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Client Alert: SEC Enforcement Division's ESG Task Force "Lifts the Vale" on Its Scrutiny of ESG Disclosures

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Since early 2021, the SEC has emphasized that ESG-related issues are important to investors and a key SEC disclosure and enforcement priority. Although the agency's heightened focus on these issues led to the recent proposal for new climate disclosures, the SEC also has made clear that it would seek to bring cases under existing law and not wait for new rules to be passed.

The reality that the SEC Enforcement Division is on the ESG beat was reinforced late last month, when the Climate and ESG Task Force filed charges against a Brazilian mining company – Vale, SA. Vale describes itself as the world's largest producer of iron ore, pellets, and nickel. The case stems from an investigation opened after one of the company's dams collapsed, causing over 200 deaths and dramatic environmental damage. In its complaint, the SEC alleged that Vale made misstatements about its dam's safety and engaged in deceptive conduct that concealed it had committed misconduct in obtaining required certifications related to dam safety. After the SEC filed action, Vale indicated that it denied the allegations in complaint and intended to defend the action.

The SEC's approach to the Vale litigation provides a roadmap for public companies to consider how ESG-related disclosures and statements will be scrutinized when the company is impacted by adverse events that are ESG-related. It illustrates that companies should be prepared for the SEC to closely scrutinize statements about risk in ESG disclosures such as sustainability reports or climate impact analyses. This alert discusses the SEC's case against Vale and real-world "lessons learned" for all public companies when publishing materials about ESG, climate, and operational risks.

Summary of the SEC's Allegations in Complaint against Vale

The SEC's complaint alleges that Vale failed to make appropriate disclosures in the lead-up to an environmental disaster that had a direct impact on its investors' bottom line. The January 25, 2019 collapse of Vale's Brumadinho dam was described by the SEC as "one of the worst mining disasters in history," releasing "nearly 12 million cubic tons of mining waste... – a toxic sludge of iron, manganese, aluminum, copper, and other rare earth minerals – in a deluge rushing downhill toward the Paraopeba River." Compl. ¶2. The disaster killed 270 people "while also poisoning the

Paraopeba River and its tributaries and causing immeasurable environmental, social, and economic devastation." *Id.* As a result of the dam's collapse, both the company's financial performance and stock performance were impacted. In the earnings released the quarter after the dam's collapse, Vale "reported quarterly loss and negative earnings (EBITDA) for the first time in its history." Compl. ¶212. Vale's corporate credit rating was also downgraded to junk status. In the aftermath of the dam's collapse, the SEC also alleged that Vale's American Depository Shares "fell by nearly 25%, wiping out approximately $4.4 billion in market capitalization." *Id.*

The SEC alleged that "Vale and its executives knowingly or recklessly engaged in deceptive conduct and made materially false and misleading statements to investors about the safety and stability of its dams." Compl. ¶¶277, 280, 283. As is typical, the SEC complaint details the key section of the defendant's periodic statements that it alleged were false and misleading. Compl. at ¶284. In addition, the SEC included allegations that reflected its investigation had focused closely on the company's ESG-related disclosures. The complaint includes false and misleading statements in Vale's sustainability reports and "ESG Webinars" posted on the company's public website. *E.g.*, Compl. ¶¶ 23, 29, 245.

In alleging fraud, the SEC emphasized that Vale had committed misconduct in connection with obtaining dam stability declarations required by local law. Because of past disasters in Brazil, the company was required to obtain stability declarations from auditors to certify that auditor had approved the mine's safety. Compl. ¶ 1. To obtain the required certifications, the SEC alleged that Vale "concealed material information from its dam safety auditors," and "concealed material and "removed auditors and firms who threatened Vale's ability to obtain [the required] dam stability declarations." *Id.* The SEC also alleged that it "removed auditors and firms who threatened Vale's ability to obtain dam stability declarations." *Id.*

Although statements to auditors and local regulators are not typically themselves actionable under the federal securities laws, the SEC used this misconduct to support its argument that Vale defrauded investors. First, it alleged that Vale described the stability declarations that it had obtained without also disclosing the circumstances in why it procured these certifications. Second, in pursuing its case, the SEC also used this misconduct to prove the company's executives acted in bad faith. Consistent with this, the SEC emphasized Vale's "deceptive conduct" in connection with the audit through the complaint.

In framing this case as about ESG misstatements, the SEC was able to note that Vale itself had highlighted dam safety as an important ESG issue. Undoubtedly, Vale's own ESG characterization of its publications addressing dam safety made them a target for an enforcement analysis with an ESG lens. For example, in 2017, in the last Sustainability Report issued before the Brumadinho dam collapse, Vale identified "priority topics" in its "materiality matrix," which included commitments concerning "health and safety of the workforce and of the community" and "management of social, environmental and economic impacts," as well as "management of mineral waste" and "management of business and operational risks." Vale publicly considered "sustainability" to include many aspects of its operations, including dam safety. 2017 Sustainability Report, pp. 11-12. Indeed, in the 2019 Sustainability Report, issued in the year after the dam collapse, Vale described the consequences of the dam collapse using ESG-type language, "the rupture…cannot be understood only in light of the survey of its impacts on the population and the environment. For the company, these situations impacted the human rights of the people affected, residents and local workers." 2019 Sustainability Report, p. 14. Thus, Vale's emphasis on ESG issues in its framing of its operations and goals apparently gave the SEC an opportunity to focus on "ESG disclosures" as part of its Climate and ESG Task Force enforcement initiative.

Potential Implications and Lesson Learned

The SEC emphasized that the case against Vale was part of its focus on ESG-related issues. In the press release announcing the filing of the action against Vale, Gurbir Grewal, the Director of the Enforcement Division, emphasized the SEC's consistent theme that ESG statements are material to investors. Grewal said, "Many investors rely on ESG disclosures like those contained in Vale's annual Sustainability Reports and other public filings to make informed investment decisions," and he stated that the company's misstatements "undermined investors' ability to evaluate the risks posed by Vale's securities."

The SEC's focus on ESG and climate issues has increased the importance of ensuring the accuracy of disclosures (and omissions) on those issues. Although the Vale case represents a unique set of facts, it provides an important reminder on importance of carefully vetting ESG-related disclosures. Such ESG disclosures should be considered not just a marketing initiative but should be scrutinized carefully for accuracy and proper caveats. In practice, this means that companies should ensure that it has backup for each statement made. In addition, companies should be mindful of how "worst case" scenarios or "black swan" events could impact their disclosures.

The case also highlights that the SEC will investigate a potential defendant's interactions with regulators in evaluating fraud charges. If it finds evidence of misconduct, the SEC could cite it to prove intent to deceive or to allege that the lies to investors were designed to conceal misconduct.

This reinforces the importance of making sure communications with such regulators are carefully vetted. In the US, for example, companies often disclose information about their workplace safety and environmental operations. A serious workplace or environmental accident resulting in a material impact could lead to an SEC enforcement action led by its Climate and ESG Task Force, in addition to any fines, penalties, or damages resulting from the accident itself.

Conclusion

The Enforcement Division's focus on ESG-related issues is likely to continue. As detailed above, the SEC's action against Vale provides a roadmap for how they will approach these issues and this framework can help companies better prepare for this scrutiny.

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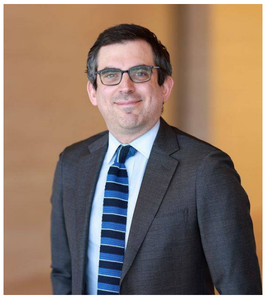

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