two-thirds of respondents to its annual policy survey indicate that it is somewhat important to very important for companies to report performance on social and environmental criteria as part of their routine disclosure. Also, larger companies have frequently been the targets of shareholder proposals at annual shareholder meetings requesting heightened reporting on social and environmental practices and policies. Companies that have not yet adopted and promoted green policies may become the targets of shareholder proposals from activist shareholders seeking to pressure companies to implement such policies. Those that have may become targets of disgruntled shareholders on either or both sides of the debate: those who feel that the company's policies do not measure up and those who feel that shareholders' interests are being sacrificed to other, less important interests.

With climate change and carbon footprint issues coming to the forefront in recent years, awareness and interest among the shareholder community in corporate environmental practices and green policies has boomed. While the interest of some segments of the shareholder community may be ideological, many other shareholders perceive risks and policies relating to climate change as a potential bottom-line issue. As a consequence, companies are more likely to face shareholder-related risks in implementing and publicizing their green policies, especially those in industries (such as oil and gas, coal, utilities, insurance and transportation) for which carbon footprint-related risks are particularly heightened.

Given the investment community's heightened awareness and interest in green policies and related environmental issues, it is certainly conceivable that public companies' disclosures about these matters will begin to affect investment decisions (if they have not already done so). As shareholder interest in these issues continues to grow, companies should brace themselves for potential securities fraud lawsuits relating to their disclosures around green policies and related environmental practices. It would not be surprising to see activist shareholders adopt the securities fraud lawsuit as one tool for pressuring companies to implement and follow green policies that are acceptable to these shareholders.

For these reasons, public companies should take steps to ensure that any statements made or practices adopted to promote green policies are not actionable by shareholders. A public company that holds its business or policies out as being green could expose itself to shareholder suits if the company neglects to follow adopted policies or its disclosures regarding green policies contain material misrepresentations. For example, if a company's green policies are posted on its

website and the claims made are found to be unsubstantiated, a publicly traded company could be subject to an enforcement action brought by the SEC or a securities fraud lawsuit brought by private litigants on the ground that the claims have unfairly influenced company investors to purchase stock.

Companies that choose to adopt and publicize green policies should be serious about following those policies. Like any important corporate policy, a well-publicized failure to follow a corporate green policy that leads to some sort of company loss could expose directors to shareholder derivative lawsuits based on claims that the board failed to discharge its oversight duties.

### *BREACH OF CONTRACT RISKS*

Companies should also be aware of green statements made and policies adopted to avoid breach of contract claims, including breach of express or implied warranties made in marketing materials. Litigation can often be avoided by being precise in drafting contracts and by complying with obligations created under agreements. For example, statements in merger or acquisition deals or other agreements warranting or representing that a company follows its green policies or that its facilities are developed and managed in an environmentally conscientious manner could subject the company to a breach of contract claim if those statements prove to be false. In addition to false advertising or greenwashing claims, contract claims can arise if a party makes inaccurate representations or warranties regarding the "green" characteristics of products or services to be provided. Similarly, as discussed in our first update in this series, claiming in an agreement that a facility will be certified "green" based on environmental standards (*e.g.*, the U.S. Green Building Council's LEED<sup>®</sup> standards) can leave developers, managers and landlords liable for exposure for breach of contract if the certification is not achieved. Likewise, green leases promising tenants environmental features that do not materialize could lead to legal redress.

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*SIDEBAR: PRACTICAL TIPS TO MANAGE GREEN POLICY RISKS*

1. *KNOW WHAT YOU HAVE.*

- Take an inventory of your "green" facilities, operations and practices. That assessment could also include review of the carbon footprint of your business. Use this information as a benchmark to examine your green policy implementation. Be aware that this data could also be relevant as new climate-related regulatory regimes emerge, such as carbon cap-and-trade programs or carbon taxes.
- Review your agreements regarding green facilities or practices, including service contracts, leases, management policies and procedures.
- Assess your public disclosures and advertisements for representations regarding green issues.

2. *UNDERSTAND THE SCOPE OF YOUR GREEN POLICIES.*

- Analyze the terms used in your corporate green policies. Are the terms defined? If not, how does your company interpret the policy and monitor its implementation? If your policies are ambiguous, overbroad or vague, consider referencing or incorporating outside parameters for your green policy interpretation.
- Watch for emerging federal or state standards and look for ways to track your compliance in a manner that is consistent with public policy.

3. *MONITOR IMPLEMENTATION OF YOUR GREEN POLICIES.*

- Make precise green marketing claims and examine such claims for consistency with your company's green policies. Look to the FTC's Green Guides and similar standards for guidance. Make sure your claims are substantiated and well documented with credible evidence. Be prepared to provide such documentation upon request.
- Implement compliance programs and protocols to ensure company facilities, operations and communications comply with the organization's green policies. Provide employee training for those persons whose job duties most directly interface with implementation of green policies.
- Keep good records and establish monitoring protocols to maintain a finger on the pulse of the green efforts of the organization and to set goals for meeting long-term green objectives. By maintaining a finger on the pulse of your organization, areas of improvement and new opportunities can be discovered for evolving green policies.

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<sup>1</sup> See <http://www.environmentalleader.com/2009/02/19/uptime-institute-announces-global-green-100-list/>.

<sup>2</sup> 539 U.S. 654, 123 S. Ct. 2554 (2003).

<sup>3</sup> *Id.* at 654.

<sup>4</sup> Until 2004, individuals or groups that had not suffered any direct loss or harm could sue on behalf of the general public under California's false advertising law. In November 2004, California voters passed Proposition 64, which imposed stronger standing requirements (actual injury, loss of money or property) for persons filing suit under this law.

<sup>5</sup> *Id.* at 656.

<sup>6</sup> *Id.* at 657-8.

<sup>7</sup> *Id.* at 664.

<sup>8</sup> The Federal Trade Commission, Guides for the Use of Environmental Marketing Claims ("Green Guides"), *available at* <http://www.ftc.gov/bcp/gnrule/guides980427.htm>

<sup>9</sup> <http://sinsofgreenwashing.org/>

<sup>10</sup> See 15 U.S.C. § 45.

<sup>11</sup> See <http://www.ftc.gov/opa/2009/06/kmart.shtm>; see also <http://www.ftc.gov/os/caselist/0823186/090609kmartanal.pdf>.

<sup>12</sup> See <http://www.ftc.gov/opa/2009/08/bamboo.shtm>.

<sup>13</sup> 15 U.S.C. § 1125(a).

<sup>14</sup> *Barrus v. Sylvania*, 55 F.3d 468, 470 (9th Cir. 1995).

<sup>15</sup> See <http://www.nadreview.org/content/pressdoc/4944PR.pdf>.

<sup>16</sup> See ASA adjudications reports at <http://www.asa.org.uk/asa/adjudications/public/>.