Global Perspectives

International Trends in Commercial Disputes

April 2023

ReedSmith

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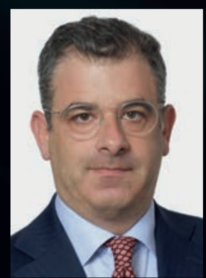
Note from the Editors

Welcome to the April 2023 edition of our Global Perspectives publication.

In this issue, our authors explore a number of significant themes within the disputes landscape. Leading practitioners located across our global offices consider legal frameworks to address allegations of greenwashing across different jurisdictions, including avenues of enforcement and insurance considerations. Experienced litigators explore the powerful disruptive potential of decentralized autonomous organizations and how one can prepare to protect oneself in the event of a dispute. This edition also provides insight into whistleblower reward programs in the U.S. and why whistleblowing and bounty payments are expected to grow. Finally, our contributors discuss regulatory enforcement in the U.S., and what trends to expect throughout 2023.

We hope you find this edition interesting, and we will continue to provide our global perspective on legal issues and developments as they occur.



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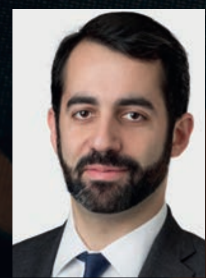

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Resolving DAO-related disputes

Decentralized autonomous organizations (DAOs) have powerful disruptive potential. However, founders, members, and investors can also face novel legal risks and challenges. Those who are well prepared and advised will be in a better position to protect their rights and interests.

DAOs and DeFi

As is well known in the industry, a DAO is an emerging form of cooperative structure that has no central governing body and whose members share a common goal to act in the best interest of the entity.

DAOs are intended to enable trustless and decentralized operations – “trustless” in that a third party need not be relied upon to operate between you and your cryptocurrency transactions or holdings; “decentralized” in that no one entity or person makes decisions.

DAOs aim to achieve this by relying on coded governance rules, with smart contracts and utility tokens automating administrative duties and allowing decentralized decision-making by users.[1] These structures govern some of the best-known decentralized finance (DeFi) protocols, allowing for peer-to-peer financial services. But of course, they can also be used to structure investments, decentralized networks or protocols, collector or social groups, or charitable organizations.

Dispute drivers

Many in the industry consider that DAO structures, based on self-executing smart contracts, will ultimately reduce the scope for commercial disputes. However, even with the best-designed DAO, there exist risks. These include the following:

- Interpersonal risk. Like other business endeavors, DAOs are susceptible to differences of opinion or divergence in interest. Disputes can arise between co-founders and between founder and investor as to what was promised between the parties and who is entitled to what.

- Smart contract risk. DAOs built on smart contracts are vulnerable to errors or flaws in the code. There is a risk of malicious actors exploiting these flaws for their own profit.[2] 2021 and 2022 were record-breaking years for hacks and exploits with $3 billion lost in each year.[3] Additional smart-contract risks arise from manipulation of “oracles,” the conduits through which off-chain information is provided to smart contracts[4] and input or data-entry errors.

- Progressive decentralization risk. Many DAOs start life as centralized entities, with founders gradually handing power away to DAO members. However, member and founder interests might diverge, for instance, regarding honoring of legacy third-party contracts.[5]

- Intermediary risk. Some DAOs rely on intermediaries such as individuals who are authorized to control DAO treasuries. This leads to risk of human error or misconduct, a risk magnified if there is no way to validate the identity or credentials of the intermediary, which might be the case for an anonymous “treasurer.”

- Governance risk. DAO voting rights allocated by ownership of freely traded tokens can lead to risk of governance attacks[6] or other issues when one or more individuals obtain concentrated ownership of tokens. Governance issues can also arise when one part of a community holds greater sway due to their history or status.[7]

The industry is developing its own means to combat these issues. For example, smart contract risk may be mitigated with better security measures such as formal verification, audits, bounties, monitoring tools, and automated firewalls.[8] Intermediary risk could be reduced by future developments in digital identity, which might reduce risks associated with anonymous treasurers. DAOs can also be designed to limit governance risks arising from control by prominent individuals or groups.[9]

However, these efforts do not entirely remove the possibility of disputes arising, which in turn can engage difficult and untested areas of law.

Legal and strategic issues

Some of the issues that could be particularly thorny in the context of DAO disputes include the following:

- Emerging law. Disputes involving blockchain technology often involve disagreements about issues such as the proper scope of developer duties toward users[10], or the circumstances in which a legitimate arbitrage trade becomes an illegitimate exploit.[11] Depending on jurisdiction, these may be new areas of law with little precedent in place.

- Method of resolution. Without a jurisdiction agreement in place, a party would need to establish jurisdiction through other means. Subject to the applicable law, this might involve arguments regarding party residence, place of performance, and location of assets, each of which may be difficult to establish in the DAO context.

- Pseudonimity. Parties in DAO disputes may be pseudonymous, which has the potential to cause difficulty in jurisdictions that require a party to be named. Some leading jurisdictions allow claims to be brought against “persons unknown” by reference to wallet addresses,[12] and/or legal service to be effected by airdropping claim documents to those wallets.[13]

- Individual liability. Where a claim is brought against a DAO itself, the question will be whether it has incorporated itself into one or more legal entities, as is increasingly the case, meaning that liability will be limited to those entities. If it has remained unincorporated, this can lead to additional risk, and the members themselves can be found to have assumed personal liability for any wrongdoing of the DAO.[14]

- Preservation and enforcement. Parties will want to consider means of tracing and securing assets pending the outcome of the dispute, as well as ways in which the claim can be formulated so as to allow for an enforceable remedy. Both steps require consideration of the portability, custody, and price volatility of digital assets residing on a blockchain ledger. This can involve difficult and nuanced analysis, which is further complicated given that such assets are banned in some jurisdictions,[15] and their legal status is unclear in others.[16]

Being prepared

DAOs are often early-stage businesses that are highly vulnerable to economic shocks and changes in market sentiment. Disputes, if handled wrongly, can be highly disruptive if not fatal to a DAO’s operations.

However, DAO founders, investors, and members can take measures in advance to protect their rights in the event of a dispute.

1. Parties should structure their DAOs with a view to mitigating risk. Some DAOs might want to incorporate within a legal wrapper in order to shield individual members from unlimited personal liability. They may also wish to vest authority to act on behalf of a DAO in an entity, whether it be a legal wrapper or an external foundation.

2. DAOs should put in place mechanisms for resolving disputes quickly, effectively, and in a way that allows for due process and an enforceable decision. Arbitration is a natural choice for DAO-related disputes given its flexibility of procedure, allowing for a shorter process determined by a tribunal with relevant expertise, and the ready cross-border enforceability of arbitral awards.[17]

3. Parties should have in place a plan for contingencies such as exploits or disputes. As a DAO's consensus-based decision-making may not be suitable for prompt decision-making, this might involve nominating an individual or committee to represent the DAO in advising counsel and briefing the market. It is also important to have advisors on standby to quickly assess risk and trace exploited assets.

4. Parties should remain flexible and open to commercial resolution. This might include on-chain measures,[18] informal liaison with third parties, or even post-dispute agreements with counterparties, such as agreeing with a user to confidentially arbitrate the specific question of whether or not a particular trade was legitimate.

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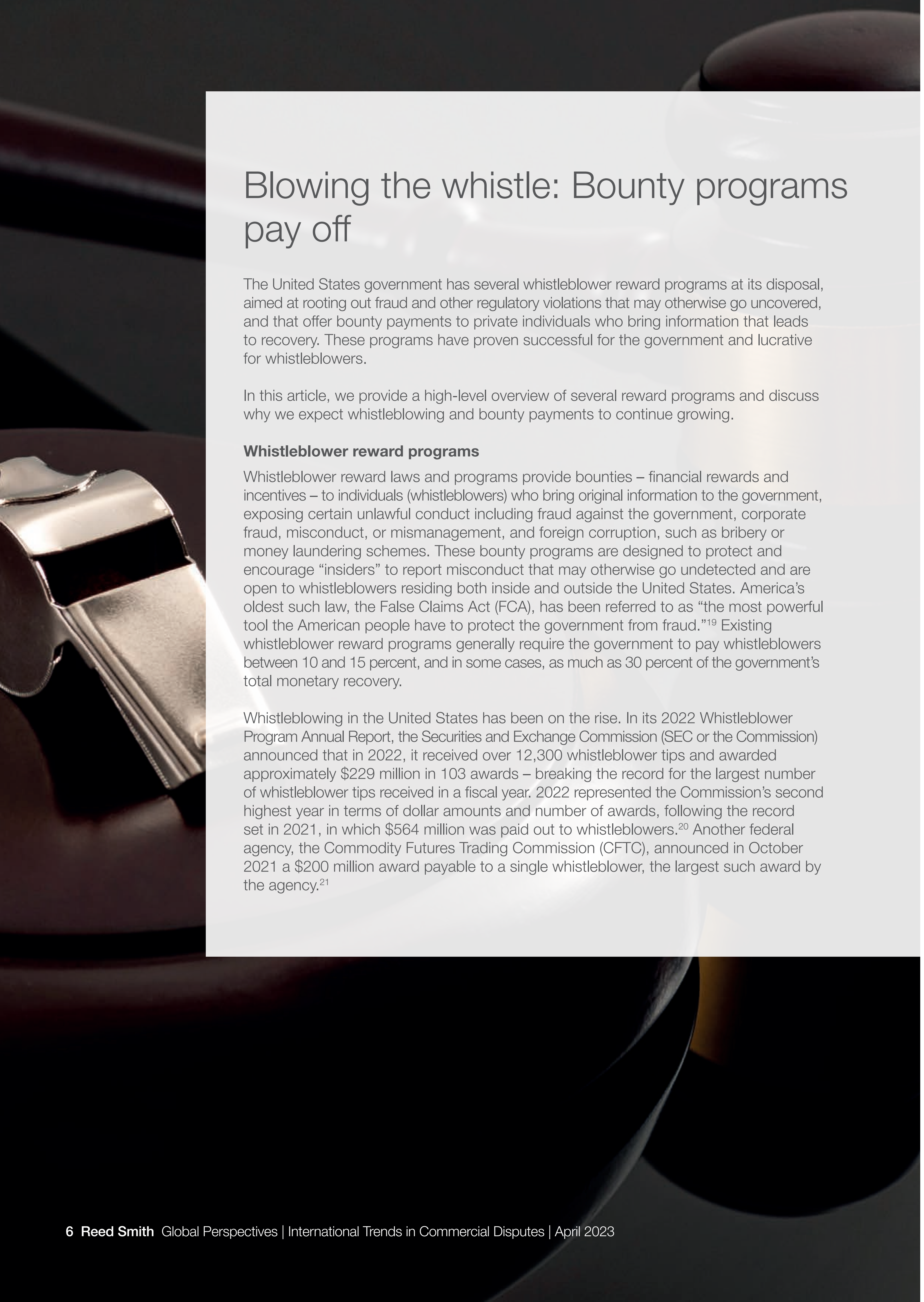

Blowing the whistle: Bounty programs pay off

The United States government has several whistleblower reward programs at its disposal, aimed at rooting out fraud and other regulatory violations that may otherwise go uncovered, and that offer bounty payments to private individuals who bring information that leads to recovery. These programs have proven successful for the government and lucrative for whistleblowers.

In this article, we provide a high-level overview of several reward programs and discuss why we expect whistleblowing and bounty payments to continue growing.

Whistleblower reward programs

Whistleblower reward laws and programs provide bounties – financial rewards and incentives – to individuals (whistleblowers) who bring original information to the government, exposing certain unlawful conduct including fraud against the government, corporate fraud, misconduct, or mismanagement, and foreign corruption, such as bribery or money laundering schemes. These bounty programs are designed to protect and encourage "insiders" to report misconduct that may otherwise go undetected and are open to whistleblowers residing both inside and outside the United States. America's oldest such law, the False Claims Act (FCA), has been referred to as "the most powerful tool the American people have to protect the government from fraud."[19] Existing whistleblower reward programs generally require the government to pay whistleblowers between 10 and 15 percent, and in some cases, as much as 30 percent of the government's total monetary recovery.

Whistleblowing in the United States has been on the rise. In its 2022 Whistleblower Program Annual Report, the Securities and Exchange Commission (SEC or the Commission) announced that in 2022, it received over 12,300 whistleblower tips and awarded approximately $229 million in 103 awards – breaking the record for the largest number of whistleblower tips received in a fiscal year. 2022 represented the Commission's second highest year in terms of dollar amounts and number of awards, following the record set in 2021, in which $564 million was paid out to whistleblowers.[20] Another federal agency, the Commodity Futures Trading Commission (CFTC), announced in October 2021 a $200 million award payable to a single whistleblower, the largest such award by the agency.[21]

With such large awards available, government agencies responsible for investigating and prosecuting misconduct will likely continue to receive an increasing number of whistleblower tips. There are currently five significant whistleblower reward programs, and we anticipate that new programs are on the horizon.

1. The False Claims Act/qui tam lawsuits

The False Claims Act's qui tam provision allows private individuals, known as relators, to bring suits on behalf of the United States against wrongdoers who are defrauding the government. This can include overcharging the government, providing non-compliant products and services, or failing to pay the government money owed. A successful relator is entitled to receive between 15 and 30 percent of any money recovered, depending on several factors, including whether the government itself litigates the case and the extent to which the person substantially contributed to the prosecution of the action. This may result in substantial compensation for the whistleblower, given that False Claims Act defendants could be liable for treble damages and civil penalties.[22] In fiscal year 2022, the federal government recovered over $2.2 billion through FCA actions, with over $1.9 billion of those gains arising from lawsuits pursued by either the government or whistleblowers. In total, the government and whistleblowers were party to 351 settlements and judgments, the second-highest in a single year.[23]

Twenty-nine states[24] and the District of Columbia have their own false claims acts (most are modeled after the federal False Claims Act), which provide for the awarding of whistleblowers who report on health care or other fraud against the state.

2. The SEC Whistleblower Reward Program

The U.S. federal securities laws aim to protect investors. Whistleblowers who provide original information to the SEC about violations of such laws that leads to enforcement action and a recovery of over $1 million, are awarded up to 30 percent of any government recovery. Since implementation of the program in July 2010, the SEC has paid over $1.3 billion in 328 awards to individuals for providing information that led to successful enforcement actions by the SEC and other agencies.[25]

According to the SEC's annual report, "[e]nforcement actions brought using information from meritorious whistleblowers have resulted in orders for more than $6.3 billion in total monetary sanctions," including over $4 billion in "disgorgement of ill-gotten gains and interests," and $1.5 billion of those funds have been or are scheduled to go back to harmed investors.[26]

Notably, on August 26, 2022, the SEC announced that it had adopted two amendments to its whistleblower program.[27] The amendment to Rule 21F-3 expands the scope of non-SEC "related actions" by allowing whistleblowers who would have been eligible for an award under another whistleblower program to receive an award from the SEC if another award program that was more direct or relevant to the action would not give them as high an award. Prior to this amendment, whistleblowers were ineligible for awards under the SEC's whistleblower program if the SEC determined that another award program was more appropriate for the action at issue. This change ensures that whistleblowers are not disadvantaged by another whistleblower program that would award them less than the SEC could offer.

The second amendment was made to Rule 21F-6, affirming the SEC's authority to consider the dollar amount of a potential award for the limited purpose of increasing an award, but not to lower an award. Prior to this amendment, the SEC retained discretion to make downward adjustments to award amounts that exceeded $5 million.

Both amendments are significant for the SEC's whistleblower program given that they allow for even higher potential awards to whistleblowers, further demonstrating the value of the program and incentivizing whistleblowers to come forward with information regarding potentially unlawful conduct. Companies should ensure that all personnel are aware of and encouraged to use the company's internal reporting protocol, and should consider implementing strong internal controls to evaluate and properly react and respond to such complaints before they are raised with the SEC. Ultimately, such incentives could lead to more dubious allegations of wrongdoing, thereby burdening both the agency and the company against which the allegation was made.

3. The CFTC Whistleblower Reward Program

The CFTC Whistleblower Reward Program rewards whistleblowers who provide original information to the CFTC about violations of the Commodity Exchange Act that led to enforcement action and a recovery of over $1 million. Whistleblowers may receive an award of up to 30 percent of any government recovery.

Since issuing its first award in 2014, the CFTC has paid approximately $330 million to whistleblowers.[28] In fiscal year 2021, the CFTC made history by issuing a record-breaking award of nearly $200 million to a single whistleblower whose credible and specific information ultimately contributed to an investigation, which led to three enforcement actions.[29] While no awards granted in 2022 have broken that record, the Commission has continued to demonstrate an upward trend in granting whistleblower awards in increasing amounts.[30]

Additionally, in an effort to increase their oversight of cryptocurrency platforms and digital tokens, individuals such as CFTC Chair Rostin Behnam have backed a number of bills currently before Congress.[31] One of these bills, the bipartisan Digital Commodities Consumer Protection Act of 2022, would give the CFTC exclusive jurisdiction over digital commodities trading, including the cryptocurrencies with the greatest market capitalizations, ether, and bitcoin.[32] This growing focus may signal new initiatives by the CFTC to expand the current whistleblower program or result in the creation of a new bounty program.

4. The IRS Whistleblower Reward Program

Under the IRS Whistleblower Reward Program, a whistleblower who provides original information to the IRS regarding a taxpayer who is avoiding or underpaying a tax obligation to the federal government and the information results in the collection of at least $2 million in taxes, penalties, or other interest from the non-compliant taxpayer, may receive an award of up to 30 percent of any government recovery.

Since 2007, the IRS Program has paid more than $1.05 billion dollars in awards to whistleblowers, and has led to the successful collection of $6.39 billion from non-compliant taxpayers.[33] In December 2019, the IRS, "looking to do more for whistleblowers," teamed up with the Alcohol and Tobacco Tax and Trade Bureau (TTB), and agreed to process TTB claims for whistleblower awards under internal revenue laws.[34]

While in recent years the IRS's whistleblower program experienced a dip in whistleblower payouts, the IRS Whistleblower Office has made it clear that it intends to strengthen the program. As part of this new effort, in October 2022, the IRS Whistleblower Office held its first summit for persons representing whistleblowers to better understand how they can interact with the IRS. During the widely attended summit, attendees discussed topics such as status and stage letter responses; easing the review process for administrative file reviews; partial payments; and how whistleblowers should approach submissions that involve significant amounts of data. The summit served as an acknowledgement by the IRS that a stronger whistleblower program would aid the agency in its mission.

The October 2022 summit is only the first of many changes to the IRS Whistleblower Program that we anticipate will roll out under the new IRS deputy commissioner, Douglas O'Donnell, and newly appointed director of the Whistleblower Office, John Hinman. The agency has demonstrated a clear desire to increase whistleblower participation and will likely expand the program to encourage submissions and provide whistleblowers with generous payouts.

5. The Anti-Money Laundering Whistleblower Reward Program

The Anti-Money Laundering (AML) Whistleblower Reward Program, enacted in January 2021, is the most recent of such programs, demonstrating that the government is looking for opportunities to develop new bounty programs. This program rewards a whistleblower who provides original information to the Department of the Treasury's Financial Crimes Enforcement Network about any possible violation of the Bank Secrecy Act and its regulations. It provides that whistleblowers whose tips lead to enforcement action and a recovery of over $1 million may receive an award of up to 30 percent of any government recovery.

In December 2021, the White House published the United States Strategy on Countering Corruption, which highlighted the government's commitment to combat money laundering, including its intent to "address deficiencies in the U.S. anti-money laundering regime" and "implement newly established tools for investigating and prosecuting money laundering offenses."[35] One of those tools the government is looking to improve is its whistleblower program. There has already been movement on that front with a December 2021 bipartisan bill sponsored by Senators Charles Grassley (R-IA) and Raphael Warnock (D-GA) that would remove the current discretionary whistleblower payment standard and implement a 10 percent mandatory minimum reward to encourage more whistleblowers to come forward. That bill passed the Senate in December 2022 and was sent to the House.

In early December 2022, the U.S. Senate voted unanimously to expand the whistleblower initiative by passing the Anti-Money Laundering Whistleblower Improvement Act.[36] The new bill is meant to support the AML whistleblower program by increasing support for whistleblowers who report violations of U.S. sanctions laws, ensuring that whistleblowers will be paid a base award amount, and providing a way to pay whistleblower awards. Specifically, the proposed legislation:

- Enables whistleblowers to disclose a violation of the Foreign Narcotics Kingpin Designation Act, the Trading with the Enemy Act, and/or the International Emergency Economic Powers Act that leads to a successful enforcement action;
- Entitles whistleblowers to an award ranging between 10 and 30 percent of the value of fines collected; and
- Creates a $300 million fund to pay whistleblower awards from fines collected by the DOJ and U.S. Department of Treasury.

When announcing passage of the bill, Senator Grassley, one of the bill's co-sponsors, noted that "with the False Claims saving taxpayers $70 billion, the SEC whistleblower program saving over $4.8 billion, and the IRS whistleblower program saving over $6 billion[,] I'm optimistic that our

new program encouraging individuals to come forward for suspected sanctions violations will be successful as well."[37] Senator Grassley further explained that "[g]iven the expansive sanctions we've implemented on Russia as they wage an unjust war on Ukraine, our legislation is urgently needed to hold bad actors accountable."[38] If signed into law, this legislation could significantly expand the potential monetary rewards available to whistleblowers under the AMLA.

Other federal whistleblower reward laws

Other whistleblower laws reward the reporting of specific unlawful activities. These include: (1) the Motor Vehicle Safety Act, which allows the National Highway Traffic Safety Administration to reward whistleblowers for reporting safety-related problems in vehicles; (2) the Financial Institutions Reform, Recovery, and Enforcement Act, which authorizes the DOJ to sue federally insured financial institutions for civil penalties for certain criminal conduct, including mail, wire, and bank fraud, and reward whistleblowers up to $1.6 million of any government recovery; and (3) the Act to Prevent Pollution from Ships, which is enforced by the U.S. Environmental Protection Agency and rewards whistleblowers for reporting unlawful ocean dumping.

While each of these programs have their own unique procedural requirements, they all have the potential to result in a substantial payday for individual whistleblowers.

The future of bounty programs and the impact on businesses

Building off the success of the existing programs, in December 2021, the FTC Whistleblower Act of 2021 was introduced to Congress. Patterned after the SEC program, if enacted, this law would reward reports of potential or suspected violations of any law, rule, or regulation enforced by the Federal Trade Commission.

It's hard to argue with the data. Whistleblower bounty programs have proven to be a resounding success for the government. In the words of former SEC Chair Mary Jo Wright, they are a "game changer."[39] And as recent developments have shown, the government is not only looking to develop more ways to incentivize and make it easier for individuals to take advantage of current programs, but it is also looking to develop more bounty programs and interacting more closely with whistleblowers and their representatives to discuss and determine how the bounty programs like the IRS Whistleblower Program can be remodeled to be even more whistleblower-friendly.

With potential life-changing payouts to be had, private individuals are highly incentivized to look for unlawful conduct wherever they can, and instead of following their in-house reporting processes, "blow the whistle" directly to the relevant federal agency. Seeking the greatest financial reward appears to be the growing trend based on the record number of tips received in recent years by the federal agencies. With whistleblower incentives on the rise, ordinary individuals may potentially now, more than ever, actively seek out or concoct allegations against companies to increase their chances of receiving a large payout. In light of this trend, to promote in-house reporting, companies should consider: (1) implementing strong anti-retaliation and other whistleblower protection policies; (2) encouraging and rewarding integrity within the workplace, including rewarding internal whistleblowers; and (3) promptly addressing compliance concerns raised by employees. If a company finds itself the subject of an enforcement action, it should engage experienced counsel as early as possible to mitigate any possible risk of exposure.

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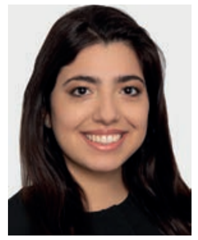

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Greenwashing in the EU: Legal framework and avenues of enforcement (part 1)

Introduction: What is greenwashing?

More and more companies, across sectors, are seeking to gain climate, sustainable, or green legitimacy by asserting that a product or service:

- Has a positive environmental impact or no impact on the environment.
- Is less damaging to the environment than a previous version of the same product or service.
- Is less damaging to the environment than competing products or services.

If these assertions are not true or cannot be verified, or are irrelevant or vague, there is increasing risk as authorities worldwide are actively clamping down on misleading claims.

Greenwashing may be intentionally deceptive or simply the result of imprecise wording. It can come in a variety of shades and forms such as environmental imageries (e.g., using images of forests, animals), self-created or self-declared labels, logos or certification schemes (e.g., "Certified", "100% organic"), company statements (e.g., annual accounts, corporate sustainability reports, and websites), advertising, or social media platforms.

Although greenwashing is not a new concept, its prevalence has increased in recent years because of growing consumer demand for green or sustainable products. This trend should be seen against the background of the EU's regulatory push to transition to a climate-neutral and resource-efficient economy by 2050 under the EU's Green Deal and associated legislative initiatives concerning circular economy, sustainable finance disclosure, energy efficiency, land use, and industry decarbonization, among others.

The legal framework in the EU

At present, greenwashing is primarily dealt with under the legal framework of unfair commercial practices. The EU rules on unfair commercial practices enable national enforcers to curb a broad range of unfair business practices, and greenwashing can be characterized as falling within such practices. When promoting, selling, or supplying products, companies must give consumers sufficient and accurate information to enable them to make an informed buying decision. If they fail to provide this information, their actions may be considered unfair. Examples of unfair business practices include providing untruthful information to consumers or using aggressive marketing techniques to influence consumers' choices. The rules on unfair commercial practices apply to business-to-consumer relations, and their focus is very much on consumer protection.

There is also relevant competition law regulation, including where a company claims that its products are greener than its competitors and in doing so, denigrates competitors' products, or where competing companies use an environmental claim as a screen to engage in anti-competitive collaboration.

Badmouthing a competitor's products can also lead to denigration claims under comparative advertising standards, and national authorities have the power to protect businesses from misleading marketing by other businesses.

The fight against greenwashing has become a policy priority in the EU, and to supplement the existing legal framework, the European Commission proposed the so-called Green Claims Directive on 22 March 2023, which will require companies to substantiate claims they make about the environmental footprint of their products by using relevant international standards for quantifying them. The aim of the Green Claims Directive is to make environmental claims as well as environmental labeling schemes reliable, comparable, and verifiable labeling across the EU. The rationale behind all the rules above is generally to ensure that claims are built on accurate, scientifically verified data, with information being accessible and accurate for traders and consumers.

Typical avenues of enforcement

The greenwashing legal framework is primarily enforced at the national level. However, when the trader and the consumer are established in different countries, national authorities can also take action at the European level through collaboration with regulators in other member states based on the Consumer Protection Cooperation Regulation framework.

While national authorities in charge of consumer protection law enforcement are in general best placed to enforce the rules against greenwashing, competition authorities, sectoral regulators with concurrent powers, or advertising watchdogs such as the UK Advertising Standards Authority, are also well placed to enforce these rules.

In parallel to enforcement by these public authorities, in some instances, private stakeholders can also rely on the rules against greenwashing. Consumers who are being misled or deceived as a result of greenwashing can act, either individually or in certain jurisdictions, by way of class actions led by consumer-rights associations. In addition, environmental lobby groups, as well as private investors and shareholders, can also initiate actions seeking compensation for a drop in a company's stock price resulting from misleading environmental statements. The potential for more claims such as these could fuel the interest of claimant law firms and litigation funders. Exposure also arises from other entities with whom companies do business and in the value chain, such as joint-venture partners, suppliers, contractors, and subsidiaries, whose own possible greenwashing or environmental, social, and governance (ESG) failures could have a spillover effect.

The main risk for a company engaging in greenwashing used to be reputational damage, but there is now a clear shift toward more litigation and ensuing financial risks for perpetrators of greenwashing. While public authorities can and do issue prohibition orders and/or impose fines, the trend is moving toward court proceedings as the principal avenue of enforcement.

Following an investigation resulting from either a public authority's own review of misleading claims or whistleblower indications, public authorities can go to court for enforcement purposes. Private stakeholders can also go to court to obtain access to documents and to obtain damages to compensate them for the harm caused by the unfair commercial practices.

Conclusion: increased exposure

No industry is immune from greenwashing allegations. Although green marketing makes good business sense in view of consumers' demand for green products and services, there is an increased risk of disputes and regulatory investigations following the heightened focus of regulators on detecting greenwashing and the rising awareness of ESG issues among consumers. This upward trend in disputes exposure for companies is mirrored with the burgeoning and ever-changing regulatory landscape related to green claims and ESG disclosures. Companies would be well advised to seek assistance from legal counsel when formulating statements about the green credentials of their products or services or if their competitors are engaging in greenwashing. Legal counsel will be able to identify whether these statements comply with applicable rules and guidance, and advise on appropriate language and supporting evidence.

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Greenwashing in Germany: Legal framework and case law (part 2)

An introduction to greenwashing can be found in part 1. This section will provide an overview of the specific legal framework for addressing greenwashing allegations in Germany and the current enforcement approach by German courts.

The legal framework in Germany – UWG

There is no definition or regulatory guidance on greenwashing or environmental claims under German law. Instead, Germany pursues the concept of self-regulation of the market. As of now, any conflict that arises from possible greenwashing or environmental claims is assessed on a case-by-case basis under the German Act against Unfair Competition (Gesetz gegen den unlauteren Wettbewerb) (UWG).

Misleading commercial practices are prohibited according to section 5(1) UWG, if they are suited to causing the consumer or other market participants to make a transactional decision, which he would not have made otherwise. A commercial practice is regarded as misleading if it contains false statements or other information suited to deception regarding the circumstances listed in section 5(2) UWG. One of the relevant circumstances for greenwashing can be seen in the "main characteristic of the goods or services" according to section 5(2)(1) UWG. Environmental aspects like climate protection, sustainability, or environmental protection are becoming increasingly important to consumers. The relevant perspective for evaluating a possibly misleading claim is how an average consumer/recipient will understand the specific claim made (section 3(4) UWG). This places a clear obligation on companies to verify environmental statements they use in advertising campaigns.

A violation of section 5(1) UWG often leads to extra-judicial warning letters being issued by a competitor. In addition, the Centre for Protection against Unfair Competition (Wettbewerbszentrale) and the consumer associations (Verbraucherzentralen) can also issue such warning letters. These letters primarily include a demand to cease and desist (with a penalty clause) and the reimbursement of legal fees. Additionally, the party issuing the warning may assert a right to information and may claim damages.

Since May 2022, a consumer who made a transactional decision based on a misleading commercial practice can claim damages according to section 9(2) UWG. As this change in the law is still very recent, its practical impacts remain to be seen, but the expectation is that several claims might be assigned to a single body and pursued this way – moving closer to class action claims – although such claims are strictly not possible under German law.

The legal framework in Germany – additional laws to be considered

In extreme cases, the decision-makers of a company could eventually face fraud or embezzlement charges under sections 263 and 266 of the German Criminal Code (Strafgesetzbuch) (StGB) for making inaccurate or exaggerated environmental statements. In the context of the banking industry, section 264a StGB (capital investment fraud) and section 119 (1) of the Securities Trading Act (Wertpapierhandelsgesetz) (WpHG) could also be considered.

Companies that have to submit non-financial statements according to the German Commercial Code (Handelsgesetzbuch) (HGB) could face sanctions under section 331 HGB if an incorrect representation of an environmental activity is identified.

Section 30 of the German Administrative Offenses Act (Ordnungswidrigkeitengesetz) (OWiG) can also be considered, as this is the only provision to sanction the company itself and not the natural persons acting.

Examples of German greenwashing cases

If a company receives a warning letter based on UWG from a competitor and is not willing to sign the cease and desist claim, the dispute often ends up in court. To get a general sense of what is going on in this sphere in Germany, please find below a summary of some key cases from as early as 1988 up to 2022:

A. In an early judgment on this subject (20.10.1988 – I ZR 238/87), the German Federal Supreme Court (Bundesgerichtshof) (BGH) stressed that environmental claims require specific substantiation and must always be judged – similar to health advertising – according to strict standards. In this case, a company advertised toilet paper with the words "[...] from recycled paper" in the headline of a leaflet. The BGH confirmed the decision of the lower court, which found that consumers could think that the toilet paper is made 100 percent from recycled paper when in fact the amount was only 80 percent.

B. In 1996, the BGH (05.12.1996 – I ZR 140/94) had to decide whether the claim [...] "So that people & nature have a chance!" was misleading in that the company was pretending non-existent environmental compatibility of its products. While the court of appeals found the slogan misleading, the BGH ruled against that, relying on general life experience that there is no such thing as absolute environmental compatibility. Furthermore, the slogan was worded in general terms and was not made with regard to a specific product.

C. The Higher Regional Court (Oberlandesgericht) (HCR) Hamm (19.08.2021 – 4 U 57/21) decided that advertising messages such as "CO_2 reduced," "Environmental friendly products and sustainable packaging," and "Our contribution to sustainability" are misleading. These broad statements were made without explaining them in any way. The average consumer is not able to distinguish which aspect of the production process – the packaging or the distribution – related to an environmental friendliness or if a CO_2 reduction actually exists.

D. The Regional Court Oldenburg (16.12.2021 – 15 O 1469/21) ruled that the statement "climate-neutral" is misleading if the advertiser does not place a reference (next to the statement) to what the promised climate neutrality of the products refers to. The court decided that the average consumer would assume that either the products are manufactured in a climate-neutral way or that climate-neutrality is achieved by compensation. In fact, the advertising company wanted to achieve climate-neutrality by compensation through donations to climate protection projects. The fact that the company pointed this out on its website is not sufficient according to the court, as there would have been sufficient space for a clarifying notice next to the advertisement.

E. In the beginning of 2022, the Regional Court Stuttgart (31.01.2022 – 36 O 92/21 KfH) found the statements of a fund manager misleading. The manager advertised his European Long-Term Investment Fund with the statement that investors can offset their carbon footprint with an investment. In detail, the website stated that an investment of €10,000 would avoid 3.5 tons of CO_2. In fact, these 3.5 tons were only a target value, which could be significantly undercut. Without an additional explanation, these statements were ruled misleading.

F. The Regional Court Mönchengladbach (25.02.2022 – 8 O 17/21) ruled that the statements "climate-neutral product" and "climate-neutral price-performance classic" were misleading as the manufacturing of the product (jam) was not climate neutral, but climate-neutrality was achieved through compensation. Without any additional information on the climate-neutrality, the Regional Court classified this advertisement as misleading for the consumers.

G. In contrast to the decision of the Regional Court Mönchengladbach, the Regional Court Kleve ruled in June 2022 that the advertising message in a food newspaper –"Since 2021 […] manufactures all products climate-neutral" – without any additional information was not misleading to a professional audience. The food newspaper could be purchased by consumers, but the main audience was a professional audience in the food industry. The climate-neutrality was achieved by compensation. This route of climate-neutrality is known by the professional audience, and therefore, the advertisement was not misleading.

H. The HCR Schleswig-Holstein ruled in June 2022 (30.06.2022 – 6 U 46/21) that advertising with the slogan "climate-neutral" was not misleading in general. In this specific case, a company printed the words "climate-neutral" next to its logo on a garbage bag. Ruling contrary to the court of first instance, the HCR took the position that the average consumer is used to companies who distribute both "climate-neutral" and other products. Additionally, the phrase "climate-neutral" can be not only defined (DIN EN ISO 14021:2016) but also contains a statement that can be verified as to its truthfulness. Therefore, this slogan does not need any additional explanation.

As is evident, greenwashing cases are decided on a case-by-case basis. For example, the same wording, "climate-neutral," can be ruled misleading and not misleading, depending on the individual factors of a specific case, leading to the potential for confusion for companies using environmental statements in their advertisements. A thorough audit of any such statement is not only recommended but should be best practice in any organization. Companies should also be aware of the potential public backlash a greenwashing case can create. Consumers might feel deceived if an organization they supported because of its green image ends up in court due to an environmental claim.

Conclusion and outlook

At the moment, the risk of potential legal issues in the context of greenwashing is increasing as consumers increasingly take environmental aspects into account when making their purchasing decisions. As a result, companies should ensure that their competitors do not gain an unfair advantage by using environmental statements. Recent developments are expected to support more legal actions by individual consumers and lead to an increase in claims being pursued in court.

Companies who want to use environmental statements in advertisements should run an in-depth review in collaboration with their legal counsel before publishing. If a warning letter by a competitor or a non-profit organization is received, the cease and desist should not be signed without consulting legal assistance. Similarly, if an organization wishes to issue a warning letter and assert claims against a competitor, it is essential that legal counsel assist.

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Greenwashing regulation and litigation: Why insurance coverage matters (part 3)

An introduction to greenwashing can be found in part 1, and coverage of the legal framework and recent case law can be found in part 2. This third part will provide an overview of the U.S. and UK perspectives and related insurance considerations.

The U.S. perspective

Over the past year, the U.S. Securities & Exchange Commission (SEC) has increased its surveillance on U.S.-listed corporations and their compliance with touted environmental, social, and governance (ESG) initiatives. In March and May 2022, the SEC's Climate and ESG Task Force introduced new proposed rules that would require corporations to disclose climate-related information in their registration statements and periodic reports, including their exposure to climate-related risks and the implications of those risks on their financial performance. While the SEC's climate disclosure rules are still in proposal form, the time for public comments have closed and the SEC has indicated that it could issue a ruling adopting the reporting requirements as early as April 2023.[41]

The SEC has also recently issued a number of fines to U.S. financial institutions for making material misstatements and omissions in connection with ESG quality reviews and metrics for mutual funds.

In addition to ongoing regulatory activity, shareholder and consumer litigation in the U.S. tied to corporate ESG initiatives is also increasingly growing. The targets of these lawsuits span a wide variety of industries, including oil and gas companies, food and beverage producers, "fast fashion" clothing manufacturers, and beauty brands. Complaints typically include claims for violation of federal securities laws, violation of unfair and deceptive trade practices statutes, fraud, false advertising, and public and private nuisance. Although some businesses have been more successful than others in dismissing greenwashing allegations, even a cursory review of the recent "greenwashing" litigation landscape in the United States underscores just how difficult it can be for a company to substantiate its environmental claims. When it cannot, the lawsuits can result in millions of dollars in defense fees and settlements, and, of course, potential adverse judgments.

The UK perspective

There is currently no specific anti-greenwashing legislation in the UK, nor any legal definition of "greenwashing."

Nonetheless, organizations can find themselves open to claims of misrepresentation and potentially be caught by existing (as well as recently strengthened) consumer protection laws, as is the case across much of Europe.

While in relation to the former, a claimant must establish in particular that it relied on the relevant misleading statement for a misrepresentation claim to succeed, cases are expected to increase significantly over the coming years as instances of reliance are able to be evidenced.

In relation to the latter, the Advertising Standards Agency (ASA) regime for penalizing businesses for misleading advertisements is well established. In February 2023, the ASA announced updated guidance which advises advertisers to avoid making unqualified "carbon neutral" or "net zero" sustainability claims in view of the lack of agreement around the meaning of these terms. Over the last year, the ASA has increased its enforcement action against major corporations for greenwashing advertisements.

Recently, Lufthansa's advertisement claiming it was "Connecting the world. Protecting its future." was found to give the misleading impression that the company had already taken meaningful steps to ensure its environmental impact was not harmful and the advertisement therefore breached rules 3.1, 11.1, 11.3 and 11.4 of the CAP Code.[42]

In addition, the Competition and Markets Authority (CMA) published in September 2021 a "Guidance for businesses making environmental claims in the UK," including a Green Claims Code and checklist of do's and don't's. The grace period for implementation ended in January 2022. The CMA has now launched investigations into environmental claims in the fashion retail sector (more specifically, scrutinising claims made by ASOS, Boohoo, and ASDA)[43] and in the fast-moving consumer goods sector.[44] In April 2022, the UK government also announced plans to give the CMA the power to directly fine businesses who breach consumer protection laws up to 10% of their global turnover – without needing to go to court.[45]

In parallel, the regulatory regimes have tightened, in particular around the sustainability of financial products and services. In October 2021, the UK government published "Greening Finance: A Roadmap to Sustainable Investing." Subsequently, regulations were introduced requiring that the largest listed UK companies disclose climate-related financial information as of April 2022. In its "Mansion House Update"[46] and elsewhere, the UK government has been clearly aware of the need to keep pace with U.S. and EU regulators.

More recently, in October 2022, the Financial Conduct Authority (FCA) published a consultation paper, "Sustainability Disclosure Requirements (SDR) and investment labels."[47] The paper contains proposals for: the use of standardized, clearly visible, sustainable investment labels or rules for detailed sustainability disclosure; an anti-greenwashing rule requiring sustainability-related claims to be "clear, fair and not misleading" and the banning of sustainability-related terms to describe investment products. The consultation closed in January 2023 and the FCA intends to publish the final rules by the end of Q2 2023.

Subject to approval, there will be a phased implementation of the proposed rules from June 30, 2023 to June 30, 2025.

Such a regulatory environment is in turn likely to fuel further claims. As has been the experience in the United States, the increase in ESG-related reporting obligations may well result in many more "s90 FSMA"[48] claims. These would be brought as class actions on behalf of a group of institutional investors in listed companies, seeking compensation for losses suffered as a result of certain statements contained in listing particulars or prospectuses. This has not yet been tested in the English (or other UK) courts in relation to ESG claims, but the increased perception of such risks has also impacted the insurance environment.

Finally, it should be noted that the European Commission recently published its proposal for the "Directive on substantiation and communication of explicit environmental claims." The purpose of this proposed legislation is to protect consumers from unclear and not well-substantiated environmental claims and to empower consumers for the "green transition." If implemented, businesses will face additional obligations when making environmental claims and failure to comply could result in fines up to 4% of their annual turnover. This may at least encourage similar moves in the UK.

The insurance position

From an insurance coverage standpoint, businesses should therefore be very careful about how they are framing their responses to ESG initiatives in their public regulatory disclosures and on insurance policy applications – which typically incorporate certain public regulatory disclosures.

Policyholders should also scrutinize their directors' and officers' liability (D&O) and other management and professional liability insurance policies to ensure that those policies do not have any ESG-related exclusions. Conversely, businesses should consider insurance carriers willing to offer ESG-related coverage enhancements.

For example, several insurance companies have already committed to participating in Marsh's ESG D&O initiatives for companies based in the United States and continental Europe, which is marketed as resulting in "preferred" D&O policy terms and conditions on ESG-related exposures.[49]

Because these policy enhancements are in the early stages, the language should be carefully reviewed to ensure that it provides adequate protection for an organization's particular ESG-related risks.

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U.S. regulatory enforcement in 2023: What to expect

Introduction

The White House, the Department of Justice (DOJ), the Securities and Exchange Commission (SEC), and other federal regulators are focusing more than ever on (1) cryptocurrency, (2) corporate misconduct, (3) tax fraud, (4) global money laundering, (5) corruption, and (6) national security. Federal regulators have announced new enforcement initiatives focused on these areas, demonstrating a notable shift in regulators' priorities and strategies. Accordingly, government agencies are expected to launch an increasing number of such investigations and enforcement actions in 2023.

The current trend toward increased enforcement poses particular risks for businesses involved in global commerce and the digital asset sector. The United States' devotion of such significant resources to enforcement in these areas signals long-term commitment. Businesses would be wise to make sure that their compliance programs are working as efficiently and effectively as possible to seek to avoid or mitigate regulatory and enforcement issues. That is particularly so following the collapse of the $32 billion crypto exchange FTX. As the adage goes, an ounce of prevention is worth a pound of cure. That appears to be the messaging emanating from federal regulators today, and we expect it to continue through 2023.

Expected priority areas in the year ahead

While federal enforcers and regulators have long been interested in illicit uses of cryptocurrency, corporate misconduct, tax fraud, global money laundering, corruption, and national security enforcement efforts, the Biden administration has placed more emphasis on these areas than ever before.

Cryptocurrency

Regulators have increased their focus on crimes within the digital asset space. For example, in late 2022, the DOJ announced the formation of the nationwide Digital Asset Coordinator Network of federal prosecutors. At the same time, the White House issued a fact sheet addressing enforcement in the digital asset industry, which (among other things) encouraged the SEC and the Commodity Futures Trading Commission (CFTC) to aggressively pursue investigations and enforcement actions against alleged unlawful practices in the digital asset space.

In light of the collapse of FTX and criminal fraud charges against its former CEO and others, this regulatory focus is expected to intensify. And it is expected to intensify further still given the precipitous drop in the value of cryptocurrencies in 2022 – the so-called crypto winter – when we saw the crypto market lose more than $2.2 trillion in value after reaching an all-time high of $3 trillion. These desperate times, the saying goes, may lead some in the industry to take desperate measures; and that concern will likely drive DOJ, SEC, and other regulatory investigations and enforcement actions in this space through 2023.

Corporate misconduct

The Biden administration has signaled increased enforcement in the corporate crime space. For example, in 2022, the DOJ issued a new corporate crime enforcement policy to much fanfare, which emphasized the importance of compliance programs and self-disclosure, as well as the need for individual accountability. In 2023, the DOJ released a new voluntary self-disclosure policy for corporate misconduct, offering companies significant benefits, including non-prosecution or a considerable reduction in a fine recommendation. We have seen evidence of increased corporate crime enforcement in 2022, and we expect more to come in the year ahead.

We think at least three areas will be subject to increased DOJ and SEC scrutiny:

- First, large-scale investment fraud. Concerns with the direction of the economy, and the challenges and opportunities that the current climate generates, may serve as an impetus for the DOJ and the SEC to probe, for example, investment firms for sales practices.

- Second, pandemic relief fraud. Initially, at the start of the government's COVID-19 relief efforts, regulators were focused on lower-level frauds – for example, clear falsehoods on applications for pandemic relief. We expect regulators to focus not only on more sophisticated corporate-level pandemic fraud but also on banks and other financial institutions that allegedly aided and abetted these frauds.

- Third, we expect continued regulatory scrutiny of businesses' supervision and retention of employee messages on personal devices. Increasingly, employees have begun using personal devices to conduct company business. For example, an employee might use their personal cell phone to send a business-related text to a colleague's personal device. When that happens, it can be hard for companies to identify, much less maintain, those communications. But that is the challenge confronting companies. The SEC and the CFTC have collected $2 billion in fines from enforcement actions in this area. And the DOJ recently (1) announced that it would take companies' performance in this area into consideration when determining an appropriate resolution following corporate misconduct, and (2) issued factors for prosecutors to consider when assessing a company's business messaging policies and procedures. Thus, all signs point to continued scrutiny through 2023.

Tax fraud

In 2022, legislation was passed that included $45.6 billion for tax enforcement activities, such as hiring a fleet of new enforcement agents – reportedly 87,000 of them. This activity is consistent with statements from President Biden himself, who has indicated that combatting tax fraud is a White House priority. The IRS, for its part, has signaled that it will focus on investigations involving digital assets, high-net-worth individuals, and corporate taxpayers in the year ahead.

Given these focus areas, we expect to see more collaboration between the IRS and other federal agencies, such as the DOJ. There appears to be significant overlap between DOJ and IRS priority areas, making agency cooperation more likely. For example, the DOJ's focus on corporate crime dovetails well with the IRS's focus on corporate taxpayers. In sophisticated white-collar investigations, it is sometimes the case that tax charges are the simplest to prove, and it may be that the government will attempt to leverage that reality in its broader effort to police corporate misconduct.

Global money laundering

In late 2022, the DOJ and the Treasury Department released a report indicating that global money laundering was a substantial concern, particularlyin the digital asset space. As part of the report, the DOJ recommended revising the Sentencing Guidelines for certain money laundering offenses to better reflect "the gravity of [Bank Secrecy Act (BSA)] violations that facilitate money laundering and other illicit activity." Notably, the report also stated that the Sentencing Guidelines should recognize that "organizations with weak or non-existent BSA policies and programs in the digital assets industry facilitate the illicit use of digital assets and allow criminals to cash out or otherwise profit from their crimes." In other words, it appears that the DOJ is particularly focused on scrutinizing company anti-money laundering programs through the lens of digital assets.

The above-noted report reflects a reinvigorated, digital asset-focused effort to deter corrupt actors and their facilitators who often rely on financial systems to hide the proceeds of illicit activities. The report's emphasis on company "policies and programs" should be taken as a call to review anti-money laundering policies anew, addressing any regulatory gaps and strengthening detection mechanisms domestically and abroad, especially with respect to digital currency.

Corruption

The DOJ appears poised for an increase in Foreign Corrupt Practices Act (FCPA) enforcement in 2023. In 2021 and 2022, it appears that the DOJ resolved only 11 corporate and individual FCPA enforcement actions, though this relatively low number may be attributed to the pandemic. With the pandemic now largely behind us, many signs point to an uptick. For one, as to those FCPA matters that were brought in the past two years, it appears that there has been appreciable international cooperation. If that is a feature of this administration's approach to FCPA enforcement, it could bear much fruit going forward, as such cooperation tends to facilitate and expedite investigations. Other signs pointing to increased enforcement include, as noted above, the DOJ's revamped corporate crime enforcement policy, emphasizing self-disclosure and the benefits that attach thereto, and the DOJ's expected guidance on the retention of business messages on personal devices (which might suggest that the DOJ has found this area to be problematic in current investigations, including those in the FCPA context).

Here too the takeaway is compliance, compliance, compliance. While the FCPA is a well-worn law, it is still able to generate new compliance challenges. That may be the situation that companies find themselves in today. Given the potential for increased international cooperation, companies should review their compliance policies and mechanisms here and abroad. And based on the DOJ's increased focus on compliance in general and messaging applications in particular, companies would do well to ensure that their policies and procedures cover employee usage of personal devices.

National security

In early March 2023, the DOJ announced that it will increase its focus on investigating sanctions and export control violations – "the new FCPA," according to Deputy Attorney General Lisa Monaco, in terms of the DOJ priorities and compliance expectations. What does this area entail? Consider a simple example. The United States has imposed sanctions on Russia. A company that seeks to circumvent U.S. export laws and send controlled goods to Russia would find itself in the teeth of a sanctions and export control issue. Now consider the permutations that this simple example can take and increase by several orders of magnitude. That is the enterprise risk that many companies face in this context.

This leads to a similar refrain: Compliance is key. Given this invigorated DOJ priority, companies that conduct cross-border work would do well to assess their risk profile in this area. Companies should consider their compliance apparatus through the lens of sanctions and export controls, and identify those heightened risk areas where procedures can be implemented to help ensure that controlled goods do not illegally make their way to sanctioned countries.

Next steps

Enforcers and regulators have made clear that they will seek to increase their enforcement efforts in 2023 to combat criminal misuse of cryptocurrency, corporate misconduct, tax fraud, global money laundering, corruption, and sanctions and export control violations. Businesses involved in global commerce and the digital asset sector must be conscious of this trend. Companies should expect a greater number of investigations and, potentially, the imposition of more significant penalties. In order to effectively deter and identify criminal conduct in these areas, companies at risk for violations should evaluate and enhance their compliance programs. An ounce of prevention now may avoid a pound of scrutiny and enforcement later.

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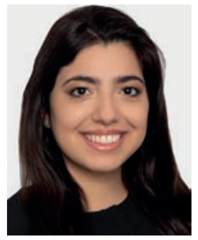
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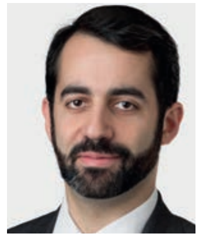
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Endnotes

Resolving DAO-related disputes

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Blowing the whistle – bounty programs pay off

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