

# Decarbonisation disputes: the evolving frontier of climate-related risk

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# Decarbonisation disputes: the evolving frontier of climate-related risk

The Net Zero transition will not be smooth. The scale of the investment required and the appetite and ability of countries to implement new policy – both now and in the years to come – will cause unprecedented disruption and dislocation. The greatest investment opportunity and capital reallocation in history will produce winners and losers as governments make short-term decisions for expediency's sake, while the shift needed over the next quarter of a century in 198 countries will present arguably the greatest new source of litigation for business. Here we explore the myriad ways the Net Zero transition will generate claims – and take a deep-dive into the main areas of risk through a series of Q&As.

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**In May 2021, during the depths of the COVID-19 pandemic, a court in the Netherlands handed down one of the most headline-grabbing decisions to date in the evolving frontier of climate-related litigation.**

**The case – brought by Milieudefensie (Friends of the Earth Netherlands) – ended with one of the world's biggest oil majors being told to slash its carbon emissions by 45% relative to their 2019 levels within a decade.**

The decision is important for two reasons – firstly because it applies not only to the company's own emissions but also those created by the use of its products. And secondly because it is the first time a court has ordered a company to reduce its carbon output in line with the trajectory that the Paris climate agreement has set for countries.

While the ruling raised eyebrows, the fact it came from the Netherlands did not. Six years earlier the Hague District Court was the venue for another high-profile climate dispute, this time launched by the environmental group Urgenda and 900 Dutch citizens against the Dutch state.

Then, the court (and later the Court of Appeal and Supreme Court) ordered the government to take further action to reduce the Netherlands' greenhouse gas emissions, ruling that not doing so would violate the human rights of Dutch citizens.

## **Dutch courts have become pioneers for climate disputes**

The Dutch courts have been pioneers in their willingness to find that governments owe a duty to mitigate their contributions to climate change, and they could do the same for businesses (pending the outcome of an appeal).

Other courts have followed suit – including in France and Belgium – while there are also three cases pending before the European Court of Human Rights (the first such cases to be heard by the ECHR) that could provide fresh impetus for a new wave of climate-related disputes.

The claims argue the extreme weather that flows from climate change poses a threat to life and to physical and mental health, and that members of the Council of Europe have a duty to protect their citizens under Articles 2 and 8 of the European Convention on Human Rights (which cover the right to life and the right to a private and family life).



Protecting citizens in this context could involve setting tougher emissions reduction targets, among other things.

Public hearings before the ECHR's Grand Chamber (which is reserved for the most significant matters) have been held in the first two cases, with the third scheduled for later in 2023. Once complete, the Court is expected to issue a judgment which will be legally binding on all 46 Council members.

### Litigation and its role in climate governance

In 2022, the UN's Intergovernmental Panel on Climate Change (IPCC) acknowledged that litigation is having an increasing influence on "the outcome and ambition of climate governance".

Research from the London School of Economics (LSE) reveals that the number of climate change-related lawsuits has doubled since 2015, with more than 2,000 cases filed around the world. A quarter were launched between 2020 and 2022, and while most involved governments, dozens are aimed at businesses.

These cases seek to discourage high-carbon activities, target alleged failures to adapt to the Net Zero transition, claim compensation for climate damage, and highlight instances of "greenwashing".

Litigation is also being used in a bid to hold business leaders accountable for perceived corporate failures to manage climate risks.

In monitoring these cases over decades, the LSE has been able to track claimants – often non-governmental organisations (NGOs) – using ever-more creative approaches in pursuit of their goals. In many instances their aim is not to win but to draw attention to climate issues and force a change in corporate behaviour.

In recent years the LSE's research has revealed an uptick in cases based on human rights law as well as litigation linked to the advance of attribution science, which attempts to tie emissions to extreme weather events at local level.

Here there have been tort claims against businesses seeking compensation for the impact of floods, wildfires and more intense storms, as well as to cover the cost of mitigation measures designed to protect against them.

Work such as the Carbon Majors study – which takes total greenhouse gas emissions since the start of the industrial era and assigns them proportionally to businesses and countries – has led to damages claims against corporates over the alleged effects of climate change thousands of miles from their home jurisdictions.

Alongside this, a landmark 2022 report into the human rights implications of climate change from the Commission on Human Rights of the Philippines found carbon majors were aware of the effects of global warming yet engaged in "obstruction" to prevent meaningful climate action.

The report concluded that this breached their responsibilities to respect human rights, and while non-binding it may have some precedential value.

It's possible we may see claimants invoke the report in future litigation to support arguments that climate change adversely impacts human rights, and that companies therefore have certain duties in response.

While the tort claims mentioned above target a small number of defendants and are not indicative of a broader trend, they serve to establish a link between companies and climate change in the public consciousness.

The LSE's researchers have also identified the emergence of "systemic lawyering", whereby disputes are brought strategically to drive change across broad swathes of the economy.

Here, claimants will identify business "nodes" within different systems – for example food or transport – and pinpoint interventions they hope will destabilise the nodes and create a ripple effect across the broader economy.

Rather than simply going after the biggest emitters, claimants are instead focusing on financial institutions and manufacturers that sit at the centre of complex supply chains.

### From Peru to Germany: *RWE vs Lliuya*

In *RWE vs Lliuya*, the 125-year-old German utility is being sued by a climate-focused NGO over the alleged impact of its historic emissions on the livelihood of a Peruvian farmer, Saúl Luciano Lliuya. While the original suit was dismissed by the District Court of Essen, an appeal has seen the case progress to a hearing.

The aim of the suit is to make RWE pay a share of Mr Lliuya's climate mitigation costs relative to its historic contribution to global emissions (as claimed by the Carbon Majors study). While the value of the claim is small (running to less than EUR20,000), it could set an important precedent.

“Litigation is being used in a bid to hold business leaders accountable for perceived corporate failures to manage climate risks”

### The threat from climate-related disclosures

Away from their direct impact on the environment, businesses also face growing litigation risk from their climate-related disclosures.

The risks here revolve around whether companies have adequately assessed the impact of global warming on their operations, the urgency of the actions they are taking to support the Net Zero transition, and whether they have provided relevant climate-related information to their shareholders, regulators and other stakeholders.

Perhaps the best-known “greenwashing” case to date saw the New York Attorney General sue a U.S. oil major, alleging it had misled investors and the public about the financial risks it faced from climate change, as well as the regulatory costs of reducing its emissions.

The suit was dismissed but the judge censured the company over its “deficient” disclosure practices, while its chairman, CEO, and other directors have also been subject to securities and financial regulation lawsuits.

The greenwashing of financial products is also in regulators’ sights, with authorities paying close attention to whether the sustainability claims made in marketing materials stack up against reality.

### Prospectus rules bring greenwashing liability

The major source of greenwashing *liability* for businesses stems from prospectuses, where U.S. securities laws and instruments such as the EU Prospectus Regulation present a relatively low bar for claims.

States, too, are not immune from prospectus risk – in 2020 an Australian student filed a civil action against her government for failing to disclose climate risks to bond investors. Katta O’Donnell’s case alleges Australia’s response to climate change has been inadequate, threatening the country’s economy and reputation in financial markets and by extension the returns on government gilts.

Current greenwashing litigation focuses on disclosures made by companies about both their activities *and* their products.

The most significant legal risk comes from securities lawsuits (where the U.S. is a nexus of activity), but cases are also being brought under consumer protection and advertising laws, with many EU claims linked to the implementation of the Unfair Commercial Practices Directive.

Many of these suits revolve around whether consumers fully understand concepts such as “climate neutrality” or “Net Zero”, which often involve a combination of reducing greenhouse gas emissions and offsetting high-carbon activities, rather than ending them.

We are also seeing claimants pushing companies to provide a *holistic* picture of climate impacts in their disclosures rather than simply focusing on the positives.

France, Germany and the Netherlands (again) are emerging as the most active European jurisdictions for greenwashing lawsuits, with certain energy majors for example being targeted over whether their pledges to be carbon neutral by 2050 are misleading given their fossil fuel investments today.

Moreover, to prevent greenwashing, the European Commission has proposed a “Green Claims Directive” to address greenwashing risk by tackling false environmental claims made towards consumers.

The proposal targets claims made explicitly and voluntarily by businesses to customers where they relate to the environmental aspects of a product or the trader itself. If and when the directive is adopted, it too may provide another trigger for litigation.





## Financial institutions in firing line over funding decisions

For financial institutions, the main source of climate-related litigation risk stems from whether their assessments of the impact of climate change on their loan portfolios are realistic, and in relation to the negative environmental impact of the activities they fund.

We have seen banks targeted in a bid to force them to reduce the emissions generated by their lending activities, with one of the latest cases brought under France's Duty of Vigilance Law (which requires large companies to identify and prevent risks to human rights and the environment that could occur as a result of their activities).

The claimants – a group of French NGOs – are demanding that a major bank “immediately stops supporting (both directly and indirectly) new fossil [fuel] projects and [complies] with the Paris goal of limiting global warming to 1.5C”.

And with the EU's proposed Corporate Sustainability Due Diligence Directive (CSDDD) set to be implemented into member state law in 2024, we could see more such disputes – particularly if Brussels opts for full harmonisation (i.e. requires all governments to follow an EU-wide standard, including those that already have their own due diligence laws in place).

Adding further complexity to the picture is the risk of banks and investors being sued for *withdrawing* financing for high-carbon projects or businesses, either because changes in regulation impact the viability of the underlying investment or because financiers' own sustainability objectives cause them to turn away from carbon-intensive activities.

In 2019, the U.S.-headquartered Westmoreland Coal Company took a Canadian state-owned export credit agency (ECA) to an arbitral tribunal after it demanded early repayment of Westmoreland's debt.

Westmoreland claimed the ECA's decision was motivated by political pressure to divest from coal, and that this violated the terms of the loan which did not include any environmental or social criteria.

The case was settled in 2020, with the lender agreeing to extend the loan maturity as well as reduce the coupon.



### Red states' ESG backlash raises antitrust risk

In the past year we have also seen a number of Republican-led states in the U.S. hit back against investors over their ESG policies, defying the federal government which has unleashed a blizzard of policymaking designed to accelerate decarbonisation and promote ESG-positive activities.

In 2021, Arizona's Attorney General launched an antitrust investigation into whether lenders' ESG activities affect their relationship with energy companies to such an extent that they constitute "unlawful market manipulation".

In 2022, a group of state attorneys general opened an investigation into whether the policies of six members of the Net-Zero Bank Alliance – which deny some companies access to banking services based on their environmental records – amount to anticompetitive co-ordination and violate consumer protection laws.

States have also implemented measures requiring government investors such as state-sponsored pension funds to divest from entities they deem to be promoting ESG goals. For example, Kentucky and Texas have passed laws mandating the sale of stakes in companies that "boycott" high-carbon energy producers.

Additionally, Florida's chief financial officer has prohibited asset managers within the state's deferred compensation programme from investing in financial products that involve ESG standards.

Several states (including Florida and Kansas) have introduced bills that require government investors to base their investment decisions only on "pecuniary factors", often defined to exclude ESG analysis.

Some funds have refused to comply (arguing that to do so would breach their fiduciary duties), raising the prospect of disputes further down the line.

Any litigation that arises could test whether ESG decisions have a positive or negative effect on investment performance, with subsequent court rulings having potentially far-reaching consequences.

These types of cases draw plenty of media attention. But away from the headlines can be found a multitude of other claims driven by the energy transition.

Significant shifts in policy – something we also explore in our report, [Financing the gap](#) – are a major driver of disputes, with claims launched against governments seeking compensation for energy investments "stranded" by Net Zero regulation or damaged by the *removal* of green incentives.

In the Netherlands, two German coal plant owners sued the Dutch state claiming that the country's Coal Ban Law (which prohibits coal-fired power generation from 2030) is unlawful due to the lack of adequate compensation offered to asset owners, among other things.

While the claim was initially denied, the case is now pending appeal. Further complicating the situation, both businesses also filed arbitration claims under the Energy Charter Treaty, and although one has been withdrawn the other is still pending.

“Significant shifts in policy are a major driver of disputes”



### **Decision to end nuclear programme sparks disputes**

Although not directly related to Net Zero, Germany's decision to end its nuclear power programme in the wake of Fukushima was also the subject of litigation in relation its compensation provisions, with the country's constitutional court ordering the government in November 2020 to revise its nuclear exit law for the second time.

The Keystone XL pipeline (which links Canada's tar sands to the Gulf of Mexico) has been the source of several lawsuits after it was blocked, restarted and then blocked again during the shift from the Obama to the Trump and Biden administrations.

Likewise the EU's Emissions Trading Scheme has sparked complaints from European businesses who claim it makes their products uncompetitive relative to those from countries that allow carbon to be emitted at will. Brussels' attempt to redress the balance via its Carbon Border Adjustment Mechanism may itself be challenged by those who believe it violates the rules of the World Trade Organization.

### **Further litigation over decommissioning, contracts and environmental patents**

Elsewhere we can expect a rising tide of lawsuits over the decommissioning of high-carbon infrastructure, as parties dispute the allocation of costs and liabilities for the closure of facilities and the clean-up of contaminated sites.

In 2018 the UK government found itself at the centre of one such dispute when it was sued for changing the rules around the tax reliefs available for the decommissioning of offshore platforms. The claim was eventually settled, with the government agreeing to reinstate the relief.

We will see more construction litigation as low-carbon production facilities and transmission equipment are installed, and a rise in commercial disputes around non-performance of contracts as the energy transition impacts the provision of goods and services.

As with other areas of fast-developing technology, energy transition patents will become another driver of litigation, with innovators potentially facing challenges protecting or enforcing their intellectual property rights or in accessing the IP of others.

We may even see countries look to apply compulsory licences to breakthrough climate technologies, with those decisions challenged through the courts.

*This contentious environment – in which investors battle investees, companies sue governments, and NGOs litigate against corporates and financial institutions – will only intensify as the Net Zero transition accelerates. In the Q&As that follow, we address the critical issues involved in each subset of lawsuits – and explain the steps businesses can take to defend their interests*



# Q&A: How businesses are being sued over their contribution to climate change

NGOs and individuals are increasingly suing governments, public bodies and private entities over their impact on the climate. Here we answer the key questions for businesses on this growing wave of disputes.

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## What developments are we seeing in this space?

One of the most significant is the so-called “human rights turn”, which has seen cases launched – primarily against carbon-intensive industries – that draw on human rights-based arguments to achieve their goals.

Here, the cases often target businesses that adhere to or support the UN Guiding Principles on Business and Human Rights, with the logic that a company’s public statements aligning with the UNGPs could define the duty of care to which it will be held accountable.

Courts around the world are increasingly receptive to hearing these cases, which have been successfully deployed to establish direct corporate responsibility for environmental harm.

Within the European Union, we are also seeing permit litigation used in a bid to force regulators and permit-granting authorities to address (and regulate or limit) scope 3 emissions from installations.

These cases argue the environmental impact assessments (EIA) that underlie the granting of any permit for a project should address scope 3 impact as part of the “indirect emissions” required by regulation. It is anticipated that this issue may soon be submitted to the European Court of Justice for preliminary review.

Alongside this, the CJEU (in its *Deutsche Umwelthilfe* (C-873/19) ruling), considerably expanded the rights of environmental associations, by allowing NGOs to take legal action against the EC type-approval of vehicles fitted with “dieselgate” software.

The ruling suggests claimants can bring proceedings against *any* acts and omissions that contravene the provisions of national environmental law – paving the way for more intense and broader climate disputes in future.

## Is there a standout climate impact case?

In a landmark decision in May 2021, the District Court in The Hague ordered an oil major (itself an adherent to the UNGPs) to cut its global carbon emissions by 45% from their 2019 levels by the end of 2030.

The ruling in the case – led by Milieudefensie (Friends of the Earth Netherlands) – applies not just to the company’s own emissions, but also to those created by its products.

It is the first example of a court ordering a company to reduce its carbon output in line with the trajectory that the Paris climate agreement has set for countries. The ruling has inspired further claims against other significant industry players.

## Why did the Netherlands lawsuit succeed?

Claimants in the case were able to argue that the company was bound to take steps to prevent dangerous climate change under a domestic, statutory duty of care, which holds that companies have a duty not to do damage to others, or do too little to prevent such damage occurring.

## What barriers do claimants face in common law jurisdictions?

Early tort-based climate litigation has had limited success (at least in a strict legal sense) in common law jurisdictions.

One of the primary challenges is that these cases often depend on the claimant being able to demonstrate a relational link to the defendant company – that is, a sufficiently proximate connection to warrant the imposition of a corporate duty of care.

This has proved difficult to establish in many of the negligence claims we have seen to date.

Then there is the challenge of establishing a causal link between a defendant's contribution to a collective issue and the particular harm suffered by a claimant.

In the case of climate change, this is particularly complex given its temporally and geographically diffuse effects.

### Is there anything on the horizon that changes this picture?

It is possible that rapid scientific developments (including advances in quantifying the proportional contribution of the world's largest emitters to climate change), coupled with the global recognition of the impact of carbon emissions on catastrophic climate events set out in the Paris Agreement, may help courts resolve issues of causation.

Businesses are also starting to feel the impact of corporate duty of vigilance laws (such as those introduced in France, Germany and Norway), which require companies in scope to identify and prevent any severe environmental impacts across their supply chains.

These frameworks create the corporate duty of care to protect the environment which has been so difficult to establish through the courts in common law jurisdictions, sparking a wave of lawsuits against banks over the climate impact of the activities they finance.

And with the EU's proposed Corporate Sustainability Due Diligence Directive (CSDDD) set to be implemented into member state law next year, we could see an uptick in climate-related litigation follow.

### What risks does climate litigation pose for boards?

As a result of the duties of care and diligence they owe to their companies, company directors could be held responsible for not taking adequate measures to manage and mitigate the impact of climate change on the business. For example in the UK, directors and officers may face claims for breach of fiduciary duties based on their alleged failure to consider the environmental impact of their

decisions in the context of their obligation to promote the success of the company.

In some jurisdictions, directors and officers of financial institutions may face claims alleging that their decisions to finance "brown" energy, in and of themselves, constitute a breach of duty given the likely short-term damage to the reputation of the business, as well as the longer-term risks that such loans might become non-performing due to regulatory change.

As Lord Sales, a Justice of the Supreme Court of the United Kingdom, observed in remarks to the Anglo-Australian Law Society: "Under certain circumstances ... companies' interests may be so implicated by climate change effects that [directors' and officers'] general fiduciary and due care obligations actually require them to cause their companies to take action to reduce their contribution to climate changing activity."

While this remains a developing area of the law, it is important for directors to weigh climate change factors in their decision-making to limit any adverse reputational and financial impacts on the companies they manage and, in turn, reduce the potential for climate-related litigation.

### What actions can companies and their boards take to reduce the risk of litigation related to their impact on climate change?

In most jurisdictions, board directors are ultimately responsible for understanding the climate-related risks and opportunities their business faces, as well as its potential exposure.

As far as mitigating the risk of litigation over *historic* climate impacts, boards should therefore ensure they are aware of key legislative and case law developments, especially in relation to rulings that establish precedents around causation.

In terms of climate impact litigation more broadly, the principal risks arise from any perceived failures to reduce the impact of the business and its supply chain on the

climate, and to manage the effect of climate change on the business (we look at the litigation risks associated with climate-related disclosures in a separate Q&A [here](#)).

Good risk management processes ensure that climate impacts are taken into account in board decision-making and that this is appropriately documented in board minutes.

Boards should also look at their governance structures and consider whether responsibility for climate-related issues should sit with a nominated director or committee.

Some investors are putting pressure on companies to go further than this (for example by proposing specific climate-related resolutions that are binding on the business), so proactive engagement with shareholders is critical.

The rise of duty of vigilance laws requires businesses to prevent severe harms to the environment across their supply chains, which necessitates extensive due diligence to map where these issues arise.

"Prevent" in this context requires the business to use whatever leverage it has with its suppliers (in much the same way as with human rights laws such as the UK Modern Slavery Act), for example by renegotiating contracts to introduce penalties for poor environmental performance or by switching to greener business partners.





# Q&A: How climate-related disclosures are driving a wave of greenwashing litigation

Claims alleging that companies have harmed their investors by making material misstatements concerning sustainability-related risks are on the rise. So what do businesses need to know?

credentials are promoted. In addition, corporates and financial institutions also face risks in ensuring their public statements and disclosures to investors regarding ESG metrics are accurate.

As far as financial products are concerned, greenwashing risks go beyond marketing language – issues may arise if the proceeds of green bonds, for example, are not used to further green goals (for example, green bonds may lack binding covenants requiring issuers to use the proceeds in this way).

## Why is greenwashing such a big issue right now?

As investor appetite for green or ESG-branded financial products grows, so does the number of legislative and regulatory initiatives across the world designed to prevent or mitigate greenwashing.

At the same time, a loud counter-movement is developing in certain U.S. states where governors, state legislatures and state treasurers have initiated an “anti-ESG” movement to restrict the ability of government institutional investors (such as state and local pension funds) to consider ESG factors in their decisions. Some significant investments have been terminated on this basis.

Alongside the rising risk of regulatory enforcement, the threat of civil litigation for issuers, banks and other financial institutions is also on the rise.

Investors who sustain losses could claim that they were misled into investing based on false disclosures; where institutions make positive statements about green products, the scope of claims based on alleged misrepresentations becomes wider, and the investor’s ability to prove that it relied on the climate-related disclosures becomes easier.

The same is true for corporates, who also face greenwashing risk from incorrect or omitted information in financial reports, non-financial statements and prospectuses, as well as a lack of transparency around the limitations of the methodologies that *underpin* disclosures. Where those errors or omissions relate to equity or debt securities, the financial institutions that acted as managers and or/underwriters are also exposed.

According to the United Nations Principles for Responsible Investment (UNPRI), the 2022 proxy season had one of the highest records for majority-supported ESG shareholder proposals in recent years, and the 2023 season is off to a similar start.

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## What do we mean by greenwashing?

“Greenwashing” is the process of conveying a false impression or providing misleading information about either a company’s or a product’s environmental performance to create an overly positive image.

Accusations of greenwashing could relate to statements made by a business in an attempt to revamp its green credentials or the marketing of “green” bonds, “green” funds, or any other product where environmental

Investors and good governance groups are also focused on whether a company has “congruence” between its stated public positions on matters such as the environment, social issues (abortion, LGBTQ+ support, systemic racism, and criminal justice, to name a few), and their indirect lobbying, political, and electoral engagement.

Additionally, the legal and regulatory framework around climate-related disclosures is developing rapidly across the world, driven by the recommendations of the Task Force on Climate-Related Disclosures (TCFD).

A number of jurisdictions and authorities, including the U.S. Securities and Exchange Commission, have either proposed or introduced frameworks requiring TCFD-aligned reporting, while EU member states will need to introduce legislation in line with the EU’s Corporate Sustainability Reporting Directive (CSRD) by 2024.

In order to settle regulatory investigations into their sustainability disclosures we have seen a number of corporates agreeing to take on additional, ongoing reporting obligations.

### How are climate disclosures driving risk for business?

Greenwashing litigation comes in a variety of forms, with the main threat coming from securities and shareholder lawsuits in the United States.

One of the best-known examples involves a major U.S. oil producer, one of whose stockholders filed a securities fraud class action against it and three of its directors in a Texas district court in 2016.

The complaint alleged the company’s public statements were materially false and misleading because they failed to adequately disclose the impact of climate change on the business, and that as a result, its stock price was artificially inflated.

When the company subsequently announced it might need to write down the value of some of its fossil fuel assets, its share price dropped. While a similar case brought by the New York Attorney General was dismissed, the Texas suit is still live, seven years later.

In Europe we have seen cases brought against energy majors over whether their pledges to be carbon neutral by 2050 are misleading given their fossil fuel investments today, and lawsuits targeting airlines in relation to “responsible flying” campaigns that NGOs claim give consumers “the false impression that ... flights won’t worsen the climate emergency.”

These threats may seem remote to many businesses. But there are activities common to a much broader range of companies that also present litigation risks. It is possible we may see NGOs taking a closer look at corporate offsetting, and in particular whether emissions reduction credits deliver their stated decarbonisation benefits. If they don’t, it could spark complex contractual claims between corporates, offsetting providers, and the bodies that certify them.

While not litigation, we are also seeing NGOs bring complaints against companies through the Organisation for Economic Cooperation and Development’s (OECD) network of National Contact Points (which were established to promote adherence to the OECD’s Guidelines for Multinational Businesses).

In 2017, a group of NGOs filed a complaint in the Netherlands against an international bank alleging it had failed to disclose the quantity of greenhouse gas emissions emitted as a result of its financing activities.

The complaint resulted in the bank making a number of commitments to reduce its climate impact, including by steering its lending portfolio in a direction more compatible with the aims of the Paris Agreement.

### Where else is risk coming from?

The principal source of greenwashing *liability* for businesses stems from prospectuses, where US securities laws and instruments such as the EU Prospectus Regulation and other national instruments present a relatively low bar for claims.

Here we are seeing private parties engage with authorities to put pressure on companies; as an example, in 2017 an NGO asked a Canadian securities regulator to stop an infrastructure company’s initial public offering based on allegations that the prospectus had deficient disclosures around climate-related risks. After the regulator agreed to review the request, the company amended the prospectus.

Where greenwashing claims relate to particular financial products marketed as “green”, claims have been brought on the grounds of mis-selling, misleading advertising and unfair business practices.

It can be challenging for investors to *win* these cases however, as doing so requires them to demonstrate they have suffered a loss.

The fact a product isn’t as green as it says may not have any impact on its price, and even if there has been a drop, the impact on individual investors may be so small as to make it uneconomic to bring a claim.

As a result, any uptick in mis-selling claims in relation to green financial products is likely to arise in jurisdictions with claimant-friendly class action regimes, such as the U.S. and Australia.



Within the EU, greenwashing investor claims could become class actions under the Representative Actions Directive if the EU were to expressly bring ESG-related regulations within scope, or if member states go beyond the directive's minimum framework in their national implementations.

### What actions can companies and their boards take to reduce the risks they face?

These ESG disclosure-related risks exist now, based on existing legislation, regulation and legal doctrine, and we can expect them to intensify as companies are faced with additional climate-specific legal and regulatory disclosure obligations.

In response, corporates and financial institutions should avoid overstating their ESG-related commitments, and keep abreast of legal and regulatory developments that may impact the need for – and nature of – those disclosures, including applicable legal grounds, regulators' recommendations and industry standards and guidance.

These standards and guidance will also evolve as more greenwashing cases are dealt with. At the same time, initially non-binding international standards such as the TCFD framework can be incorporated into national law.

On a more granular level, businesses should be clear about which "carbon accounting" methodologies underpin their disclosures and *why* they are used, and understand the assumptions and weaknesses inherent in the data that informs their disclosures.

They should implement robust internal governance processes around who oversees the creation of disclosures, senior management and employees should be trained regularly to understand ESG fundamentals and the risks of greenwashing, and disclosures should be assured by external counsel.

Finally, it's important that businesses do not simply copy and paste information from annual reports into prospectuses given the greater liability risks they present.

### What can we expect in the future?

To some extent, the risk of greenwashing is no different from the risks inherent in any misleading statement about a product, service or fund.

However, the lack of uniform international standards increases the complexity of the challenge and therefore the potential liabilities for business.

In addition, markets often develop faster than regulation and this vacuum can create exposure. Take the example of a bank taking on the new role of "sustainability agent or coordinator" for sustainability-linked loans, where the performance of the issuer against certain key performance indicators (KPIs) can trigger changes to the loan's interest rate.

The sustainability agent or coordinator typically negotiates these KPIs with the borrower prior to the syndicated loan being issued, but there are a lot of unanswered questions around the duties that come with the role. What happens if the targets are ineffective for example – could other members of the syndicate bring claims?

“Organisations should keep abreast of legal and regulatory developments that may impact the need for disclosures”



# Q&A: Why shifts in energy transition policy are driving a new wave of disputes

Implementing laws and regulations to change society's centuries-long dependence on fossil fuels is a massive challenge. Here, we explore how energy policy is driving disputes.

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## How do shifts in energy policy drive litigation?

The first and perhaps most obvious way is where government decarbonisation reforms upset existing interests in the conventional energy sector.

In January 2021, a German energy company filed a claim seeking compensation from the Netherlands government over its 2019 decision to phase out coal-fired power generation by 2030.

The company brought its claim under the Energy Charter Treaty (ECT), arguing that the law amounts to an indirect expropriation of its investment in a Dutch coal-fired power plant, which began operating in 2015 and has a design life of 40 years.

Similarly, Canada faced a claim by a U.S. investor, Westmoreland Coal Company, under the North American Free Trade Agreement (NAFTA) following a scheme introduced by the Alberta government to phase out coal-fired power by 2030.

Although the claim was ultimately rejected on jurisdictional grounds, states look set to face further such claims when they implement initiatives to cut the use of fossil fuels.

## What arguments are governments using to defend themselves?

The Netherlands and other states defending these claims will no doubt argue that they have the sovereign right, indeed an *obligation*, to adopt measures to protect the environment and public health in line with their commitments under the Paris Agreement.

They will also argue that any harmful impact of a measure on a private individual or entity must be weighed against the threat posed by climate change.

In that context, a state may argue that any given decarbonisation measure must be considered proportionate and indeed necessary. Even if this defence is unsuccessful in an arbitration, it is conceivable that similar arguments may be used to resist the enforcement of the resulting award in national courts on the basis that the measures are required by overriding public policy concerns.

## What challenges are those arguments likely to face?

These arguments could be deployed to defend ambitious measures of general application designed to phase out electricity generation from fossil fuels, but they may be less persuasive where governments adopt an inconsistent or erratic approach – for example by trying to prohibit a fossil fuel project that they have previously permitted or endorsed.

Some inconsistency in policy is almost inevitable in a democracy, where successive governments may not share the same outlook on the urgency of decarbonisation and the appropriate means to achieve it.

Moreover it is also common for municipal, regional and national arms of governments to have opposing views on how to regulate fossil fuels.

## Is this inconsistency in policy also driving litigation?

Yes. Where a project is adversely impacted by inconsistent policy, the project's stakeholders may bring claims against the government.

One such claim was brought against Italy by Rockhopper Exploration Plc, a British company involved in the exploration and development of offshore oil and gas.



In 2014, Rockhopper invested in a project in the Adriatic Sea and subsequently secured an environmental impact assessment approval and a production concession from the Italian authorities.

However, in late 2015, the Italian parliament passed a law that banned all exploration and production activities within 12 nautical miles of the Italian coast, effectively preventing Rockhopper from developing the project and rendering its investment worthless.

Rockhopper's claim against Italy under the ECT resulted in a 2022 arbitral award ordering Italy to pay EUR190 million in compensation.

However the Keystone XL pipeline in North America is perhaps the best example of policy inconsistency driving litigation. Keystone XL was designed to transport up to 830,000 barrels of crude oil per day from the Alberta tar sands to refineries and ports on the U.S. Gulf Coast.

Amid opposition to the project from environmental groups and scientists, in 2015 the Obama administration rejected the pipeline on the basis that it would not serve the national interest of the United States.

In response, the pipeline's owner, TransCanada, sued the U.S. government for allegedly violating the U.S. Constitution and the NAFTA.

TransCanada's claim was then discontinued after President Trump issued a new presidential permit for the pipeline, citing its potential benefits for energy security, jobs, and trade.

In 2018, a federal judge in Montana blocked construction on the basis that it failed to comply with federal environment regulations. President Trump responded by issuing a new presidential permit authorizing construction.

Subsequently, on his first day in office, President Biden signed an executive order revoking the permit. President Biden's order stated that the pipeline "disserves the U.S. national interest" and that the U.S. "must prioritize the development of a clean energy economy."

As a result, the U.S. has received notice of a further claim, which would be brought as a NAFTA legacy arbitration under the new U.S.-Canada-Mexico agreement.

What does this show? That projects caught in the crosshairs of changes to decarbonisation policies will, if negatively impacted, give rise to multiple claims.

We can expect more of these cases as governments grapple with competing economic, environmental, and other priorities.

#### **What about emissions-reduction measures? Can they be a source of disputes?**

Again, yes. Governments will likely be exposed to claims where policies aimed at reducing carbon emissions are deemed to be disproportionate or discriminatory by the affected parties.

Moreover, attempts to modify these policies to alleviate the burden on those affected may serve only to trigger claims elsewhere.

The European Union is a good example – one of the instruments the EU uses to regulate and price carbon emissions is the EU Emissions Trading System (ETS), which covers around 45% of the bloc's greenhouse gas emissions.

The ETS sets a cap on the total emissions permissible for participants in the scheme and allocates a certain number of emission allowances that can be traded on a market. If participants emit more than their allocated allowances, they have to buy more from the market or face a penalty.

This has generated complaints from EU-based companies who argue the ETS increases the costs of goods manufactured in Europe and gives a competitive advantage to competitors who operate in third countries without such rules.

To try to address this, the EU is now close to adopting a Carbon Border Adjustment Mechanism (CBAM) which will require importers of certain energy-intensive goods (including iron and steel, cement, fertilizers, aluminium, electricity and hydrogen) to pay a levy that corresponds to the price of emissions allowances under the EU ETS.

Reporting obligations under the CBAM will apply starting from October 1, 2023, while the obligation for importers to pay will begin in 2026.

The overarching rationale of the regulation is to address the risk of "carbon leakage", whereby the emissions reductions achieved *within* the EU under the ETS could be offset by covered operators shifting their activities to jurisdictions outside the scope of the ETS and/or by EU firms increasing their imports from these jurisdictions.

**“Projects caught in the crosshairs of changes to decarbonisation policies will, if negatively impacted, give rise to multiple claims”**

While this may solve the existing problem, some claim it may violate the rules of the World Trade Organization, illustrating the difficulty of calibrating an ambitious decarbonisation policy that is entirely free of controversy.

### How about changes to renewables incentives, or the imposition of windfall taxes?

Another source of litigation risk comes where governments induce investment in renewable energy projects and then seek to unwind incentive schemes as circumstances or their priorities change.

This has happened in a number of countries (including Spain, Italy, the Czech Republic, Poland, Hungary, Romania, France and Mexico), which secured vast sums of private investment in wind farms, solar parks, and hydro projects through ambitious support schemes only to implement or announce retroactive cuts to those regimes.

These shifts can destroy the financial viability of renewable energy plants and have resulted in an avalanche of arbitral awards granting billions of dollars in compensation to affected investors.

In most instances, governments enacted the cuts following the 2008 financial crisis. Faced with gaps in their budgets, they elected to abandon expensive renewables subsidies to help balance the books.

More recently, the spike in energy prices following Russia's invasion of Ukraine has caused a number of European countries to implement windfall taxes on energy companies.

In response, affected parties have indicated their intention to challenge these measures on the basis that they improperly discriminate against them.

Given that energy projects tend to have a design life of several decades, they will continue to be buffeted by myriad policy changes in response to evolving economic and geopolitical conditions.

States will be forced to defend claims where their responses to those changes are perceived to be erratic, too abrupt, or inconsistent with their existing obligations.

### Any other areas of emerging risk?

Claims against governments may also arise from a new wave of "resource nationalism" linked to decarbonisation. Lithium is a good example – the mineral is a key component of rechargeable batteries and will therefore play a critical role in decarbonisation, both as part of the electrification of transport and in the storage of electricity generated by intermittent renewable sources such as wind and solar power.

According to some estimates, compared to 2019 levels, global demand for lithium could more than triple by 2025 and continue to increase beyond that.

Not surprisingly, the price of lithium has skyrocketed, and in August 2022 the Mexican government issued a decree reserving to the people of Mexico the exclusive right to exploit all lithium resources within the country.

This may lead to the nationalization of existing lithium development projects in Mexico, a move that is likely to trigger claims against the government.

That's not to say that local communities always welcome new mining projects, no matter how valuable they might be. Take the development of the San Jose lithium deposit in Caceres, Spain.

The mine is touted by its developer as a crucial source of lithium for the European market and a major boost to the local economy. However, it faces opposition from residents, environmental groups and cultural associations who claim that it would cause irreversible damage to Caceres, a UNESCO World Heritage Site. If that opposition results in the project being cancelled, significant litigation would follow.

“Energy projects that have a design life of several decades will continue to be buffeted by policy changes in response to evolving economic and geopolitical conditions”

“Litigation generated by the extraction of minerals necessary for decarbonisation is an extension of familiar disputes provoked by the siting of renewable energy plants”

In a sense, the litigation generated by the extraction of minerals necessary for decarbonisation are an extension of familiar disputes provoked by the siting of renewable energy plants.

Wind turbines have long been the subject of opposition over their impact on the landscape, and as a result, the construction of wind turbines anywhere near urban areas has long been difficult.

Indeed, it has been reported that an informal rule exists in the wind power sector whereby developers will not plan a turbine within 30 miles of a Starbucks, the presence of which suggests a well-resourced local population with the potential to block the granting of planning permission.

This also applies to the construction of the transmission lines required to transport electricity from a renewable energy plants to consumers.

In January 2021, the U.S. Department of Energy issued a Presidential permit for the New England Clean Energy Connect transmission line, which aims to deliver hydroelectric power from Quebec, Canada, to the New England grid via a 145-mile corridor through Maine.

In November that year, voters in Maine approved a referendum halting construction of the project on the grounds that it would result in the loss of a 53-mile section of forest, sparking, you guessed it, litigation.

### Are steps being taken to reduce the risks governments face?

Given the vast potential for decarbonisation policies to result in claims against states, governments have recently taken steps to reduce their exposure.

The attempt to “modernize” the Energy Charter Treaty (ECT) foresees amending it to carve out from its scope of protection: (a) new fossil fuel investments made after August 2023; and (b) all fossil fuel investments 10 years from the date on which the amendment takes effect.

This would avoid liability under the ECT for the future phase-out or cancellation of fossil fuel projects.

Spain, the Netherlands, France, Poland, Slovenia, Germany and Luxembourg deemed this to be insufficient and have recently declared their intention to withdraw from the treaty altogether.

This has prompted the European Commission to call for a coordinated withdrawal from the ECT by all EU Member States, and the EU itself. Although withdrawal should not eliminate their exposure under the ECT entirely, given that its protections remain applicable to existing investments for a further 20 years following withdrawal, it has been argued that states may agree among themselves to disapply such “sunset clauses” by mutual agreement.

In any event, there exist multiple other international, regional, and domestic fora where adversely affected parties can challenge decarbonisation policies. As such, while the decarbonisation of the global economy is critical, it will also remain highly contentious.





# Q&A: What disputes risks will flow from the decommissioning of high-carbon infrastructure?

The drive to deliver Net Zero will require high-carbon infrastructure to be decommissioned on an unprecedented scale. The process could cost in excess of USD200bn – and with the regulatory environment in constant flux, the potential for disputes is enormous.

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## What does decommissioning involve?

This process of taking existing offshore oil and gas facilities out of service comes with a host of technical, environmental and social risks.

If these are not managed correctly, the result is likely to be costly and complex disputes between stakeholders, in addition to the practical challenges of managing the decommissioning itself.

Safely and responsibly terminating the production and operation of offshore oil and gas facilities that are no longer economically viable, technically feasible, or environmentally acceptable will involve, among other things, plugging and

abandoning wells, removing or reusing equipment and structures, restoring sites and seabeds, disposing of waste and hazardous materials, and monitoring and managing any residual impacts or liabilities.

It is difficult to conceptualise the scale of the decommissioning that will be required to deliver Net Zero. Industry analysts estimate the global cost will exceed USD200 billion in the coming decades, with around 2,000 offshore projects needing to be taken offline.

## What sort of disputes can we expect?

Any change process on this scale will inevitably lead to risks and disputes. But the decarbonisation of the offshore oil and gas sector is likely to be particularly challenging for a number of reasons.

### 1. Regulatory uncertainty

Offshore oil and gas facilities are spread across the world and are often in remote and/or contested territories.

This matters because the legal and regulatory frameworks governing the sector – including decommissioning obligations – vary massively across jurisdictions.

In addition, many of those frameworks are changing rapidly in response to the evolving climate agenda and the reluctance or inability of some participants to fulfil what governments consider to be their obligations.

### 2. Contractual challenges

The overarching legal frameworks described above also need to be applied in the context of contractual arrangements among relevant parties, such as joint operating agreements, production sharing contracts, service contracts, and decommissioning security agreements.

The continual evolution of the regulatory framework inevitably creates uncertainty and inconsistency in the interpretation and application of these rights and obligations.

While this can arise with all contractual counterparties (including joint venture (JV) partners and other contractors), it is particularly evident when national governments are involved because they often play a dual role in both *establishing* the regulatory framework and are also (via national oil companies) *partners* in the operations through production sharing contracts.

These complexities raise the risk that existing contractual frameworks may not adequately address the allocation of risks and costs associated with the decommissioning process.

This is particularly so because those contractual frameworks were often established years (or even decades) earlier, in the context of different legal and societal expectations.

Accordingly, the risk allocation in those contracts is often outdated and inconsistent with the new regulatory regimes. This may manifest itself in, for example, uncertainty as to who should bear the costs of decommissioning (particularly in circumstances where a JV partner has departed the tie-up or no longer has the financial capability to perform), or indeed even what the decommissioning process itself is to involve.

Any such inconsistency will again likely lead to a clash between both internally within the operators, and also with the relevant regulatory bodies.

### 3. Technical and operational challenges

The decommissioning of offshore oil and gas sector requires the use of innovative and sophisticated technologies (a topic we explore in more detail in a separate Q&A [here](#)).

Deploying these solutions, particularly in remote locations, is challenging from a technical and operational perspective, which may affect the delivery and quality of projects and services.

Such novel technologies are prone to (at best) delays, and (at worst) complete failure, and the ability to address any such issues is severely compromised by the fact that replacement parts, procedures, know-how or personnel cannot be easily accessed in those locations.

Furthermore, the decommissioning of offshore oil and gas assets involves complex and hazardous activities which pose significant risks of accidents, injuries, damages, and pollution, which in turn can result in litigation.

### 4. Capacity challenges

As explained above, the level of decommissioning required to deliver Net Zero is unprecedented. As a result there are likely to be shortages of contractors and equipment available to do the work, especially in deepwater and harsh environments.

This may make it difficult for operators and regulators to comply with their legal obligations and environmental standards, as well as for contractors and suppliers to meet the contractual and technical requirements of their clients.

The scarcity of capacity – and the uncertainty of demand (the rate at which decommissioning needs to happen will vary significantly depending on the path the world takes to Net Zero) may also lead to disputes over pricing, scheduling, liability, and performance, which would again likely result in delays and cost overruns.

### 5. Environmental and social impacts

Decommissioning in and of itself is a complex process that can give rise to breaches of environmental laws and regulations, non-compliance with environmental impact assessments and permits, and disputes with local communities and indigenous groups.

As projects come to the end of their useful lives, these matters are typically closely scrutinised to ensure any issues are addressed before the project is abandoned.

### What can businesses do to manage risk?

Given the complexity and range of the dispute risks outlined above, stakeholders involved in the decommissioning of offshore oil and gas assets need to adopt a proactive and holistic approach to risk management and mitigation.

This will include conducting comprehensive due diligence and risk assessments of the legal, technical, environmental, and social aspects of the projects in advance, in an effort to provide adequate safeguards and remedies in case of disputes or other issues that arise.

It will also be important to engage in constructive dialogue and cooperation with the relevant stakeholders, and seek to align their interests and objectives at an early stage.

“Existing contractual frameworks may not adequately address the allocation of risks and costs associated with the decommissioning process”



# Q&A: Managing risk in cutting-edge Net Zero projects

The shift to Net Zero will require the transition to cutting-edge technologies. In this environment, traditional contracting models – for example engineering, procurement and construction (EPC) – may not be tailored to the risks involved.

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## How do infrastructure contracts typically work?

The starting point to any consideration of these issues is to remind ourselves that, at their core, contracts are all about the allocation of risk.

To take a well-known example, any mention of an “EPC contract” means market participants familiar with construction and infrastructure projects have certain expectations about how they will operate. For example, there is likely to be:

- A Principal, who will be the ultimate owner of the project.
- An EPC Contractor, who is obliged to deliver the complete project to the Principal, usually on a guaranteed date, with a guaranteed performance of the project, and for a guaranteed price. If the EPC contractor fails to

comply with these obligations – particularly around time and performance – then they are liable for liquidated damages.

The EPC Contractor rarely performs all of the actual “on the tools” work itself, which will typically be subcontracted to other specialists.

However, the EPC contractor retains a single point of responsibility to the Principal – “wrapping” the risk associated with the design, engineering, procurement, construction and testing of the facility. From the perspective of the Principal, this is a key feature and benefit of this contractual regime.

## How do standard infrastructure projects work?

Traditional energy infrastructure projects (i.e. those producing or using oil and gas) operate in a reasonably predictable fashion that has been honed over decades of use.

Very experienced parties typically act as Principals or EPC Contractors; they know the underlying processes and technology and have an appreciation for the risks and how they might be allocated.

Further, the regulatory framework is reasonably settled and the parties usually have relationships with the regulators, so again there is a level of certainty about the likely outcomes.

In this context, both the Principal and the EPC Contractor (and, for that matter, the downstream contractors) can engage with the EPC contract in a manner consistent with these expectations, with a fair amount of certainty.

They are dealing with known quantities, both in terms of the work scope and the market participants. Importantly, they are in a position to anticipate, manage, and price risk.

## What's different in a low-carbon project?

Renewables projects, and particularly those using cutting edge, speculative, or otherwise novel technologies, can turn a lot of this on its head.

Firstly, there are the risks of the technologies themselves. Second, you often have less experienced contractors involved, particularly at a subcontractor level. And third, you have an ever-changing regulatory landscape in which they are deployed.

What that means is that many of the traditional features of an EPC contract are put under significant strain. This requires a critical assessment as to whether the traditional allocation of risk remains relevant.

As explained above, a key facet of an EPC contract is that the EPC Contractor normally “wraps” the risk – i.e. they are the single point of contact to the Principal.



If anything goes wrong, it is the EPC Contractor that is liable to the Principal. The EPC Contractor then normally “back-to-backs” that risk to its subcontractors.

However, in the context of a renewable project:

- The parties are often dealing with new or unproven technologies, which come with unknown risks. As a result there needs to be a detailed consideration as to whether the EPC Contractor is in a position to “wrap” the design and performance risk.

In other words, is the EPC Contractor able to reliably identify, and price, the types of risks that might arise? And even if it can, are its traditional back-to-back arrangements with subcontractors feasible?

Many of the contractors involved in developing edge technologies are often of a smaller (or even start-up) scale and may be financially vulnerable. This increases the focus on where the risks might otherwise be allocated, including to insurance.

- Assessing performance can also be challenging. For example, the output of a previously untested solar farm technology can be uncertain, leaving aside the fact that it might be affected by unknown environmental conditions (i.e. the amount of sun over a designated period) in ways that traditional coal- or gas-fired power stations are simply not.

As a result, existing clauses around (for example) performance liquidated damages need to be re-assessed to determine whether they remain appropriate for those new technologies.

This re-assessment is challenging given those parameters need to be set at the date of the contract, well in advance of when they might actually be tested.

- Another ever-present issue is the constantly changing regulatory landscape that is seeking to “keep up” with the new wave of technologies. For example, it’s possible that the EPC Contractor could build a “perfect” windfarm, but that is only relevant if it can be connected immediately to the electricity grid by the appropriate regulator.

As regulators are assessing these new technologies, their requirements are in flux. There is therefore a need to assess who bears the responsibility for any changes to these requirements (which may cause delays to the commencement or operation of the project), as this can have implications not only for liabilities between Principal and EPC Contractor, but also the interface with other offtake and maintenance contracts.

### How can these risks be mitigated?

All of these challenges arise from the tension between allocating all of the risks to the EPC Contractor as a single point of responsibility (which is the whole point of an EPC contract for the Principal) and those risks being unknown, or at least difficult to anticipate or price.

In our experience, it can be challenging to determine exactly how issues are to be treated under a contract, simply because they were not anticipated at the outset and therefore not expressly allocated.

Managing risk in cutting-edge infrastructure projects requires very careful engagement with the technical teams who will be responsible for delivering the project. There is a real need to break down into components every step of the construction and testing/performance regime, critically assess each step, and hold point to ensure it has been considered and addressed.

In this way, even if the position is that the risk still ends up being allocated to the EPC Contractor, the potential issues will be highlighted to all parties and provision will be made to ameliorate them, whether through contractual mechanisms such as “change in law” clauses, or the involvement of third parties.

“Many traditional features of an EPC contract are under significant strain. This requires a critical assessment of whether the traditional allocation of risk remains relevant”



# Our decarbonisation disputes experts







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