ARTICLES

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Climate Risk Is Investment Risk

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ABSTRACT

In January of 2020, BlackRock, the world's largest asset manager with over seven trillion dollars under management at that time, announced it was placing environmental sustainability at the center of its investment approach because it had concluded that climate risk was investment risk. It warned of a very rapid movement of capital toward "sustainable" businesses. The coronavirus pandemic has intensified the appeal of sustainable investing. There is a push in the United States and the European Union to rethink the purpose of investor-owned corporations in light of the unprecedented need to deeply decarbonize the global economy and meet the Sustainable Development Goals on a very short timeframe. Without making substantive legal reforms, a common ground in this debate appears to be to reduce risks by promoting transparency and accountability. These values are aided by accurate and thorough reporting of a corporation's environmental and social impacts, which facilitates investors' ability to manage risk, and can inform broader public policy. Sustainability reporting also serves an internal purpose for boards of directors, alerting them about the effect the business is having on the environment and society, systemic risks, and ability of the company to achieve success in the long term. There is a growing awareness that a well-run company should have long-term plans charting its way toward environmental, social, and economic sustainability: the triple bottom line. One step in the direction of this call for transparency and accountability occurred in 2017 when the EU Non-Financial Reporting Directive became effective. This new law requires EU publicly traded corporations and financial and insurance institutions with more than 500 employees to report on environmental, social, and governance metrics. Strategically increasing access to information holds promise because it moves corporate social responsibility out of the voluntary realm; but early results already indicate areas where the law needs to be improved. This Article will explain how the climate crisis places a new focus on the purpose of the corporation; private governance and voluntary sustainability reporting; and the new mandatory reporting approach in the EU, its limitations and potential reforms, and possible replication in the United States.

INTRODUCTION

The 2020s will be shaped by a strong push in the European Union (EU) and the United States to rethink the purpose and role of multinational corporations in light of the climate crisis. We face an unprecedented call by the signatories to the Paris Agreement and the scientists on the United Nation's Intergovernmental Panel on Climate Change to deeply decarbonize the global economy and meet the Sustainable Development Goals on a very short timeframe. The scale and speed necessary to move off fossil fuels requires the public and the private sector to be fully engaged in the transformation.

At the signing of the Paris Agreement, in December 2015, even with the United States at the leadership table, the commitments to reduce climate-disrupting gases still fell short of what scientists agree is necessary to avoid the worst risks of climate change. Nations have shown they are not yet doing enough to positively shape the transformation, which places a larger emphasis on the private sector to lead from within.

We are at a pivotal time for the private sector. Two watershed moments occurred within the span of six months (August 2019 and January 2020) that indicate we are on the verge of a significant shift in the corporate sector. The degree to which this will make a difference in climate and broader sustainability outcomes is unclear, and lawyers who represent corporations have an important role to play in shaping that future. In August 2019, the American Business Roundtable issued a Statement on the Purpose of the Corporation that endorsed a stakeholder commitment, breaking from its longstanding support for shareholder primacy.[1] Shareholder primacy has been a norm of behavior in which corporations have prioritized delivering shareholder profits above all other considerations. The newly articulated stakeholder purpose includes protecting the environment and embracing sustainability. They "commit" to "[s]upporting the communities" where they work, respecting people in those communities, and "protect[ing] the environment by embracing sustainable practices" across their businesses.[2]

1 *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans*,*'* THE BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/NZ2W-7UPH].

2 *Id.*

Then at the dawn of the decade, in January 2020, BlackRock, the world's largest asset manager with seven trillion dollars under management, announced it is making sustainability integral to its risk management and investment approach.[3] BlackRock put the companies in which it invests on notice that they need to produce sustainability data this year. BlackRock asserted that climate change will have a defining impact and that it must become an integral part of business practices and plans.[4] As a fiduciary, BlackRock sees a genuine business risk and cost to continuing business as usual.[5]

After these developments, the first quarter of 2020 revealed a wave of banks and corporations announcing climate-related commitments. To name a few of the major players: JP Morgan, the world's largest financier of fossil fuel projects, will "stop any new financing of drilling in the Arctic National Wildlife Refuge and expand restrictions on financing coal projects."[6] Microsoft is carbon neutral today and plans to be carbon negative by 2030, which means it will remove more carbon from the atmosphere than it emits. By 2050, it has a goal of being carbon negative for all the carbon it has emitted during its life, since 1975, by investing in renewables, carbon capture technology research, and planting trees.[7] Amazon pledges ten billion dollars to combat climate change; it set a goal of 50% of all shipments being carbon neutral by 2030; it is investing in 100,000 electric trucks to deliver its packages; and it is building wind and solar power plants for its cloud computing servers.[8] Delta commits to going carbon neutral globally; it will spend $100 million annually for the next decade to purchase carbon offsets through projects such as reforestation, although it will continue to emit greenhouse gases (GHGs) by flying planes.[9]

Clearly, there is a shift occurring within the top tier of corporate America. These announcements, however, raise many issues. Will the

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3 Andrew Ross Sorkin, *Can Corporations Stop Climate Change?*, THE DAILY N.Y. TIMES PODCAST (Feb. 24, 2020), https://podcasts.apple.com/us/podcast/the-daily/id1200361736?i=1000466504388.

4 *Id.*

5 *Id.*

6 Kate Aronoff, *The Planet is Screwed, Says Bank That Screwed the Planet*, THE NEW REPUBLIC (Feb. 25, 2020), https://newrepublic.com/article/156657/planet-screwed-says-bank-screwed-planet [https://perma.cc/L9G4-8955].

7 Sorkin, *supra* note 3.

8 *Id.*

9 *Id.*

top tier force the issue for everyone else, even in the absence of the government setting the rules, so all companies participate in this transition to renewables and greater energy efficiency? Will these voluntary corporate commitments have a genuine impact on mitigating climate change? Are the carbon offsets real? Does this herald fundamental changes in the corporate sector? Will climate risk disclosures produce enough quality information to direct capital toward the renewables revolution at the level needed to limit warming to +1.5°C?

Even J.P. Morgan's economists recognize that climate change represents "a global market failure in the sense that producers and consumers of CO_2 emissions do not pay for the climate damage that results."[10] However, in the absence of a global carbon tax set at a meaningfully high level and increasing over time, increasing the information flow to investors and corporate boards plays a critical role in redirecting capital away from fossil fuels.

In the wake of these announcements of significant changes in sustainable finance and corporate purpose, the world encountered the coronavirus pandemic in early 2020. Nations closed borders, students from kindergarten to graduate school attended classes online, economies ground to a crawl, and the ranks of the unemployed swelled. In the first month alone, twenty million Americans lost their jobs.[11] In order to save lives, we slowed ourselves into the worst global economy since the Great Depression.

Fighting the pandemic is in many ways horrific, with far too many deaths. Yet as people stayed home and factories shuttered operations, ecosystems started to recover. In those first months, Indians could see blue skies and the Himalaya Mountains for the first time in thirty years. From Los Angeles and New York to Milan, and New Delhi to Beijing and Seoul, the air was free of unhealthy smog and smoke, and freeways were empty.[12] In April, with demand for oil depressed, oil prices went

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10 DAVID MACKIE & JESSICA MURRAY, J.P. MORGAN, RISKY BUSINESS: THE CLIMATE AND THE MACROECONOMY 16 (Jan. 14, 2020).

11 Andrew Soergel, *ADP: More than 20 Million People Lost Their Jobs in April*, U.S. NEWS & WORLD REP. (May 6, 2020), https://www.usnews.com/news/economy/articles/2020-05-06/adp-more-than-20-million-people-lost-their-jobs-in-april.

12 Beth Gardiner, *Pollution Made COVID-19 Worse. Now, Lockdowns Are Clearing the Air*, NAT'L GEOGRAPHIC (Apr. 8, 2020), https://www.nationalgeographic.com/science/2020/04/pollution-made-the-pandemic-worse-but-lockdowns-clean-the-sky/ [https://perma.cc/WDQ3-C5YP].

negative for the first time in history, and U.S. oil companies paid to shed their product.[13]

By the end of April, the United States had already approved spending three trillion dollars to try to get the economy moving, and some economists think much more will be needed. The looming uncertainty is whether governments, with hindsight from the 2008 global financial crisis, will create economic stimulus programs aligned with meeting the climate emergency and reducing climate risk through mitigation and adaptation. This is an opportunity to jump-start the economy in ways that promote ecological balance and healthy communities. The EU and South Korea have enacted or strengthened Green New Deals to put people back to work by investing in advanced technology, building renewable power generation, increasing use of electric vehicles, making buildings more efficient, and growing diversified, sustainable agriculture.[14] If nations bail out industries, such as airlines, they could require carbon neutrality by 2030. And as fossil fuel companies teeter on bankruptcy, Congress could condition economic stimulus funds on acquiring controlling interests, with an explicit plan for the managed phaseout of fossil fuel production and a just transition to renewables.

If governments fail to align economic stimulus with mitigating the climate emergency, climate risk will intensify, making clear sustainability reporting even more important for investors. Companies will likely prioritize their existing liabilities, payroll, and paying shareholders over voluntary investments in sustainability pledges, which will mean more GHGs and failing to hold down temperature increases. This will lead to investors facing even greater risks from climate-related losses to business facilities from flooding, sea level rise, extreme temperatures, drought, productivity declines, and violent weather. Thierry Philipponnat, a board member of the French Financial

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13 Leah McGrath Goodman, *Inside the Biggest Oil Meltdown in History*, INSTITUTIONAL INV. (May 6, 2020), https://www.institutionalinvestor.com/article/b1lhy2h328jhpt/Inside-the-Biggest-Oil-Meltdown-in-History.

14 *See* Sung-Young Kim et al., *South Korea's Green New Deal Shows the World What a Smart Economic Recovery Looks Like*, THE CONVERSATION (Sept. 9, 2020), https://theconversation.com/south-koreas-green-new-deal-shows-the-world-what-a-smart-economic-recovery-looks-like-145032 [https://perma.cc/CGL7-NZWC].

Markets Authority and Chair of its Sustainable Finance Commission, calls this the "climate-finance doom loop."[15]

The abrupt devaluation of stocks at the beginning of the pandemic in spring 2020 underscores the urgency of transparency in disclosing climate risk. Investors need to be able to assess how companies are strategically positioning themselves to thrive in the clean energy economy and making contingency plans. The increasing flow of information to investors and corporate boards plays a critical role in redirecting capital away from companies that are worsening the climate emergency.

These combined forces make a sophisticated understanding of climate risk and sustainability a top priority for lawyers who are advising corporate clients: how to define it, how to incorporate it into a business model, and how to measure and report on it. There is a need to achieve transparency and accountability through accurate accounting of a corporation's environmental and social impacts; a need for boards of directors to consider the effect the business is having on the environment and society, systemic risks, and the ability of the company to achieve success in the long term. A well-run company should have long-term plans charting its way toward environmental, social, and economic sustainability.

The degree to which sustainability reporting is voluntary or mandatory is shifting, as is whether the reporting is driven by private governance (e.g., BlackRock's new requirement) or public law. Unlike the largely voluntary approach in the United States, the EU created a public law mechanism, the EU Non-Financial Reporting Directive, that went into effect in 2017.[16] This new law requires EU publicly traded corporations and financial and insurance institutions to report on environmental, social, and governance metrics. Strategically increasing access to information holds promise because it moves corporate social responsibility out of the voluntary realm; but early results already indicate areas where the law needs to be improved. With these

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15 Matthew Vincent, *Threat from Climate Change to Financial Stability Bigger than COVID-19*, FIN. TIMES (June 7, 2020), https://www.ft.com/content/710cc474-15f7-4db0-8d54-a50f161f76bb.

16 Directive 2014/95/EU, of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, O.J. (L 330), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095 [https://perma.cc/B6FK-AKGG].

additional reforms, the EU's approach can inspire similar reforms in the United States, as many companies operate in both jurisdictions.

Further, the companies that are adept at incorporating sustainability into their business models, measuring and reporting under the EU Directive or voluntarily, will be better positioned to succeed in the transition to the post-pandemic clean energy economy. John Cruden, who advises corporate clients on environmental law, believes the

> Global Reporting Initiative and EU Non-Financial Reporting requirements, along with BlackRock's sustainability push, are bringing us much closer to a standard practice of carbon reporting. We are now at the point where every investor-owned corporation needs to strongly consider self-reporting its impact on the climate. Lawyers need to advise their clients to position them for success in the clean energy economy.[17]

This Article will proceed in three parts. Part I will explain the internationally shared goals of deep decarbonization and achieving sustainable development. Part II will discuss the gold standard for sustainability reporting, the Global Reporting Initiative (GRI), and the gap between reporting and actual environmental improvements. Lastly, Part III will orient readers to the new EU law requiring sustainability reporting, its limitations, and potential reforms. With amendments to strengthen the Non-Financial Reporting law, other jurisdictions, such as the United States, may benefit from replicating it.

I
DEEP DECARBONIZATION AND SUSTAINABLE DEVELOPMENT

In 2020 the world changed dramatically and unexpectedly, first with significant climate-protective shifts in the private sector, then with the coronavirus pandemic. We entered the decade facing fires ravaging Australia and an unprecedented call by the signatories to the Paris Agreement and the scientists on the United Nations' Intergovernmental Panel on Climate Change (IPCC) to deeply decarbonize the global economy and meet the Sustainable Development Goals (SDGs). The scale and speed necessary to abandon fossil fuels require full engagement by the public and private sector and a massive reallocation of capital. The global Task Force on Climate-Related Financial

17 Interview with John Cruden, Principal, Beveridge & Diamond (May 3, 2020).

Disclosures (TCFD) estimates this transition will cost one trillion dollars annually for the foreseeable future.[18]

A. Current International Efforts to Reduce Greenhouse Gases

The international scientific consensus indicates we are on a deadly trajectory of our own making due to releasing increasing amounts of GHGs from our economic activities. According to the IPCC's 2018 report, atmospheric levels of carbon dioxide (CO_2) are at their highest levels in over 800,000 years and continue to rise. Global average temperatures are one degree Celsius higher than preindustrial temperatures, and the sea has been rising, warming, and becoming more acidic as it has absorbed CO_2 and heat.[19]

Entered into force in 1994, the UN Framework Convention on Climate Change is a treaty with the long-term objective to set GHG concentrations "at a level that would prevent dangerous anthropogenic (human induced) interference with the climate system."[20] The United States is a party to this treaty, which the Senate approved per its constitutionally prescribed process.[21] Every year since forming this treaty, the United Nations has held a Conference of the Parties to advance collective objectives. In December 2015, the annual Conference of Parties resulted in the Paris Agreement, which sets a common goal of holding temperature increases to +2°C and efforts to limit warming to +1.5°C.[22] In order to limit warming, the Paris Agreement calls for GHG emissions to peak as soon as possible and to achieve global GHG emission neutrality by 2050, meaning emissions

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18 *Recommendations of the Task Force on Climate-Related Financial Disclosures*, TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, ii (June 2017), https://www.fsb-tcfd .org/publications/final-recommendations-report/ [https://perma.cc/UHN6-FDXK].

19 U.N. Intergovernmental Panel on Climate Change, *Special Report on Global Warming of 1.5°C*, Summary for Policymakers 6–7 (2018), https://report.ipcc.ch/sr15 /pdf/sr15_spm_final.pdf [https://perma.cc/7Q2W-GA2K] [hereinafter IPCC Report]; JOHN C. DERNBACH, LEGAL PATHWAYS TO DEEP DECARBONIZATION IN THE UNITED STATES, 2–6 (Michael B. Gerrard & John C. Dernbach eds., 2019).

20 *What Is the United Nations Framework Convention on Climate Change?*, UNITED NATIONS, https://unfccc.int/process-and-meetings/the-convention/what-is-the -united-nations-framework-convention-on-climate-change [https://perma.cc/7XLY-QY2P].

21 *Paris Climate Agreement Q&A*, CTR. FOR CLIMATE & ENERGY SOLS. (2016), https://www.c2es.org/content/paris-climate-agreement-qa/ [https://perma.cc/RE3F-RARJ].

22 Framework Convention on Climate Change, Paris Agreement, art. 2, Dec. 12, 2015, https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf [https://perma.cc/8PXN-6F69] [hereinafter Paris Agreement].

of GHGs are entirely offset by removals of GHGs by carbon sinks, such as forests.[23]

Rather than require all nations to meet agreed-upon GHG emissions reductions, negotiators chose a different approach: each nation was asked to come to Paris with a voluntary "Intended Nationally Determined Contribution"—the INDC.[24] The Paris Agreement commits the parties to prepare, communicate, and maintain these INDCs, which are essentially national goals for either economy-wide emissions reductions (developed countries) or reductions in emissions per GDP or per capita (developing countries).[25] The Paris Agreement includes an assessment of these goals and progress every five years, called a global stocktake, which may spur nations to be more aggressive in setting their national commitments toward meeting the goal of carbon neutrality by 2050.[26]

Yet, the signatories recognized, even as they signed the Paris Agreement, that the combination of these national goals was not enough to limit warming to +2°C.[27] More is clearly needed from national governments. U.S. President Trump went in the opposite direction with his embrace of coal and withdrawal of the United States from the Paris Agreement at the earliest possibility, which was November 4, 2020.[28] A future President may reenter the Agreement. On his first day in office, President Biden signed an executive order recommitting the United States to the Paris Agreement.[29]

At the close of the decade, the world saw biodiversity worldwide in an alarming decline, as reported by the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services.[30] Regarding

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23 *Id.* at art. 4 & 5.

24 *Id.* at art. 4, para. 2.

25 *Id.* at art. 4, para. 4.

26 *Id.* at art. 14.

27 *Id.* at 3, para. 17.

28 Press Statement, Michael R. Pompeo, Sec'y of State, U.S. Dep't of State, On the U.S. Withdrawal from the Paris Agreement (Nov. 4, 2019), https://www.state.gov/on-the-u-s-withdrawal-from-the-paris-agreement/ [https://perma.cc/AN5M-SWJT].

29 Press Release, President Joseph R. Biden Jr., Paris Climate Agreement (Jan. 20, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/paris-climate-agreement/ [https://perma.cc/WUT4-GJFM]. The United States officially rejoined on February 19, 2021. Dino Grandoni & Brady Dennis, *U.S. Officially Rejoins Paris Accord, Vowing to Make Up for Lost Time*, WASH. Post (Feb. 19, 2021), https://www.washingtonpost.com/climate-environment/2021/02/19/climate-paris-accord/.

30 Press Release, Intergovernmental Sci.-Pol'y. Platform on Biodiversity and Ecosystem Servs., Nature's Dangerous Decline 'Unprecedented'; Species Extinction Rates

this deterioration, unprecedented in human history, J.P. Morgan's report noted that GDP fails to measure the impact of climate change on the natural world. It observed that "the rate of extinction globally is estimated at tens to hundreds of times higher than the average over the last 10 million years."[31] Exacerbating the climate crisis by removing vital carbon sinks, the Amazon and Australia were engulfed in fires as we entered the 2020s, releasing dangerous air pollution and reducing the capacity of established trees to absorb more carbon dioxide. Even further, some scientists estimate that the Australian wildfires caused the deaths of one billion animals either from being caught in the fires or from loss of habitat.[32]

B. The International Consensus on Sustainable Development Goals (SDGs)

To make matters worse, the global problems are broader than the climate challenges. The unanimous United Nations' Sustainable Development Goals (SDGs) of eradicating poverty and reducing wealth inequality, to name a couple of fundamental priorities, will be harder to reach due to climate disruption.[33]

If we continue business as usual, the path we are on leads to "climate-related risks to health, livelihoods, food security, water supply, personal security, and economic growth," according to the 2018 report from the United Nations' Intergovernmental Panel on Climate Change (IPCC Report).[34] To put it more clearly, if we do not change course in this decade and deeply decarbonize the economy, within the next generation (2050 and beyond), it is very likely that parts of Earth will be uninhabitable due to extreme heat, all the life-supporting coral in the oceans will die, 143 million people will migrate within their countries' borders, and the Amazon and Australian fires of 2019 will be the norm.[35] As highlighted by J.P. Morgan's economists,

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'Accelerating' (2019), https://ipbes.net/news/Media-Release-Global-Assessment [https://perma.cc/6HKY-JVTY].

31 MACKIE & MURRAY, *supra* note 10, at 15.

32 Sigal Samuel, *A Staggering 1 Billion Animals Are Now Estimated Dead in Australia's Fires*, VOX (Jan. 7, 2020, 2:10 pm), https://www.vox.com/future-perfect/2020/1/6/21051897/australia-fires-billion-animals-dead-estimate [https://perma.cc/E5H8-52J9].

33 IPCC Report, *supra* note 19, at D.2.

34 *Id.* at B.5.

35 David Wallace-Wells, *The Uninhabitable Earth*, N.Y. MAG., (July 10, 2017), http://nymag.com/daily/intelligencer/2017/07/climate-change-earth-too-hot-for-humans.html [https://perma.cc/3VJK-8PJJ]; *see* MACKIE & MURRAY *supra* note 10, at 1–16.

the projections of how climate change might affect global GDP do not account for any of these significant losses and levels of suffering that humans and other species will face if business continues as usual without government policy interventions.[36]

There is a growing awareness around the world that we must act decisively to move the global economy off fossil fuels immediately and rethink and redesign our relationship with natural resources. The United Nations has provided an international scientific consensus about the system-changing sustainability the world needs to implement throughout the 2020s and beyond. The IPCC Report urges swift decarbonization to get to net zero CO_2 as soon as possible. The IPCC's recommendations and the SDGs are an international call for action not at some distant point but in this decade.

Echoing the IPCC, Dernbach tells us that to deeply decarbonize we need rapid transitions in energy, farming and forestry, transportation, urban infrastructure, and industrial systems.[37] Such transitions depend on using fewer resources, creating greater energy efficiencies, and powering our energy needs with renewables.[38] The faster we can reach and sustain net zero global CO_2 emissions before 2050, the greater chance we have to maintain a livable planet, says the IPCC.[39]

Moreover, the IPCC warned that the large majority of climate models were unable to limit global warming to 1.5°C without simultaneously pursuing international cooperation and alleviating inequality and poverty.[40] The IPCC report articulated a need for broad participation in this orientation toward sustainable development. Government at all levels, civil society, the private sector, indigenous peoples, and local communities are all needed in taking climate

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36 MACKIE & MURRAY, *supra* note 10, at 10–16.

37 All the ways to construct an economy for deep decarbonization are based on "'three pillars of energy system transformation.' These are: (1) energy efficiency and conservation across all sectors of the economy, including power generation, transportation, buildings, industry, and urban design; (2) low-carbon electricity from replacement of fossil-fuel based generation with combinations of renewable energy, nuclear energy, and the use of carbon capture and storage (CCS) at fossil fuel based generating facilities; and (3) switching from more carbon-intensive fuels to less carbon-intensive fuels, and eventually switching from fossil fuel use to decarbonized energy carriers, principally electricity, in all economic sectors." DERNBACH, *supra* note 19, at 8.

38 *Id*.

39 *See* IPCC Report, *supra* note 19. According to the IPCC, net zero is achieved when "anthropogenic CO_2 emissions are balanced globally by anthropogenic CO_2 removals over a specified period." *Id.* at 24.

40 *Id.* at D.6.3.

action.[41] Thus, an essential aspect of the economic transformation off fossil fuels is integrating the SDGs to address the socioeconomic implications of transitioning to a clean energy economy.

In 2015, the 193 United Nations member states unanimously approved seventeen SDGs, which established a consensus development agenda with articulated targets to be met by 2030.[42] The SDGs are 1) end poverty, 2) zero hunger, 3) good health and well-being, 4) quality education, 5) gender equality, 6) clean water and sanitation, 7) affordable and clean energy, 8) decent work and economic growth, 9) develop local industry, innovation and infrastructure, 10) reduce inequality, 11) sustainable cities and communities, 12) responsible consumption and production, 13) climate action, 14) protect life below water, 15) protect life on land, 16) peace, justice, and strong institutions, and 17) partnerships for the goals.[43] These SDGs recognize the breadth of the challenges.

C. What Is the Role and Purpose of Corporations During These Global Transformations?

What is the role and purpose of corporations amidst these larger global concerns? Millstone argues that businesses do not need to simply reduce their environmental impact; they should ensure their products and services do not harm the ability of future generations to meet their environmental resource, educational, and financial needs.[44] Given the scope of the pollution, overuse, and extinction problems, business activity is most beneficial when it goes further and restores the environment.

While public law is essential for setting GHG reduction goals and priorities, the world cannot afford to wait to get the laws right. The private sector also provides powerful drivers by setting internal governance measures, influencing capital flows, and switching off fossil fuels even before a legal requirement. More and more businesses are setting goals to power their operations on 100% renewables in short

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41 *Id.* at D.7.

42 SUSTAINABLE DEVELOPMENT SOLUTIONS NETWORK, ET AL., MAPPING THE RENEWABLE ENERGY SECTOR TO THE SUSTAINABLE DEVELOPMENT GOALS: AN ATLAS 12 (2018), http://biblioteca.olade.org/opac-tmpl/Documentos/cg00717.pdf [https://perma.cc/V3MU-JW3L].

43 *Id.* at 6–10.

44 CARINA MILLSTONE, FRUGAL VALUE: DESIGNING BUSINESS FOR A CROWDED PLANET 2 (2017).

order. These are not just the businesses with clear environmental identities and certified as B Corps, such as Patagonia, but multinationals such as 3M, Danone, Apple, Google, and more.[45]

When there is a strong "business case for sustainability," we see corporate sustainability leadership. If multinational corporations commit to environmental sustainability and corporate social responsibility (CSR) more broadly, the sheer scale of their potential impact may start moving the trend lines in the correct direction to reduce GHGs and poverty. It is essential for investor-owned corporations to lead when it comes to environmental sustainability and encouraging to see more corporations moving in this direction. These commitments were a factor in obtaining the Paris Agreement: at the time of the Conference, many companies had registered their commitments to reducing GHGs.[46] As of February 2021, there were 4,302 companies that had registered their climate goals on the U.N. platform.[47]

Over a decade ago, in *Green to Gold: How Smart Companies Use Environmental Strategy to Innovate, Create Value, and Build Competitive Advantage*, Esty and Winston argued that no company could afford to ignore environmental issues due to a variety of developments, including increasing clarity about environmental problems, chronic poverty in parts of the world, transparency, and rising levels of public expectations for corporate CSR.[48] They asserted that leading corporations do more than comply with the law—industry leaders incorporate environmental considerations into all their operations. The fact that Walmart has committed to obtaining 100% of its electricity from renewable energy by 2035 and producing or procuring 7,000 GWh of renewable energy by the end of 2020 indicates the world is at a significant transition point.[49] Even absent legal

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45 RE100, Members, https://www.there100.org/re100-members [https://perma.cc/CM3B-GBPJ] (last visited Feb. 4, 2021).

46 CENTER FOR CLIMATE AND ENERGY SOLUTIONS, *supra* note 21.

47 *Companies*, GLOBAL CLIMATE ACTION NAZCA, https://climateaction.unfccc.int/views/stakeholders.html?type=companies [https://perma.cc/UW3S-B2S5] (last visited Feb. 4, 2021).

48 DANIEL C. ESTY & ANDREW S. WINSTON, GREEN TO GOLD: HOW SMART COMPANIES USE ENVIRONMENTAL STRATEGY TO INNOVATE, CREATE VALUE, AND BUILD COMPETITIVE ADVANTAGE 11–21 (Yale Univ. Press, 2006).

49 RE100, *supra* note 45. Similarly, over a decade earlier, Unilever, one of the world's largest purchasers of fish, committed to sourcing 100% of its fish from sustainable sources by 2005 because of its enlightened self-interest of not destroying fish stocks. ESTY & WINSTON, *supra* note 48, at 30.

mandates, when there is a business case for environmental protection, as there clearly is for the private sector's embrace of renewables, investor-owned corporations can make strong advances to meet the goals.

Further, although shareholders have the ability to influence environmentally sustainable corporate behavior, their impact to date has been limited. Activist shareholders can target their investments to companies that are promoting environmental sustainability or can advocate shareholder resolutions in favor of climate-related disclosures. To date, socially responsible investing and shareholder resolutions have not picked up enough momentum to change the problematic trend lines showing increases in global GHGs and a growing wealth inequality gap.

Nowiski argues, "The lack of standardized and mandatory climate risk reporting no longer is regarded solely as an environmental or social governance issue, but one that impacts future global financial stability."[50] Yet, the U.S. Securities and Exchange Commission (SEC) has not only sat idly on the sidelines, but several SEC commissioners have openly opposed new non-financial disclosure reforms.[51] Harper Ho asserts that although shareholder activism is powerful, it is "an inefficient substitute for non-financial disclosure reform under the federal securities laws . . . ."[52] This is particularly problematic in the United States, where the SEC relies on the tool of disclosure instead of substantive regulation of governance in order to facilitate investors' ability to protect their individual interests against fraud and mismanagement.

To complicate matters, until recently there had been no guidance in the United States on the materiality of sustainability issues that would lead to disclosure of those issues. The Financial Accounting Standards Board has focused solely on developing the accounting principles used in financial statements in the United States and has not included non-financial accounting. However, in 2011 the Sustainability Accounting Standards Board (SASB) formed to develop and disseminate sustainability accounting standards. The SASB focuses on developing industry-specific disclosure standards that are or should be

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50 Natalie Nowiski, *Rising Above the Storm: Climate Risk Disclosure and Its Current and Future Relevance to the Energy Sector*, 39 ENERGY L.J. 1, 1 (2018).

51 Virginia Harper Ho, *From Public Policy to Materiality*, 76 WASH. & LEE L. REV. 1231, 1234 (2019).

52 *Id.* at 1235.

incorporated into financial reporting.[53] By early 2014, the SASB had developed sustainability standards for forty-five industries.[54]

Khan, Serafeim, and Yoon used this new SASB classification to develop a novel data set to measure firm investment performance.[55] In their 2016 article, they found firms with "strong ratings on material sustainability issues have better future performance than firms with inferior ratings on the same issues."[56] Their results are "consistent with materiality guidance being helpful in improving the informativeness of ESG [environmental, social, governance] data for investors."[57]

More recently, Serafeim and collaborators at Harvard Business School are calculating the monetary environmental impact of corporations around the world. He argues that monetizing social and environmental impacts permits the development of risk-return-impact optimization that can change the flow of capital on the time scale needed. While overhauling accounting standards is needed, Serafeim urges that "[c]apital markets could bring that change faster. Important levers will be companies understanding the value of information to make better decisions; investors incorporating impact-weighted measures in their decisions; and stock exchanges asking for disclosure of impact-weighted metrics."[58]

In 2015, the global Financial Stability Board established the Task Force on Climate-Related Financial Disclosures (TCFD), which in turn issued recommendations in June 2017 that are considered authoritative on reporting financially material climate-related information.[59] They recommend companies report climate risk in financial filings, consistent with most G20 jurisdictions' legal requirements to disclose material information in financial filings. The TCFD said climate change-related risk to investors is extensive and urged that long-term

53 Jill E. Fisch, *Symposium: Deconstructing the Regulatory State: Perils and Possibilities*, 107 GEO. L.J. 923, 945 (2019).

54 Mozaffar Khan, George Serafeim & Aaron Yoon, *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1, 10 (2016).

55 *Id.* at 3.

56 *Id.* at 26.

57 *Id.*

58 George Serafeim, *Companies Must Include Environmental and Social Performance Measures*, FIN. TIMES (Feb. 23, 2020), https://www.ft.com/content/0c282a0c-3c36-11ea-a01a-bae547046735 [https://perma.cc/6R8Z-U76Z].

59 *Task Force on Climate-Related Financial Disclosures*, UNEP FIN. INITIATIVE, https://www.unepfi.org/climate-change/tcfd/ [https://perma.cc/S5F3-5526] (last visited Feb. 4, 2021).

investors need adequate information about how companies are preparing for the transition.[60]

This rapid transformation in climate risk and sustainability reporting will be enhanced by public laws, but it is noteworthy that it is being led by private entities with outsized capital influence that does not stop at political boundaries. In order to more fully realize the potential of sustainability reporting, it is important to learn from the experience of those engaged in reporting under private governance and public law structures.

II
PRIVATE GOVERNANCE AND SUSTAINABILITY REPORTING

Sustainability is a ubiquitous word that can mean anything from running a business profitably to operating a business whose products actually restore natural resources and produce renewable energy. At its worst, sustainability has been seen as an ambiguous and malleable term, which has allowed corporations pursuing business as usual to "greenwash" their behavior to gain market share.[61] The trap of the private sector focus on sustainability is that it could ultimately be more smoke than fire and not result in the significant reductions in GHGs and advances in sustainable development goals that are needed to mitigate the existential threat of climate disruption. That trap is one that investors have a strong interest in avoiding to protect the long-term value of their investments.

A strategy to reduce risks that a business faces from climate change and that a business poses to climate change is to clearly define sustainability, understand the reporting requirements and standards, and see the limitations of the information. This will better position system-shaping investors or governments to craft climate-related sustainability disclosure requirements that ensure comparability and transparency, with the ultimate goal to limit global warming to 1.5°C and attain the Sustainable Development Goals.

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[60] TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES 5–6 (2017).

[61] Benjamin J. Richardson & Beate Sjåfjell, *Capitalism, the Sustainability Crisis, and the Limitations of Current Business Governance*, *in* COMPANY LAW AND SUSTAINABILITY: LEGAL BARRIERS AND OPPORTUNITIES 1, 22–23 (Beate Sjåfjell & Benjamin J. Richardson eds., 2015).

A. What Is Sustainability?

The term "sustainability" is often shorthand for the concept of "sustainable development."[62] The 1992 U.N. Earth Summit defined "sustainable development" as development that will create economic, environmental, and social benefits that "improve the living standards of current and future generations, contribute to peaceful coexistence, social cohesion, social justice and social progress, and do so in a way that protects and does not degrade the natural environment."[63]

The 1987 Bruntland Report, delivered at the 1992 United Nations Earth Summit, explained that sustainable development "meets the needs of the present without compromising the ability of future generations to meet their own needs."[64] The Report contains within it two key understandings: that an overriding priority is for the "essential needs of the world's poor" and that the ability "to meet present and future needs" may be limited by "the state of technology and social organization."[65]

Importantly, the concept recognizes that ecological and other crises will persist in a world with widespread poverty and inequity. "Sustainable development requires meeting the basic needs of all and extending to all the opportunity to satisfy their aspirations for a better life."[66]

The SDGs for this current decade put a finer point on the concept by setting goals for progress in seventeen specific areas, as explained in Section I.B. In sum, sustainability sees the economy as nested inside society and working within the limits of ecology. Continuing in this vein, the investor-owned corporation, as a primary business organization in the dominant economy, should also operate within society and the limits of ecology if it is a sustainable company.

B. How Private Governance Can Promote Sustainability Reporting

Sustainability can be promoted by public laws, as will be discussed in the next section, and by private governance. This section will focus on the latter. Some U.S. scholars argue that private environmental

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62 *Id.* at 1.

63 International Co-operative Alliance, Guidance Notes to the Co-operative Principles 87 (2015), https://www.ica.coop/sites/default/files/publication-files/ica-guidance-notes-en-310629900.pdf [https://perma.cc/MWM9-ZV9K].

64 *Id.* at 86.

65 *Id.*

66 *Id.*

governance is essential to fill the environmental protection gaps left by a federal government that is actively deregulating.[67] For instance, in the immediate aftermath of U.S. President Trump's announcement that the United States would leave the Paris Agreement on climate change, an outpouring of U.S. corporations declared they were still committed to reduce GHGs. Many major corporations (e.g., eBay, Citi, Estée Lauder) and cooperatives (CROPP/Organic Valley) formally committed to using 100% renewable energy on the RE100 platform in 2017 or after, although not legally required to do so.[68]

Even in jurisdictions with more stringent environmental regulations, private environmental governance can be used to encourage more aggressive changes within the private sector on quicker timelines. Viewed as a parallel or complement to public law, private environmental governance "encompasses actions that private institutions . . . take that reduce negative externalities, manage common pool resources, and affect the distribution of environmental amenities."[69] The government may be somewhere on the periphery, while nongovernmental actors take the lead in creating and enforcing these standards.[70] For instance, if private governance is put into the form of a contract regarding a supply chain standard, the government could play a judicial role in enforcing the terms. Other forms of enforcement include third party certification or audits, consumer publicity, and boycott campaigns.[71]

Private governance includes private standards an individual business sets for itself, third-party certifications, and standards and codes created by business associations. The standards can be sorted by instrument choice, similar to public law. They may be prescriptive and enforceable (such as a third-party certification), create property rights (such as an easement that maintains an agricultural land use), leverage markets

67 MICHAEL VANDENBERGH & JOHNATHAN GILLIGAN, BEYOND POLITICS: THE PRIVATE GOVERNANCE RESPONSE TO CLIMATE CHANGE 9–10 (2017).

68 *RE100 Progress and Insights Annual Report, November 2018, Annex 1*, http://media.virbcdn.com/files/c1/36cff88178ac5f22-AppendixTable-newIKEAchange.pdf [https://perma.cc/HJ4A-3QY6].

69 Sarah E. Light & Michael P. Vandenbergh, *Private Environmental Governance*, *in* ENVIRONMENTAL DECISION MAKING, ENCYCLOPEDIA OF ENVIRONMENTAL LAW 253, 254 (Lee Paddock & Robert Glicksman eds., 2015).

70 *Id.* at 261.

71 *Id.*

(such as internal carbon trading and self-imposed carbon taxes), and disclose information (such as sustainability measuring and reporting).[72]

Making sustainability a top priority for corporate leaders is shifting dramatically and rapidly, pushed by private governance. The SASB may have planted the seeds for this: BlackRock, the world's largest investment manager, was a founding member of the SASB's Investor Advisory Group. At the beginning of 2020, BlackRock sent a letter to CEOs of the companies in which it invests entitled, "A Fundamental Reshaping of Finance." In it, Mr. Fink, the Chair and CEO, declared that "[e]very government, company, and shareholder must confront climate change."[73] BlackRock ranked climate change as a top issue that has become "a defining factor in companies' long-term prospects."[74] The letter continued that "climate risk is investment risk" and outlined the major features of risk including floods, droughts, food costs, productivity declines from extremes, uncertainties about mortgages, and urban infrastructure needs in order to adapt to climate disruptions.[75] He asserted there will be a significant reallocation of capital in the near future.[76] In response to this risk assessment, BlackRock is placing "sustainability at the center" of its investment approach.[77] This will involve moving money out of investments that present high risks, such as "thermal coal producers" and creating new products that screen to exclude fossil fuels.[78]

Sustainability disclosures will see a major boost from this directive at the top of the investing system. BlackRock argues, "Each company's prospects for growth are inextricable from its ability to operate sustainably and serve its full set of stakeholders."[79] To that end, it announced that the companies in which it invests need to produce sustainability data this year to show how they are managing climate, including how the Paris Agreement's 2°C goal affects them, how they are serving their stakeholders (not just shareholders), workforce diversity, supply chain sustainability, and protection of consumer data.

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72 *Id.* at 257–260.

73 Larry Fink, *Letter to CEOs: A Fundamental Reshaping of Finance* (Jan. 2020), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [https://perma.cc/9DA6-42C9].

74 *Id.*

75 *Id.*

76 *Id.*

77 *Id.*

78 *Id.*

79 *Id.*

Significantly, BlackRock underscored the purpose of the corporation as "the engine of long-term profitability."[80] In reflecting on his forty years in finance, Mr. Fink distinguished climate change as a "structural, long-term crisis" different from any the world has experienced since the 1970s.[81]

In BlackRock's related letter to clients, entitled, "Sustainability as BlackRock's New Standard for Investing," it explained how it will be playing an active and constructive role in the transition to a "low-carbon" economy and that sustainability is "increasingly material to investment outcomes."[82] It assured that, in light of the "growing investment risks surrounding sustainability," it will be "increasingly disposed to vote against management when companies have not made sufficient progress."[83] BlackRock is moving the dial on corporate sustainability reporting by requiring it for all its investments.

The 2020 gathering of billionaires and top corporations at the World Economic Forum in Davos followed that thread with its theme, "Stakeholders for a Cohesive and Sustainable World," and invitation to teen climate activist Greta Thunberg to address them. This shift in focus could signal a turning point in the global economy and rapid movement of capital toward businesses that are taking the lead in forging a sustainable future through deep decarbonization. How businesses measure and report sustainability is going to take on a much greater significance in this reshaping of finance.

C. The Gold Standard in Sustainability Reporting

Most large corporations use the Global Reporting Initiative (GRI) to structure their efforts to measure and report about sustainability. GRI describes itself as "an independent international organization that has pioneered sustainability reporting since 1997."[84] It is organized as a nonprofit and says it is "working in the public interest toward a vision of a sustainable global economy, where organizations manage their

80 *Id.*

81 *Id.*

82 BlackRock's Global Executive Committee, *Letter to Clients: Sustainability as BlackRock's New Standard for Investing*, BLACKROCK (Jan. 2020), https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter [https://perma.cc/AQ7A-DNN3].

83 *Id.*

84 *About GRI*, GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/information/about-gri/Pages/default.aspx [https://perma.cc/AT9Z-UF4G] (last visited Feb. 4, 2021).

economic, environmental, social, and governance performance and impacts responsibly."[85]

Driven by investors, regulators, and public pressure, the use of some form of sustainability reporting among the world's largest 250 companies increased from 12% in 1993 to 71% in 2013.[86] In 2015, GRI reported that its Sustainability Disclosure Database contained at least 24,000 reports, and "[twenty-seven] countries and regions reference GRI in their policies."[87] Similarly, in the Alliance for Corporate Transparency's analysis of 2018 non-financial data reporting by the EU's large publicly traded and financial companies, most of them (59%) used GRI to comply with the EU's Non-Financial Reporting Directive.[88]

The GRI reports are based on global standards related to economic, environmental, and social impacts of a company.[89] The standards do not come from democratically elected or government agency officials who have enacted them in public law but are devised by GRI's Global Sustainability Standards Board and their Oversight Committee. GRI describes this body as composed of "disinterested" and independent appointees.[90]

The GRI system of private governance establishes mandatory requirements, optional recommendations, and instructional guidance for companies preparing the reports.[91] For instance, when measuring and disclosing reducing energy consumption, GRI *requires* a company to report the amount of energy reduced as a "direct result of

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85 GLOB. REPORTING INITIATIVE, SUSTAINABILITY AND REPORTING TRENDS IN 2025 – PREPARING FOR THE FUTURE – GRI'S REPORTING 2025 PROJECT: FIRST ANALYSIS PAPER (2015), https://www.globalreporting.org/resourcelibrary/Sustainability-and-Reporting-Trends-in-2025-1.pdf [hereinafter GRI, TRENDS].

86 *Id.* at 4.

87 *Id.* at 7.

88 ALL. FOR CORP. TRANSPARENCY, 2018 RESEARCH REPORT: THE STATE OF CORPORATE SUSTAINABILITY DISCLOSURE UNDER THE EU NON-FINANCIAL REPORTING DIRECTIVE 28 (2019), http://allianceforcorporatetransparency.org/assets/2018_Research_Report_Alliance_Corporate_Transparency-66d0af6a05f153119e7cffe6df2f11b094affe9aaf4b13ae14db04e395c54a84.pdf [https://perma.cc/M5UB-6ZMQ].

89 *GRI Standards*, GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/standards [https://perma.cc/E6CS-6A37] (last visited Feb. 4, 2021).

90 *Governance Bodies*, GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/information/about-gri/governance-bodies/Pages/default.aspx [https://perma.cc/QWB2-ECKE] (last visited Feb. 4, 2021).

91 GLOB. REPORTING INITIATIVE, GRI 101 FOUNDATION 6 (2016), https://www.globalreporting.org/standards/media/1036/gri-101-foundation-2016.pdf [https://perma.cc/5CUH-84FX].

conservation and efficiency initiatives," *recommends* a company describe its approach to selecting methodologies, and *guides* a company to optionally describe energy reduction initiatives' process redesign, behavior changes, etc.[92]

In 2015, GRI's Corporate Leadership Group examined sustainability trends businesses face and did a deeper dive into climate change, human rights, wealth inequality, and data and technology.[93] Climate change was the top of their agenda, as they see it as a critical global risk and prominent in the seventeen SDGs.[94] They assess that a climate focus is being driven by governments' INDCs under the Paris Agreement, related new funding sources, and climate-related financial and risk disclosure requirements for certain corporations.[95] Related to climate reporting, the GRI contains a variety of standards and disclosures, such as energy consumption, reducing energy requirements of products and services, and tracking GHG emissions, among others.[96] With the fairly universal adoption of the GRI sustainability reporting framework, voluntary corporate commitments to sustainability are now very much in the mainstream globally.

However, measuring and reporting sustainability does not necessarily lead to actual improvements. According to the GRI's self-assessment, so far sustainability measuring and reporting has not generated improved environmental and social outcomes on the scale needed.[97] In fact, in 2015, GRI's Corporate Leadership Group observed that measuring and reporting sustainability has not influenced "the decision-making processes that underpin the transition of governance structures, business models and resource consumption patterns to a sustainable level."[98] This conclusion is based on seeing increases exactly where sustainability calls for decreases.[99]

Significantly, the GRI self-assessment highlighted the enduring global economic model of linearity instead of circularity as a particular

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92 *Id.*

93 GLOB. REPORTING INITIATIVE, FUTURE TRENDS IN SUSTAINABILITY REPORTING – INSIGHTS FROM THE GRI CORPORATE LEADERSHIP GROUP ON REPORTING 2025, at 6 (Jan. 2017), https://www.coursehero.com/file/26107731/GRI-CLG-Report-FutureTrends2025.pdf/ [https://perma.cc/536P-BS39].

94 *Id.* at 7.

95 *Id.*

96 *Id.* at 24.

97 GRI, TRENDS, *supra* note 85, at 4.

98 *Id.* at 5.

99 *Id.*

problem. It observed that companies "harvest and extract materials, use them to manufacture a product, and sell the product to a consumer—who then discards it when it no longer serves its purpose."[100] It reported an increase in volume of raw materials entering the economy: 65 billion tons in 2010, expected to grow to about 82 billion tons in 2020.[101]

By contrast, a circular economy business model designs products and services for durability and long lives, repair and reuse, and at the end of a product's useful life, it becomes raw materials for another product.[102] A circular economy paradigm is defined by the concept that nothing is waste: materials are by design circling through primary use, reuse, repair, repurpose, remanufacture, and recycle.[103]

The GRI Corporate Leadership Group provides suggestions for improvements. For instance, it urges companies to identify an economic model, such as the circular economy, and to report on how it is making a transition to this model.[104] Further, company reports could show how they are meeting specific sustainability metrics derived from the SDGs.[105] Another option is to place a monetary value on externalities and report on this in a much more transparent way in language understood by investors.[106]

If companies implement the GRI's suggested reforms, they could accelerate moving the world economy to be more sustainable. The push for publicly traded corporations to embrace CSR is a positive trend that includes environmental sustainability. This often bumps up against the norm of maximizing profits for shareholders. True reform in the sense of a new business model, suggested by GRI, faces practical and ideological limitations.[107] Some scholars worry that CSR is just another marketing tool for businesses to maximize profits instead of securing

100 *Id.*

101 *Id.*

102 *Towards an Eco-Efficient Economy in the Use of Resources*, ECONOMIACIRCULAR.ORG, http://economiacircular.org/EN/?page_id=62 [https://perma.cc/CV7P-LAAY].

103 Michael Burger, *Materials Consumption and Solid Waste*, *in* LEGAL PATHWAYS TO DEEP DECARBONIZATION IN THE UNITED STATES 184 (Michael B. Gerrard & John C. Dernbach eds., 2019).

104 GRI, TRENDS, *supra* note 85, at 8.

105 *Id.*

106 *Id.* at 9.

107 CAROL LIAO, LIMITS TO CORPORATE REFORM AND ALTERNATIVE LEGAL STRUCTURES 274, 274 (Beate Sjåfjell & Benjamin J. Richardson, eds., 2015).

enduring reductions in environmental harms and lowering resource use.[108]

Of course, there are shining stars in the investor-owned world, such as Interface, which has doggedly been pursuing environmental sustainability since 1994. There are alignments between environmental protection and restoration and profit that make the business case in certain situations. Interface's passionate Founder and Chair was able to lead the company to reframe its purpose and sustainability practices while growing into the world's largest producer of modular carpet.[109] Similarly, Esty and Winston's case studies identify a variety of corporate exemplars that predate certified B Corps and their expanded notion of stakeholders and social and environmental responsibility.[110] These exceptions need to be encouraged to flourish. Yet, the reality is that corporate sustainability leaders have been too few as they have not modified the important trend lines in GHG emissions, extinction, water quality, resource use, and other measures of global environmental outcomes.

Sustainability calls for a fundamental shift to create lifestyles that use fewer resources. Instead of a culture seeking *more*, we need a culture of *enough*. Since investor-owned corporations have been driving high-consumption lifestyles in order to drive growth in sales and profits, the challenge is for businesses to operate with a different model.[111] To accomplish this, sustainability must be part of the DNA of the business enterprise, its core purpose, so it infuses every decision, employee, and aspect of day-to-day implementation. Such businesses can be profit seeking but not profit maximizing (putting profits ahead of environmental sustainability).[112]

For sustainability results, new business models designed for a circular economy, or meeting the SDGs, and featuring goals for multiple stakeholders are essential.

In the absence of legal reforms that go to the heart of defining the purpose of the corporation and to whom it owes fiduciary duties, voluntary sustainability reporting to date has not been an effective

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108 *Id.* at 274–75.

109 *The Interface Story*, INTERFACE, https://www.interface.com/US/en-US/campaign/climate-take-back/Sustainability-A-Look-Back-en_US [https://perma.cc/5QTV-E3SC] (last visited Feb. 4, 2021).

110 ESTY & WINSTON, *supra* note 48.

111 MILLSTONE, *supra* note 44, at 185.

112 *Id.*

driver of change, as measured in environmental outcomes. If the government sets firm transparency requirements around sustainability that makes measuring and reporting sustainability mandatory, will it provide better results in terms of meeting sustainability outcomes? The EU's initial experience provides some answers.

III
PUBLIC LAW AND SUSTAINABILITY REPORTING: THE EU EXAMPLE

The EU has moved beyond voluntary disclosures with its relatively new Non-Financial Reporting Directive. Non-financial reporting is a way to increase transparency about the externalities of business. The social costs of pollution, resource depletion, worker health and safety, wealth inequalities, and human rights abuses are known as externalities. Economists and accountants typically do not account for externalities at the enterprise level, and society, or stakeholders, are left to shoulder the costs. Yet, a growing cadre of academic and business leaders have pushed to change this by legally requiring corporate accounting for these non-financial matters.[113] The audience for reporting is the investor community, civil society, and governments that seek to assess CSR.

While it is unclear that legally required disclosure leads to improved environmental outcomes, Ioannou and Serafeim argue that it is good for businesses. They conducted an instrumental variables analysis suggesting "increases in sustainability disclosure driven by the regulation are associated with increases in firm valuations."[114] China, Denmark, Malaysia, and South Africa have regulations requiring disclosure of environmental, social, and governance (ESG) information.[115]

By May 2020, BlackRock reported that amid the coronavirus pandemic they have seen that strong sustainability characteristics have

113 *E.g.*, RICHARD C. WILLIAMS, THE COOPERATIVE MOVEMENT: GLOBALIZATION FROM BELOW (2007) (advocating for corporate charters to require non-financial accounting of externalities).

114 Ioannis Ioannou & George Serafeim, *The Consequences of Mandatory Corporate Sustainability Reporting* (Harvard Bus. Sch. Rsch., Working Paper No. 11-100, 2017).

115 *Id.*

been essential to helping companies weather the crisis,[116] and investors have increasingly sought out sustainable investment strategies.[117] They reported that "94% of a globally-representative selection of widely-analyzed sustainable indices outperform[ed] their parent benchmarks."[118]

In 2017, the first EU-wide legal requirements to report on sustainability became effective. With the EU's Non-Financial Reporting Directive, the European law firm Frank Bold asserts that "[m]ore than 6,000 large companies will have to disclose information on their business model, policies, risks and outcomes regarding environmental, social and employee matters; respect for human rights, anti-corruption and bribery issues; and board diversity."[119] They interpret the objective of this law to be to "lay the foundation for an integrated model of corporate reporting" that supplements and complements "financial transparency" already required of companies, in order to "understand a company's development, performance and position, as well as the impact of its activity on society."[120]

The Non-Financial Reporting Directive (EU Directive) requires companies to provide, at a minimum, the following information:

- a brief description of the undertaking's business model;
- a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
- the outcome of those policies;
- the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;

116 BlackRock, Sustainable Investing, Resilience Amid Uncertainty 3 (2020), https://www.blackrock.com/corporate/about-us/sustainability-resilience-research [https://perma.cc/C3ZH-9B9W].

117 Attracta Mooney, *ESG Passes the COVID Challenge*, FIN. TIMES (June 2, 2020), https://www.ft.com/content/50eb893d-98ae-4a8f-8fec-75aa1bb98a48 [https://perma.cc/4Z4A-LE5Q].

118 BlackRock, *supra* note 116; Mooney, *supra* note 117.

119 FRANK BOLD, *Responsible Companies*, http://en.frankbold.org/our-work/programme/responsible-companies [https://perma.cc/444Y-72YJ] (last visited Feb. 4, 2021).

120 *Id.*

- non-financial key performance indicators relevant to the particular business.[121]

While the EU Directive requires reporting, it does not prescribe a uniform report to use or specific metrics that must be disclosed. This complicates comparisons across companies and may prove to undermine the efficacy of this legal requirement.

The EU Directive applies to publicly traded corporations, banks, and insurers with more than 500 employees.[122] By December 2016, each EU member was supposed to enact the EU Directive into their national laws.[123] In so doing, individual countries can require more. For instance, Sweden, Iceland, and Denmark apply the requirements to all companies with more than 250 employees.[124]

The corporations required to report under the EU Directive typically operate in multiple jurisdictions beyond the EU. Ultimately, the EU may be trying to use one of the largest economies in the world to influence the global economy to align its activities with achieving a shared social and environmental purpose that increases prosperity for all.[125] The aim of the EU Directive is "to reorient capital flows towards sustainable investments and manage risks stemming from climate change, environmental degradation and social issues."[126] From a purely pragmatic perspective, advocates for this law highlight that "mismanaged" human rights and environmental risks are bad for a company's economic performance due to costly "accidents, litigation,

121 ALL. FOR CORP. TRANSPARENCY, *supra* note 88 at 12 (citing Directive 2014/95/EU of the Eur. Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, U.N. Doc 2014/95/EU (2014), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095 [https://perma.cc/Y2PL-D3FS].

122 EUROPEAN COMM'N, *Commission Guidelines on Non-Financial Reporting* (June 26, 2017), https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en.

123 CSR EUROPE, MEMBER STATE IMPLEMENTATION OF DIRECTIVE 2014/95/EU 5, https://www.accountancyeurope.eu/wp-content/uploads/NFR-Publication-3-May-revision.pdf [https://perma.cc/5CBB-V8E3].

124 Paige Morrow, *Non-Financial Reporting: How to Comply? What Does It Mean for the Climate?*, RESPONSIBLE INVESTOR (Jan. 5, 2017), https://www.responsible-investor.com/articles/non-financial-reporting-fb [https://perma.cc/7KDC-87UB].

125 Kimberly Amadeo, *Largest Economies in the World*, THE BALANCE (Dec. 10, 2020), https://www.thebalance.com/world-s-largest-economy-3306044 [https://perma.cc/E3K4-JDBS]. As measured by GDP, China has the largest economy ($25.3 trillion dollars), the EU has the second largest ($22 trillion dollars), and the United States has the third largest ($20.5 trillion dollars). *Id.*

126 ALL. FOR CORP. TRANSPARENCY, *supra* note 88, at 6.

supply chain disruptions, damaged reputation, and failed . . . investments."[127]

The Alliance for Corporate Transparency, a cohort of leading civil society organizations, is analyzing the first three years of how the largest companies operating in the EU have complied with this new law. In their first report, they assessed 105 companies' 2018 disclosures in the areas of the environment; social, employee, and human rights; and anti-corruption.[128] Overall, they found that only half of the companies provided clear environmental information "in terms of concrete issues, targets and principal risks."[129] Nordic companies, at 92%, provided the most clarity.[130] Similarly, when focused on key issues and targets for improvement related to climate change, only half the companies provided any information.[131]

While they found 90% of the companies reported on climate change, only 47% actually described the goal of their corporate climate policy and how it would be achieved.[132] Reporting on GHG emissions is widespread, at 82% overall, and ranging from nearly universal reporting in the energy sector to 70% in the health care sector.[133]

However, only 26% of energy and resource extraction companies reported on how they were achieving a transition to below 2°C.[134] The report of the U.K. energy company, EDF, is highlighted as an example of how an energy company could accomplish this.[135] Based on these findings, the Alliance for Corporate Transparency recommends an update to the legislation to "clarify the requirement for the disclosure of companies' long-term transition plans to a zero-carbon economy and their economic implications."[136]

The researchers found a similar absence of meaningful information in reporting about water and biodiversity in the 2018 disclosures. For instance, only 24% of energy and health care companies operating in

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127 *Id.*
128 *Id.*
129 *Id.* at 7.
130 *Id.* at 26.
131 *Id.* at 68.
132 *Id.* at 32.
133 *Id.*
134 *Id.* at 7.
135 *Id.* at 33.
136 *Id.* at 7.

water-scarce areas reported on water use.[137] Strikingly, the research showed that less than 10% disclosed lobbying expenditures and the public positions on which the corporations lobbied.[138] The researchers found a correlation between company size and report quality, with the largest companies (more than 50,001 employees) presenting better results than the smallest companies (fewer than 1,500 employees).[139]

The researchers' second analysis expanded to 1,000 companies' 2019 disclosures under the law and showed similar deficiencies. Companies seem to focus on reporting about their policies in a way that is disconnected from assessing risks and showing results in outcomes. For instance, in the 2019 disclosures about climate change, "82[%] of companies have policies, but only 35[%] have targets and even fewer — 28[%]—report on their outcome."[140] In other words, only a minority of companies provide specific enough information to understand a company's exposure to climate risk and impact on the climate.[141]

Corporations are also not aligning their reports with the international conventions they espouse to support: the Paris Agreement and the SDGs. Of the corporations that include a climate target in their report, only 14% align this to the Paris goal of limiting warming to +2°C (aiming for +1.5°C).[142] Even within the sector that has the most significant and direct impact on climate disruption and its potential mitigation, the energy and resource extraction sector, only 36.4% report on climate-related targets.[143]

BlackRock's 2020 announcement that it will require sustainability reports from the companies in which it invests is better understood against the backdrop of sustainability reporting across the EU's financial sector. In the analysis of 2019 disclosures, the sector that largely determines what businesses receive capital via investments and lending has an even worse response than the energy sector: only about

137 *Id.*

138 *Id.* at 8.

139 *Id.* at 27.

140 ALL. FOR CORP. TRANSPARENCY, 2019 RESEARCH REPORT: THE STATE OF CORPORATE SUSTAINABILITY DISCLOSURE UNDER THE EU NON-FINANCIAL REPORTING DIRECTIVE 4 (2020), http://www.allianceforcorporatetransparency.org/assets/2019_Research_Report%20_Alliance_for_Corporate_Transparency-7d9802a0c18c9f13017d686481bd2d6c6886fea6d9e9c7a5c3cfafea8a48b1c7.pdf [https://perma.cc/HV57-HM5E].

141 *Id.* at 13.

142 *Id.* at 6.

143 *Id.* at 16.

20% report on climate targets.[144] Moreover, the researchers convey that in the financial sector

> very few organizations are specific about the exposure of their lending, investment, and underwriting activities to sectors contributing to climate change (13.4%) or provide an estimation of the exposure of assets (financial, non-financial, under management) or the value of collaterals to climate-related risks (3.1%).[145]

The Non-Financial Reporting Directive is a prescriptive public law strategy to increase access to sustainability information. Currently it does this without setting any particular goals or purposes or even a standardized reporting format. The effectiveness of a reporting requirement leading to a change in corporate purpose and goals is unknown. How investors will respond to the non-financial disclosures remains to be seen. This holds potential, but the analysis on compliance with the new law points out areas where the law needs to be amended to make it more meaningful. As it stands, the poor quality and comparability of the data reduce its usefulness for investors who are trying to assess risks and inform the flow of capital.

In June 2019, the European Commission released nonbinding Guidelines on Reporting Climate-Related Information to influence the reporting under the EU Directive. The Guidelines emphasized the need for "sufficient, reliable and comparable sustainability-related information" from investor-owned corporations.[146] They asserted that, without such information, "the financial sector cannot efficiently direct capital to investments that drive solutions to the sustainability crises we face, and cannot effectively identify and manage the risks to investments that will arise from those crises."[147]

The Guidelines incorporate June 2017 recommendations from the Task Force on Climate-Related Financial Disclosures. The G20 Financial Stability Board established this Task Force, and the European Commission describes their recommendations as "widely recognised as authoritative guidance on the reporting of financially material climate-related information . . . ."[148] An important distinction is that the

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144 *Id.*

145 *Id.* at 17.

146 EUROPEAN COMM'N, GUIDELINES ON REPORTING CLIMATE-RELATED INFORMATION 4 (2019), https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf [https://perma.cc/RB4F-V9DL].

147 *Id.*

148 *Id.*

Task Force's recommendations are focused only on the financial materiality of climate change's impact on the company (e.g., simply put, does sea level rise threaten corporation X's factory). However, this is only part of assessing climate-related risk. The European Commission includes this but adds the materiality of the company's impact on the climate, consistent with the EU Directive.[149] It is this latter information that is critical to the private-sector mitigation of climate change. Without it, investors cannot effectively screen investments and direct capital to the companies that show a strong ability to mitigate climate change.

The European Commission's new Guidelines on climate-related reporting provide an example of risks that corporations pose to the climate:

> - A company's industrial production facility might directly emit greenhouse gases (GHGs) into the atmosphere.
> - The energy that a company buys to run its operations might have been produced from fossil fuels.
> - The product that a company makes might require the consumption of fossil fuels, for example in the case of cars that run on petrol or diesel.
> - The production of materials used by the company might result in GHG emissions upstream in their value chain. This may be the case for companies that use materials such as cement or aluminum in their production processes. Similarly, a company producing or processing forest or agricultural commodities, including in sectors such as food, apparel, or wood processing industries, could potentially be causing, directly or indirectly, land use change including deforestation and forest degradation and related GHG emissions.[150]

Further, even when sustainability reporting is in response to a law requiring it, as opposed to a voluntary measure with GRI, reporting on externalities without more data does not appear to curb the externalities. In the analysis of the first year's data, researchers say that "the assessment of companies' reporting on their business model suggests a common disconnection between the non-financial statement and the rest of the annual report."[151] Leaving corporate transformation solely to these voluntary means, even when coupled with mandatory

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149 *Id.* at 7.

150 *Id.* at 8.

151 ALL. FOR CORP. TRANSPARENCY, *supra* note 88, at 9.

non-financial disclosures, will likely fall short of being able to mobilize the private sector at a scale needed to move the global economy off fossil fuels in a manner that supports achieving broader sustainability in the SDGs.

In his study of the Non-Financial Reporting Directive, as it relates to human rights reporting, Hess came to a similar conclusion. He observed that "the empirical evidence on sustainability reporting shows continued problems of selective disclosure, impression management, incomparable disclosures, and the use of disclosure as an end in itself (as opposed to a process that leads to organizational change)."[152] He argued that transparency policies "have become the default way to regulate the complex issues" of CSR.[153]

The short timelines for financial returns that investors demand push against sustainability despite new research showing long-term financial data for companies with strong CSR is positive.[154] The short timelines and elevation of profit above all other goals may ultimately undermine the ability of sustainability reporting leading to improvements in sustainability outcomes.

Investor-owned corporations, if they are required to pay for additional sustainability rather than externalizing those costs, as is the current status quo, have several ways to accomplish this: by reducing returns to shareholders, reducing compensation to executives, reducing wages paid to labor, or increasing prices to consumers. Without reforming shareholder primacy and excessive executive compensation (as measured by the gap between the highest- and lowest-paid in an enterprise), workers will pay in stagnant wages, and consumers will pay in higher prices. The "yellow vest" protests in France showed the world this dynamic when France raised fuel prices.[155] Failing to address unequal burdens on workers and consumers undermines the ability of the government to aggressively mitigate climate change. In other words, if addressing inequality is a primary goal, as it is in the SDGs, while deeply decarbonizing economic activity, reforms to shareholder primacy and executive pay in investor-owned corporations

152 David Hess, *The Transparency Trap, Non-Financial Disclosure and the Responsibility of Business to Respect Human Rights*, 56 AM. BUS. L.J. 5, 5 (2019).

153 *Id.* at 8.

154 Khan, Serafeim & Yoon, *supra* note 54.

155 Alissa J. Rubin, *Macron, Confronting Yellow Vest Protests in France, Promises Relief*, N.Y. TIMES (Dec. 10, 2018), https://www.nytimes.com/2018/12/10/world/europe/macron-france-yellow-vests.html. [https://perma.cc/6H4K-FFEQ].

are essential. Without it, consumers and labor will be left to bear the brunt of the costs of conservation and deep decarbonization, and governments will face increasing social unrest. A deep discussion of this problem is beyond the scope of this Article, but it is noted to highlight the limits of sustainability reporting without broader changes in corporate law.

Within the smaller realm of sustainability reporting, there are legal reforms that may improve environmental outcomes. At the beginning of 2020, it appears the European Commission will substantially update the Non-Financial Reporting Directive and initiate the development of the European Non-Financial Reporting Standard. The European Commission's Guidelines for climate reporting and the results of the first two rounds of analysis of the reports companies have provided in response to the EU's reporting law indicate areas where they could improve the efficacy of the law.

The Guidelines propose climate-related disclosures for a company's "(a) business model (b) policies and due diligence (c) outcome of policies (d) principal risks and risk management and (e) key performance indicators."[156] Through identification of specific disclosures, the Guidelines tie these five elements together. For example, a disclosure they suggest is for the company to "[d]escribe any climate-related targets the company has set as part of its policies, especially any GHG emissions targets, and how company targets relate to national and international targets and to the Paris Agreement in particular."[157] In that single disclosure there is a tying together of the company's policy and emission target and an anchoring of the target to the larger international convention. That disclosure needs to be coupled with reporting on specific outcomes, such as percentage of GHG emissions reduced from year 1 to year 2 and how this relates to the company target.[158] In order for comparability across companies, the law could require reporting specific indicators in common units. For instance, a company could be required to report direct and indirect (including supply chain) GHG emissions measured in metric tons of CO_2e.[159]

156 EUROPEAN COMM'N, *supra* note 146, at 11.

157 *Id.* at 14.

158 *Id.* at 16.

159 *Id.* at 19. "A carbon dioxide equivalent or CO_2 equivalent (CO_{2e}) is a metric measure used to compare the emissions from various greenhouse gases on the basis of their global-

In sum, the EU's Non-Financial Reporting Directive has now produced two years of reports from its largest publicly traded corporations, banks, and insurance companies. From this data, it is evident that while companies are providing sustainability reports, these reports are disjointed and disconnected from setting clear climate-related targets and showing progress on reducing climate impacts. They are not using a uniform set of reporting standards or even format for the reports, which limits comparability and transparency and undermines the usefulness of the reports for investors, consumers, and governments. Reforms of the EU law are on the horizon, and other jurisdictions, like the United States, can learn from this experience to create sustainability reporting requirements that are stronger and more likely to lead to improved sustainability outcomes.

CONCLUSION

The number of companies measuring and reporting sustainability, especially using the Global Reporting Initiative framework, has rapidly grown in the past decade to become the norm among the largest corporations. The EU now requires sustainability reporting from any publicly traded corporation, insurance company, or bank that employs 500 or more people.[160] As of 2020, BlackRock requires all the companies in which it invests to report on sustainability. These private governance and public law levers place a new importance on non-financial reporting. As the world rapidly transitions off fossil fuels and toward renewable electricity and sustainable development, the sustainable company is best positioned to access capital and succeed.

In addition to the trillions of dollars BlackRock manages, the EU will be investing at least another one trillion euros over the next decade on sustainability projects. In January 2020 remarks by the European Commission's Executive Vice President Dombrovskis, he provided this figure and added that "[a]round half of that will come from the next EU budget, with at least 25% of spending earmarked to support climate action."[161] He envisions the government establishing a path for

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warming potential, by converting amounts of other gases to the equivalent amount of carbon dioxide with the same global warming potential." *Id.* at 19 n.22.

160 Directive 2014/95/EU, *supra* note 16.

161 Vladis Dombrovskis, Exec. Vice President, Remarks by Exec. Vice President Dombrovskis at the Conference Implementing the European Green Deal: Financing the Transition (Jan. 28, 2020), https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_20_139 [https://perma.cc/2ABM-DUYW].

sustainable investments that will ultimately attract even more private sector funding in the form of equity, loans, and project finance. The primary focus of these efforts is to meet the EU's ultimate goal of carbon neutrality by 2050.[162]

The U.S. SEC has nothing comparable to the EU's Non-Financial Disclosure Requirement and has resisted requiring sustainability disclosures. The SEC Guidance has had some limited climate disclosures since 2010. In the face of this inaction by the regulatory agency, there have been a couple of attempts for new legislation. In 2018, Massachusetts Senator Elizabeth Warren sponsored the "Climate Risk Disclosure Act" with seven cosponsors.[163] Reintroduced in 2019 with thirty-five cosponsors, but it still failed to gain traction.[164] If enacted, the law would direct the SEC to issue rules within one year that require every public company to disclose

- "direct and indirect greenhouse gas emissions[,]…
- total amount of fossil fuel-related assets that it owns or manage[s,]"
- impact on valuation if climate change continues at its current pace or if policymakers successfully restrict greenhouse gas emissions to meet the Paris accord goal, and
- "risk management strategies related to the physical risks and transition risks posed by climate change."[165]

Given the rapid movement of capital toward sustainable companies that will occur over the next decade in the race to rapidly decarbonize the economy, the United States should take a more active role in shaping this new reality. Especially for U.S. companies that compete globally, it is not an advantage to be a novice or laggard in sustainability measurement and reporting.

Governments and system-shaping private actors should note that sustainability reporting does not necessarily lead to improvements in environmental and social outcomes. The information has to be high quality, linked to the ultimate goal of carbon neutrality, and require the use of common metrics tied to climate targets for it to be useful to guide

162 *Id.*

163 Climate Risk Disclosure Act of 2018, S. 3481, 115th Cong. (2018).

164 Climate Risk Disclosure Act of 2019, H.R. 3623, 116th Cong. (2019).

165 Climate Risk Disclosure Act of 2018, S. 3481, 115th Cong. (2018); Climate Risk Disclosure Act of 2019, S. 2075, 116th Cong. (2019).

public and private sector investments in this global economic transition.

The analysis of the EU's reporting law in the first two years of reports (2018 and 2019) shows areas where improvements should be made in the law. Dombrovskis signaled that later in 2020 he will forward a sustainable finance strategy, including amendments to improve the Non-Financial Reporting Directive. Such improvements may take the form of reporting standards, which he says the European Commission will support.[166] Recognizing the need for international cooperation beyond the EU, he invited other countries to similarly move forward in a coordinated manner through the new International Platform on Sustainable Finance.[167]

In order to get the most out of sustainability reporting to guide public and private sector investments in this global transition, the information must be high quality, linked to the ultimate goal of carbon neutrality, and require the use of common metrics tied to climate targets. For instance, reports should include scientifically based targets (e.g., limiting warming to +1.5°C) and the internationally approved SDGs; require consistent, performance-based reporting that provides comparability across companies; and explicitly tie the business model to these goals and outcomes. Importantly, companies should report on the financial materiality of climate change's impact on the company and the materiality of the company's impact on the climate. The required reporting metrics are best developed with an eye to what is most material to maintaining a livable planet, not what is easiest to quantify.

166 Dombrovskis, *supra* note 161.

167 *Id.*