

THE EU CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

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Why Disclosure?

The Non-financial Reporting Directive (NFRD) n. 2014/95/EU has been the first European source of legislation providing for disclosure on a company's policy on consideration of sustainability factors (so called E.S.G.), including diversity. Companies and directors are not obliged to pursue sustainability policies but just to disclose the choice and if no consideration is given to these factors to justify the reasons why.

Disclosure on these factors was required because, as resulting from the preparatory Resolutions by the European Parliament, omitting to consider them may cause a negative impact in the long term management of the company (i.e. by litigation, accidents, climate physical and transition risks etc.): European legislation wanted to prevent financial risks for companies and foster consideration of E.S.G. factors. While the Impact Assessment highlights that, by contrast, considering these factors makes companies more competitive and efficient, improves reputation etc.

Risks may be avoided and opportunities may arise by considering these factors. Later on, with European legislation specifically delivered on banks and financial intermediaries, it has become even more evident that entities that do not consider ESG factors may have problems even in being funded by banks, venture capital, institutional investors, etc.

Is Disclosure Enough ?

The European Commission had originally adopted in NFRD a mild approach: no imposition of stakeholders' consideration but information to the market for most important companies (exceeding 500 employees and, in any case, banks and insurance companies); no standardised information (from the Impact Assessment this was believed to be too burdensome) but flexibility to companies.

Disclosure however had consequences in the management of companies and since 2015/2016 most European companies have really started to consider sustainability factors in setting their strategy despite it was not an obligation.

CSRD n. 2464/2022: What Changes?

- Expansion of addressee companies: all large undertakings (> 250 employees), banks and insurance companies; all listed companies on any regulated market, but for micro undertakings (10 employees) from 11.600 to 49.000 entities (!);
- **Duty to disclose policies: no justification for lack of disclosure;**
- Change of name = Sustainability Reporting (# Non-financial reporting; why? These information may have financial impacts);
- Information shall be included in the Management Report (separate report no possible) + electronic reporting format;
- Double materiality test to select information to be published: impacts from sustainability factors on undertakings (development, performance and position) and from undertakings on sustainability factors (outside-in + inside-out);
- Audit (with limited assurance) by auditors or other independent assurance services' providers;

CSRD n.
2464/2022:
What Changes?

- Standardization of information by EFRAG (European Financial Reporting Advisory Group), new standards: see Final Report «Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard-Setting» february 2021 <https://www.efrag.org/lab6> and first set of Draft ESRS <https://www.efrag.org/lab6#subtitle4>. The European Commission will consult EU bodies and Member States on the draft standards, before adopting the final standards as delegated acts in June 2023, followed by a scrutiny period by the European Parliament and Council. The reporting requirements will be phased in over time for different kinds of companies: the first companies = will have to apply the standards in financial year 2024, for reports published in 2025; listed SMEs are obliged to report as from 2026, with a further possibility of voluntary opt-out until 2028, and will be able to report according to separate, proportionate standards that EFRAG will develop next year. Coordination between EFRAG and other setters of international standards (IFRS, SASB). However CSRD already identifies and specifies information under art. 29b.

CSRD n.
2464/2022:
Report's Contents
on Sustainability
in General

- Risks related to sustainability matters; how they are managed;
- Resilience of business model and strategy to sustainability related risks;
- Opportunities with reference to sustainability matters;
- How business model and strategy take into account interests of stakeholders and impacts on sustainability matters;
- Policies on sustainability matters and how strategy has been implemented;
- Incentive schemes in remuneration;
- Governance for sustainability including skills and expertise of relevant bodies.

CSRD n.
2464/2022:
Report's Contents
on Climate
Change

- Plans(that include implementation / financial/ investment plans) to ensure coherence with the transition to a sustainable economy and with the 1.5° limit under the Paris Agreement and the European climate neutrality target by 2050 (as established by Regulation N. 2021/1119) + any exposure to coal-oil and gas activity;
- Greenhouse gas reduction targets for, at least, 2030 and 2050 and progression on them (reference to conclusive scientific evidence).

CSRD n.
2464/2022: Due
Diligence and
Supply Chain

- Due diligence process adopted;
- Actual or potential adverse impacts of its own operations and its value chain and supply chain;
- How these impacts are identified and monitored;
- Actions taken to prevent, mitigate, remediate or bring to an end results of those impacts and results of the actions;
- Also in case branches or subsidiaries are located in a third party country.

For all the factors mentioned in the Directive= indicators (k.p.i.) shall be included.

CSRD n.
2464/2022: Main
Focus is on
Climate Change

In addition to required policies on climate targets, lots of information refer to environment among the sustainability reporting standards, such as:

- Climate change mitigation (including reference to Scope 1, 2, 3) and adaptation;
- Water and marine resources;
- Circular economy;
- Pollution;
- Biodiversity and ecosystems.

CSRD n.
2464/2022:
Directors' Duties

Nothing is expressly stated by CSRD. However in all jurisdictions the board of directors is responsible and liable (together with the supervisory board if the one-tier model is not adopted) for a company's information.

Duty of care in all member states include: duty to gather all available information with reference to the various factors; duty to keep herself/himself informed on the various evolution (in particular, climate change requires more technical expertise). In case it is needed, boards may/shall require external consultancy.

Business judgment rule = but no excuse for lack of knowledge of the most updated information and studies.

CSRD n.
2464/2022:
Directors' Duties.
Just Disclosure ?

Even under the NFRD it was clear that disclosure was not the end of the legislation but it was functional to embed those factors within the company's strategy (no box ticking). With CSRD this intention is even bolder and basically companies are required to take into account sustainability factors, especially with reference to climate. Relevant undertakings are all called to action. It is not specified how – this is left to boards and business judgment rule – but it is a must to act. The European Union is being very ambitious to reach a sustainable capitalism and a net zero economy and to export this model around the world.

CSRD n.
2464/2022:
Directors' Liability

Nothing is stated by CSRD: member states' legislation does apply.

If the sustainability report contains false or misleading information or greenwashing statements = same liability as for financial statements to directors applies and therefore:

- Liability to company (damage to a company's assets) for breach of the duty of care in drafting the sustainability reporting, or not considering risks/not exploiting opportunities/reputational damages and loss of investors, customers etc./civil actions/difficulty in finding banks or venture capital to finance the undertaking;
- Liability to third parties (individual shareholders, or other investors)? Yes, tortious liability if shares or other financial instruments are bought ignoring information are false or misleading and therefore paying for them a higher price compared to market value. Damages arise, in particular, if relevant undertakings do not identify potential risks = assets are overvalued (stranded assets) and therefore financial statements need an impairment test with the consequential loss to be recorded.

First Lawsuit vs
Directors
personally:
*ClientEarth vs
Shell*

ClientEarth vs Shell Directors, Feb. 2023: derivative action for breach duty of care (sec 172 CA 2006) for mismanagement of climate risk. Claims:

1. Declaration from the High Court that directors are breaching CA duties;
 2. Order by the High Court to directors to adopt a strategy in compliance with the Paris Agreement.
- In particular, the shareholder claims that the strategic plan is inconsistent with decarbonization and net zero transition:
 - Shell failed to adopt a short term target to reduce GHGs emissions;
 - Medium term targets do not include Scope 3 emissions (that exceed 90% total emissions);
 - Carbon capture and storage (CCS) and reforestation plans are not realistic (the latter refer to lands equal to UK lands);
 - Capex incoherent with reduction strategy;
 - Shell plans to expand the gas business and to build new infrastructure for oil and gas without diversification or investment in renewables.

First Lawsuit in
Italy: *Greenpeace,
Recommon + 12
citizens vs ENI*

May 2023. This is not a derivative action based on

company law (similar challenges around the world).

However plaintiffs, two Associations and 12 citizens,

claim economic and non economic losses for

breach of the right to life and health by ENI for:

1. Contribution to climate change in the last decades;
2. Order that ENI will be obliged to revise its strategy to reduce GHGs emissions by 45% at least, within 2030 and to comply with the Paris Agreement;
3. Order to ENI's controlling shareholder (the Ministry of Finance) to adopt a climate strategy complying with the Paris Agreement;

No damages are requested but a declaratory action

to hold ENI responsible for the losses and to revise

strategy.

Conclusions

CSRD increases information on ESG, improves its quality, extend addressee undertakings. More boldly than NFRD, CSRD indirectly obliges boards of relevant undertakings to consider sustainability matters.

The *ClientEarth vs Shell* litigation can be the first of a long list of legal actions against companies and their directors that do not take into consideration sustainability related risks and opportunities especially from when (2024) CSRD will be in force.

Readings

- Sabrina Bruno, «Dichiarazione non finanziaria e obblighi degli amministratori», in *Rivista delle Società*, 2018, n. 4, p. 974-1020;
- Sabrina Bruno, «Obblighi degli amministratori e *corporate governance* sostenibile: quale disciplina ? », in *Studi in Onore di Sabino Fortunato*, being published;
- Sabrina Bruno, «Il ruolo della s.p.a. per un'economia giusta e sostenibile: la Proposta di Direttiva UE su "*Corporate Sustainability Due Diligence*". Nasce la *stakeholder company*?», in *Rivista di diritti comparati*, RomaTre Press, 2022, p. 303-338;
- Sabrina Bruno, International Corporate Law and the Emergency of Climate Change, in *Comparative Law in Times of Emergencies*, 2022 RomaTre Press, p. 3878-400;
- Sabrina Bruno, «The World Economic Forum Principles on "*Climate Governance on Corporate Boards*": Can Soft Law Help to Face Climate Change around the World?», in *Corporate Governance and Research & Development Studies*, 2019, p. 37-55;
- Sabrina Bruno, «Climate Corporate Governance: Europe vs USA?», in *European Company and Financial Law Review*, 2019, 1-37;
- Sabrina Bruno, «Cambiamento climatico e organizzazione delle società di capitali a seguito del nuovo testo dell'art. 2086 c.c.», in *Banca, Impresa e Società*, 2020, p. 47-66;
- Sabrina Bruno, «Impegno degli azionisti in materia di sostenibilità secondo la Direttiva n. 2017/828/UE: il cambiamento climatico», in A.A.V.V., *Disciplina delle società e legislazione bancaria. Studi in onore di Gustavo Visentini*, Luiss University Press, 2020, p. 95-123.