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Liability for corporate governance in today's volatile world

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As the rules regarding ESG reporting are strengthened and modernised, environmental, social and corporate governance matters gain momentum and importance among an increasing number of companies across Europe. The pressure is on to not only become more environmentally sustainable ("E") and to positively impact wider society and the workplace itself ("S"), but also to implement good policies for decision making, reporting and logistics within a company ("G"). But what exactly does the last letter in the ESG acronym stand for? What are the regulatory issues connected to corporate governance and the related liability of companies and their directors?

"G" in a nutshell

It is hard to give a comprehensive list of components that constitute corporate governance issues as represented by the "G" letter in the ESG acronym. Corporate governance essentially means a structure of rules, policies and practices used to manage a company. The company body that is primarily responsible for structuring corporate governance is its management board. Good or bad, the performance of the management board in this respect can boost or hinder the company's activity and profitability and can impact the relationships between the company's shareholders, directors, management and employees.

Topics referred to when discussing corporate governance include, among others: the structure of the company bodies (*e.g.* the management board and supervisory board), transparency of the company's shareholding structure, shareholders' rights, gender balance in the workplace, remuneration of the members of the company bodies, recognition of the interests of the company's other stakeholders, rules regarding conflicts of interests and related parties' transactions, as well as integrity, ethics, transparency and disclosure policies.

It seems obvious that corporate governance is an umbrella term which cannot be comprehensively captured in one legal act. Therefore, there exist many regulations, both as soft and statutory law, that refer to corporate governance issues. To name but a few: the G20/OECD Principles of Corporate Governance, and as for EU law: Directive 2007/36/EC establishing rights for shareholders in listed companies, Directive 2004/25/EC on takeover bids, Women on Boards Directive (i.e. Directive (EU) 2022/2381) and the proposal for a Directive on corporate sustainability due diligence (legislative procedure no. 2022/0051/COD). It goes without saying, however, that corporate governance issues are also present in the legislation regarding non-financial / ESG reporting: Non-Financial Reporting Directive (i.e. Directive 2014/95/EU; "NFRD") and Corporate Sustainability Reporting Directive (i.e. Directive (EU) 2022/2464; "CSRD").

Corporate governance in ESG reporting

Over the course of the last couple of years, the NFRD has served as an instrument in terms of advancing the European Union's agenda for CSR and later ESG, including corporate governance issues. This directive is now being replaced by the CSRD, which entered into force in early 2023, and which sets the rules for disclosing information related to environmental, social and corporate governance issues on the part of companies. The first companies to apply the new CSRD rules will have to do so when publishing reports in 2025 that cover the 2024 financial year.

One of the biggest differences between the NFRD and the CSRD is that the latter implements common reporting standards, known as the European Sustainability Reporting Standards (ESRS). The main aim of the ESRS is to guarantee the good quality of ESG reporting, making it comparable, relevant and verifiable.

The ESRS determine the rules and structure of disclosure requirements under the CSRD, among other elements related to corporate governance issues. Within this topic they outline the following aspects: *the role of administrative, management and supervisory bodies* (ESRS 2 GOV-1), *information provided to and sustainability matters addressed by the undertaking's administrative, management and supervisory bodies* (ESRS 2 GOV-2), *integration of sustainability-related performance in incentive schemes* (ESRS 2 GOV-3), *statement on due diligence* (ESRS 2 GOV-4) and *risk management and internal controls over sustainability reporting* (ESRS 2 GOV-5). Corporate governance matters are also present in ESRS G1, devoted to the topic of business conduct*: business conduct policies and corporate culture* (ESRS G1-1), *management of relationships with suppliers* (ESRS G1-2), *prevention and detection of corruption and bribery* (ESRS G1-3), *incidents of corruption and bribery (ESRS G1-4), political influence and lobbying activities* (ESRS G1-5) and *payment practices* (ESRS G1-6).

Corporate governance liability

EU regulations regarding ESG reporting do not contain direct provisions regarding sanctions for breaches of the rules of reporting. For instance, determining the penalties of CSRD infringements will be at the discretion of EU Member States based on local legislation and how the directive is transposed. It has been decided, however, that penalties should be effective, proportionate and dissuasive so that the goals of CSRD reporting are met.

Noncompliance with the rules of ESG reporting, including corporate governance issues, will have numerous consequences. Firstly, we can expect criminal liability for those who are responsible for ESG reporting (e.g. companies' directors) as is currently the case with regard to noncompliance with the rules of financial reporting. Liability will, however, be broader, as noncompliance with the rules of corporate governance might also result in a company's reputational damage, a decline in its competitiveness in the market, or even lead to limiting its access to financing. Liability for corporate governance issues will be borne both by the companies themselves and their directors.

As far as the liability of directors is concerned, it is worth mentioning that there exists D&O (directors and officers) liability insurance that protects against personal losses resulting from serving as a director or an officer of a company. On the one hand, the above insurance covers directors and officers in the event of a lawsuit, but on the other, it can serve as an indicator of the quality of the company's corporate governance, as the premium amount is dependent on whether, and to what extent, the company complies with the rules of good corporate governance.

In conclusion, Corporate Governance is not only a buzzword. As one of the main topics within the ESG trend, it actually shapes the evolution of the market and that of many companies. Those who are responsible for the integration of corporate governance within companies are mainly said companies' directors, who also bear liability for any noncompliance therewith. However, the companies themselves can also suffer consequences stemming from irregularities connected to corporate governance issues in the form of potential reputational damage, a decline in competitiveness, or problems accessing future financing. Bearing all of the above in mind, it is necessary to underline the importance of good corporate governance in today's volatile world.

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