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Lawyer Insights

Legal Considerations For Circular Economy Strategies

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Over the past several years, circular economy goals have become nearly ubiquitous in corporate sustainability strategies.

This trend is driven by a number of factors, including consumer interest in sustainable products, opportunities for generating circular revenue — i.e., generating revenue at multiple points in a product's life cycle, such as through product collection and refurbishing — and the presence of circular economy metrics in commonly used voluntary sustainability standards, such as those issued by the Global Reporting Initiative and Sustainability Accounting Standards Board.

Recent legal and policy developments in multiple markets may counsel in favor of reassessing existing corporate strategies related to the circular economy.

To maximize the value of existing efforts, companies should consider three categories of legal developments when setting or reassessing circular economy goals: government incentives, regulations, and reporting and disclosure requirements.

The U.S. Environmental Protection Agency describes a "circular economy" as

> a change to the model in which resources are mined, made into products, and then become waste. A circular economy reduces material use, redesigns materials, products and services to be less resource intensive, and recaptures "waste" as a resource to manufacture new materials and products.

Environmental benefits include waste and pollution reduction, as well as reduced greenhouse gas emissions. In addition, circular economy efforts can help promote supply chain security by reducing reliance on imports.

In recognition of these benefits, governments in many jurisdictions have started to develop new legal frameworks to promote circular economy efforts.

In 2020, the European Union adopted a circular economy action plan. The EU continues to develop new regulatory and policy actions in support of the plan.

In 2022, the U.S. passed the Inflation Reduction Act, the CHIPS and Science Act, and the Bipartisan Infrastructure Law, all of which contain provisions targeted at promoting circularity and recycling.

A number of U.S. states have adopted or are considering laws that require producers to increase use of post-consumer content, or take responsibility for end-of-life products or packaging.

Incentives

Companies that sell certain types of products — especially products related to renewable energy infrastructure, such as batteries or solar panels — have increasing access to economic incentives targeted at creating a domestic circular supply chain.

For example, in the Inflation Reduction Act of 2022, Congress amended the definition of "new clean vehicle" to allow for electric vehicle battery materials recycled in North America, regardless of their origin, to qualify for the U.S. clean vehicle tax credit. This incentivizes companies to establish domestic recycling facilities by creating consumer demand for domestically recycled EV batteries.

Understanding available economic incentives and the criteria for obtaining them is now a critical step in making decisions about product design and sourcing.

Regulations

New regulations targeted at achieving circular economy goals address both product design and end-of-life management.

In the packaging context, several jurisdictions have begun to impose legal requirements for source reduction or recycled content that will help shape these efforts going forward.

Notably, several states have passed laws mandating certain levels of post-consumer content in packaging products, and administrative rulemaking to further define requirements.

Increasingly, producers will also need to take responsibility for products at the end of their life after they have been in the hands of consumers.

Several states have passed or proposed extended producer responsibility, or EPR, legislation for single-use packaging, often in combination with recycled content requirements. These programs have broad applicability and may affect companies that sell products in many different industries.

As in the incentive space, U.S. EPR programs have also targeted renewable energy technologies, including solar panels, wind turbines and batteries.

Washington is leading the nation with the photovoltaic module stewardship and take-back program, an EPR program for solar panels, and also recently passed legislation to study the feasibility of wind turbine blade reuse and recycling.

Washington, California and the District of Columbia have also established EPR programs for small primary or portable batteries — i.e., common household batteries — and New Jersey is the first state to pass legislation that creates an EPR program for end-of-life management of electric and hybrid vehicle batteries.

Reporting and Disclosure Requirements

A third type of legal development that companies will increasingly need to consider when developing strategies related to the circular economy is reporting and disclosure requirements.

These laws are aimed at standardizing how companies report on their sustainability efforts.

Depending on whom a company's stakeholders are and how they are expected to react to new reporting, companies may need to consider whether any operational changes are needed in areas where disclosures are required.

As noted above, many companies have already been reporting on circular economy efforts under voluntary reporting standards. Now, the shift to mandatory reporting has begun.

In July 2023, the European Commission, acting in accordance with the EU's Corporate Sustainability Reporting Directive, adopted a sustainability reporting standard on resource use and circular economy known as ESRS E5.

Companies subject to ESRS E5 will need to report on company policies, goals and actions related to circular economy efforts, such as use of recycled resources, transition away from virgin materials and sustainable sourcing.

Litigation Risk

So far, there has not been a push toward mandatory reporting for circular economy efforts in the U.S.

Companies operating in the U.S., however, need to be careful about how they publicize their efforts.

The Federal Trade Commission is currently revising its guides for the use of environmental marketing claims — also known as the Green Guides — and, during the rulemaking process, sought public comment on updating its guidance regarding "recycled content" claims.

In addition, there is a growing body of cases challenging the credibility of companies' sustainability targets.

In two recent cases, plaintiffs have challenged corporate targets for recyclable packaging and post-consumer content under state consumer protection laws, arguing that the goals themselves are misleading because they either have not been, or cannot be, met.

In one case — New York v. PepsiCo Inc. in the New York Supreme Court in November 2023 — the state of New York alleged PepsiCo missed successive targets to reduce virgin plastic in plastic bottles, thus giving "a misleading impression that the company is making meaningful progress toward combatting the problem of plastic pollution."[1]

In another case — Earth Island Institute v. The Coca-Cola Co in the D.C. Court of Appeals in November 2023 — nongovernmental organization Earth Island Institute argued that because Coca-Cola had "failed to meet certain environmental goals it he past, it should not be allowed to set any for the future."[2]

Although there has not yet been a ruling in the first case and, in the second case, Coca-Cola prevailed on a motion to dismiss, these cases nevertheless demonstrate increasing litigation risk as plaintiffs scrutinize companies' progress toward meeting their circular economy goals.

Companies should accordingly be precise about setting targets, transparent in describing specific actions being taken to reach their targets, and proactive about acknowledging challenges before a target is missed.

A company that finds itself unable to reach a circular economy target should not silently pivot away from the target, but should instead prioritize transparency.

In explaining that a target cannot be reached, a company should explain any informational deficiencies that existed when the goal was set and how it is addressing those deficiencies to ensure it can set well-informed and meaningful goals upon which stakeholders can rely going forward.

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