

# Recent SEC Complaint Signals Increased Enforcement Risk for Companies on ESG Disclosures

## WRITTEN BY

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A complaint recently filed by the SEC against Vale S.A., a Brazilian mining company with U.S.-traded American Depositary Receipts (ADRs), signals an increased risk of enforcement actions targeting misrepresentations and omissions in companies' environmental, social, and governance (ESG) disclosures and is indicative of the commission's heightened review of ESG disclosures. On April 28, the SEC's Climate and ESG Task Force in the Division of Enforcement filed a civil action, alleging Vale materially misled investors in the years preceding the January 2019 collapse of the Brumadinho dam.<sup>[1]</sup> The complaint alleges Vale misled investors by intentionally concealing risks that the tailings dam — used to store waste from the Vale's iron ore mining operations — would collapse. The complaint represents the SEC's increased enforcement focus on companies' ESG disclosures. This aligns with its recently announced creation of the Climate and ESG Task Force to address the "increasing investor focus and reliance on climate and ESG-related disclosure and investment," necessitating development of new initiatives to identify and prosecute ESG-related misconduct.<sup>[2]</sup> The Climate and ESG Task Force's filing of the complaint against Vale is the latest manifestation of this new initiative.

On January 25, 2019, the Brumadinho dam at Vale's Córrego do Feijão mine in Minas Gerais, Brazil collapsed, killing 270 people and releasing nearly 12 million cubic tons of toxic mining waste. According to the complaint, the release of the tailings "poison[ed] the Paraopeba River and its tributaries" and "caus[ed] immeasurable environmental, social, and economic devastation" in "one of the worst mining disasters in history."<sup>[3]</sup> Following the collapse, Vale's market capitalization declined by more than \$4 billion, the company's credit rating was downgraded to junk status, and Vale's ADRs lost more than 25% of its value on the New York Stock Exchange.<sup>[4]</sup>

The complaint alleges that Vale had known since 2003 that the Brumadinho dam had an increased risk of collapse through a process known as liquefaction.<sup>[5]</sup> Following the earlier collapse of the Mariana dam in 2015, another tailings dam owned by Vale, the company retained experts to evaluate the strength of the Brumadinho dam. These experts allegedly found that the dam "presented [a] significant liquefaction failure risk," but according to the complaint, Vale "engaged in a pattern of deceptive acts" designed to skirt Brazilian mine safety regulations and repeatedly reassured investors that Vale's facilities, including the Brumadinho dam, were operating within the applicable regulations and posed no heightened risk for collapse.<sup>[6]</sup>

In securities filings dating back to April 10, 2017 and continuing through the collapse, Vale touted the results of the allegedly corrupted audits to reassure investors about any risk posed by the dam.<sup>[7]</sup> Following the collapse, the complaint alleges Vale continued to make false statements that the dam was operating within acceptable standards and had been certified by external auditors, stating "the dam had a Safety Factor in accordance with the world's best practices and above the reference of the Brazilian Standard."<sup>[8]</sup> But when making these

statements, the complaint alleges Vale's leadership team knew or should have known that the inspections were not reliable and had been corrupted.<sup>[9]</sup> The complaint goes on to allege that these false statements about the safety of Vale's Brazilian tailings dams and specifically the Brumadinho dam were material to investors, demonstrated by the significant decline in market capitalization and ADR value, as well as the downgrading of the company's credit rating following the collapse.<sup>[10]</sup> The complaint charges Vale with violations of Sections 10(b), 13(a), and 17(a) of the Exchange Act, all relating to Vale's alleged misrepresentations of the safety and stability of the Brumadinho dam.<sup>[11]</sup> In a press release accompanying the complaint, the SEC stated that "Vale compounded the social and environmental harm caused by the Brumadinho dam's tragic collapse and undermined investors' ability to evaluate the risks posed by Vale's securities."<sup>[12]</sup>

The complaint draws a direct link between Vale's disclosures relating to the environmental risks posed by the Brumadinho dam and investors' decisions to purchase Vale's U.S.-traded ADRs. The complaint is indicative of the SEC's increased enforcement focus on ESG disclosures and recognizes that investors rely on companies' ESG disclosures when deciding to invest. In the past, ESG disclosures and audits may have been thought of as noneconomic, designed to reassure investors that a given company aligns with their social or moral views. But the complaint against Vale takes this line of reasoning a step further, suggesting that the contents of ESG disclosures can materially induce investors to purchase a company's securities — and, therefore, material misstatements in ESG disclosures are actionable under the antifraud provisions of the federal securities laws. The complaint against Vale is in line with previous SEC statements, indicating an increased focus on ESG matters and in particular, ensuring the accuracy of companies' ESG-related statements.<sup>[13]</sup> The enforcement action against Vale demonstrates that the SEC views misstatements in ESG disclosures in the same way as misstatements about corporate performance — in other words, ESG disclosures are not merely marketing tools used to reassure investors about noneconomic concerns, but rather these disclosures are material to investors' decisions to invest and the performance of a company as a whole. The SEC's repeated mention of the market costs associated with the Brumadinho dam collapse creates a clear link between environmental concerns and economic performance.

Companies making ESG disclosures should take efforts to ensure ESG disclosures are scrutinized and vetted to the same degree as any other statements to investors and should recognize that ESG-related risks can have a significant economic impact on performance and share price. The SEC's prior statements on ESG matters and the recent complaint against Vale demonstrate that the SEC views ESG statements as more than just statements to reassure investors' sensibilities about noneconomic issues, but rather as significant factors affecting the market performance of a company. Companies making ESG disclosures, especially those operating in industries with high environmental or social risks, should take care to ensure risks are disclosed adequately and truthfully in communications to investors and public filings.

The complaint was not filed as a settled matter, and at the time of publication, Vale has not responded to the allegations in the complaint.

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<sup>[1]</sup> Complaint, *Securities and Exchange Commission v. Vale S.A.*, Civil Action No. 22-cv-2405 (E.D.N.Y. Apr. 28, 2022), ECF No. 1.

[2] See SEC Announces Enforcement Task Force Focused on Climate and ESG Issues, Press Release No. 2021-42 (Mar. 4, 2021), *available at* <https://www.sec.gov/news/press-release/2021-42>; see also ESG Risk Alert (April 9, 2021), *available at* <https://www.sec.gov/files/esg-risk-alert.pdf>.

[3] Complaint, *supra* note 1, at 2.

[4] *Id.*

[5] *Id.* at 5.

[6] *Id.*

[7] *Id.* at 57-64.

[8] *Id.* at 64-65.

[9] *Id.*

[10] *Id.* at 70.

[11] *Id.* at 71-74.

[12] SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse, Release No. 2022-72 (Apr. 28, 2022), *available at* <https://www.sec.gov/news/press-release/2022-72>.

[13] See *supra* note 2.

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