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STRENGTHENING CORPORATE GOVERNANCE IN INDIA THROUGH ESG FRAMEWORKS: A LEGAL ANALYSIS OF THE REGULATORY LANDSCAPE

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Abstract:

Today, ESG criteria for companies have emerged as one of the essential measures that may be useful for improving the corporate governance structure in India. For probing how regulatory practices associated with ESG criteria have been developed in India, this research paper will try to address those legislative efforts that have been made under the provisions of the “*Companies Act of 2013*,” and also those business responsibility and sustainability reporting measures based on compliance introduced by SEBI. For studying this problem, the research paper will consider using the method of doctrinal analysis for exploring the transition from shareholder-oriented corporate governance to that of sustainable companies. Nevertheless, there are several obstacles to doing so, such as the lack of proper legislation for ESG criteria, the restricted scope of regulations, and greenwashing.

Keywords: Environmental, Social, Governance, Sustainability disclosure, Companies Act, 2013, Corporate Social Responsibility, Business Responsibility and Sustainability Reporting (BRSR).

1. Introduction:

A concept that has significantly influenced the development of the corporate governance structure in contemporary organisations is the ESG, or Environmental, Social, and Governance. The corporate governance structure of this concept has made it possible to develop sustainable practices in organisations. Some of the elements that constitute this concept include environmental sustainability, social accountability, and corporate governance. The significance of this concept can be explained through the incorporation of several clauses in the “*Companies Act 2013 of India*”. The inclusion of several clauses in sections 149 and 135 of the “*Companies*

Act of 2013” has greatly contributed to the significance of this concept.¹ In addition to the above points, the measures adopted by the Securities Exchange Board of India with regard to the listing obligations and disclosure requirements regulations 2015 concerning the reporting of business responsibility matters have contributed to the evolution of the reporting of the ESG principles.² It should be remembered at this stage that the environmental principles concerning the "polluter pays principle" and "climate accountability," which are constitutionally recognised under “*Articles 14 and 21 of the Constitution of India,*”³ respectively also play a substantial role in the ESG law of India. Therefore, the ESG principles supersede the traditional "shareholder-centric" approach of corporate governance with the "stakeholder-centric" approach of corporate governance in view of the global sustainability agenda, such as the United Nations Sustainable Development Goals.

2. Statement of problem:

Though the application of the Environmental, Social, and Governance principles is considered to be of great importance in the context of the strengthening of corporate governance in India, the application of the ESG principles in the context of the legal framework is in disarray. While the provisions of the Companies Act, 2013, and the initiatives taken by the Securities Exchange Board of India, which has introduced the Business Responsibility and Sustainability Reporting, are encouraging in the context of the application of the ESG principles, difficulties are faced in the context of the enforcement of the same. Therefore, the applicability of the ESG principles in the context of the strengthening of corporate governance in India needs to be assessed.

3. Research Objective:

To study and critically analyse the existing legal regime prevailing in India with regard to Environmental, Social, and Governance (ESG) principles under corporate governance and to suggest legal and regulatory reforms necessary for strengthening ESG compliance and corporate governance.

¹ Companies Act, No. 18 of 2013, § 135 (India)

² Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, SEBI (India); SEBI Circular on Business Responsibility and Sustainability Reporting (BRSR), SEBI/HO/CFD/CFD-SEC-2/P/CIR/2021/562 (May 10, 2021).

³ *Vellore Citizens Welfare Forum v. Union of India*, (1996) 5 S.C.C. 647 (India).

4. Research Question:

How effective is the existing legal system in India in incorporating Environmental, Social, and Governance (ESG) factors into corporate governance, and what legal and regulatory changes are necessary to enhance ESG-compliant corporate governance standards in India?

5. Research Methodology:

The current study is based on a doctrinal research methodology in which both primary and secondary sources of information have been used. The primary sources of information of this study include statutes, regulations, and decisions of courts relating to ESG and corporate governance in India. The secondary sources of information of this study include books, articles, reports, and online sources such as Google Scholar, Scopus, JSTOR, Springer, ResearchGate, etc. The existing literature of this study has been critically examined in order to examine ESG principles in the Indian corporate legal regime and identify legal challenges in ESG-compliant corporate governance.

6. Conceptual framework:

The conceptual context is grounded in the incorporation of the values of Environmental, Social, and Governance (ESG) in the wider context of corporate governance to endorse company transparency and accountability. ESG serves as a corporate governance support mechanism through the provisions of various laws and regulations like the Directors' Duty and Corporate Social Responsibility provisions of the Companies Act, 2013⁴, and the disclosure-based regulations like the Business Responsibility and Sustainability Reporting (BRSR) mandated by the Securities and Exchange Board of India.⁵ The framework also takes into consideration the principles of environmental jurisprudence, which include sustainable development and the polluter pays principle. This increases corporate accountability and ensures that corporate governance is aligned to global best practice for sustainability⁶, including the United Nations Sustainable Development Goals. In this way, ESG acts as a bridge between legal compliance and corporate governance.⁷

⁴ Companies Act, No. 18 of 2013, §§ 134, 135, 166 (India)

⁵ SEBI Circular on Business Responsibility and Sustainability Reporting (BRSR), SEBI/HO/CFD/CFD-SEC-2/P/CIR/2021/562 (May 10, 2021)

⁶ *Vellore Citizens Welfare Forum v. Union of India*, (1996) 5 S.C.C. 647 (India)

⁷ G.A. Res. 70/1, Transforming Our World: The 2030 Agenda for Sustainable Development (Sept. 25, 2015)

7. Analysis of the Effectiveness of the ESG Framework in the Indian Legal System in Strengthening Corporate Governance:

- **ESG Framework under the Companies Act, 2013:**

The applicability of the principles of Environmental, Social, and Governance in corporate governance can be identified in the provisions of the Companies Act, 2013. The provisions have been framed in a manner that corporate governance principles of transparency, accountability, and stakeholder engagement can be developed. The provisions that can be identified as the pertinency of the principles of ESG in corporate governance are the provisions related to *Corporate Social Responsibility (CSR) under Section 135 of the Companies Act, 2013*.⁸ The section has made it mandatory for corporate entities to set apart a percentage of profits for corporate social welfare. This is a shift from voluntary corporate philanthropy to compulsory corporate social responsibility, thus improving the social aspect of ESG criteria in corporate governance structures.

In addition to this, the expansion of the fiduciary duty of directors under Section 166 of the Act, which requires them to act in the interests of employees, the community, and the environment, provides yet another dimension to ESG criteria for corporate governance structure.⁹

- **Role of SEBI in Strengthening ESG Disclosure Framework:**

The character of the Securities and Exchange Board of India has been quite important in the development of the integration of the ESG factors with the adoption of the disclosure-based corporate governance norms for the listed companies in India. The development of the “*Business Responsibility and Sustainability Reporting (BRSR)*” framework under the “*Listing Obligations and Disclosure Requirements’ Regulations, 2015*,” of the SEBI, is a major step towards the development of the reporting of disclosures in the area of sustainability reporting for the top 1000 listed companies in India.¹⁰ The reporting of structured disclosures on various parameters like environmental factors, social factors, and governance factors are all part of the BRSR framework.

The development of BRSR Core has also helped to enhance in the ESG compliance by ensuring third-party assurance for some of the key performance indicators identified, thereby ensuring the reliability and credibility of the ESG report. The above regulations are in line with the

⁸ Companies Act, No. 18 of 2013, § 135 (India).

⁹ Companies Act, 2013, § 166 (India)

¹⁰ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (India)

implementation of the investor-centric sustainability reporting practice. The above regulations are contributing to the development of an effective ESG-based corporate governance mechanism.¹¹ However, the scope of the above approaches is limited as the above approaches are focused on ensuring the disclosure-based sustainability compliance.

- **Contribution of Environmental Legislation to ESG Governance:**

The role of environmental legislation in India in the enhancement of the environmental dimension of ESG compliance requirements for corporate entities involved in industrial and commercial activities is of critical importance, as the “*Environment (Protection) Act, 1986*,” enables the authorities to frame norms for the environment and check pollution arising from corporate activities.¹² The act, therefore, becomes the foundation for enforcing environmental responsibility in corporate governance.

- **Judicial Contribution towards ESG- oriented Corporate Accountability:**

The judiciary has also played a significant role in strengthening the integration of ESG factors into corporate governance, as they have interpreted the Constitutional provision on environmental protection and the recognition of the responsibility towards the climate. The scope of the right to life, as enunciated under “*Articles 14 and 21 of the Constitution of India*,” has also included the right to clean and healthy environments.¹³

The dilemma of the development of renewable energy infrastructure and biodiversity conservation was addressed by the Supreme Court, which emphasised the need to balance the objectives of mitigating climate change and biodiversity conservation¹⁴. In the same manner, the aforementioned environmental litigation has further emphasised and reinforced the significance of forest conservation, as well as the constitutional obligation to prevent ecological degradation due to unchecked growth and development in the industry¹⁵. Furthermore, the aforementioned environmental litigation has further emphasised and reinforced the significance of the ESG compliance requirement in the Indian legal framework¹⁶. All the aforementioned developments highlight the significance of environmental jurisprudence in the development of the ESG requirement for governance.

¹¹ SEBI Circular on BRSR Core Framework (2023).

¹² Environment (Protection) Act, No. 29 of 1986 (India).

¹³ India Const. arts. 14, 21.

¹⁴ *M.K. Ranjitsinh v. Union of India*, W.P. (C) No. 838 of 2019 (India)

¹⁵ *T.N. Godavarman Thirumulpad v. Union of India*, (1997) 2 S.C.C. 267 (India).

¹⁶ *Ridhima Pandey v. Union of India*, Original Application No. 187/2017 (NGT).

- **Effectiveness of ESG Integration in Corporate Governance in India:**

The present legal regime in India has made tremendous progress in the incorporation of ESG principles in corporate governance, which can be evaluated on the basis of the provisions incorporated in the regulations and judicial pronouncements. The enforcement of the “*Corporate Social Responsibility (CSR)*” obligation under the Companies Act, 2013, has helped to improve corporate involvement in social and environmental development activities.¹⁷ whereas the regulations relating to Business Responsibility and Sustainability Reporting (BRSR) framed by the Securities Exchange Board of India (SEBI) have helped to improve transparency and awareness among investors regarding sustainability performance indicators.¹⁸ Furthermore, the present environmental regulations and constitutional provisions have helped to improve corporate responsibility for environmental protection and sustainable development.¹⁹

However, the scope of the ESG integration in the corporate governance system is limited in the context of the absence of the standalone ESG regulatory system. The ESG compliance in India is largely based on the fragmented legislative provisions, rather than the comprehensive legislative system that can facilitate the enactment of the ESG compliance. Secondly, the ESG disclosure is applicable to the listed companies. This indicates that the ESG integration in the Indian corporate governance system is in the developing stage.²⁰

- **Need for Legal and Regulatory Reforms to Strengthen ESG-Compliant Corporate Governance:**

In order to have better ESG-compliant corporate governance standards in India, legal and regulatory reforms need to be incorporated into the existing system to bridge the gaps. The incorporation of ESG regulatory guidelines will definitely go a long way in better harmonising corporate governance standards and ESG. The expansion of the fiduciary duty of directors as mentioned in Section 166 of the “*Companies Act, 2013*,” to include ESG will definitely help in improving corporate governance standards.²¹

¹⁷ Companies Act, No. 18 of 2013, § 135 (India).

¹⁸ Securities and Exchange Board of India, Business Responsibility and Sustainability Reporting (BRSR) Framework, SEBI Circular No. SEBI/HO/CFD/CFD-SEC-2/P/CIR/2021/562 (May 10, 2021).

¹⁹ *Vellore Citizens Welfare Forum v. Union of India*, (1996) 5 S.C.C. 647 (India); Environment (Protection) Act, No. 29 of 1986 (India); India Const. art. 21.

²⁰ Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, 6 Hastings Bus. L.J. 281 (2010); Ministry of Corporate Affairs, National Guidelines on Responsible Business Conduct (NGRBC) (2019).

²¹ Companies Act, No. 18 of 2013, § 166 (India); Afra Afsharipour, *Corporate Governance Convergence: Lessons from the Indian Experience*, 29 Nw. J. Int'l L. & Bus. 335 (2009).

Apart from this, making third-party assurance of ESG disclosures more effective and extending mandatory reporting to unlisted companies is likely to help in developing greater transparency as well as comparability in different industries. Better coordination among different regulatory bodies, such as the Securities Exchange Board of India and the Ministry of Corporate Affairs, as well as environmental bodies, is likely to help in making ESG integration within corporate governance structures more effective.²² These are critical in developing ESG compliance as a disclosure-based tool to a performance-based tool for sustainable corporate development in India.²³

8. Critical Analysis:

The present study aims to evaluate the significance and consequences of the Environmental, Social, and Governance (ESG) approach to enhancing corporate governance under the Indian legal system. The study shows that even if various provisions under the “*Companies Act, 2013*,” relating to corporate governance, along with disclosure requirements like the Business Responsibility and Sustainability Reporting (BRSR) framework framed by the Securities Exchange Board of India, are favourable to ESG, the approach is more based on disclosure than enforcement. The nonappearance of an inclusive legal regime on ESG and monitoring acts as a constraint for the effectiveness of ESG in corporate governance.

9. Suggestion:

The ESG framework must be improved through the development of a more "uniform and comprehensive regulatory structure within the Indian legal framework." There is also the need to "transition from disclosure-based compliance to mandatory performance-based ESG standards, moving beyond the Companies Act, 2013, and the Business Responsibility and Sustainability Reporting (BRSR) framework proposed by the Securities Exchange Board of India." Furthermore, "there is a greater need to develop stakeholder awareness and board-level accountability for ESG implementation to further enhance corporate governance practices." The strengthening of the linkages between environmental laws and corporate governance regulations will also help to enhance ESG practices within India.

²² Securities and Exchange Board of India, *Business Responsibility and Sustainability Reporting by Listed Entities* (2021); Ministry of Corporate Affairs, *Report of the Committee on Business Responsibility Reporting* (2020).

²³ Organisation for Economic Co-operation and Development (OECD), *Corporate Governance and Sustainability in Asia* (2018); World Bank, *ESG Integration in Emerging Markets: Practices and Challenges* (2019).

10. Conclusion:

The essentials of Environmental, Social, and Governance are coming up as key factors for the development and growth of corporate governance in India, and this is all because of the factors of sustainability and ethical corporate practices. Although the legal framework of the Companies Act of 2013 and the various regulatory initiatives of BRSR have provided a vital framework for the implementation of the ESG principles, it has also been seen to be wanting with regard to the role and functions of ESG as a viable tool for the development of corporate governance and sustainable development.

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