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Du Plessis, J. and Rühmkorf, A. (2015) New trends regarding sustainability and integrated reporting for companies: what protection do directors have? Company Lawyer, 36 (2). 51 - 64. ISSN 0144-1027

New Trends Regarding Sustainability and Integrated Reporting for Companies: What Protection do Directors have?*

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Abstract

The authors explore some significant developments in recent times regarding modern expectations of corporations and the considerable impact of corporations on modern society. They also focus on some of the most dominant corporate law theories like the shareholder primacy theory, the enlightened shareholder value theory and the stakeholder theory. They illustrate that these developments require broader reporting than just financial reporting as is currently required by law for purposes of financial statements and reports. They then analyse the trend of broader reporting also on social and environmental issues. These forms of reporting have been done under general descriptive terms like corporate social reporting (CSR),

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* The authors would like to thank Professor Mervyn King, SC, for his valuable advice on several earlier drafts of this article. The views expressed in this article are, however, the views of the authors and should not in any way be seen as views that Professor King necessarily support. Jean J du Plessis would like to acknowledge the financial support of the Alexander von Humboldt Foundation and the German Federal Ministry of Education and Research, through the Anneliese Maier Research Award awarded to him from 2013-2017, that enabled him to undertake the research for his part of this joint article.

sustainability reporting, integrated reporting and responsibility reporting. The question is then asked whether directors are opening themselves to greater liability by doing these forms of non-statutory reports. They compare three jurisdictions, namely Australia, Germany and South Africa. They conclude that the safe-harbour statutory provisions and some other statutory provisions in Australia and South Africa should be sufficient to protect directors against personal liability for judgment calls honestly made as long as the requirements of the statutory protection are present. The protection for directors in Germany seem to be more limited, especially in light of current statutory provisions requiring reporting on issues broader than financial issues and because of some recent developments in the European Union (EU) that will widen reporting obligations even further.

1. Introduction

Professor Mervyn King, having been involved in groundbreaking and world-leading corporate governance developments since the first South African King Report was released in 1994, reflects on some of the most fundamental issues regarding corporations in modern times:

> The concept of value creation by corporations in the 21st century has changed. It is no longer looked at through a financial lens defined as the present value of discounted future cash flows. There is an appreciation that business is at the junction of the economy, society and the environment. The corporation carries on business in the

> context of these three aspects and it is important for stakeholders to be informed as to how it makes its money as well as how its product or service impacts on all three.[1]

It is generally accepted that the financial report is critical but not sufficient to fulfill the purpose of corporate reporting which is to inform stakeholders in an understandable manner about the ‘state of play’ in a company.[1] Recently additional forms of reporting like sustainability reporting, responsibility reporting and integrated reporting became very prominent and will be an important focus for the foreseeable future as will be explained in detail in this article.

The idea of ‘integrated thinking’ has been actively promoted by the International Integrated Reporting Council (IIRC) and is now promoted further under the concept of ‘Integrated Reporting <IR>’.[2] Integrated thinking involves an acceptance that a corporation uses six capitals, namely financial, manufactured, human, intellectual, natural and social which includes the relationships with the corporation’s key stakeholders and how the company makes its money.[3] The latter involves its governance, its enterprise risk management, its strategy short, medium and long term, and its internal controls. The business model of the company impacts on the three aspects while the company produces a product. The product in turn impacts on those three aspects.[4]

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[1] Professor Mervyn King, Speech Delivered at the ICAEW, accepting an Honorary Membership (London, 4 March 2014).

[2] See <http://www.theiirc.org/>.

[3] Professor Mervyn King, Speech Delivered at the ICAEW, accepting an Honorary Membership (London, 4 March 2014).

[4] Professor Mervyn King, Speech Delivered at the ICAEW, accepting an Honorary Membership (London, 4 March 2014).

In this article the authors focus on the significance of integrated and sustainability reporting and why it is essential that corporations should embrace such reporting. We also discuss some of the most recent trends in this area.

However, will integrated and sustainability reporting expose directors to risks of personal liability? Will directors be held liable for mere errors of judgment reflected in these reports? In this article the authors look at Australia, Germany and South Africa, three jurisdiction that recently introduced safe harbour rules, and ask whether these rules or other statutory provisions would protect directors against bona fide errors of judgment contained in, for instance, integrated or sustainability reports.

2. Significant developments in recent times[5]

2.1 The corporate governance debate and the 'shareholder primacy' theory

The corporate governance debate became particularly prominent when the basic perception of the company changed. At first the only real concern for a company was the maximisation of profits[6] for the shareholders.[7] This was clearly articulated in 1919 in the US case of Dodge v

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[5] This part is based on parts in J.J. du Plessis et al, Principles of Contemporary Corporate Governance (Cambridge University Press, 3rd edition – FORTHCOMING, November 2014) Chapters 1 and 2.

[6] A.A. Berle, 'The Impact of the Corporation on Classical Theory' in T. Clarke (ed.), Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance (Routledge, 2004), 45, 49 et seq.

[7] M.M. Blair, 'Ownership and control: rethinking corporate governance for the twenty-first century' in Thomas Clarke (ed.), Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance (Routledge, 2004) at 175, 181. See also Stephen M Bainbridge, The New Corporate Governance in Theory and Practice (Oxford University Press, 2008), 53.

Ford Motor[8] and is a view many commentators adhered to for a considerable period of time and it is argued, very convincingly by David G. Yosifon, still to be the law not only in the rather insignificant corporate law jurisdiction of the State of Michigan (*Dodge's* case was decided in the State of Michigan), but also in the leading AU corporate law State, namely in Delaware.[9] According to this view, the shareholders are the 'owners of the company',[10] the primary stakeholders and most important providers of capital to enable the company to conduct business. This is called the shareholder primacy theory.[11] Professor Mervyn King explains as follows[12]:

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8 Dodge v Ford Motor 170 N.W. 668 (Mich. 1919) at 684; (1919) 204 Mich. 459, 507: 'A business corporation is organized and carried on primarily for the profit of the stockholders The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to the change of the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.' For an overview of *Dodge's* case, see L.I. Rothman, 'Re-evaluating the Basis of Corporate Governance in the Post-Enron Era' in Corporate Governance after the Financial Crisis (PB Vasudev and Susan Watson eds.) (Edward Elgar, 2012) 101, pp. 110-112.

9 D.G. Yosifon, 'The law of corporate purpose' (2013) 10 Burkley Business Law Review 181, pp. 188 ff.

10 See generally Kent Greenfield, The Failure of Corporate Law (The University of Chicago Press, 2006), p. 43, but see his arguments dispelling this 'myth' on 44-47.

11 See generally on the theory of 'shareholder primacy' I. Esser, Recognition of Various Stakeholder *Interests in the Company Management: Corporate Social Responsibility and Directors' Duties* (VDM Verlag Dr Müller, 2009). Pp.19–23.

12 Professor Mervyn King, Speech Delivered at the ICAEW, accepting Honorary Membership (London, 4 March 2014).

> 'This perception of the shareholder being the 'owner' of a company persisted notwithstanding that during the 20th century, share ownership became dispersed among many institutions with their ultimate beneficiaries unknown. Right to the end of the 20th century, in the Anglo-American business world, it was believed that corporations should be governed according to the principle of shareholder primacy. It is to be noted, with respect, that the shareholder primacy theory was advocated by economists and not by lawyers or accountants. It should also be noted that the company is a legal entity and a person in its own right. Slavery was abolished a long time ago. A person cannot be owned. Shareholders have a conglomeration of very important incorporeal rights which entitle them to determine the purposes of the company, vote for the appointment of directors, remove directors, institute action against directors for breach of fiduciary duties (if the company does not agree to do so) and to receive a dividend if the board has declared one, but it is not correct to say that they 'own' the company.'

2.2 Moving away from the 'shareholder primacy' theory to the 'enlightened shareholder value' theory

Gradually the 'shareholder supremacy'[13] view changed, and the company, especially the large public company, came to be seen in a different light. It was observed more pertinently that there were other stakeholders of a company, too; that if the only purpose of a company was 'the maximisation of profits for the shareholders', society could suffer tremendously – poor working conditions for workers, exploitation of natural assets, pollution and so on.[14] Society and natural assets would be subsidising the corporation and its 'owners'.

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[13] See generally Kent Greenfield, The Failure of Corporate Law (2006), pp. 2 and 44-46.

[14] See also K.H. Baker and J.RR Nofsinger, 'Socially Responsible Finance and Investing: An Overview' in K.H. Baker and J. R. Nofsinger (eds), Socially Responsible Finance and Investing:

The concept of 'managing the corporation' then came to be expressed in terms of these other interests,viz the balancing of the company's responsibilities – to workers as members of the company, to consumers of the goods and services it provides, and to the community of which it is a citizen.[15]

Traditional wisdom regarding shareholder primacy[16] began to be challenged more forcefully with statements like 'managerial accountability to shareholders is corporate law's central problem'[17] and, most recently, that '[s]hareholder primacy theory is suffering a crisis of confidence'.[18] Nowadays the calls ring loud for a rethinking of the traditional Anglo-American notion of the company still relying on 18th and 19th century principles, concepts and notions.[19]

From all of this emerged a slightly different theory, one moving away from the narrow 'shareholder primacy' theory to what is called an 'enlightened shareholder value' theory. The 'enlightened shareholder value' theory, very generally, entails that productive relationships (with other stakeholders) can be achieved within the framework of existing corporate law and corporate governance concepts, in fact maintaining 'shareholder

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Financial Institutions, Corporations, Investors, and Activists – Robert W. Kolb Series in Finance (John Wiley and Sons, 2010 - 2012) Vol 612, 2.

[15] G. Goyder, The Responsible Company (Blackwell, 1961), p. 45.

[16] See again Esser, Recognition of Various Stakeholder Interests in the Company Management: *Corporate Social Responsibility and Directors' Duties* (2009), pp. 19–23.

[17] D. Millon, 'New directions in corporate law: communitarians, contractarians, and the crisis in corporate law' 1993 (50) Washington & Lee Law Review 1373, 1374.

[18] L. A. Stout, 'The Shareholder Value Myth' (April 1, 2013) European Financial Review - available at SSRN: <http://ssrn.com/abstract=2277141>.

[19] See in particular B. Tricker, Corporate Governance: Principles, Policies and Practices (Oxford University Press, 2nd edn, 2012), pp. 164-165 and 488.

supremacy', but ensuring that directors pursue shareholders' interests in an enlightened and inclusive way, meaning having regard to the interests of other stakeholders, but no more than that.[20] The principal manifestation of this theory is found in section 172 of the UK Companies Act 2006:[21]

> **172 Duty to promote the success of the company**
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —
>
> > (a) the likely consequences of any decision in the long term,
> > (b) the interests of the company's employees,
> > (c) the need to foster the company's business relationships with suppliers, customers and others,
> > (d) the impact of the company's operations on the community and the environment,
> > (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> > (f) the need to act fairly as between members of the company.

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[20] See generally D. Millon, 'Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without Law' in Corporate Governance after the Financial Crisis (PB Vasudev and Susan Watson eds.) (Edward Elgar, 2012), 68, pp. 68 and 79-80; A. Keay, 'Tackling the issue of corporate objective: An analysis of the United Kingdom's "enlightened shareholder value approach"' (2007) 29 Sydney Law Review 577, pp. 589-590; I. Esser and J.J. du Plessis, 'The stakeholder debate and directors' fiduciary duties' (2007) 19 South African Mercantile Law Journal 346, 351-352.

[21] See A. Keay, 'Section 172(1) of the Companies Act 2006: An interpretation and assessment' (2007) 28 The Company Lawyer 106; Millon, 'Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without Law' in Corporate Governance after the Financial Crisis (2012) 68, pp. 69 and 79-80.

> (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
> (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

The 'enlightened shareholder value' theory could possibly be described as the interim step, buying more time to reflect more on the flaws of the 'shareholder primacy' theory and the merits of a proper 'all inclusive stakeholder' theory.

2.3 The 'stakeholder theory'

Gradually the concept of 'corporate governance' began to adopt a new articulation of 'managing the corporation', with a central focus on the interrelationship between internal groups and individuals such as the board of directors, the shareholders in general meeting, employees, chief executive officers (CEOs), managing directors, executive directors, non-executive directors, managers, audit committees and other committees of the board. However, also particularly significant to note, more and more other 'stakeholders' started to be identified, including creditors and customers. It was not long before 'the community', 'the environment' and 'the Government' were also identified as 'stakeholders'.[22]

It is not difficult to motivate why all these last-mentioned stakeholders have vested interests in the sustainability of corporations.[23] The shareholders want to maximise returns on their investment, not only by receiving good dividends, but also by making profits when they sell securities in a corporation. The employees are dependent on the company, not only to

[22] See J.J. du Plessis, A. Hargovan and M. Bagaric, Principles of Contemporary Corporate Governance (Cambridge University Press, 2nd edition, 2010), pp. 24-35.

[23] M. King, The Corporate Citizen (Penguin Books, 2006), p. 63.

support themselves and their families, but in some cases also as holders of employee benefits, including securing retirement benefits from the company. The creditors also have a strong interest in the sustainability of the company as their expectation is that they are paid in accordance with the conditions agreed upon with the corporation, while supplier–creditors are of necessity dependent upon corporations to continue manufacturing products and services. Customers want to continue trading with corporations that provide excellent goods and services, and they will deal with the company to enforce guarantees and warranties against suppliers. The communities, in which corporations do business, manufacture their goods or deliver their services, gain by corporations providing job opportunities and creating wealth that leads to the improvement of living conditions, as long as the corporations adhere to good corporate citizen practices with positive impacts on society and natural assets. The environment is our 'pearl' and is highly dependent on sustainable and environmentally friendly corporations. The government has an interest in the sustainability of corporations, as not only do they provide job opportunities to citizens, they are also responsible for a large part of governmental income through taxes, levies, licenses etc., which income is eventually re-invested into a country's infrastructure, health, education etc. to ensure prosperity for its citizens.

Nowadays, it is fairly generally accepted that 'in future the development of loyal, inclusive stakeholder relationships will become one of the most important determinants of commercial viability and business success';[24] that 'recognition of stakeholder concern is not

[24] D. Wheeler and M. Sillanpää, The Stakeholder Corporation (Pitmann, 1997), p. ix. See further J. E. Post, L.E. Preston and S. Sach, Redefining the Corporation: Stakeholder Management and Organizational Wealth (Stanford Business Books, 2002), pp 1–3; and M.J. Roe, 'Preface' in M.M. Blair and M. J. Roe (eds), Employees & Corporate Governance (Brookings Institute, 1999), p. v.

only good business, but politically expedient and morally and ethically just';[25] and that '[t]he corporation as a legal entity grew out of its ability to protect not only the shareholders but also other stakeholders'.[26]

As a result of the recognition and acceptance of a variety of stakeholders, other considerations started to become more prominent than just profit maximisation for shareholders and these considerations include 'corporate social responsibility' (CSR))[27] and the concept of 'corporate citizenship'.[28] The continued relevance and importance of companies being 'good corporate citizens' and that they have corporate social responsibilities are highlighted by the sheer number of articles and books, dedicated to corporate citizenship and the importance of companies being good corporate citizens as well as corporations' 'corporate social responsibilities', especially since about 1990.

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[25] D.S.R. Leighton and D.H. Thain, Making Boards Work (McGraw-Hill Ryerson, 1997), p. 23.

[26] M. Huse, Boards, Governance and Value Creation: The Human Side of Corporate Governance (Cambridge University Press, 2007), p. 29.

[27] For an explanation of the interrelationship between corporate governance and corporate social responsibility (CSR), see A. Rühmkorf, The Promotion of Corporate Social Responsibility in English Private Law, PhD Thesis, University of Sheffield (2013) at 58-62. See also See B. Sjåfjell and L. Anker-Sørensen, 'Directors' Duties and Corporate Social Responsibility' in H. S. Birkmose, M. Neville and K.E. Sørensen (eds.), Boards of Directors in European Companies (Wolters Kluwer, 2013) 153 ff.

[28] For an informative review of the history of CSR and the meaning of CSR, see R. Broomhill, 'Corporate Social Responsibility: Key issues and debates' (2007) 1 Dunstan Papers 1, pp 9-11; I. Freeman and A. Hasnaouvi, 'The meaning of corporate social responsibility: The vision of four nations' (2011) 100 Journal of Business Ethics 419.

3. Beyond CSR: Corporate responsibility reporting (CR reporting), Integrated Reporting (<IR>) and sustainability reporting

3.1 Building a better society and acting in the public good for the long term benefit of all stakeholders including shareholders.

It is clear that the debate regarding the role and potential impact of companies is getting wider, moving away from narrower corporate social responsibilities issues to the wider issue of corporate responsibility generally. As is explained in a 2013 consultation paper by the UK Department for Business Innovation & Skills:

> Corporate responsibility – the increasingly more acknowledged term for corporate social responsibility – is the responsibility of an organisation for the impacts of its decisions and activities on society and the environment through transparent and ethical behaviour above and beyond its statutory requirements.[29]

It seems as though we have truly and inevitably moved away from the view that the primary aim of corporations is 'to make a profit' or 'to make money',[30] without consideration of how it makes its money and the impacts of its product, to one of having [31] 'responsibility for the public good' – sustainable value creation.[32] Professor Mervyn King summarises this well:[33]

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[29] UK Department for Business Innovation & Skills, Corporate Responsibility, Consultation Paper (June 2013) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209219/bis-13-964-corporate-responsibility-call.pdf> at 3

[30] P. Hawken, The Ecology of Commerce, (Harper Business, Revised ed, 2010), pp. 1-2 makes this point very clear.

[31] A.C. Hutchinson, The Companies We Keep (Irwin Law, 2005), p. 326.

[32] Rühmkorf, The Promotion of Corporate Social Responsibility in English Private Law (2013) at 18, fn 47, referring to M. Blowfield and A. Murray, Corporate Responsibility: A Critical Introduction (Oxford University Press, 2008), p. 13.

> 'The board of directors, in discharging its duty of care and diligence, can no longer ignore the impact which the company's business model and its product has on society and natural assets. Strategically the board has to ensure that the company's business model and its product enhances positive impacts and eradicates or ameliorates negative impacts on society and natural assets. This creates total value – also called sustainable capitalism. And this is good hard-nosed business in the changed world of the 21st century.'

3.2 Demonstrating responsible and sustainable conduct to investors

It is based on these views that a new trend developed, namely for corporations, especially large public corporations, to illustrate, in a practical way, that they behave in a responsible way.

Integrated reporting requires the board to apply its collective mind to those reports. The board must understand these reports and explain 'the state of play' in the company in clear, concise and understandable language. Such a report enables all stakeholders, including investors, to make an informed assessment about the company's stability and sustainability.

The focus on the environment and the ways in which it is being used and protected,[34] with a view to maintaining long-term growth (recently contrasted with 'short-termism', ie the pressure to deliver quick results to the potential detriment of the longer-term development of

[33] Professor Mervyn King, Speech Delivered at the ICAEW, accepting an Honorary Membership (London, 4 March 2014).

[34] See generally J. Dine and M. Koutsias, The Nature of Corporate Governance: The Significance of National Cultural Identity (Edward Elgar, 2013), pp. 56-62.

a company)[35] is of pivotal importance. Put simply, if the manner in which resources are being used to achieve growth now cannot be sustained, then long-term growth is not achievable. What is needed is long-term, sustainable growth. However, it is one thing to promote long-term, sustainable growth, but how do we measure whether we are on the right track at the right pace and how do we encourage sustainable growth?

This is where the new trends of integrated thinking and doing an integrated report have become particularly prominent in recent years. It is not only financial reporting that matters, but reporting on the long-term business success of companies and illustrating that companies are acting in a responsible way. As is pointed out in the Australian Council of Superannuation Investors' (ACSIs) 2013 research paper, Corporate Reporting in Australia: Disclosure of Sustainability Risks among S&P/ASX200 Companies, environmental, social and governance (ESG) issues will profoundly impact the ability of companies and their investors to achieve sustainable growth and prosperity into the future.[36] To enable investors to effectively price and manage risk during their analysis of an investment, there is a need for relevant information, and companies need to understand the form that information should take[37] – that is the ultimate aim with integrated reporting to enable the user to receive

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[35] Sir George Cox, Overcoming Short-termism within British Business: The Key to Sustained Economic Growth, Independent Review Commissioned by the Labour Party (March 2013) <http://www.yourbritain.org.uk/uploads/editor/files/Overcoming_Short-termism.pdf>.

[36] Australian Council of Superannuation Investors' (ACSIs), 2013 Research Paper, Corporate Reporting in Australia: Disclosure of Sustainability Risks among S&P/ASX200 Companies <http://www.acsi.org.au/images/stories/ACSIDocuments/generalresearchpublic/Sustainability%20Reporting%20Journey%202013%20-%20public%20version.pdf> at 2.

[37] Australian Council of Superannuation Investors' (ACSIs), 2013 Research Paper, Corporate Reporting in Australia: Disclosure of Sustainability Risks among S&P/ASX200 Companies

understandable information obtained from such reporting in order to enable members of the ACSI, for example, to make informed decisions whether they are investing in sustainable businesses.

The sustainable reporting agenda is nowadays promoted actively internationally with remarkable progress made in 2013. Under the banner 'Integrated Reporting <IR>', the International Integrated Reporting Council (IIRC)[38] explains as follows:

> [Integrated reporting] is a process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation … An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term.[39]

To promote consistency with integrated reporting, the IIRC released an International <IR> Framework on 9 December 2013. It followed a three-month global consultation led by the IIRC[40] earlier in 2013,[41] which elicited over 350 responses from every region in the world, the overwhelming majority of which expressed support for integrated thinking and the

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<http://www.acsi.org.au/images/stories/ACSIDocuments/generalresearchpublic/Sustainability%20Reporting%20Journey%202013%20-%20public%20version.pdf> at 2.

[38] See < http://www.theiirc.org/the-iirc/structure-of-the-iirc/>.

[39] See < http://www.theiirc.org/>.

[40] See < http://www.theiirc.org/the-iirc/structure-of-the-iirc/>.

[41] On 26 March 2013, at the request of the International Integrated Reporting Council (IIRC), the International Federation of Accountants (IFAC), together with the Chartered Institute of Management Accountants (CIMA) and PwC, released a background paper, titled 'Business Model', which highlights the business model as being at the heart of integrated reporting. The report revealed wide variation in how organisations define their business models and approach to disclosure and that highlighted the need for a clear, universally applicable, international definition of a business model – see IFSA, 'Companies Lagging on Business Model Reporting; Background Paper Released to Tackle the Issue', Press Release, 26 March 2013 <http://www.ifac.org/news-events/2013-03/companies-lagging-business-model-reporting-background-paper-released-tackle-issu>.

integrated report.[42] Already in April 2013 the European Commission (EC) had announced the possible amendment to existing legislation to ensure transparency and require companies with more than 500 employees[43] to report, in a shorter form, information on policies, risks and results as regards:[44]

- environmental matters;
- social and employee-related aspects;
- respect for human rights;
- anti-corruption and bribery issues; and
- diversity on the boards of directors.

Companies that do not pursue policies in relation to one or more of these matters shall provide an explanation for not doing so. This was taken one step further on 26 February 2014 when it was announced that the European Parliament and Council reached agreement on the EC proposal of April 2013.[45] In order to become law, the Commission's proposal must be

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[42] See <http://www.theiirc.org/international-ir-framework/>.

[43] It will also apply to companies that, during the financial year, exceed on their balance sheet dates either a balance sheet total of EUR 20 million or a net turnover of EUR 40 million.

[44] See European Commission (EC), 'Commission Moves to Enhance Business Transparency on Social and Environmental Matters', Press Release, 16 April 2013 <http://europa.eu/rapid/press-release_IP-13-330_en.htm>.

[45] European Commission (EU), 'Disclosure of Non-Financial Information by Certain Large Companies: European Council Reach Agreement on Commission Proposal to Improve Transparency', Press Release (26 February 2014) <http://europa.eu/rapid/press-release_STATEMENT-14-29_en.htm?locale=en>. See also European Commission (EC), Statement (Brussels, 26 February 2014), 'Disclosure of non-financial information by certain large companies: European Parliament and Council reach agreement on Commission proposal to improve transparency', available at: <http://europa.eu/rapid/press-release_STATEMENT-14-29_en.htm>.

adopted jointly by the European Parliament and by the EU Member States in the Council (which votes by qualified majority). In April 2014, the European Parliament adopted the Directive. It will now enter into force once adopted by the Council and published in the EU Official Journal.[46] It is expected that approximately 6,000 large companies and groups across the EU will be affected by the new legislation. The approach taken ensures that administrative burden is kept to a minimum. Companies will be required to disclose concise, useful information necessary for an understanding of their development, performance, position and impact of their activity, rather than a fully-fledged and detailed report. Furthermore, disclosures may be provided at group level, rather than by each individual affiliate within a group.[47]

On 9 June 2014 the UK Financial Reporting Council (FRC) released its Guidance on the Strategic Report.[48] The FRC Guidance on the Strategic Report and the IIRC's International <IR> Framework are now much closer aligned and this will ensure better quality reporting in the UK.[49]

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[46] European Commission (EC), 'Improving corporate governance: Europe's largest companies will have to be more transparent about how they operate', Press Release (15 April 2014), available at: <http://europa.eu/rapid/press-release_STATEMENT-14-124_en.htm>.

[47] European Commission (EC), 'Improving corporate governance: Europe's largest companies will have to be more transparent about how they operate', Press Release (15 April 2014), available at: <http://europa.eu/rapid/press-release_STATEMENT-14-124_en.htm>.

[48] See FRC, Guidance on the Strategic Report, (June 2014) <https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf>.

[49] See IIRC, 'IIRC Welcomes Move towards Better Quality Reporting in the UK', Press Release (9 June 2014) <http://www.theiirc.org/2014/06/09/iirc-welcomes-move-towards-better-quality-reporting-in-the-uk/>.

3.3 Reporting outside statutory required reporting has taken root firmly

The eighth edition of KPMG Survey of Corporate Responsibility Reporting 2013 (released on 10 December 2013) illustrates the wider reporting expectation, and that companies are starting to live up to such expectations. This edition of the KMPG Report surveyed 4,100 companies across 41 countries and it was found that responsible reporting has evolved into a mainstream business practice over the last two decades, that is, reporting the financial and the non-financial. In the KPMG survey it was found that 71% of the companies surveyed undertook responsible reporting and, in particular, that there has been a dramatic increase in responsible reporting rates in Asia Pacific in 2012 and 2013.[50]

4. Risks and potential liability of directors when reporting

At this juncture it is important to pause for a moment and consider a few practical realities regarding risks and potential liability of directors when reporting. It is well known that there is a statutory duty on directors to ensure that financial reporting is done correctly. This is the case in all jurisdictions with developed company law and financial reporting legislation. There are indeed huge risks of liability for directors if the financial statements and reports of a company contain incorrect or misleading information. One of the most striking recent examples of the risks involved for directors in this area is the Australian case of ASIC v Healey (27 July 2011),[51] also generally called the Centro case, referring to the collection of companies associated with the Centro property development group that started doing business

[50] KMPG, The Survey of Corporate Responsibility Reporting 2013, <http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Pages/corporate-responsibility-reporting-survey-2013.aspx>.

[51] Australian Securities and Investments Commission v Healey [2011] FCA 717 (27 July 2011) available at <http://www.austlii.edu.au/au/cases/cth/FCA/2011/717.html>. We refer to the paragraph numbers of this case.

in Queensland in Australia, but expanded rapidly and later on got involved in international business activities, especially in the USA. In ASIC v Healey (27 July 2011)[52] the Australian Federal Court of Appeal held that directors and an officer of a company were liable for a breach of their duty of care and diligence by not picking up that the company's financial statements incorrectly classified a large amount of current liabilities as non-current liabilities.

The case has sent shock waves through Australia especially because of the liability of the non-executive directors. They were held liable irrespective of the fact that the financial statements were prepared in close collaboration with the auditors and the audit committee and the CEO recommended approval of the financial statements by the board of directors, but because they did not exercise proper care and diligence in scrutinising the financial statements they were held liable. Although the ultimate penalties for them were considered to be 'light' it was the underlying principles and potential of liability for directors that concern many Australian directors.[53]

Getting back to integrated and sustainability reporting, what are the risks involved for directors? Will cases like the Centro case make directors reluctant to report because of the fear of liability?

5. Possible forms of protection for directors

5.1 Australia: The business judgment rule, reliance provision and power of court to grant relief from liability

[52] Australian Securities and Investments Commission v Healey [2011] FCA 717 (27 July 2011).

[53] J.J. du Plessis and I. Meaney, 'Directors' liability for approving financial statements containing blatant incorrect items: Lessons from Australia for all directors in all jurisdictions' (2012) 33 Company Lawyer 273, pp. 279 and 280-282.

As early as 1958 directors' duty of care and diligence was expressed in Australian legislation.[54] This duty was refined over time and currently it is contained in section 180(1) of the Australian Corporations Act 2001 (Cth):

> **180 Care and diligence—civil obligation only**
>
> Care and diligence—directors and other officers
>
> (1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
>
> (a) were a director or officer of a corporation in the corporation's circumstances; and
>
> (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.
>
> Note: This subsection is a civil penalty provision (see section 1317E).

It should be noted that even though the duty of care and diligence was contained in legislation since 1958, it was only more than 40 years later that a statutory business judgment rule or safe harbor rule was added to Australian legislation. There were several Reports in Australia, since 1989,[55] that recommended that the American 'business judgment rule' should be introduced in Australia by way of a statutory provision[56]. The Cooney Report recommended that the rule be coupled with an obligation on directors 'to inform themselves of matters

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54 J.J. du Plessis, 'A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia' [2010] Acta Juridica 263, p. 280. The following part is based on this article.

55 Senate Standing Committee on Legal and Constitutional Affairs, Com*pany Directors' Duties,* Report on the Social and Fiduciary Duties and Obligations of Company Directors (Cooney Report) (1989), para. 3.35; Companies and Securities Law Review Committee, Company Directors and Officers: Indemnification, Relief and Insurance Report No 10 (1990), paras. 76–81; House of Representatives Standing Committee on Legal and Constitutional Affairs, Report on Corporate Practices and the Rights of Shareholders (Lavarch Report) (1991). paras. 5.4.29–5.4.30 and 5.4.42.

56 See generally R. Baxt, 'Corporate law reform – directors' duties - objective standards - business judgement rule - other issues' (1992) 66 Australian Law Journal 294; and C.A. Schipani, 'Defining corporate director's duty of care standard in the United States and Australia" (1994) 4 Australian Journal of Corporate Law 152, pp. 164-165.

relevant to the administration of the company ...' and a requirement that they show that they exercised an 'active discretion' or a 'reasonable degree of care in the circumstances'[57].

These recommendations were not adopted immediately after the Cooney Report as it was thought, given that the rule had been developed by the United States judiciary, its introduction and refinement should be left to the Australian courts[58]. It was also argued that both the American Law Institute (ALI) and the American Bar Association (ABA) had difficulties in formulating a statutory business judgment rule; that a type of business judgment rule was already recognised by the Australian courts (referring to the case of *Harlowe's* Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL[59]); and that there was uncertainty as to exactly what was intended to be achieved by the introduction of a business judgment rule — was it protection for directors against liability, or a lowering of the standards of care and diligence expected of directors[60]?

It was only in 1999 that a statutory business judgment rule was enacted in Australia through the Corporate Law Economic Reform Program (CLERP) Act of 1999, despite another wave of criticism pointing out, inter alia, that the legislation was unnecessary and/or unwarranted and that it would lower the standards against which directors' actions were to be judged. The business judgment rule is currently contained in section 180(2) and (3) of the Australian Corporations Act, 2001 (Cth):

Business judgment rule
180(2)

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57 Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties,* Report on the Social and Fiduciary Duties and Obligations of Company Directors (Cooney Report) (1989), para. 3.35.

58 The Parliament of the Commonwealth of Australia - House of Representatives, Explanatory Memorandum to Corporate Law Reform Bill 1992, para. 89 (<http://www.takeovers.gov.au/content/Resources/acts_bills_ems/downloads/Corp_Law_Reform_Bill_1992.pdf>). See also J.H. Farrar, 'Towards a Statutory Business Judgment Rule' (1998) 8 AJCL 237.

59 (1968) 121 CLR 483.

60 J.H. Farrar, 'Report on modernising Australian Corporation Law' (1992) August Business Council Bulletin 13, p. 18.

> A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment, if they:
>
> (a) make the judgment in good faith for a proper purpose; and
>
> (b) do not have a material personal interest in the subject matter of the judgment; and
>
> (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
>
> (d) rationally believe that the judgment is in the best interests of the corporation.
>
> The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.
>
> 180(3) In this section:
>
> **Business judgment** means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

The Explanatory Memorandum made it clear that the business judgment rule would only operate in respect of duties under proposed subsection 180(1), that is, directors' statutory duty of care and diligence and the equivalent duty at common law or in equity, including common law principles governing liability for negligence. This is currently explained in the "Note" to section 180(2) of the Australian Corporations Act 2001 (Cth):

> This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence) — it does not operate in relation to duties under any other provision of this Act or under any other laws.

This is significant as directors' other fiduciary duties are contained in ss 181-183 of the Australian Corporations Act 2001 (Cth), which means that the business judgment rule cannot and will not protect directors against a breach of any of these duties, for instance, the duty of directors to act in the best interests of the corporation and for a proper purpose (s 181), and the duty to use their position as director to gain an advantage for themselves or someone else, or cause detriment to the corporation (s 182) or use information obtained as a director improperly to gain an advantage for themselves or someone else or cause detriment to the corporation (s 183). The aim was clearly also to ensure that the statutory business judgment should not protect directors against a breach of any other statutory duty contained in the

Corporations Act, 2001 (Cth), such as the duty to prevent insolvent trading under section 588G.[61]

5.1.1 Statutory required financial statements and reports

Approving financial statements and reports is a statutory obligation and, as the directors have no discretion whether or not to have them prepared (for certain types of companies) and then to approve them, it has been pointed out that that there is no 'business judgment' involved as the term is defined under Australian law.[62] Thus, the business judgment rule in Australia does not provide protection to directors for not detecting errors in the statutory required financial statements and reports. They would not be able to argue that the errors in the financial statements or reports were very difficult to detect and that they should not be liable because they acted in good faith and for a proper purpose; did not have any personal interest in the subject matter; informed themselves about the subject matter to the extent they reasonably believed to be appropriate; and rationally believed that the approving the financial statements was in the best interests of the corporation. In other words, the typical 4-layered requirement that would allow a director to rely on the protection of the business judgment rule.

Under Australian law the most significant protection for directors for not detecting errors in financial statements and reports would probably be section 189 of the Australian Corporations Act 2001 (Cth), which is the provision providing protection to directors relying on the advice of others without having any reasonable suspicion that the advice was in fact incorrect or provided negligently:

> **189 Reliance on information or advice provided by others**
>
> If:
>
> (a) a director relies on information, or professional or expert advice, given or prepared by:
>
> (i) an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or
>
> (ii) a professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or

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61 See, for instance, R. Langford, 'The new statutory business judgment rule: Should it apply to the duty to prevent insolvent trading?" (1998) 16 C&S LJ 533.

62 Du Plessis and Meaney, 'Directors' liability for approving financial statements containing blatant incorrect items: Lessons from Australia for all directors in all jurisdictions' (2012) 33 Company Lawyer 273, p. 279.

(iii) another director or officer in relation to matters within the director's or officer's authority; or

(iv) a committee of directors on which the director did not serve in relation to matters within the committee's authority; and

(b) the reliance was made:

(i) in good faith; and

(ii) after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation; and

(c) the reasonableness of the director's reliance on the information or advice arises in proceedings brought to determine whether a director has performed a duty under this Part or an equivalent general law duty;

the director's reliance on the information or advice is taken to be reasonable unless the contrary is proved.

The directors would potentially be protected if they relied on, for instance, information and professional advice from the company's auditors. It should, however, be pointed out that this section has not been the subject of in-depth judicial scrutiny, not even in the Centro case mentioned above.[63]

There is also another form of protection for directors if it was proven that they had breached their duty of care and are not protected by the business judgment rule. This protection is contained in section 1317S (Relief from liability for contravention of civil penalty provision) and 1318 (Relief from liability). Under these provisions a director can approach the court and request relief from liability for negligence, default, breach of trust or breach of duty in a capacity as such a person. The court can grant that relief if it is of the opinion that the person has acted honestly and that, having regard to all the circumstances of the case, including those connected with the person's appointment, the person ought fairly to be excused for the negligence, default or breach. It should, however, be noted that these sections only apply when a breach has already been proven and it is thus one that a director will rely on as a last resort. At this stage they would have already suffered reputational damage and this form of protection will be an ill consolation in light of the legal proceedings the directors were already involved in, in most cases over a long period of time and normally at huge expenses as far as legal costs are concerned.

[63] Du Plessis and Meaney, 'Directors' liability for approving financial statements containing blatant incorrect items: Lessons from Australia for all directors in all jurisdictions' (2012) 33 Company Lawyer 273 at 287.

5.1.2 Integrated reporting

Different from the statutory required financial statements and reports, integrated reporting is not currently a compulsory statutory obligation. Thus, the directors still have a discretion to do the reporting on a voluntary basis. Although there are no decided cases on this point, if a board of directors exercised a judgment to do integrated reporting it will probably be seen as a 'business judgment' as it will probably fall within the meaning of 'business judgment' as defined in section 180(3), namely '[a] decision to take … action in respect of a matter relevant to the business operations of the corporation'.

It means that, as far as integrated and sustainability reporting is concerned, the directors will be protected by the business judgment rule if they did reporting in good faith and for a proper purpose; did not have any personal interest in the integrated reporting; informed themselves about the integrated reporting to the extent they reasonably believed to be appropriate; and rationally believed that doing the integrated report was in the best interests of the corporation.

Why do we say that to adopt integrated thinking and to do an integrated report is a business judgment call? Firstly, integrated thinking is a change in corporate behavior functionally and operationally and secondly an integrated report can enable the company to raise capital and borrow more easily and more cheaply because the provider of capital and the lender can measure risk on a more informed basis. Thus, the decision to do integrated and sustainability reporting is an 'action in respect of a matter relevant to the business operations of the corporation' as required under the definition of 'business judgment' in s 180(3). Furthermore, this view is supported, as will be seen by the examination of the German business judgment rule, providing protection under comparable situations when directors adopt integrated thinking and doing an integrated report.

5.2 Germany: The business judgment rule

5.2.1 Duty of care

Pursuant to section 93(2) of the German Stock Corporations Act (Aktiengesetz – hereafter AktG) members of the management board who violate their duties of care to the company are jointly and severally liable to the company for any resulting damage. Directors are under an obligation to comply with the law and they therefore breach their duty of care to the company where they violate any statutory obligation such as the duty to produce a management report.[64] The same applies to members of the supervisory board.[65]

Statutory reporting duties that are relevant in the context of discussing sustainability reporting are imposed by the German Commercial Code (Handelsgesetzbuch – hereafter HGB). S289a of the HGB requires public companies to issue a declaration of corporate governance. It consists of three components: First, the declaration of past and future compliance with the German Corporate Governance Code pursuant to s161 AktG; secondly, relevant information about the company's corporate governance practices which are applied beyond the statutory requirements, including a note where these can be found; thirdly, a description of the functioning of the management board and the supervisory board as well as the composition and functioning of the committees. Large corporations are also required to include nonfinancial performance indicators into their management report such as information about environmental and employee matters to the extent necessary for an understanding of the company's development, performance or position of the company's business.[66] However, the caveat of this reporting duty is the clause 'to the extent necessary for an understanding of…'. As discussed above, this reporting about nonfinancial information will be expanded under the proposed EU Directive discussed.

As the duty of care requires directors to comply with the law, incorrect statements about the company's past record in the management report are a ground for liability. With regard to the liability for future-looking sustainability statements, it is useful to consider the legal situation surrounding the statements that companies are currently required to make in their management report about the expected development and performance of the company in the future, including risks and opportunities.

The existing duty to forecast the expected development and performance of the company requires an assessment of the opportunities and risks that the company faces in the future.[67] The report must also explain the premises upon which the assessment is based. As

[64] Hölters in Hölters (ed), Aktiengesetz: Kommentar (2nd edn, Beck Verlag 2014), §93, para 55 – 56.

[65] Pursuant to §116 AktG, §93 on the duty of care and responsibility of members of the management board shall, with the exception of (2) sentence 3, apply analogously to the duty of care and responsibility of the members of the supervisory board.

[66] S289 (3) HGB.

[67] S289 (1) 4 HGB.

the management report has to be accurate, the forecast must be oriented at realistic expectations.[68] It must not be misused to overstate the true business state of affairs of the company as far as the public and investors are concerned. It is important for directors to explain the premises for their forecast in order to protect themselves against liability. When making their assessment, the directors do not know if the company will meet its targets, so it is important for them to be able to demonstrate that their outline of the expected development of the company, including risks and opportunities was based on realistic expectations.

If these principles are applied to forward-looking sustainability statements by directors, then it is clear that the directors need to take reasonable care and be cautious in what they report. They could otherwise be subject to liability for forecasts which are not based on a proper assessment of the future development and performance . The directors will therefore have to be careful not to unreasonably overstate what the company can achieve in terms of sustainable future development. Even where the forecast is not based on facts, but only outlining targets, strategies and their intended implementation, directors may be liable if they exaggerate expectations or the expectations are not based on reasonable grounds. Much will, in fact, depend on the circumstances of the individual case, such as the seriousness of the deviation between the statements made and the actual development and performance of the company. But, in practice, the likely consequence of this situation is that the majority of directors can be expected to resort to general statements rather than making ambitious claims.

5.2.2 Does the German business judgment rule sufficiently protect directors?

Directors who face liability for breach of their duty of care as a consequence of incorrect or unfounded future-looking sustainability statements, will base their defence on the business judgment rule in section 93(1)2 of the AktG. Germany codified the business judgment rule in 2005 based on the business judgment rule already codified in some Anglo-American jurisdictions.[69] It is a safe harbour provisions for directors.[70].

The section provides that the duty of care (Sorgfaltspflicht) is not breached if the management board member, based on appropriate information, could reasonably believe that a business

[68] D. Kleindiek in Münchener Kommentar zum Bilanzrecht (Beck Verlag 2013), §289 HGB, para 62.

[69] D. Kocher, 'Zur Reichweite der Business Judgment Rule' (2009) CCZ 215.

[70] W. Hölters in W. Hölters (ed), Aktiengesetz: Kommentar (2nd edn, Beck Verlag 2014), §93, para 29.

decision was taken in the best interests of the corporation. It implies that managerial conduct cannot be judicially reviewed, when four prerequisites are fulfilled:[71]

1. a business decision was taken (unternehmerische Entscheidung);
2. the decision was taken in the best interests of the corporation (zum Wohle der Gesellschaft);
3. the decision was taken in good faith, or, closer to the wording of the provision, the person could reasonably believe (vernünftigerweise annehmen durfte) that it was a business decision taken in the best interests of the corporation, which implies that the person must be unbiased and has no conflicts of interests;[72] and
4. the decision was reached based on appropriate information (angemessener Information) or, put more generally, an informed decision was taken.

The rule clearly involves directors exercising a discretion in their decision-making. The underlying rationale is that business decisions relate to the future and are based on business plans.[73] The members of the management board should not easily be liable for the failure of their plans, as they need to take risks. The business judgment rule in the AktG is, therefore, intended to provide scope for taking risks, as long as the decisions also meet prerequisites 2-3 as listed above.

The key issues for the applicability of the business judgment rule in the context of future-looking sustainability statements are: First, is the decision to publish a report a business decision? Secondly, did the directors base their decision on adequate information? With regard to the first issue, business decisions are those decisions which are taken freely, i.e. the directors have a choice.[74] They do not have a choice where their decisions are legally

[71] J.J. du Plessis, B. Grossfeld, C. Lutterman, I. Saenger, O. Sandrock and M. Casper, German Corporate Governance in International and European Context (Springer Verlag, 2nd edn, 2012) 83.

[72] See O. Wunsch, 'Verhaltenspflichten des Vorstands im Vorfeld von und bei öffentlichen Übernahmen - eine Checkliste für den Vorstand' (Teil 1)' (2010) 12 M&A Review 582 at 583. M. Roth, 'Outside director liability: German Stock Corporations Law in transatlantic perspective' (2008) 8 JCLS 337, p. 348 points out that vernünftigerweise could in actual fact also be translated as meaning both reasonably and rationally.

[73] Hölters in Hölters (ed), Aktiengesetz: Kommentar (2014), §93, para 30.

[74] M. Lutter in H-M Ringleb et al. (eds), Kommentar zum Deutschen Corporate Governance Kodex (5th edn, Beck Verlag 2014), p. 2. Teil: Kommentierung zum Deutschen Corporate Governance Kodex

required by statutory provisions for instance the approval of financial statements and reports, the articles of association, employment contracts or internal regulations. It is therefore important that the directors have discretion in their decision-making.[75] Insofar as the directors are required by law to report on sustainability issues (limited at the moment, but potentially more extensively in the future), it could be argued that the business judgment rule does not apply to statements they make in order to fulfill their statutory reporting duties. However, the directors still have discretion to decide whether or not to publish the report in its drafted form and which statements they will make, particularly those which are future-looking. Some have therefore criticized the view that the business judgment rule does not apply when, what is required of the directors to do, is required by statute, for instance the approval of financial statements and reports. The argument is that the view is too narrow. [76] This issue has not finally been decided yet. Nevertheless, based on the court cases and the views of several commentators, it is likely that the increased statutory sustainability reporting under the proposed EU Directive (see discussion under part 3.2 above) will not be covered by the business judgment rule as it will be considered to be a statutory obligation rather than a business judgment over which the directors have a discretion such as whether or not to do an integrated report and which specific issues they want to include in the integrated report with statutory details of the financial and sustainability reports being available probably on the company's website.

However, provided that the business judgment rule will be applicable (potentially in relation to integrated or sustainability reporting not required by law), directors must also prove that they have based their decision to publish a particular statement on adequate information. This condition requires the management board to use all information which is available objectively speaking for the particular decision.[77] It is necessary to take into account the time available for acquiring information.[78] The question if a director has based his decision on adequate information requires a balance between the cost of acquiring

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in der Fassung vom 13. Mai 2013, 3. Zusammenwirken von Vorstand und Aufsichtsrat, 5. Die Business judgment Rule, para. 482.

[75] Hölters in Hölters (ed), Aktiengesetz: Kommentar (2014), §93, para. 30.

[76] D Kocher, 'Zur Reichweite der Business Judgment Rule' (2009) CCZ 215, 218.

[77] Hölters in Hölters (ed), Aktiengesetz: Kommentar (2014), §93, para. 34.

[78] Hölters in Hölters (ed), Aktiengesetz: Kommentar (2014), §93, para 34.

information and the benefit of gaining information.[79] Generally, all available sources of information are necessary. The director must have good reason to believe that the information was adequate.[80] 'Good reason' adds an objective criterion to the assessment of this question. The issue what constitutes 'good reason' will have to be assessed from an ex-ante view.[81]

Where directors take a risk by making firm or ambitious future-looking statements which subsequently turn out to be unachievable, it is important that they can demonstrate that they have based their claims on adequate information. The crucial point will be that the directors can show that they have sufficiently informed themselves about the likelihood of achieving the promises that they make. A mere signing of sustainability reporting will, therefore, not be adequate. It is, however, difficult to predict to what lengths directors should go in preparing and publishing these reports to be covered by the business judgment rule. This is, of course, no different from any other 'business judgment'. Each case will have to be determined on its own merits. All that can be said with certainty is that all the prerequisites of the business judgment rule need to be met for directors to be protected. This means that directors will probably be very cautious when it comes to making firm sustainability statements. It can be expected that, on grounds of risk, most directors will resort to rather general declarations. This will minimise their risk to be held liable, but it will of necessity diminish the usefulness of these reports as instruments for investors to determine what the company has achieved in terms of sustainability and what it can achieve in the future. In other words, to rely on integrated and sustainability reports to make informed investment decisions. Already, sustainability/CSR reports are often kept in rather vague terms and look similar. The danger of the existing liability regime is, therefore, that directors will probably not make any ambitious firm statements about the company's sustainability goals in order to shield themselves from liability. This likely outcome would not be the desired aim of sustainability reporting in the first place. Where directors stop taking risks, the goals that they

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[79] OLG Celle, AG 2008, 771.

[80] Hölters in Hölters (ed), Aktiengesetz: Kommentar (2nd edn, Beck Verlag 2014), §93, para 35.

[81] D. Kocher, 'Zur Reichweite der Business Judgment Rule' (2009) CCZ 215, 216. The commentary of the business judgment rules states that sufficient documentation is important on grounds of evidence, as the director will have to prove that he did base his decision on adequate information, see Hölters in Hölters (ed), Aktiengesetz: Kommentar (2014), §93, para 34.

pursue will be less ambitious. Consequently, directors would probably view mandatory sustainability reporting as yet another ‘box-ticking’ activity rather than an opportunity to truly reflect on their company’s ability to be more sustainable. Forward-looking sustainability statements would then likely to be cautious, general and be relatively moderate, unless reasonable protection is provided to directors.

Also in Germany there are some further possible forms of protection for directors in addition to the business judgment rule. Section 93(4) (dealing with directors’ duty of care) AktG stipulates that the members of the management board shall not be liable to the company for damages if they acted pursuant to a lawful resolution of the shareholders’ meeting. However, it is necessary that the resolution was passed prior to the act of the management board.[82] Moreover, the shareholders’ meeting must have acted within its area of competence. The shareholders will neither be competent nor willing to pass a resolution that mandates the publication of certain kinds of information on sustainability or to condone incorrect information published. Therefore, this provision will not exclude the liability of directors for integrated or sustainability reporting. It should be noted here that this possible remedy under German law is not discussed under the Australian or South African law because in Australia and in South Africa a statutory derivative action could be brought on behalf of, for instance minority shareholders, irrespective of the fact that the wrong committed by the directors were ratified by the shareholders at a properly constituted shareholders’ meeting.

Directors can also be protected by the right of the company to waive or compromise a claim for damages.[83] However, the company can only exercise these rights after the expiry of three years after the claim has arisen, provided that the shareholders’ meeting consents and that no minority whose aggregate holding equals or exceeds one-tenth of the share capital records an objection in the minutes. This subsequent exclusion of the directors’ liability is a possible form of protection; however, it is subject to important safeguards.

Finally, the management report which might soon become quite relevant for sustainability reporting in Germany due to the proposed EU Directive discussed above, must be audited before it is published. The company’s auditors are liable to the company in case

[82] S. Spindler in Münchener Kommentar zum Aktiengesetz (4th edn, Beck Verlag 2014), §93, para. 242.

[83] S 93(4)3 of the AktG.

they intentionally or negligently breach their duty of care in the auditing process.[84] It is therefore possible that the directors' liability is reduced where the company's auditors have negligently failed to notice that the statements in the report were not based on proper care and diligence.

5.3 South Africa: Safe harbour provision, reliance on information received by others and relief of liability by a court

In South Africa directors' duties of care, skill and diligence is contained in section 76(3)(c) of the South African Companies Act 71 of 2008:

> 76(3) [A] director of a company, when acting in that capacity, must exercise the powers and perform the functions of director - … (c) with the degree of care, skill and diligence that may reasonably be expected of a person (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director.

It will be noted that, different from the Australian duty of care and diligence, the South African duty of care, skill and diligence retained some of the subjective considerations that were part of the common law. Thus the 'general knowledge, skill and experience' of a particular director could be taken into consideration to determine a breach of this duty. Thus, it is possible for the less knowledgeable, less skillful and less experienced director to use that as reasons why the director did not breach the duty of care, skill and diligence.

In South Africa the safe harbour rule is contained in section 76(4)(a) of the South African Companies Act 71 of 2008. Section 76(4) of the South African Companies Act 71 of 2008 provides as follows:

> 76(4) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company —
> (a) will have satisfied the obligations of subsection (3)(b) [acting in the best interests of the company] and (c) [acting with the required care, skill and diligence] if —
> (i) the director has taken reasonably diligent steps to become informed about the matter;
> (ii) either —
> (aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

[84] S3 23(1) HGB. In case both the management board and the auditors have acted negligently, the auditors can invoke contributory negligence.

(bb) the director complied with the requirements of section 75 [liability of directors and prescribed officers] with respect to any interest contemplated in subparagraph (aa); and

(iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

It will be noted that this safe harbour rule is not limited to 'business judgments', but expands to 'the exercise of the powers or the performance of the functions of directors' generally. Thus, it is wider than the Australian business judgment rule that only applies to 'business judgments' as defined. A justification for not limiting the protection for directors to 'business judgments' is that it is not easy to define exactly what 'business judgments' are in contradistinction with 'other judgments' that directors exercise. Defining a 'business judgment' in legislation can create some difficulties because of the complexity of director decision-making processes. Thus, a statutory definition of a 'business judgment' might be seen as too narrow by some, but too wide by others.

However, as far as integrated reporting is concerned, would the South African safe harbour rule provide more protection to directors than the narrower Australian 'business judgment rule'? It is submitted that the answer is in the negative. As explained above, the decision by the board to do integrated reporting will be considered to be a 'business judgment'. In other words, it will not be the fact that the South African safe habour rule is not limited to 'business judgments' that will provide additional protection to South African directors. What may provide additional protection to some South African directors is the subjective aspects[85] that might be taken into consideration in determining whether there was a breach of the duty of care, skill and diligence. It is, however, unlikely that this form of protection will generally be considered as appropriate in other jurisdictions. Moving away from the common law subjective considerations to an objective approach regarding directors'

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[85] See s 76(3)(c)(ii) of the South African Companies Act 71 of 2008 – the director being judged for a breach of her duty of care, skill and diligence by looking subjectively to 'the general knowledge, skill and experience' of the particular director whos actions are scrutinised for a breach of these duties.

duty of care and diligence was an approach adopted since 1958 when the duty of care and diligence was introduced in legislation in Australia for the first time.[86]

Also in South Africa, directors will be protected under certain circumstances if they rely on the advice from others and this will also apply to advice received and relied upon for purposes of integrated reporting. In this regards, section 76(4) and (5) of the South African Companies Act 71 of 2007 provides as follows:

> 76(4)(b) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company … is entitled to rely on-
>
> (i) the performance by any of the persons-
>
> (aa) referred to in subsection (5); or
>
> (bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law; and
>
> (ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (5).
>
> 76(5) To the extent contemplated in subsection (4)(b), a director is entitled to rely on
>
> (a) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;
>
> (b) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters-
>
> (i) within the particular person's professional or expert competence; or
>
> (ii) as to which the particular person merits confidence; or
>
> (c) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

Also under the South African law, a director can approach the court to be relieved from liability, but similar to the provision in Australia, it will not really be considered as an effective defence for directors as they can only rely on this provision after they have already been held in breach of a duty and they would already have been involved in litigation drawn-out and expensive litigation by then. Section 77(9) provides as follows:

> 77(9) In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that-
>
> (a) the director is or may be liable, but has acted honestly and reasonably; or
>
> (b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

8. Conclusions

[86] Du Plessis, 'A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia' (2010) Acta Juridica 263, p. 280.

There is little doubt that internationally there is a move away from the narrow ‘shareholder primacy’ theory. The sole aim of corporations striving for shareholder value irrespective of negative impacts of the company’s business model or its product as opposed to total value is no longer acceptable. Nowadays, corporations, especially large public corporations, should have as a core aim building a better society and acting in a responsible way for the public good, which translate into sustainable value creation. Integrated and sustainability reporting is becoming of considerable importance for companies to illustrate that they are responsible corporate citizens striving for long-term sustainable growth.

Having looked at the potential liability of directors in Australia, Germany and South Africa, the following conclusions can be drawn: In none of the jurisdictions will directors be able to rely on the protection of a statutory safe harbour rule when they approve statutory required financial statements and reports. The reason is that it is a statutory obligation to prepare and approve financial statements and reports and it will not be seen as something over which the directors have a discretion. Although the South African safe harbor protection is not limited to ‘business judgments’, the South African safe harbour protection will also not be available when a mandatory statutory obligation like the approval of financial statements and reports is at stake.

However, as integrated and sustainability reporting is not yet required by way of statutory provisions in Australia or South Africa[87], the safe harbor protection will be available to directors in those jurisdictions doing integrated or sustainability reports as long as the prerequisites for the safe harbor protection are met.

Based on recent development in the EU, it might be that integrated or sustainability reporting may be required by way of statutory provisions in future. That will mean that directors in the EU will not be able to rely on the business judgment rule as protection as they would not have a discretion in making a decision whether or not to do a sustainability report.

[87] In South Africa the Johannesburg Stock Exchange requires integrated reporting only on an ‘apply or explain basis’.

In Australia and South Africa directors could potentially be protected by the reliance provisions (s 189 of the Australian Corporations Act 2001 (Cth) and s 76(5) of the South African Companies Act 71 of 2008). There seems to be no equivalent provision in Germany, but there are other forms of protection available to directors in Germany, for example if they acted pursuant to a lawful resolution of the shareholders' meeting or the company waived or compromised a potential claim of damages against directors.

Based on specific statutory provisions in Australia and South Africa, a court can grant that relief if it is of the opinion that the person has acted honestly and that, having regard to all the circumstances of the case, including those connected with the person's appointment, the person ought fairly to be excused for the negligence, default or breach. It was, however, pointed out that this remedy is a last-resort option as the directors would have already been involved in drawn-out and probably expensive litigation. There is no comparable statutory provision under German law.

The key challenge for the protection of directors will arise if and when sustainability reporting becomes a statutory requirement in the EU. One possible way forward for German law would be to take a broader interpretation of the term 'business judgment' in a way that it can also be applied to those situations where directors have discretion as to how they perform a certain statutory duty. For example, there are different options for the writing of a sustainability report. Directors who take risks by making firm future-looking statements should be able to benefit from the protection of the business judgment rule as long as they can prove that they satisfy the other conditions of this rule, ie that they have based their decision on adequate information and that they have acted in the interests of the company.

As long as directors in Germany, Australia and South Africa ensure that the four criteria for the application of the business judgment rule exist they have 'nothing to fear but fear itself',[88] by directing the company to adopt integrated thinking and do an integrated report. In addition there are also other forms of statutory protection for directors, although it is pointed out that the protection will be narrower and the circumstances under which they will protect directors will be extraordinary or used as a last-resort of protection.

[88] Most commonly attributed to a famous line in Franklin D Roosevelt's Inaugural Address – see <http://en.wikipedia.org/wiki/Nothing_to_fear_but_fear_itself> for other comparable uses of this line.