RHTLaw Asia

UNDERSTANDING AND ADOPTING ESG – AN OVERVIEW

Part II: ESG Reporting as a Genesis of Fiduciary & Other Legal Obligations

Introduction

In Part I of our two-part mini-series, we discussed the basics of environmental, social and governance (ESG) and how the same found its roots in CSR and had taken beyond the realms of pure philanthropy and into the realm of quantifiable numbers to determine how companies treat their staff, respond to climate change, increase diversity and inclusion, and build community links.

Now, in this Part II of the mini-series, we will be looking at some issues that crop up for companies, their directors, as well as other legal issues that arise in ESG-related disclosures and finally set out some practical recommendations for ESG disclosure-related compliances.

Companies

These days, companies are increasingly facing pressures to provide more ESG-related disclosures. Greater transparency requirements in turn, have led to increased scrutiny of companies' business and operating models, their carbon footprints, and their exposure to climate change.

In the EU, the revised Non-Financial Reporting Directive[1] (**Directive 2014/95/EU**) requires large entities and groups to disclose information on their development, performance and position and the impact of their activity, relating to ESG and other matters.

Over in the US, the Securities and Exchange Commission (**SEC**) had, in January 2020, proposed amendments to modernise and enhance financial disclosures. The proposed amendments briefly touch on ESG related disclosures, in that companies should disclose their material human capital management matters such as attraction, retention and development of workers. Notably, the amendments do not prescribe making climate disclosures mandatory for US companies.

Closer to home, the Singapore Stock Exchange (**SGX**) has had a reporting mechanism in place for Listed Companies (**List Co.s.**) since 2016 itself. While previously, the List Co.s. were required to provide (in addition to financial reports) a 'sustainability' report, with effect from December 2021, SGX has made a concerted effort towards sustainability by way of initiatives which include, among others, an aim "to provide the market with access to ESG information and solutions for investment decisions"[2].

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095

[2] https://www.sgx.com/media-centre/20201215-sgx-strengthens-commitment-sustainability-s20-million-plan

Notwithstanding the slightly differing approaches adopted by EU, US and Singapore, companies must still be mindful of the potential legal risks and litigation costs that may be associated with making ESG related disclosures. For instance, potential liability may arise from making ESG disclosures that are materially misleading and/or false. Similarly, considering ESG accounts for a company's internal governance practices as well, potential liability for companies may arise under securities and exchange regulations, company law (including rules on corporate governance), consumer protection laws and other such statues and regulations.

Directors

The basic rules of company law all over the world include the duties of directors as fiduciaries of companies. No statute can specifically outline each and every act that a director must or must not do. Therefore, the concept of fiduciary is used to encompass all such situations. Thus, a director must ensure to act in good faith and in a responsible manner since his position demands this behaviour, whether such behaviour is expressly mentioned by law or not.

Within the context of ESG reporting / disclosures, directors should understand and incorporate the company's ESG performance regardless of whether such performance is financially material or not. The assumption that ESG issues are not financially material and thus, inconsistent with fiduciary duties, is no longer supported.

Reporting ESG information with the company's financial results can benefit such company by presenting a sustainability story that is aligned to business strategy and financial performance.

Considering ESG analysis assists potential investors in identifying the financially-relevant issues within the company, neglecting ESG analysis may cause the mispricing of risks and/or poor asset allocation decisions by the investors, which in turn, might be considered to be a breach of directors' fiduciary duties.

Other Legal Issues

In addition to the potential (and inevitable) breach directors' fiduciary duties, non-disclosure of ESG information may open up companies to additional legal risks and litigation costs. For instance, as briefly set out under 'Companies' hereinabove, potential liability may arise from ESG-related disclosures that are materially misleading and/or false. Claims relating to a company's ESG disclosure may be brought under a country's statute dealing with Securities Exchange in such country, which statute would inevitably cover material misstatements and/or omissions.

Securities legislation aside, ESG-related disclosures (or the omission thereof) may, depending on the industry in which a company operates in, have legal implications under other statutes as well. For instance, in 2012, a US-based theme park was sued over its failure to disclose material facts about its treatment of 'killer whales'[3].

Closer to base, home-grown company – Resorts World Sentosa – has also previously been charged with ill-treatment of dolphins[4]. While these cases themselves may not be covered under the 'securities' legislation(s), it is imperative to note that such company policies and practices will now become **quantifiable** under the ESG-disclosure dictated regime.

This would mean that potential investors (and to a great extent, the consumers) would now be able to determine in measurable numbers, the impact of the acts and/or omissions of companies and its directors in conducting its day-to-day business and having an ESG-related claim initiated against a company (especially a List Co.) may not only have significant monetary impact viz its standing with potential investors, but also cause the company to incur a significant litigation cost and result in serious reputational damage.

Practical Recommendations

We set out below, some key takeaways and recommendations for companies seeking to commence (or continue) their ESG-disclosure journey(s) in Singapore and other jurisdictions.

a. Companies, especially List Co.s should have ESG-tailored disclaimers in their regulatory filings.

b. Companies should ensure that their ESG reports are not materially false / misleading and should be supported by verifiable facts and/or data.

c. Directors must ensure that they have a policy to cover ESG reporting in-place. This policy then needs to be effectively implemented (and modified where potential weaknesses are identified).

d. Directors should try and understand how ESG ratings and reporting methodologies work and how the same may be most suited with their respective company's profile(s).

e. Key decision-makers of companies should identify the range of stakeholders impacted by and impacting your company.

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[3] https://www.bbc.com/news/world-us-canada-16920866

[4] http://www.digitaljournal.com/article/337806

Conclusion

For some time now, the excessive focus of companies on short-term growth and earnings without due regard of long-terms costs, has accelerated the pace of environmental degradation and social inequality. This short-term mindset of the companies, exacerbated in the wake of the COVID-19 pandemic, means that in the near future there will be increased scrutiny on how companies treat their employees and customers in addition to how companies treat the environment.

As ESG reporting is not mandatory in Singapore (except for List Co.s), companies across different industries choose to disclose (if at all), disparate metrics relating to their sustainability performance. This is true overseas as well, where regulators, investors, customers and other stakeholders are increasingly focused on ESG standards, presenting businesses with new opportunities and risks in an evolving landscape.

There is now a compelling evidence that ESG issues are fast-becoming one of the major driving force(s) for investment valuation and the failure to effectively manage/disclose/omit ESG issues can significantly impair a company's investment value.

As ESG investing becomes increasingly popular, it is important for companies to be aware that robust ESG disclosure is paramount for attracting potential investors. ESG disclosures may also incentivise companies to improve internal risk management policies and processes as well as internal decision-making capabilities.

Further, under the Singapore Green Plan 2030, new and existing sustainability initiatives have come together to advance Singapore's national agenda on sustainable development. The multi-ministerial effort reflects the reality that ESG matters have an impact across all segments of the economy.

RHTLaw Asia's dedicated ESG practice aims to equip clients with the right advice and knowledge to navigate ESG considerations and regulatory requirements as well as compete in Singapore's Green Economy.

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Piyush Gupta is Partner (Foreign Lawyer) and Head of RHTLaw Asia's Transportation & Logistics Industry Group. He is also part of the firm's Environment, Social & Governance (ESG) practice group.

Piyush has close to two decades of transnational experience in competition and antitrust law and is well-versed with the complexities of this area of law. He has advised multiple MNCs on their competition law issues and has conducted numerous competition compliance audits, trainings and workshops.

About RHTLaw Asia

RHTLaw Asia offers a different perspective on client experience and commercial thinking. As a leading regional law firm headquartered in Singapore, clients can expect intelligent and innovative solutions from a team that is attuned to the nuances of doing business in Asia. With access to our own ASEAN Plus Group, a network of leading firms comprising over 2,000+ lawyers in 14 jurisdictions around Asia, as well as our membership with The Interlex Group, a global network of leading law firms, we help clients understand the local challenges, navigate the regional complexity to deliver the competitive advantage for their businesses in Asia.

We collaborate closely with the RHT Group of Companies to provide an all-rounded integrated business solution. We believe in pushing the boundaries of what can be achieved for our clients in this evolving marketplace.