LEXOLOGY

Through the Looking Glass - the Rise of ESG Risks: II Nivalion Legal Finance Summit Report

Nivalion AG

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On 26 and 27 September 2023, Nivalion hosted the second edition of the Nivalion Legal Finance Summit in Frankfurt, where business executives, in-house legal counsel, private practice lawyers, NGO representatives, litigation funders and insurers discussed ESG-related issues in connection with a plethora of aspects. The topics included climate litigation, collective redress, new technologies and how insurance and legal finance and other risk transfer solutions can mitigate associated risks. Anton Burri (Mannheim University), Johannes Nickl (Heidelberg University) and Lucas Macedo (Nivalion) report the highlights below.

Summit Lecture: Locusts in the Legal System - Is There a Need for Regulation of the Funding Industry?

Professor Dr Xandra Kramer (Erasmus University Rotterdam) and Thomas Kohlmeier (Nivalion) kicked the event off with the Summit Lecture, discussing the regulation of third-party funding (TPF) from academic and practitioner perspectives. Prof Kramer started by highlighting that the costs associated with litigation are still a key barrier to access to justice, especially in jurisdictions such as the UK, where those costs are notoriously high. Thomas Kohlmeier explained how TPF is an adequate solution for only a small fraction of cases and estimated that only a few hundred cases are funded annually in continental Europe.

Prof Kramerthen elaborated on collective redress, noting that the pro-funding WAMCA Regime introduced in the Netherlands did not lead to an increase in filed cases over the last three years. Therefore, she does not see any cause for concerns that the WMCA regime would promote a "claim culture" in the Netherlands. She further highlighted that only damage-related cases were supported by commercial third-party funders. While Prof Kramer contemplated that it might be premature to set up public funds for class actions, she indicated that such models may constitute viable solutions and that it might be worthwhile to exploremodelslike revolving legal aid funds. When addressing critical views on TPF, both speakers agreedthat any concerns that TPF could unduly increase litigation were unwarranted. In that vein, Thomas Kohlmeier emphasisedthat professional third-party funders have no economic or other interest in promoting frivolous claims but rather provide adequately priced risk transfer solutions to their customers.

The discussion then shifted to recent challenges in the TPF market, including cases like PACCAR in the UK, where the court found that the underlying funding agreement constituted an inadmissible damages-based agreement, and Airbus cases dismissed by Dutch courts, inter alia, due to the level of control that the involved third-party funder could exercise over the proceedings. Prof Kramer highlighted the varying regulatory landscape in Europe, from no or limited regulation to a full ban, with the European Directive on Representative Actions being a key framework. Thomas Kohlmeier countered proposals like the Voss Report and pointed out that professional funders are already subject to different regulatory requirements. He argued against creating new regulatory authorities, stating they would hinder market entry for new players and reduce competition, ultimately harming claimholders that seek funding to pursue their claims. He also argued that the emerging Litigation Funding industry is of no systemic relevance to the legal system due to the limited number of funded cases, so EU-wide regulation would be vastly disproportionate. The discussion concluded with both speakers agreeing that

TPF is still a developing industry in Europe and that the current regulations adequately address critical concerns and ensure consumer protection, especially in the collective redress space. They further pointed out that initiatives such as the ILFA's Resourcing the Rule of Law in Europe and the upcoming EU Commission study will help all relevant players better understand the TPF market and determine if further regulations may become necessary.

Keynote Debate: Climate Litigation - A Controversial Debate on Current Risks

The keynote debate was moderated by Kirstin Dodge (Nivalion)and offered two contrasting perspectives on the colossal task of finding efficient and effective ways to battle climate change and answering whether litigation could be one of them.Anja Ipp (Climate Change Counsel and self-proclaimed "tree-hugger") urged the audience to contribute to this fight and, considering the enormous and burning issue that is climate change, to reach for litigation as "the biggest fire extinguisher"available.

In a nod to the host of the Summit and its overall theme, Anja Ippproceeded to assess the four different types of climate litigation lawsuits, demonstrating that there can be an element of profit in this type of litigation: injunctive cases against governments (e.g., Urgenda v the Netherlands) or corporations (e.g., Milieudefensie v Shell), damages claims filed by NGOs against corporations (e.g., Lliuya v RWE), and claims of governments against corporations (e.g., State of California v. Exxon Mobil et al). While the first results mainly in "good karma" for lawyers and funders and might, therefore, be met with limited interest, especially of commercial litigation funders, the latter can represent a source of revenue, which, Anja Ipphopes, might encourage more of this type of litigation.

Her opponent on the podium, the "oil well-hugger" Leonardo Sempertegui (OPEC), cautioned that climate change and decarbonisation challenges require a different set of tools: surgical instruments rather than the sledgehammer of litigation. This is due to the complexity of containing climate change itself and the various other challenges intertwined with this task, like the rising need for energy required for the development of the "global south". Hence, he instead advocated for a systemic, fact-based and pragmatic approach, which also factored in the "global north's" obligations under the Paris Agreement and other international commitments.

While LeonardoSempertegui had to concede that climate litigation can indeed effect change, he also recalled that even successful climate litigation might not generate an outcome actually beneficial for the cause. He referred anecdotally to a case where an oil company was ordered by courts to reduce its CO2 emissions (such as the Milieudefensie v Shell decision) but thencomplied by divestingits CO2 emitting assets to other companies that may not be facing the same type of judicial constraint. On that point at least, Anja Ippagreed, citing, as another example, investor-state disputes challenging coal phase-out.

Panel I: Navigating the Rising Tide: Predictions, Preparations and Strategies for ESG Litigation

The first panel, moderated by Julia Grothaus (Linklaters), gave a glimpse into the approach to ESG risks companies face. Amanda Neil (HEAD) and Sarah Schlegel (DOUGLAS) first clarified that ESG is botha commercial risk and a legal risk, as stakeholders (especially consumers) increasingly expect businesses to act sustainably. Both also informed the audience about the challenge of being regulated indirectly via business partners affected by ESG regulation and the need to monitor all business partners along the supply chain. Anya George (Schellenberg Wittmer) reverted to the additional legal risks of ESG, manifesting differently around the globe: While in the EU, the biggest challengefor companies is thegrowing regulation and a host of well-organised and well-connected NGOs strategically that target suitable businesses, in South America it is mainly about blocking projects which are perceived as running counter to ESG values. Meanwhile, the U.S.is experiencing an "ESG backlash" where companies are attacked in the context of ESG-labelled efforts.

As to how businesses should prepare for ESG litigation, all panellists emphasised the importance of an organised and flexible legal department that works together with all stakeholders and the importance of robust risk mapping. Regarding the communication with stakeholders, Sarah Schlegel mentioned that businesses can profit from engaging with NGOs, citing the example of NGOs working to establish transparency along the supply chain for palm oil-based products. Amanda Neil added that the review of a contract, a burdensome yet vital exercise in managing ESG risks, is alleviated by the fact that, in this regard, virtually everyone along the supply chain is sitting in the same boat.

Lastly, the panellists looked into the crystal ball and predicted future developments: Amanda's mind was on the reality that the notion of "ESG" might continue to change and shift and it is not yet clear how the regulators will interpret, apply and enforce relevant legislation in all instances, so businesses will have to be alert and stay flexible so they can identify and respond to risks as quickly as possible. Sarah highlighted greenwashing as a development, especially with the Green Claims Directive on the horizon. She also noted a possible detrimental impact of this directive, as increased communication regulation with consumers might deter transparency. Anya George wrapped up the discussion by reference to her earlier remarks on different approaches vis-à-vis ESG globally: The competing agendas on the international level might increase the risk of businesses being caught up in between and having to choose which agenda to comply with.

Panel II: Power in Numbers: Exploring ESG Collective Redress — Players, Forces and Impact

Michelle Krekels (bureau Brandeis) led the second panel on an exciting ride through questions about ESG collective redress in Europe. Julia Suderow (Suderow Fernández Abogadas and Ius Omnibus) opened with the sobering assessment that most Member States have yet to implement the RAD, the quality and success of these implementations being uncertain.

Rainer Huber (KS/AUXILIA) and Philipp Eder (Allianz Rechtsschutz-Service) shared their experience as German providers of legal protection insurance, an industry still reeling from the considerable legal fallout of Dieselgate, which led to costs in excess of 1.5 billion Euro for the insurers to cover the costs of bringing 400,000 cases on behalf of consumers. They noted that adapting to this kind of mass individual claims will be challenging for the insurance industry. As to the drastic impact ESG collective redress litigation can have, Thomas Northoff (CLASSREACTION and Deloitte) cited the recent example of the Birmingham City Council, which was forced to declare bankruptcy following a judgment establishing equal pay for municipal employees. He also predicted a growing importance of the G-component of ESG (Governance) due to its catch-all function. On the topic of the players in ESG collective redress, Julia Suderow and Philipp Eder criticised that the interests of consumers were often neglected both in legislative procedures and litigation. Julia Suderow added that informing consumers about ongoing collective redress proceedings would be an important task of consumer organisations. Philipp Eder highlighted the vital role of insurers as enablers of collective proceedings, and Rainer Huber contemplated that the traditional role of legal protection insurers might change severely if, at some point, they were able to directly own or invest in law firms.

Lastly, the panel discussed alternatives to collective redress actions in the ESG space: Mediation and other ADR methods were obvious contenders. Thomas Northoff highlightedhow players such as Amazon and eBayalready solve large amounts of small disputes using their own ADRservices. Philipp Eder joined in pointing out the advantages of these instruments from an insurer's perspective, including the very limited expenditure on legal costs. In this regard, Rainer Huber underlined the growing importance of legal tech startups in Germany, noting that investing in such companies can be used by insurers to hedge the risks associated with their traditional business model. Following up on the promises of legal tech, Philipp Eder closed the panel by remarking that the legal system would have to adapt as well –the current systemis rooted in the 19thcentury,and he expects increasing stress in light of the technical possibilities the 21stcenturyholds.

Panel III: Innovative Solutions in Claims Handling: Exploring Tech Trends that Shape the Industry

The third panel, chaired by Ben Bornemann (CDC), dove deeper into legal tech solutions, a field with many promises and pitfalls. Katja Nikolaus (JUNE) argued that legal tech allows law firms to have a "bigger leverage with fewer people". AI-powered platforms, for example, enable firms to streamline workflows by offering immediate access to information andgenerating instantaneous reports on the status of pending matters and KPIs. Although technology simplifies the lives of lawyers in many ways, she reminded the audience that humans retain ultimate responsibility for the output.

While seconding the view that legal tech tools are necessary for modern law firms, Ingrid Van de Pol-Mensing (Uncover) noted that many lawyers seem "vaccinated against change".She said this reluctance to adopt new tools is understandable, given that legal professionals often work under time pressure with little room for learning new processes. Therefore, she noted that legal tech tools should be designed in a way that allows the tools to affect as much benefits as possible whilst changing the way of working as little as possible. She emphasised, however, that especially generative AI tools quickly boost productivity and that there will be no way around them for law firms.

Meike von Levetzow (Noerr) gave an insight into Noerr's new case management platform, which automatically extracts key data from documents and uses this data to generate basic first drafts of legal documents. She welcomeddigitalisation, as, in her experience, it gives lawyers the breathing room to focus more on the strategically important aspects of matters. In addition, whereas in the old days, the personal experience of senior lawyers was often the only basis on which to make a whole range of decisions, data collection and analysis tools increasingly allow decision-makers to benefit from additional insights.

Reporting from an in-house perspective, Amaury de Bruijn (Friesland Campina) shared an illustrative anecdote about how legal tech has improved workflows in the last years: Whereas group-wide claims reporting used to require sending out Excel sheets via email to various business units and then manually compiling those excel files, today all claims are recorded on a single platform. This reducesrepetitive tasks and allowsa real-time overview of a group's claims activity on a single dashboard. He stressed, however, that a user-friendly design is key and that it was important to consult all stakeholders on their needs before introducing a new tech tool.

Overall, the panel agreed that AI will not replace lawyers but allow them to focus more on their core activities. While uptake in private practice and corporate legal departments seems unstoppable, the panel agreed state courts and public agencies still have a lot of potential. Legal tech is here to stay; those who try to resist might risk becoming irrelevant.

Panel IV: Legal Finance — a Force for the Good? Trends and Developments in Funding ESG Claims

Led by Ana Carolina Salomão Queiroz (Pogust Goodhead), the discussions of panel four centred around litigation finance interactions with ESG litigation. In an inspiring story, Leif Bremark (PowerAware AB) shared how litigation finance helped save his company's business. Driven to address the issue of people wasting electricity by leaving appliances in stand-by mode, PowerAware developed and patented an innovative approach to saving energy: a cable that makes visible the electricity which runs through it, thereby increasing awareness of energy consumption. When the companyintended to market their cables, PowerAware had to discover that several other producers violated their patents and sold asimilar product without due licenses. PowerAware's shareholders were unwilling to invest in a patent lawsuit. Only with a third-party funder's support could a patent suit be financed and, as a result, license agreements struck with the patent infringers. PowerAware's story was a powerful example of how legal finance can contribute to resolving ESG issues in that it facilitates access to justice, particularly for innovative start-up companies, which will play a key role in the green transition.

Next, Dr Ekaterina Lohwasser (FTI Consulting) relayed her experience with damages assessment in ESG litigation. In her experience, choosing the right method for damage quantification is very much a matter of picking “horses for courses” and adapting to the specific need. Although ESG cases pose some special problems, she believesthere is no need to reinvent the wheel for every case. For example, in many greenwashing cases, similar methods can be used to demonstrate share drop patterns. Ekaterina Lohwasser pointed out that standardisation for ESG reporting will make it significantly easier to assess damages in greenwashing cases, which is likely to spur the interest of legal finance providers in such cases, given that a clear view of damages is a key requirement for funding.

Given the increasing moralisation of individual and corporate behaviour, Daria Gladkov (CONSILIUM Rechtskommunikation) pointed out that, whether litigation is funded or not, litigation PR can play a crucial role, especially in the ESG context. In light of the potential media attention, companies should prepare for appropriate public communication. She emphasised that the communication strategy should be closely coordinated with the legal strategy and that collaboration between lawyers and PR advisors from the outset is key.

Sharing his perspective on investigative litigation support, Tobias Vollmer (Raedas) noted that finding the right evidence can often be difficult, especially in greenwashing claims related to long and complex supply chains. Similarly, special investigative efforts may be necessary to ensure compliance with international sanctions. He pointed out that information is power and warned against the risk of information being weaponised and abused for smear campaigns, again highlighting the need to combine legal with adequate PR advice.

The discussion showed that ESG presents a multifaceted and dynamic landscape. The heightened media attention, adapted methods of quantifying damages, access to evidence, and availability of litigation funding combined means the conditions for a perfect ESG litigation storm are forming. Thus, the topic should be high on the corporate agenda.

Panel V: ESG Claims and Beyond Exploring Strategies for Effective Risk Transfer

The conference concluded with a discussion on risk transfer solutions, moderated by Malcolm Hitching (Macfarlanes).Introducing the audience to the conceptual foundation of different insurance solutions, Linn Dolp (HDI Global Specialty) first clarified thatfrom the insurers perspective “unknown” and “known” risks need to be differentiated. A commoninsurance solution always insures risks against unknown future events, e.g., a property insurance insuring a building against an unknown event such as a fire or a BTE Legal Expenses Insurance, where companies and individuals may insure themselves against unknown legal disputes in selected areas of law. The situation is completely different in Legal Finance, where insurability is provided only for known risks, e.g., ongoing legal disputes or known breaches of duties that can result in legal disputes.In this segment, insurers need to comprehend the risks they are underwriting to set premiums and balance their portfolios. Consequently, due diligence becomes a crucial aspect of an insurance transaction, which can sometimes be time-consuming. However, she pointed out that the due diligence process can be significantly expedited if a reputable third-party funder has already vetted a case. She further underscored the importance of maintaining neutrality and objectivity when assessing the risks and potentials of a case. This can be challenging, particularly in ESG cases that have the potential to serve the greater public good. Although insurers are not in the business of philanthropy, they may neverthelesschoose to offer more socially sustainable premiums for matters of public interest.

Building on these thoughts, Robin Ganguly (AON) gave an insight into the plethora of litigation-related insurance solutions. He outlined that cost protection insurance covers the expenses of enforcing or defending a legal claim, while damages protection insurance covers potential liability for the insured party. He further introduced the concept of judgmentpreservation insurance or “JPI”. This type of insurance covers the risk of a successful first-instance judgment being overturned on appeal and can thus be employed either by a claimholder

or a funder to protect its return on investment. The insured judgment policy can then serve as a basis for the claimant to raise capital against, essentially acting as a security. The combination of these instruments allows funders to provide liquidity injections, while insurers, who have access to cheaper capital, can bear the risks inherent in litigation, leading to overall highly attractive solutions for clients.

Finally, Maximilian Herberger (Schuberth Helmets) shared his perspective on litigation-risk transfer as CFO of a medium-sized Germancompany. For him, legal finance tools are valuable because they allowthe smootheningof litigation-related cash flows and help de-risk the company for an exit, which is especially relevant for portfolio companies of private equity funds. Legal finance and insurance can take risks off the balance sheet and help avoid negativeimpacts. For him, as CFO, it is key that an insurance advisor hasa good know-how of the various risk-transfer solutions on the market and a clear understanding of the concerned company's risks. He noted that protection against cyber risks is currently top of mind, but ESG risks will likely move to centre stage as increased ESG accounting helps identifypreviously unknown risks.

The panel concluded that while not all risks can be insured, many litigation-related risks can. As a result, collaboration between insurance companies and legal finance providers is already happening and will be a defining trend in the industry's future.

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