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ENVIRONMENTAL LAW

Corporate Sustainability Reporting: Capturing Benefits, Avoiding Pitfalls

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Special to the Legal

Looking to satisfy the demands of a variety of stakeholders and to gain a competitive edge in the marketplace, businesses are increasingly issuing corporate sustainability reports describing their environmental and social stewardship initiatives. The surge of companies issuing sustainability information reflects a sea change in the manner in which corporate health is measured, reported and evaluated — no longer limited to traditional financial data, it now involves complex indicators of social and environmental impacts as well.

Moreover, these indicators are not uniform mandated regulatory standards, but arise from evolving practices and standards developing in numerous forums and markets around the globe and they can pose a host of new issues and challenges to companies seeking to position themselves through sustainability reporting. This article discusses the evolving trend and provides insights into navigating the rapidly changing landscape for those seeking to capture the benefits of corporate sustainability reporting while avoiding potential pitfalls.

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WHAT IS CORPORATE SUSTAINABILITY?

Corporate sustainability typically refers to business operations and accounting that incorporate a "triple bottom line" approach. This term was coined in 1994 by John Elkington to express an expanded measure of business accounting that addresses "people, planet and profit." Today, most corporations using the triple bottom line approach measure and report on environmental, social and economic aspects of their operations. Increasingly, businesses are developing a strong triple bottom line by integrating sustainability concepts into their decision-making processes and core operations.

While enhancing financial value may be a familiar concept, the other two aspects of the triple bottom line are likely new territory for many businesses. Strategies to address environmental effects may include actions to reduce energy, water and raw material use, reduce waste and pollutants, and increase recycling. Strategies to address a business' social impacts may include community investments and partnerships, employee training and support and enhanced occupational safety programs.

WHY REPORT ON SUSTAINABILITY?

Business leaders increasingly view sustainability reporting as a tool to reduce risk, enhance reputation, attract and retain customers (and employees), identify operational efficiencies and cost-savings and create new business opportunities. Legal mandates dating back to the 1930s have required public corporations to report on their financial health and, in the last several decades, federal and state environmental programs have required both public and private companies to report on certain aspects of their environmental performance. Now corporations are moving beyond compliance mandates and are voluntarily reporting on a broader scope of information in the form of corporate sustainability reports. These reports aim to assure stakeholders that businesses are looking beyond short-term profits and are implementing broader goals that address environmental, social and economic performance. In addition to financial indicators and environmental disclosures, sustainability reports may include disclosures about climate change and water scarcity risks, labor practices, human rights, community relations and diversity and equal opportunity.

The increasing trend toward sustainability reporting is also attributable in part to a growing demand for sustainability data and transparency from a wide variety of stakeholders, including shareholders, investors, customers, business partners, government agencies, public interest groups and the general public. Investors, for example, are seeking out sustainability performance information and major financial indexes, including the Dow Jones Sustainability Indexes, the FTSE KLD Global Sustainability Index and the NASDAQ OMX CRD Global Sustainability 50 Index, now enable them to track the performance of companies that have self-reported sustainability activities. Likewise, retail giant Wal-Mart recently announced a program to develop a sustainable product index to help consumers evaluate the sustainability of its products. As part of that initiative, it is requiring all businesses in its supply chain to provide it with information about their sustainability practices, which will be used in developing the index.

Importantly, regardless of whether a company prepares its own sustainability report, information already available in the marketplace may allow stakeholders to interpret a company's sustainability performance. By self-reporting sustainability data, a company has an opportunity to control the content and context of available information and to convey key messages about its sustainability performance.

INTERPLAY WITH SEC REPORTING REQUIREMENTS

While current U.S. Securities and Exchange Commission regulations do not specifically address sustainability disclosures by publicly held companies, they may nevertheless affect a company's sustainability reporting and, thus, should be carefully considered before preparing sustainability reports. Likewise, measured sustainability indicators should be reviewed and evaluated for inclusion in SEC-mandated reports.

For example, pursuant to its Rule S-K, the SEC requires that certain corporate reports include discussions of trends, events or uncertainties that will be reasonably likely to have a material effect on a company. Certain requirements of Rule S-K may be broad enough to encompass issues considered for inclusion in a corporate sustainability report.

For example, Item 101 of Rule S-K requires disclosure of the material effects of environmental compliance costs; Item 103 requires disclosure of material pending or contemplated administrative or judicial proceedings, including those related to environmental and health issues; Item 303 requires disclosure of "known trends, events or uncertainties" that may have a material effect on a company's financial condition; and Item 503(c) requires disclosure of the most significant risks that could affect a company's business, financial condition or future results. These provisions may capture certain risks or liabilities relating to issues addressed by corporate sustainability reporting

and, thus, the SEC reporting implications of those issues should be carefully considered.

VOLUNTARY REPORTING FRAMEWORKS

In the absence of specific regulatory mandates, a number of voluntary reporting frameworks have emerged to guide sustainability reporting. Some popular frameworks include the Global Reporting Initiative's, or GRI's, Sustainability Reporting Guidelines, or G3, the Coalition for Environmentally Responsible Economies Principles, AccountAbility's AA1000 standards and the International Organization for Standardization's ISO 14031 standard for environmental performance evaluation.

Sustainability reports may follow a single established reporting framework, may use components of two or more existing frameworks or may use a framework created by or for a specific corporation. For example, the General Electric Corporate Citizenship Report 2007-2008 relied on both the GRI G3 Guidelines and the AA1000 standards.

The GRI G3 Guidelines are a popular sustainability reporting framework. GRI estimates that more than 1,000 organizations worldwide have issued and registered sustainability reports based on its G3 Guidelines, including 13 percent of the companies listed on the U.S. S&P 500 Index. The G3 Guidelines provide guidance on how to report, including the content, quality and boundaries of the report and what to report, including disclosures on organizational profile, management approach and performance indicators. The G3 Guidelines state that a sustainability report should include key performance indicators reflecting an organization's material economic, environmental and social impacts, or indicators that would otherwise influence stakeholder assessments and decisions. Also, they direct companies to provide management disclosures for each category and to disclose other information about organizational goals, policy, responsibility and training and awareness. Further, they note that a report should include only those entities over which the reporting company has control or significant influence.

For most organizations, the GRI recommends reporting on the "core performance" indicators identified in the GRI G3 protocol. GRI has also developed "Sector Supplements" guidance for particular industries (e.g., airports, food processors, real estate, etc.). Identified major indicator categories for measuring baseline and continuing sustainability success include environmental, human rights, labor practices and decent work, product responsibility, economics and society. For example, environmental performance indicators include materials used by weight or volume, direct energy consumption and total direct and indirect greenhouse gas emissions by weight. Social performance indicators include anti-corruption training, public policy positions and monetary value of fines for non-compliance with laws and regulations. Among others, economic indicators include financial implications and other risks to a company because of climate change.

Until a single mandatory or market-preferred reporting framework emerges, companies should select a framework that includes indicators that are relevant to their business, that will assist them in delivering sustainable outcomes, that will assist them in delivering key sustainability messages and that will meet the requirements of existing regulatory disclosure requirements.

ACCURACY AND VERIFICATION

Absent a mandatory framework, sustainability reports currently tend to be of varying quality and complexity. Because environmental, social and community indicators are not measured in a standardized fashion, some argue that there is room to manipulate data or provide misleading information (i.e., greenwashing). This has led some stakeholders to advocate for third-party verification of corporate sustainability data and reports.

To improve the credibility and transparency of reported sustainability information, companies should consider third-party verification. However, even before the point of verification, companies should start by developing and implementing systems to consistently identify and accurately measure data relevant to the triple bottom line for potential use in sustainability reporting. By implementing such systems, companies can themselves initially verify the accuracy and completeness of sustainability data even before third-party verification and public reporting.

Even where reports are verified, however, companies reporting sustainability information may face public scrutiny related to reported information and how accurately it portrays true achievements in sustainability. Companies should take care to review the context in which the information is presented to avoid potential claims that the information may be misleading. In addition, care should be taken to ensure that the company is not making inconsistent information disclosures (e.g., where voluntary disclosures contradict mandatory SEC disclosures).

> *Sustainability reports may include disclosures about climate change and water scarcity risks, labor practices, human rights, community relations and diversity and equal opportunity.*

LEGAL LANDSCAPE

Potential risks associated with sustainability reporting include government enforcement actions, shareholder lawsuits or greenwashing claims, which may result in legal liabilities or adverse reputational impacts. Selection of a suitable reporting framework and an appropriate verification system can help protect against these pitfalls.

In 2007, after an investigation into the adequacy of the public disclosures of five energy companies, the state of New York asserted that certain SEC filings inadequately addressed the expected impacts of climate change and climate change regulation on company operations, financial conditions and plans to build new power plants. In 2008, Xcel Energy and Dynegy entered into settlements in which they agreed to specifically disclose certain risks associated with climate change, setting the stage for possible similar charges of inadequate disclosure of sustainability information in the future.

Shareholder class action lawsuits under Rule 10b-5 of the Securities Exchange Act raising allegations of inaccurate sustainability disclosures (particularly where companies have explicitly touted their sustainability performance) present another potential pitfall. Rule 10b-5 prohibits misleading disclosure and the omission of facts necessary to make statements to investors not misleading. Companies should be careful not to overreach in their claims about corporate efforts to achieve sustainability.

Likewise, exaggerated claims may qualify as unfair or deceptive under Section 5 of the Federal Trade Commission Act. The FTC's "Green Guides," currently awaiting revision, provide guidance regarding the boundaries of green marketing claims, including claims made in sustainability reports. In mid-June, after an extended hiatus from enforcement of the Green Guides, the FTC charged three companies with making false and unsubstantiated claims about the greenness of their products. The FTC could similarly use its enforcement power to rein in companies whose sustainability reports disregard the protocol of the Green Guides.

Also of note, the SEC has recently indicated a potential interest in specifically addressing corporate accountability in sustainability reporting. Meeting on July 27, the SEC's newly established Investor Advisory Committee considered an agenda including possible revisions or additions to existing SEC disclosure requirements in order to address the importance to investors of sustainability issues, including environmental compliance and climate change.

Likewise, Congress is also giving attention to sustainability reporting. For example, the American Clean Energy and Security Act legislation passed by the House includes provisions addressing environmental disclosures, particularly in the realm of corporate risks related to climate change. Similarly, ASTM International is developing a new standard addressing climate change-related disclosures.

LOOKING FORWARD

Measuring and managing corporate sustainability is becoming an essential part of doing business. More than a marketing tool, sustainability reports can help companies identify opportunities to build their businesses and to avoid risk. To reap the full rewards from sustainability reporting and avoid possible legal pitfalls, companies must carefully consider the information in their sustainability reports, ensuring that the performance indicators are accurate, consistent with other reported information, and have appropriate context. •

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