SQUIRE PATTON BOGGS

Reflection on *ASIC v Vanguard*

ASIC's First Court Enforcement Decision on "Greenwashing"

Australia – May 2024

In late March 2024, the Australian Securities and Investments Commission (ASIC) won its first "greenwashing" civil penalty action against Vanguard Investments Australia Limited (Vanguard).

While greenwashing has been a major focus of ASIC and the Australian Competition and Consumer Commission (ACCC) since 2022, and will remain so into the foreseeable future, this is the first instance where ASIC has obtained a court judgment against a corporation for misleading environmental, social and governance (ESG) statements.

The court found that Vanguard had contravened the *Australian Securities and Investments Commission Act 2001* (Cth)[1] (*ASIC Act*) by making misleading claims about ESG exclusionary screening and composition of Vanguard's ESG-focused fund, known as the "Vanguard Ethically Conscious Global Aggregate Bond Index Fund" (Fund) (the Decision).

In our view, the Decision does not clarify or expand the law relating to misleading or deceptive statements under the *ASIC Act* or the equivalent statutory prohibitions in the *Corporations Act 2001* (Cth) and *Competition and Consumer Act 2001* (Cth). Rather, the judgment provides a practical example of how the preexisting case law applies to companies' ESG-type representations.

The Decision

Facts

The Vanguard-managed Fund commenced operation in August 2018. As at 26 February 2021, the total funds or assets under management of the Fund were over AU$1 billion.

ASIC alleged that, during the period between 7 August 2018 and 17 February 2021, Vanguard had engaged in conduct that was likely to mislead the public as to the nature, the characteristics and the suitability for their purpose of those financial services.

In broad terms, ASIC alleged that the statements made by Vanguard represented to investors that:

- The Fund offered an ethically and conscious investment opportunity.
- Before being included in the Fund, securities were researched and screened for significant business operations in relation to fossil fuels, alcohol, tobacco, gambling, military weapons and civilian firearms, nuclear power and adult entertainment (the ESG Criteria).
- Securities that violated applicable ESG Criteria were excluded or removed from the Fund.

ASIC alleged that these representations were false or misleading because:

- The research and screening of securities for inclusion in the Fund against the applicable ESG Criteria had significant limitations.
- A significant proportion of the securities in the Fund[2] were from issuers that were not researched or screened against applicable ESG Criteria.
- Contrary to Vanguard's representations, the Fund included issuers that violated applicable ESG Criteria.

Evidence was led and accepted that Vanguard (in effect) relied upon market research, securities indices and screening analysis undertaken by third parties (Bloomberg and MSCI), in determining the Fund's eligible investments. The index used by these third parties to screen the eligible investments was known as the "Bloomberg Barclays MSCI Global Aggregate SR Exclusions Float Adjusted Index" (Bloomberg SRI Index).

Addtionally, throughout the proceedings, Vanguard made several critical admissions in relation to ASIC's factual and legal allegations, the consequences of which we review in more detail below.

Outcome

Given Vanguard's broad-ranging admissions, there were limited contested matters requiring the court's determination and resolution, and the court's findings that Vanguard had contravened the *ASIC Act* were generally assured. Accordingly, on 28 March 2024, the Federal Court of Australia delivered its judgment finding Vanguard had engaged in several instances of misleading or deceptive conduct, contrary to the prohibitions contained in the *ASIC Act*.

As to where from here, the court has listed the proceedings for a further hearing on 1 August 2024 with respect to outstanding legal issues of pecuniary penalties or an adverse publicity order.

1 Specifically, ss. 12DB(1)(a) and (e) and 12DF(1) of the *ASIC Act*.

2 As at 12 February 2021: (A) 46% of the securities (in number) held by the Fund were not subject to ESG screening (whatsoever, howsoever described); and, (B) those 46% of securities (in number) amounted to 74% of the market value of the Fund.

Potential Risks and Practical Steps To Manage

In our view, the Decision is not factually and/or legally novel but rather represents the application of well-settled legal principles albeit in a new factual context. It does, however, serve as a timely reminder for corporations about several key risks highlighted by this case and the steps corporations can take to manage those risks, as set out below.

Item for Review	Potential Risk Highlighted by *ASIC v Vanguard*	Practical Steps To Manage Risk
Exclusionary ESG Screening Criteria	The Decision represents one of a number of civil penalty proceedings instituted by ASIC against superannuation funds regarding statements about the ESG screening undertaken for their investments, including proceedings against Mercer Superannuation and Active Superannuation. ASIC now has a track record of taking companies to task regarding the accuracy and truthfulness of these statements.	• Ensure all ESG-related claims can be properly substantiated (if required). • Ensure ESG screening policies for investments are true, correct and accurate and any limitations in the screening policies are conspicuously stated.
Reliance on third-party analyses and opinions	While there was no suggestion in the case that Bloomberg or MSCI improperly compiled the Bloomberg SRI Index with reference to the applicable ESG Criteria, the Decision held: • Vanguard knew (or ought to have known) that the Bloomberg SRI Index had major limitations in its screening process. • Those limitations should have been communicated in Vanguard's corporate statements. Corporate entities cannot escape liability for misleading or deceptive conduct at law[3] by merely relying upon the analyses and associated opinions of third parties, and relaying those analyses and opinions without qualification (in some instances).	• Corporations should probe (if possible) the truth and veracity of third-party statements prior to relying upon and relaying those statements, based upon the information those entities can reasonably gather and test the statement's truthfulness and veracity against. • If they are unable to do so, corporations ought to consider whether an appropriate and targeted written disclaimer should be included in respect of the relayed statement.
ASIC's powers to compel written statements	Prior to commencing the litigation ASIC gathered information regarding the Fund by using broad powers granted to it under the *Corporations Act 2001* (Cth)[4] to compel Vanguard to provide a written statement in response to ASIC's questions. Vanguard's responses would have been carefully scrutinised by ASIC prior to making a decision whether or not to commence the Court enforcement action. While ASIC's use of these powers is not new or novel, this case provides a timely reminder that ASIC's powers to compel corporations to provide information are broad (and sometimes require responses in a relatively short timeframe, which can be significantly disruptive to the recipient company's operations).	Engage with external lawyers (where possible) when formulating the written statements in response to these notices to ensure the corporation's legal position is protected as much as possible while complying with ASIC's compulsory information gathering powers.
Statements during interviews and presentations	ASIC pointed to an interview with Vanguard's product research and development manager published on YouTube and a presentation given by that same manager later published on a financial news website as evidence that Vanguard made false or misleading representations regarding the Fund. The Decision highlights that more informal public statements by a corporation's employees can be, and are, treated (in certain instances) in the same vein as formal publications such as product disclosure statements or stock exchange announcements, or formal statements made by directors on a company's behalf.	Ensure that the public statements made by employees in their employed capacity are properly reviewed and vetted prior to those statements being made. If not, there is a risk that those "more informal" statements may be attributed to the company and actionable by the regulator.

3 In its various forms and iterations, as contained in specific provisions of the *Corporations Act 2001* (Cth), the *ASIC Act* and the *Competition and Consumer Act 2010* (Cth).

4 Specifically, s.912C of the *Corporations Act 2001* (Cth) – noting that this specific section applies to notices which may be issued to "financial services licensee[s]".

Key Takeaways

ASIC deputy chair, Sarah Court, stated "As ASIC's first greenwashing court outcome, the case shows our commitment to taking on misleading marketing and greenwashing claims made by companies in the financial services industry. It sends a strong message to companies making sustainable investment claims that they need to reflect the true position."

It is clear that regulatory action surrounding greenwashing is certainly one of ASIC's enforcement priorities for 2024. Investments that claim to be subject to ESG Criteria need to test that they indeed comply with the applicable ESG Criteria that they are representing to adhere to. Failing to do so will heighten the risk of potential ASIC regulatory action and open the organisation to possibly making misleading representations. Additionally, the obligation on companies to provide reliable information about their ESG credentials will only become more onerous in light of the federal government's recently proposed *Treasury Laws Amendment Bill 2024* (Cth), which, if passed, will require large listed and unlisted Australian corporations to publish a "climate statement".

We counsel clients in identifying and strategically managing issues in relation to potential or alleged instances of "greenwashing" and are available to assist on these and similar corporate governance issues if you should require.

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