Legal and Regulatory Considerations

Alan S. Gutterman

Sustainability reporting refers to the preparation and dissemination of disclosures pertaining to “nonfinancial information”, which has been described by Park as including information relating to climate change, water quality and quantity, ethical business practices, cybersecurity and supply chain management, as well as narrative discussions of what the company considers to be the material environmental, social and governance risks to its business and how the company is managing those risks.1 Park described the background for the views of the Securities and Exchange Commission (“SEC”) on whether nonfinancial information was material to a reasonable investor and thus required to be disclosed because it would be important to the investor’s investment decisions. Park noted that during the late 1960s and early 1970s shareholders and other organizations were beginning to ask companies to disclose more information on social, environmental and civil rights performance as well as product safety and design issues. In 1971, the National Resources Defense Council asked the SEC to expand civil rights and environmental disclosure under the federal securities law in a rule-making petition; however, after almost a decade of investigations and public hearings the SEC declined to make the requested changes based on its conclusion that they were not needed because only a small fraction of investors considered social and environmental information to be important. The SEC was also reluctant to move away from its long-standing economic understanding of materiality and to require disclosures solely for the goal of changing corporate behavior.2

Park went on to point out that the level of investor interest in nonfinancial information had dramatically increased since the SEC’s market study of the 1970s. Among the reasons that Park cited for this transformation were the growth of sustainable, responsible and impact investing; changing attitudes of investors, analysts and portfolio managers, a large majority of which had come to believe that nonfinancial information was pivotal in their investment decision-making; significant dissatisfaction among investors with the quantity and quality of disclosures of social and environmental information3; and the greater presence of long-term oriented institutional investors as owners of the largest public companies in the US and the growing commitment of those investors to

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2 Id.
3 According to a 2014 survey conducted by PwC and cited by Park, the areas of greatest dissatisfaction among investors with respect to disclosures by US companies included comparability of sustainability reporting between companies in the same industry; relevance and implications of sustainability risks; sustainability strategy that is linked to business strategy; internal governance of sustainability issues; the process used to identify material sustainability issues. Id. (citing PwC, Sustainability Goes Mainstream: Insights into Investor Views (May 2014)).
incorporating sustainable, responsible and impact principles into their investment analysis and decisions regarding allocation of capital.\footnote{According to Eccles and Rogers, investors were incorporating environmental, social and governance information into their fundamental equity analysis in several ways: economic analysis: to understand industry trends and externalities likely to affect the economic outlook and, therefore, value creation and capital formation; industry analysis: to understand factors driving competitiveness and the potential for sustained value creation in an industry, as well as externalities from an industry likely to affect other industries (and therefore portfolio risks); company strategy: to understand management quality and corporate strategy, and evaluate a company’s ability to respond to emerging trends; and valuation: to adjust traditional valuation parameters and assumptions, including cash flow and weighted average cost of capital, to reflect performance on material sustainability issues. R. Eccles and J. Rogers, The SEC and Capital Markets in the 21st Century: Evolving Accounting Infrastructure for Today’s World (Washington, DC: Governance Studies at Brookings, September 2014), 5 (as cited in D. Park, “Investor Interest in Nonfinancial Information: What Lawyers Need to Know”, Business Law Today (January 2015)).}

Cleveland et al. noted that when companies get started with sustainability reporting they have a number of basic questions: “What are we legally required to communicate?” “What are we permitted to communicate?” What can or should we say to stay competitive and protect business relationships, profitability and our social license to operate?” What standards should we use?\footnote{N. Cleveland, D. Lynn and S. Pike, “Sustainability Reporting: The Lawyer’s Response”, Business Law Today (January 2015).} They pointed out that many companies start down the path of sustainability reporting primarily as a marketing strategy, hoping to address the questions from customers and demonstrate social responsibility and philanthropy as part of an effort to build reputation. However, as the information is made available companies must be prepared to defend it by responding to demands for verification and “ratings” released by organizations that often do not seek input from the companies that they evaluate. At the same time investors are likely to have questions regarding the matters covered in sustainability reports and companies can expect that they will soon be asked to expand their reporting beyond their own activities to include their supply chains. Very quickly what may have begun as a project in the marketing department expands into a multi-disciplinary initiative that will require support from across the organization and development of a comprehensive communications program with all of the company’s stakeholders to ensure that the sustainability reporting is adequately addressing all of their reasonable needs and expectations.

Williams noted that to the extent that governments have regulated corporate responsibility \textit{per se}, such regulation has focused on disclosure and during the period 2000-2015 over 20 countries enacted legislation to require public companies to issue reports including environmental and/or social information.\footnote{C. Williams, “Corporate Social Responsibility and Corporate Governance” in J. Gordon and G. Ringe (Eds.), Oxford Handbook of Corporate Law and Governance (Oxford: Oxford University Press, 2016), 15, available at http://digitalcommons.osgoode.yorku.ca/scholarly_works/1784 (citing Initiative for Responsible Investment, Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges (March 12, 2015), available at http://hausercenter.org/iri/wpcontent/uploads/2011/08/CR-3-12-15.pdf). These countries included Argentina, China, Denmark, the EU, Ecuador, Finland, France, Germany, Greece, Hungary, India, Indonesia, Ireland (specific to state-supported financial institutions after the 2008 financial crisis), Italy, Japan, Malaysia, The Netherlands, Norway, South Africa, Spain, Sweden, Taiwan, and the UK.} Many of these countries are
in Europe and the EU has implemented a directive that requires nearly 7,000 large companies and “public interest organizations,” such as banks and insurance companies, to “prepare a nonfinancial statement containing information relating to at least environmental matters, social and employee-related matters including diversity, respect for human rights, anti-corruption and bribery matters.”\(^7\) When preparing their reports, companies are expected to describe their business model and the outcomes and risks of their policies. Larger companies are also required to include and evaluate information on their supply chains, which means that smaller companies that act as suppliers to the reporting companies will need to expand their own data collection and information reporting activities even though they are not directly subject to the public reporting requirements. In addition, several stock exchanges around the world require social and/or environmental disclosure as part of their listing requirements including exchanges in Australia, Brazil, Canada, India, Singapore, South Africa and the London Stock Exchange.\(^8\) Also, pension funds in countries such as Australia, Belgium, Canada, France, Germany, Italy, Japan, Sweden and the UK are required to disclose the extent to which the fund incorporates social and environmental information into their investment decisions.\(^9\) All things considered, surveys show that more and more jurisdictions are implementing mandatory ESG disclosure requirements and that “there is a clear trend towards an increasing number of environmental and social disclosure requirements around the world”.\(^10\)


\(^8\) C. Williams, “Corporate Social Responsibility and Corporate Governance” in J. Gordon and G. Ringe (Eds.), Oxford Handbook of Corporate Law and Governance (Oxford: Oxford University Press, 2016), 16, available at http://digitalcommons.osgoode.yorku.ca/scholarly_works/1784 (citing Initiative for Responsible Investment, Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges (March 12, 2015), available at http://hausercenter.org/iri/wpcontent/uploads/2011/08/CR-3-12-15.pdf). The listing rules for the Singapore Exchange, for example, require every listed company to prepare an annual sustainability report on its sustainability practices on a “comply or explain” basis with reference to five primary components: material ESG factors; policies, practices and performance; targets; sustainability reporting framework; and board statement. The listing rules also provide that the board is collectively responsible for the long-term success of the issuer and in exercising such responsibility the board has duties to provide strategic direction and specifically consider sustainability issues as part of its strategic formulation and to determine the environmental, social and governance factors that are material to the business and see to it that they are monitored, managed and reported upon. “SGX Sustainability Reporting Guide” in Sustainability Guide for Boards: At a Glance (Singapore Institute of Directors, KPMG and SGX, September 2017).


\(^10\) Id. at 19 (citing KPMG, UNEP, Global Reporting Initiative and Unit for Corporate Governance in Africa, Carrots and Sticks: sustainability reporting policies worldwide 8 (2013), available at https://www.globalreporting.org/resourcecenter/carrots-and-sticks.pdf.). A powerful and useful resource for monitoring actions regarding sustainability reporting among stock exchanges around the world is the United Nations’ Sustainable Stock Exchanges (“SSE”) initiative (http://www.sseinitiative.org/), which is a peer-to-peer learning platform for exploring how exchanges, in collaboration with investors, regulators, and
The US, which has comprehensive reporting requirements relating to a broad range of corporate governance matters, has been a notable laggard with respect to establishing a comprehensive general environmental, social and governance (“ESG”) disclosure framework. However, while ESG- and CSR-related reporting is not yet specifically required for companies with shares listed on US exchanges, by 2013 more than half of the companies in the S&P 500 had voluntarily decided to report and disclose ESG and CSR information and so-called sustainability reporting is well on its way to becoming an expected standard practice that must be added to oversight agenda of the entire board and the disclosure and reporting committee. Board members will need to not only understand emerging voluntary reporting standards, such as those developed by the Global Reporting Initiative (“GRI”), but must also monitor developments in other jurisdictions such as those mentioned above where regulators have been much quicker to implement formal requirements relating to ESG and CSR reporting that may ultimately become the foundation for expanded regulations in the US.

In the US the federal Securities and Exchange Commission (“SEC”) has struggled in its attempts to prescribe requirements for reporting on sustainability-matters in filings that must be made by public companies. For example, with respect to climate change the SEC promulgated Release No. 33-9106, Commission Guidance Regarding Disclosure Related to Climate Change (February 2, 2010), which suggested that climate change disclosures might be provided in responses to certain disclosure items in Regulation S-K such as Description of Business (Item 101 of Regulation S-K), Legal Proceedings (Item 103 of Regulation S-K), Risk Factors (Item 503(c) of Regulation S-K), and companies, can enhance corporate transparency–and ultimately performance–on ESG (environmental, social and corporate governance) issues and encourage sustainable investment. Among other things, the SSE has compiled a summary table of the sustainability reporting measures in place within G20 Members and by board members of the International Organization of Securities Commissions. Areas evaluated include the source of sustainability reporting initiatives, the scope of the reporting application, the scope of the subject matter, and the disclosure model.

11 Libit and Freier reported a dramatic increase in CSR-related reporting among S&P 500 companies from 2010, when approximately 20% of the companies provided such reporting, to 2012 when 53% of the companies reported on their CSR activities. B. Libit and T. Freier, The Corporate Social Responsibility Report and Effective Stakeholder Engagement (Chapman and Cutler LLP, 2013), available at https://corpgov.law.harvard.edu/2013/12/28/the-corporate-social-responsibility-report-and-effective-stakeholder-engagement/ (citing 2012 Corporate ESG/Sustainability/Responsibility Reporting: Does It Matter? Analysis of S&P 500 Companies’ ESG Reporting Trends & Capital Markets Response, and Possible Association with Desired Rankings & Ratings, Governance & Accountability Institute, Inc. (2012)). The KPMG Survey of Corporate Responsibility Reporting 2013 surveyed an even bigger group consisting of over 4,100 companies and found that 71% of them were reporting on CSR. KMPG also reported that among the world’s largest 250 companies, the reporting rate was 93%. Interestingly, however, only 5% of the companies were reporting on how environmental and social risks could impact their financial results and only 10% reported on linkages between CSR and executive compensation. As cited in H. Gregory, Corporate Social Responsibility, practicallaw.com (April 2014).

12 As a practical matter, it may not matter whether US regulators actually mandate a specific CSR-related disclosure because if non-US companies are providing such disclosures due to regulations in their home jurisdictions global institutional investors, who are comparing opportunities across borders, will effectively demand comparable disclosures by US companies seeking their capital.
Management’s Discussion and Analysis of Financial Condition and Results of Operations (Item 303 of Regulation S-K). The Release called on companies to consider disclosures on the following matters relating to climate change: the impact of legislation and regulation regarding climate change, including the potential impact of pending legislation; when material, the impact on their business of treaties or international accords relating to climate change; whether legal, technological, political, and scientific developments regarding climate change will create new opportunities or risks, including reputational risks; and the actual and potential material impacts of the physical effects of climate change on their business, such as the effects of severe weather, sea levels, arability of farmland, and water availability and quality.\(^\text{13}\)

Other sustainability-related areas in which the Congress, the SEC and state lawmakers have required disclosures include the sourcing of certain “conflict minerals”; payments to governments by resource extraction issuers; business with certain governments, persons, and entities subject to specific US trade sanctions; releases into the environment; management through recycling; median employee pay; and mine safety disclosure.\(^\text{14}\) Directors need to be involved in decisions regarding placement of CSR and corporate sustainability disclosures including links in SEC filings to online sustainability reports and adding sustainability information to proxy statements as part of the company’s investor-focused communication efforts. Companies can, and often do, rely on communications professionals to prepare sustainability reports; however, even when such reports are not included in the company’s SEC filings they should be subject to the same level of scrutiny applied in procedures established by the board’s disclosure committee.

Cleveland et al. reported on several ratings systems and screen tools that investors regularly consult to assess how companies manage their environmental and social impacts including the Bloomberg ESG Valuation Tool and its ESG Score; MSCI’s ESG Impact Monitor; the FTSE4Good Index; GS SUSTAIN and CDP reporting framework, all of which rely heavily on the nonfinancial information that companies provide in their mandatory and voluntary reporting.\(^\text{15}\) Companies can expect to see an increase in legally mandated sustainability reporting as stakeholders continue to pressure lawmakers and regulators to improve the quality and consistency of reporting on sustainability-related issues beyond what companies have been providing on a voluntary basis. It will become easier for governmental decision makers to accede to these pressures as consensus emerges on appropriate reporting standards, since these can be integrated into any new legal requirements.\(^\text{16}\)


\(^{16}\) For background on the debate in the US regarding the appropriate amount and format of sustainability-related disclosures in SEC filings, see the letter from the Business Law Section of the American Bar Association to the SEC, available at http://www.businesslaw.org/.

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Proposals from shareholder activists often help create the list of CSR and corporate sustainability topics that garner the most attention from companies and trigger movement toward greater transparency and disclosure. In recent years, companies have frequently been required to respond to call for changes in corporate policies and activities with respect to political and lobbying activity, sustainability reporting, gender pay gap reporting, and child labor issues. In many cases, companies have been able to calm the concerns of activists, sometimes getting them to withdraw their proposals, by promising to provide fuller disclosure; however, once a commitment is made to expanded disclosure the company needs to fulfill its promises and allocate sufficient resources to the effort since activists will be watching closely to ensure that their expectations are satisfied. When formulating voluntary CSR-related disclosures it is important to engage with activists to ensure that they understand the approach that the company is willing to take and the company’s need to balance disclosure against the need to protect sensitive and strategically important information.

A large number of parties providing comments to the SEC on its April 2016 concept release on disclosure required by Regulation S-K, the prescribed regulation under the Securities Act of 1933 that provides the framework for mandated disclosures in filings with the SEC, recommended that CSR disclosure be expanded and strengthened. While it is not likely that more CSR-related disclosures will be formally mandated in the immediate future, companies must nonetheless give greater consideration to CSR and corporate sustainability when responding to several current items in Regulation S-K include those related to describing the business activities of the company (Item 101); legal proceedings (Item 103); disclosures of material known events and uncertainties in the Management’s Discussion and Analysis (Item 303) and risk factors (Item 503(c)). Public companies must also be mindful of the SEC’s guidance regarding disclosures relating to climate change, which was issued in 2010, and Rule 13p-1 under the Securities Exchange Act of 1934 relating to conflicts materials disclosure.

In addition, companies may be subject to disclosure requirements under the laws of various provincial, state and local laws in the countries in which they operate. For example, under the California Transparency Supply Chains Act of 2010, which went into effect on January 1, 2012, every retail seller and manufacturer doing business in California and having annual worldwide gross receipts that exceed $100 million is required to disclose its efforts to eradicate slavery and human trafficking from its direct

Association to the SEC dated December 15, 2017 regarding Business and Financial Disclosure Required by Regulation S-K Release No. 33-10064; 34-77599; File No. S7-06-16) (generally endorsing the SEC’s traditional “principles-based approach” to reporting requirements for its flexibility, but acknowledging that there may be circumstances where the SEC should prescribe ESG disclosures that integrate both principles-based and prescriptive disclosure elements).

17 H. Gregory, “Corporate Social Responsibility, Corporate Sustainability and the Role of the Board”, Practical Law Company (July 1, 2017), 4.
20 California Civil Code § 1714.43.
supply chain for tangible goods offered for sale. The disclosures must be posted on the retail seller's or manufacturer's website with a conspicuous and easily understood link to the required information placed on the business' homepage. In the event the retail seller or manufacturer does not have a website, consumers must be provided the written disclosure within 30 days of receiving a written request for the disclosure from a consumer. At a minimum, the disclosures should disclose to what extent, if any, that the retail seller or manufacturer does each of the following:

- Engages in verification of product supply chains to evaluate and address risks of human trafficking and slavery. The disclosure must specify if the verification was not conducted by a third party.
- Conducts audits of suppliers to evaluate supplier compliance with company standards for trafficking and slavery in supply chains. The disclosure must specify if the verification was not an independent, unannounced audit.
- Requires direct suppliers to certify that materials incorporated into the product comply with the laws regarding slavery and human trafficking of the country or countries in which they are doing business.
- Maintains internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking.
- Provides company employees and management, who have direct responsibility for supply chain management, training on human trafficking and slavery, particularly with respect to mitigating risks within the supply chains of products.

The exclusive remedy for a violation of the disclosure obligations is an action brought by the California Attorney General for injunctive relief.
About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, Business Transactions Solution, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 90 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan is currently a partner of GCA Law Partners LLP in Mountain View CA (www.gcalaw.com) and has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, and the services he provides through GCA Law Partners LLP, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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