



COMMONWEALTH
Climate and Law Initiative



Directors' Liability and Climate Risk: *Australia - Country Paper*

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About the Commonwealth Climate and Law Initiative

The Commonwealth Climate and Law Initiative (CCLI) is a research, education, and outreach project focused on four Commonwealth countries: Australia, Canada, South Africa, and the United Kingdom. CCLI is examining the legal basis for directors and trustees to take account of physical climate change risk and societal responses to climate change, under prevailing statutory and common (judge-made) laws. In addition to the legal theory, it also aims to undertake a practical assessment of the materiality of these considerations, in terms of liability, and the scale, timing, probability of this and the potential implications for company and investor decision-making.

Australia, Canada, South Africa, and the UK, despite only producing 6% of current annual global GHG emissions, account for 13% of global coal reserves and 11% of global oil reserves. Their stock exchanges also have 27% of all listed fossil fuel reserves and 36% of listed fossil fuel resources. They each have large and highly developed financial systems and account for 23% of the global pension assets and contain within the G20 the 8th, 5th, 14th, and 4th largest stock markets by market capitalisation respectively.

The significant commonalities in the laws and legal systems of each of the four countries makes the initiative's work and outcomes readily transferable. They each operate a common law legal system. Their corporate governance laws are based on common fiduciary principles. Whilst their laws may differ at the margins, legal developments and judicial precedents are influential in each others' jurisdictions.

The core research findings are contained in the national legal papers for the four jurisdictions. These have been complemented by conferences in Australia (August 2016), Canada (October 2017), South Africa (January 2018) and the UK (June 2016). The national legal papers are organised by jurisdiction and follow a uniform structure to facilitate the creation of a subsequent comparative paper, which will aim to identify the strengths, weaknesses, opportunities and threats in each jurisdiction.

These papers represent a lead up to the creation of a White Paper that identifies policy recommendations for directors' associations and financial regulators in relation to the proper implementation and enforcement of directors' fiduciary laws in each of the observed jurisdictions. Moreover, the comparative work will be used to design an actionable framework for directors to integrate climate change issues into governance practice. This paper will be made available to the public at large and aim at creating a broad discussion among all targeted stakeholders.



About the Author

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Disclaimer

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Introduction

1.1 Climate change as a material financial risk

There is little doubt that climate change has evolved rapidly in recent years to become an issue that presents a foreseeable – moreover material – risk of harm to corporations in many sectors of the Australian economy, within mainstream planning and investment horizons.¹

With a solidification of the relevant science, the attention of capital markets has increasingly turned to the material financial issues associated with both the physical impacts of climate change, and the market risks associated with the economic transition to a low-carbon economy. They include:

(a) **Physical impact risks:**

- Both acute (extreme/catastrophic weather events) and chronic (gradual onset, such as rising sea levels, ocean acidification, sustained average higher temperatures), which can cause extreme precipitation in some areas, more intense droughts in others, fresh water scarcity, an increase in bush/wildfires, changes in crop yields, coral bleaching and other marine ecosystem loss, and biodiversity loss. In turn, these impacts can give rise to commercial issues including (for example) population dislocation, reduced workforce productivity, business continuity and interruption (from plant and infrastructure outages, upstream changes in the availability and price of key inputs, and downstream distribution interruption), insurance restrictions, energy price volatility, increases in adaptation capex, and increased risk of customer default; and

(b) **Economic transition risks:**

- Policy responses that attempt to either constrain the actions that contribute to adverse climate change (such as emissions restrictions or carbon pricing mechanisms), or to promote adaptation to its impacts that may result in rapid re-pricing of assets. This includes the strong market signal conveyed by 196 nation signatories to the Paris Agreement (settled at the 21st Conference of the Parties to the United Nations Framework Convention on Climate Change (COP21) on 12 December 2015, with entry into force on 5 November 2016). The Paris Agreement commits its parties to collective goals that include (amongst other measures):
 - limiting the 'increase in the global average temperature to well below 2°C above pre-industrial levels' and to pursue 'efforts to limit the temperature increase to 1.5 °C above pre-industrial levels' (Article 2(1)(a)). This goal is to be achieved by each signatory implementing emissions reduction (and other policy) commitments pledged under

¹ See for example Australian Prudential Regulation Authority (APRA) (2017a), *Australia's New Horizon: Climate Change Challenges and Prudential Risk*, speech by Executive Board Member Geoff Summerhayes to the Insurance Council of Australia Annual Forum 2017, Sydney, 17 February 2017; APRA (2017b), *The Weight of Money: A Business Case for Climate Risk Resilience*, speech by Executive Board Member Geoff Summerhayes to the Centre for Policy Development, Sydney, 29 November 2017; Hutley N., SC and Hartford-Davis, S. (2016) *Climate Change and Directors' Duties*, Memorandum of Opinion for the Centre for Policy Development and Future Business Council, 7 October 2016, available <http://www.futurebusinesscouncil.com/fiduciary_duties_media-release/>, at 2. The author of the Australian country paper was an instructing solicitor on that brief; Schroders Investment Management (2017), *Climate change: redefining the risks*, Insights, September 2017.



'Nationally Determined Contributions' (or 'NDC's'), which are subject to a 'five year review and ratchet' mechanism (Article 4(3) and (9)); and

- 'net zero' global emissions (that is, where the anthropogenic emission of greenhouse gases is equally offset by their removal by sinks) in the second half of the century (Article 4(1)).

The achievement of these policy goals will require a significant reduction to 'business as usual' emissions (which the IPCC estimates would result in warming of up to 4.8°C by 2100) (IPCC 2014, 10). The reductions will need to exceed even the post-2020 emissions mitigation NDC pledges made to date (which, if implemented, have been estimated to hold global warming to approximately 2.7°C (IEA 2015, 4). Those reductions will, in turn, necessitate a significant transformation in the global economy to a low-carbon norm;

- technology risks ie 'creative destruction' of 'old' technologies, developments in renewable energy generation, battery storage (for both the stationary energy and transport sectors), energy efficiency and carbon capture and storage;
- market risks ie impacts on supply and demand dynamics; and
- reputation and other risks associated with evolving stakeholder perceptions, expectations and preferences. The evolution of investor expectations, in particular, on investee companies' governance of climate-related risks is illustrated by the proliferation of issue-focussed advocacy networks. These include the Australian-based Investor Group on Climate Change, which represents investors with over AU\$1.5 *trillion* under management, and the global Climate Action 100+, representing more than 225 global investors with in excess of US\$26 trillion under management. The latter was announced in December 2017 as a '*five-year initiative led by investors to engage with the world's largest corporate greenhouse gas emitters to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures*';² and

(c) **Legal/litigation risks:**

- legal claims arising from either (or both) the physical impacts or economic transition risks associated with climate change. Such claims may arise in a number of broad categories, including: a failure to mitigate emissions, a failure to adapt to the foreseeable impacts associated with climate change, a failure to disclose the risks associated with climate change where an obligation exists to do so (including, for example, under corporate reporting and securities laws) and a failure to comply with climate-specific regulatory obligations (such as emissions intensity standards).³

² See < <http://www.climateaction100.org/>>, accessed 8 January 2018.

³ See for example Two Degrees Investing Initiative (2Dii) and MinterEllison (2017), *The carbon boomerang: climate litigation risk in the context of the transition to a low-carbon economy*, report to the European Union (H2020), September 2017. The author of the Australian country paper was the primary author of that report; Bank of England Prudential Regulation Authority (BoEPR) (2015), *The Impact of Climate Change on the UK Insurance Sector*, September 2015; Taskforce on Climate-related Financial Disclosures (TCFD) (2017), *Final Recommendations*, report to the G20 Financial Stability Board, 29 June 2017; *TCFD Recommendations Report Annex: Implementing the Recommendations of the TCFD* (2017a), 29 June 2017; United Nations Environment Programme (UNEP) and Columbia Law School Sabin Center for Climate Change Law (Sabin Center) (2017), *The Status of Climate Change Litigation – A Global Review*, May 2017.



Many significant sectors of Australia's economy are particularly susceptible to one or more of the above risks. Our economy is heavily skewed towards those industries considered to be at 'high-risk' to the financial impacts of climate change by the G20 Financial Stability Board's Taskforce on Climate-related Financial Disclosures – viz, *financial services* (banks, insurance companies, asset owners and asset managers), *energy* (coal, oil and gas extraction, utilities), *transportation* (air (freight and passenger), maritime, rail, trucking, automobile and components), materials and buildings (metals and mining, chemicals, construction materials, capital goods, real estate development and management), and *agriculture, food and forest products* (beverages, agriculture, packaged foods and meats and paper and forest products). For example, around two thirds of companies listed on the Australian stock exchange, the ASX, operate in the energy, resources or financial services industries alone. This concentration has resulted in S&P Dow Jones ranking the ASX50 as the most exposed major stock exchange to stranded asset risks.⁴ 'Stranded assets' refers to the risk(s) that an asset cannot viably be exploited at a value, or for the life, for which it was expected to be utilised, which negatively impacts on its current value. In a climate change context, stranded asset risks most commonly arise as a function of economic transition risks – viz changes in policy/regulation (including emissions pricing or controls), technological developments (particularly in renewable energy sources and battery storage technologies, which drives substitution of legacy plant and infrastructure with lower-emissions assets), and market and reputational risks in the transition to a low carbon economy. Not only can such market developments provoke rapid re-pricing of exposed assets, but they can also increasingly impact the cost and availability of capital funding, as financiers begin to price this risk into their lending criteria.⁵

1.2 Overview of directors' duties

A significant proportion of commerce within, and between, jurisdictions is conducted via 'corporations'. Corporations are '*legal constructs*' incorporated to '*manage the generation of wealth*'.⁶ They are 'owned' by shareholders, who have a residual claim over assets and profits,⁷ but are managed by, or under the direction of, a board of directors.⁸ In practice, boards delegate operational matters to executive management. However, they remain responsible for both the oversight of corporate performance, for the monitoring and supervision of its compliance (or 'conformance'),⁹ the approval of significant transactions, and external reporting.

⁴ S&P Dow Jones Indices, *The Carbon Scorecard*, 9 May 2017 <https://www.trucost.com/publication/the-carbon-scorecard/>, accessed 10 May 2017.

⁵ See for example Sustainability Accounting Standards Board (SASB) (2016), *Climate Risk Technical Bulletin*, TB001-10182016, October 2016, p16-17; TCFD 2017a, above n3.

⁶ Anam, Ahmed, 'A critical analysis of the UK company law corporate objective: purposive, practical and possible: Longitudinal corporate objective to remedy the enlightened shareholder value approach of the *Companies Act 2006*', unpublished, SSRN (28 June 2012) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2117591>, 9.

⁷ Shareholders claim to the residual assets and profits of the corporation remains privileged so long as the corporation is solvent. In the case of insolvency, creditors may also have residual claim – see for example Frank Easterbrook and Daniel Fishel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991); Anil Hargovan and Jason Harris, 'For Whom the Bell Tolls: Directors' Duties to Creditors after *Bell*' (2013) 35 *Sydney Law Review* 433, 436.

⁸ See for example under the Delaware General Corporation Law §141(a): '*The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors...*'; section 198A of the *Corporations Act 2001*.

⁹ See for example Amado, Jean-Christophe and Peter Adams, *Value Chain Climate Resilience: A Guide to Managing Climate Impacts on Companies and Communities*, Report prepared for Partnership for Resilience and Environmental Preparedness (PREP), Montreal, July 2012, 11; Stephen M Bainbridge, *Corporate Governance After the Financial Crisis* (Oxford University Press, 2012), 1-3, 43.



The directorial role to supervise corporate performance inherently demands the oversight of corporate risk management and strategy.¹⁰ In the corporate context, 'risk' is simply '*the effect of uncertainty on objectives*'.¹¹ It is clear that risk management and strategy are interrelated, and that board governance and oversight of both is critical to the creation of corporate value.¹²

As early as the eighteenth century, common law courts have recognised that directors are 'fiduciaries' of their corporation.¹³ A 'fiduciary' relationship exists where one party (the fiduciary) exercises power and/or holds property on behalf of, and for the benefit of, another (the principal).¹⁴ The term 'fiduciary' derives from the Latin *fiducia*, meaning trust, confidence and reliance.¹⁵

As fiduciaries, directors are subject to a number of duties in the discharge of their governance functions, directed to ensuring their single-minded pursuit of the best interests of their principal, the company. In Australia, the duties of directors of listed companies are codified in the *Corporations Act 2001* (Cth). These duties fall primarily into two categories, viz:

¹⁰ See for example Australian Institute of Company Directors (**AICD**), *Role of Board, Director Q&A* (31 January 2013) <<http://www.companydirectors.com.au/Director-Resource-Centre/Director-QA/Roles-Duties-and-Responsibilities/Role-of-the-Boardthe-Board>>; see generally *ASIC v MacDonald* [2009] NSWSC 287, Part 2.11; *AWA v Daniels* (1992) 7 ACSR 759, 867; *Centro* [2011] FCA 717; Australian Stock Exchange Corporate Governance Council (**ASXCGC**), *Corporate Governance Principles and Recommendations* (ASX, 2010); Bainbridge, above n 57; Baxt, above n 4; Grossman, above n 61; Norman T Sheehan, 'Making risk pay: the board's role' (2009) 30(1) *Journal of Business Strategy* 33

¹¹ Standards Australia, *Australian/New Zealand Standard: Risk Management, Principles & Guidelines*, AS/NZS ISO 31000:2009, 1.

¹² See for example the Australian Stock Exchange's Corporate Governance Principles at 33, which define risk management by reference to both potential adversity and *opportunity*, viz: 'Risk management is the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects... Risk management can enhance the environment for identifying and capitalising on opportunities to create value and protect established value.'

¹³ *Charitable Corp. v. Charitable Corp. v. Sutton*, 2 Atk. 400, 406, 26 Eng. Rep. 642, 645 (Ch. 1742). See for example Constance Frisby Fain, *Corporate Director and Officer Liability*, 18 U. Ark. Little Rock L. Rev. 417, 419-20 (1996); Justice Jack B Jacobs, 'Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective', (2015) 5 *Harvard Business Law Review* 141, 145.

¹⁴ See for example Murphy JA (with whom McLure P and Buss JA agreed on this point) in *Streeter v Western Areas Exploration Pty Ltd [No.2]* (2011) 29 ACLC ¶11-012, at 364-365: '*The critical feature of a fiduciary relationship is that the fiduciary undertakes or agrees to act for or in the interest of another person. The fiduciary acts in a representative character*', applying *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41, 96 – 97; *Pilmer v The Duke Group Ltd (in liq)* [2001] HCA 31; (2001) 207 CLR 165, 196 – 197 [71]; *John Alexander Tennis Club v White City Tennis Club* (2010) 241 CLR 1, [87] (French CJ, Gummow, Hayne, Heydon, and Kiefel JJ). Under United States law, see **REST 3d TRUSTS § 2, comment b**: '*[A] person in a fiduciary relationship to another is under a duty to act for the benefit of the other as to matters within the scope of the relationship.*' Under UK law, see for example *Bristol and West Building Society v Mothew* [1998] Ch 1, 18: a fiduciary is '*someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence*'.

¹⁵ See for example J Morwood (ed), *Pocket Oxford Latin Dictionary* (Oxford, 2001) 56; James Edelman, 'The Role of Status in the Law of Obligations' in Andrew S Gold and Paul B Miller, *Philosophical Foundations of Fiduciary Law*, (Oxford Scholarship Online, 2014) 23. See also discussion in Barker, Sarah, Mark Baker-Jones, Emma Fagan and Emilie Barton, 'Climate Change and the Fiduciary Duties of Pension Fund Trustees – lessons from the Australian Law', *Journal of Sustainable Finance & Investment* (2016), vol 6(3), 211-244.



- (a) Trust and loyalty (including, for example, duties relating to acting in the best interests of the corporation, avoidance of material conflicts of interest, honesty and good faith and proper purposes); and
- (b) Competence or attentiveness (including duties to act with prudence and/or due care, skill and diligence).¹⁶

Although directors are clearly fiduciaries of their companies, and owe duties to the company in the discharge of their role, not all directorial obligations are strictly 'fiduciary' in nature. In particular, although it is common shorthand parlance to refer to the suite of duties owed by directors to their corporation as 'fiduciary duties', there is a significant body of authority to suggest that the duty of due care and diligence, whilst *equitable*, is not 'fiduciary' under the Australian law.¹⁷ The nature of a duty of 'fiduciary' or otherwise is primarily relevant to the remedies that may be available for breach.¹⁸ The distinction is noted, but not discussed in this paper.

1.3 Duties under statutory vs common law

Directors' common law and equitable duties under the Australian law have been codified in the *Corporations Act*. However, pursuant to section 185 of that Act, the general law duties continue to apply concurrently:

"[the directors' duties set out in ss180-184] have effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation."

The jurisprudence on the general law duties continues to inform the interpretation of the statutory duties, and vice-versa. Where directors have been validly appointed, the distinction between the statutory and general law causes of action primarily lies in the remedies that may be available.

¹⁶ See for example *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments* (2006) 198 FLR 302 at 324. See generally discussion in Benjamin Richardson, 'Fiduciary and Other Legal Duties', in H Kent Baker and Nofsinger, John, *Socially Responsible Finance and Investing: Financial Institutions, Corporations, Investors, and Activists* (John Wiley & Sons 2012), Chapter 5; re US law see Hill, Claire A. and Brett McDonnell, 'Fiduciary Duties: The emerging Jurisprudence', in Hill, Claire A. and Brett McDonnell (eds.), *Research Handbook on the Economics of Corporate Law* (Edward Elgar Publishing, 2012), Chapter 8, 133-151; re UK law see Kay, John (2012), *The Kay Review of UK Equity Markets and Long-Term Decision Making*, Final Report to UK Department for Business, Innovation & Skills, July 2012, p.66; re EU law see for example Gerner-Beuerle, Carsten, Philipp Paech & Edmund Philipp Schuster, *Study on Directors' Duties and Liability* (LSE Enterprise 2013), http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf.

¹⁷ *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109, 158; Ford [8.320]. See generally Bruner, Christopher M., 'Is the Corporate Duty of Care a "Fiduciary" Duty? Does it Matter?', 48 *Wake Forest Law Review* 1027 (2013) for a discussion of the respective fiduciary characterisations (or otherwise) of the duty of care in the US, UK, Australia and Canada.

¹⁸ See for example *The Bell Group Ltd* (2008) 70 ACSR 1; Ford [8.010.3].

2. Duties of trust and loyalty

2.1 Trust/loyalty duties framework

2.1.1 Good faith and best interests

Section 181(1)(a) of the *Corporations Act* provides that a director must exercise their powers and discharge their duties in ‘good faith in the best interests of the corporation’, and for a ‘proper purpose’. Section 181 is a civil penalty provision.

The obligation in section 181 is recognised as imposing two separate (albeit interrelated) obligations on directors: first, to act in good faith in the best interests of the corporation’ and, secondly, ‘for a proper purpose’.

The obligations set out in section 181 are augmented by specific duties that prohibit the improper use of their position as a director (section 182) and information gained by virtue of their position as a director (ie to the gain an advantage for themselves or someone else or to cause detriment to the corporation) (section 183). Sections 182 and 183 are also civil in nature.

Under section 184, failures in the nature of those set out in sections 181-183 above may be prosecuted a criminal offence if the director acts recklessly, or with intentional dishonesty. However, a consciousness of impropriety (ie subjective bad faith or dishonesty) is not otherwise a precondition to breach (ie of the civil obligations set out in sections 181-183).

2.1.2 Conflicts of interest

Directors must also avoid material ‘conflicts of interest’ under the common law – viz where there is a ‘real or sensible possibility’ that the duality of interest would compromise the director’s ability to exercise their independent judgment in the best interests of the corporation.¹⁹ Such interest may be financial or personal (non-financial) in nature.²⁰

2.2 Application of trust/loyalty duties in a climate risk context

2.2.1 Best interests

Directors who consciously disregard, or are wilfully blind to, climate change risks in their governance of risk and strategy may fail to act in good faith in the best (financial) interests of their company pursuant to section 181 of the *Corporations Act*. For example, where such governance conduct is motivated by an extraneous interest, such as (for example) ‘default denialism’ consistent with the position promulgated by a partisan political or industry-based association with which the director is affiliated, a claim may potentially be raised that the director failed to discharge their duty to prioritise the best interests of the company. If that conduct can be shown to have been *reckless* or *intentionally dishonest*, the director may be subject of a criminal offence under section 184.

¹⁹ See for example *McGellin v Mount King Mining NL* (1998) 144 FLR 288; *Chan v Zacharia* (1984) 154 CLR 178 at 199 (“significant possibility” of conflict); *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 103 (“a real or substantial possibility of a conflict”) and *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1 at [4506] and [4508] (in which Owen J used the terms “a real sensible possibility of conflict” and “a real or substantial possibility of conflict.”). See generally Ford, [9.070].

²⁰ See for example *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1 at [4509].



Where a director's external position or affiliation may materially compromise their ability to exercise independent judgment on the governance of climate change risks, this may also give rise to an actionable *conflict of interest* (below). Whilst judicious disclosure and management of competing interests are often determinative of whether a conflict of interest comprises a breach of duty, such conflict may in fact be intractable where their membership of the extraneous organisation requires them to subscribe to (or promote) a particular position on climate change.

2.2.2 Conflicts of interest

A potential for conflict of interest may arise where the discretionary or contingent components of a director's financial incentives place their personal interests in conflict with those of the company. For example, there is some authority in other common law jurisdictions (including, in particular, Delaware) on director conflicts in merger transactions where directors are financially incentivised to favour the change of control. The courts are yet to consider this issue in the specific context of remuneration linked to stranded assets (or management of climate-related risks in general). This is not to suggest that directors who obtain pecuniary benefit due to their shareholding in their company will be in breach of duty merely because this arises as an incident of their conduct in promoting corporate best interests.²¹ In theory, however, a potential conflict may emerge between the financial interests of a company operating in the fossil fuel extractives sectors, and the personal financial interests of its directors, where (for example) contingent or discretionary components of remuneration are tied (in whole or in part) to reserve replacement ratios. This may financially incentivise directors to pursue a strategy of maximising fossil fuel reserve exploration and expansion, or to build 'conventional' power stations with no economically-credible plans for carbon capture and storage, without regard as to whether such a 'business as usual' approach to strategy is in the best financial interests of the company.

2.3 Trust/loyalty duties - conclusion

It is conceivable that a director may breach their **duty(s) of trust/loyalty** (specifically, to exercise powers and discharge duties in good faith in the best interests of the corporation and for a proper purpose under section 181(1)) where:

- the director consciously disregards, or is wilfully blind to, the financial risks associated with climate change and their potential impact on corporate risk management and strategy; or
- the director's ability to make an independent judgment in the best interests of the corporation conduct is compromised by a material conflict of interest. This may arise, for example, where the director holds an extraneous position that requires them to adhere to a position of climate change denial or obfuscation, or where their financial incentives aligned with 'business as usual' carbon-intensive business strategies (such as remuneration in the fossil fuel extractives sector tied to reserve replacement ratios).

²¹ See for example *Hirsche v Sims* [1894] AC 654, 660.

3. Competence (due care and diligence)

3.1 *Due care and diligence duties framework*

The general duty of due care and diligence of Australian company directors is set out in section 180(1) of the *Corporations Act*. It requires directors to '*exercise their powers and discharge their duties with the degree of due care and diligence that a reasonable person would exercise*' in the relevant circumstances.

The Australian duties regime is widely recognised as imposing particularly stringent standards of proactivity and professionalism on corporate directors, with a duty of care akin to 'mere negligence'. Significantly, proof of dishonesty and/or bad faith are not necessary to establish breach.

In assessing the reasonableness (or otherwise) of a director's conduct, Australian courts apply the *subjective* characteristics of the director and their corporation (including the type of company involved, the size and nature of its business or businesses, its Constitution, the composition of the board and its reserved powers, and whether the company is public or private)²² to an *objective* assessment of whether the director has taken '*all reasonable steps to be in a position to guide and manage the company*'.²³ This, in turn, requires a balancing of the magnitude of the relevant risk (its gravity, frequency and imminence) and the probability that it will crystallise, as against the expense, difficulty and inconvenience of any countermeasures, and the defendant's conflicting responsibilities.²⁴

The courts have emphasised that, regardless of the circumstances at hand, directors must discharge certain *minimum* standards to satisfy their duty of due care and diligence.²⁵ This includes the proactive acquisition and maintenance of relevant knowledge (including making enquiries of management and/or independent experts where this is warranted), active monitoring of the corporation's affairs, and an independent and critical evaluation of the matters for which they are responsible.²⁶ In this regard, the director's duty of care '*is not...limited by the director's knowledge and experience or ignorance and inaction*'.²⁷

Requirement to inform and inquire

Australian directors must acquire, and maintain, an '*irreducible core*' of knowledge and understanding of the fundamentals of their corporation, including in relation to its activities, its financial position and

²² *ASIC v Rich* (2003) 44 ACSR 341, [35]; *ASIC v Rich* (2009) 75 ACSR 1, [7201], citing *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 15, 123; *ASIC v Vines* (2005) 55 ACSR 617, [1067]; *Daniels v Anderson* (1995) 37 NSWLR 438, 505.

²³ *ASIC v Healey & Ors* [2011] FCA 717 (*Centro*), [16], [143] and [162]. See also *ASIC v Rich* (2009) 75 ACSR 1, [7205-6].

²⁴ *Wyong Shire Council v Shirt* (1980) 146 CLR 40, 47, applied in *ASIC v Rich* (2009) 75 ACSR 1, [7231, 7236] and *ASIC v Vines* (approved by the Court of Appeal in *Vines v ASIC* (2007) 25 ACLC 448); *ASIC v Ingleby* (2012) 91 ASCR 66, 69. For a general discussion of the application of the duty of due care and diligence under section 180 of the *Corporations Act* to the governance of climate-related risks, see Hutley and Hartford-Davis, above n1.

²⁵ See generally *Centro* [2011] FCA 717, [16], [143] and [162]. See also *ASIC v Rich* (2009) 75 ACSR 1, [7205-6].

²⁶ *Ibid.*

²⁷ *Daniels v Anderson* (1995) 37 NSWLR 438, 502, applied in *Centro* [2011] FCA 717, 646, [125]. Similarly, the director's conduct will be judged in the context of their *actual* responsibilities within the organisation in addition to their statutory responsibilities and those formalised in the company constitution or by board resolution: *Shafron v ASIC* (2012) 286 ALR 612; *ASIC v Rich* (2009) 75 ACSR 1, 614.



regulatory environment. Relevant issues must be identified and 'understood to facilitate properly informed consideration. In the words of the High Court in *Finch v Telstra*:

'If the consideration is not properly informed, it is not genuine';²⁸

The duty requires **proactive inquiry** by the directors, obliging them to '*take a diligent and intelligent interest in the information available to them or which they might appropriately demand from the executives or other employees and agents of the company*'.²⁹ Directors may be obliged to make (or procure the making of) further inquiries where a '*dearth of material*' on a relevant issue,³⁰ or a conflicting body of material,³¹ is otherwise placed before them, and/or to seek '*professional or expert advice*' from persons that are expert, reliable and competent where faced with complex issues.

Requirements to critically evaluate

The information proactively obtained and advice received must then be brought to bear in a process of active, 'careful', 'real and genuine consideration':³² an independent and critical evaluation of the matters for which the directors are responsible.³³

Monitoring – supervision/oversight

Delegation, and reliance on delegates' advice, is specifically contemplated under sections 198D ('Delegation'), 189 ('Reliance on information or advice provided by others'), and 190 ('Responsibility for Actions of Delegate') of the *Corporations Act*. However, the director's delegation and reliance must itself be reasonable. A director's reliance on the advice of an employee or expert may *not* be reasonable where the director did not believe, on reasonable grounds,³⁴ that the delegate or advisor was reliable and competent in the relevant matters, or the reliance was not made in good faith, or the director did not make an independent assessment of the information or advice.

²⁸ See for example *ASIC v Australian Property Custodian Holdings Ltd (re cs and mgrs apptd) (in liq) (controllers apptd) (No 3)* [2013] FCA 1342 at [571]; applied in *Sharp v Maritime Super Pty Ltd* [2013] NSWSC 389 at [33].

²⁹ *Centro* [2011] FCA 717, [16], [143] and [162]. See also *ASIC v Rich* (2009) 75 ACSR 1, [7203].

³⁰ *Alcoa of Australia Retirement Plan Pty Ltd v Frost* [2012] VSCA 238, Nettle JA at [47-48], in relation to the determination of a fund member's entitlement to TPD benefits. Section 56(3) of the SIS Act specifically contemplates that trustee directors should seek advice, and be indemnified out of the assets of the trust in doing so. In the words of Deputy President Forge in *Re VBN and APRA*: '*As essential as professional advice is, the trustees' obligation goes beyond merely seeking, accepting and following professional advice...the trustee [must] use their own acumen, knowledge and judgment in weighing all the relevant factors, including professional advice.*' - *VBN and Ors and Australian Prudential Regulation Authority and Anor* [2006] AATA 710; (2006) 92 ALD 259 (25 July 2006), 469.

³¹ *Finch v Telstra* (2010) 242 CLR 254 at 254.

³² **See for example** *Tuftevski v Total Risks Management Pty Ltd* [2009] NSWSC 1021, where a question arose as to what was required by way of enquiry on the part of a trustee in the context where the trustee had received material adverse to the employee's claim. Smart AJ held [at 16]: '*In my opinion bona fide enquiry and genuine decision making where these are required constitute an integral part of performing a fiduciary obligation. ...The process followed by the Trustee ... must involve deciding a question of fact in good faith and giving it real and genuine consideration. This often cannot be done without conducting some investigation and making relevant inquiries ...*'.

³³ *Centro* [2011] FCA 717.

³⁴ Whether or not the directors' reliance on the advice of experts or employees was 'reasonable' is a question of fact in each case: *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109; 12 ACLC 674; *Vrisakis v ASC* (1993) 9 WAR 395; 11 ACSR 162 at 215; 11 ACLC 763.



Notable circumstances in which a plaintiff has been able to establish that reliance on the professional advice by a director was unreasonable include where the delegate themselves has a conflict of interest,³⁵ where the adviser had no technical qualifications or experience which justified reliance upon their opinions,³⁶ where the directors failed to interrogate superficial or inadequate answers by the delegate which indicated further investigation was warranted,³⁷ and where the directors completely or solely relied on the conclusions of relevant experts without their own independent review or consideration.³⁸

Business judgment

The obligation to exercise due care and diligence is tempered by a 'business judgment rule' defence under section 180(2). Notably, the Australian business judgement rule applies as a **defence** to a finding that a director has breached their duty of due care and diligence – rather than as a *presumption* as it does in some other common law jurisdictions (notably including Delaware in the United States).

The defence applies where the directors make a conscious judgment that relates to the performance, risk or strategy of the business, and that judgment is made:

- in good faith for a proper purpose;
- free from material personal interest;
- upon the basis of information about the subject matter that the director reasonably believes to be appropriate; *and*
- with a rational belief that the judgment is in the best interests of the corporation.

The Australian business judgment rule is routinely raised by defendant directors. However, it is *unsuccessful* in providing a defence in nearly all cases. Defendants (having been found liable for a breach of their duty of due care and diligence) are usually unable to discharge either the threshold issue that they made a conscious judgement (as opposed to a course of action resultant of a failure to consider a matter), and/or that that judgment was based upon a robust informational basis in satisfaction of the last two limbs of the test.

3.2 Application of due care and diligence in a climate risk context

It is important to note at the outset of this analysis that the duty of care and diligence does not impose liability for incorrect commercial judgments *per se*. The courts are extremely reluctant to engage in a judicial re-assessment of the commercial wisdom of a particular decision. The fact that a company underperforms – or even suffers a loss in value – is not in and of itself a breach of duty.³⁹ Rather, as outlined above, compliance with the duty of due care and diligence is assessed by reference to the

³⁵ *In Re HIH Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2004) 41 ACSR 72; 20 ACLC 576; [2002] NSWSC 171; BC200200827, at [451].

³⁶ *Australian Securities and Investments Commission v Citofresh International Ltd (No 2)* (2010) 77 ACSR 69; 28 ACLC 10-002; [2010] FCA 27 at [54]–[59].

³⁷ *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109; 12 ACLC 674; see also *Vrisakis v ASC* (1993) 9 WAR 395; 11 ACSR 162 at 215; 11 ACLC 763.

³⁸ *ASIC v Healey & Ors* [2011] FCA 717.

³⁹ See for example *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs apptd) (in liq) (controllers apptd) (No 3)* [2013] FCA 1342 at [571]; applied in *Sharp v Maritime Super Pty Ltd* [2013] NSWSC 389 at [33].



robustness of the *process* of information gathering and deliberation, rather than a retrospective assessment of whether an optimum financial outcome was achieved.⁴⁰ The relevant inquiry is whether the *procedural effort* applied to the consideration and governance of climate change risks is so inadequate as to risk breach of the minimum standards of due care and diligence expected of directors in the circumstances.

The answer to that question will, of course, turn on the facts of each case. The material risks and opportunities associated with climate change, and appropriate risk management treatments, vary across geographies, industries and corporations, and will need to be weighed against conflicting corporate obligations and expenses. It is therefore difficult to set out a universal governance strategy that will satisfy the duty in directors' governance of climate change risks (or, conversely, that are unlikely to do so).⁴¹ However, the scope, scale and probability of the relevant risks will be relevant in considering the standard of governance conduct required. The significant – and increasing – materiality of climate change risks suggests that the minimum benchmark of care and diligence that should be applied in the circumstances is proportionately-high. With that general proposition in place, we can assess whether the nature of governance of climate change risks by directors in that sector is likely to be sufficient to satisfy their duty of due care and diligence, in two broad categories, *viz*:

- (a) **A total failure** to consider and govern for climate change risks in strategic planning and risk management: either in general or in relation to material projects or acquisitions that require board oversight or approval, due to honest ignorance, or blind or unquestioning reliance on the advice of delegates or advisors on point; or
- (b) **Inadequate or deficient consideration and/or governance** of climate change-related risk exposures, due to (for example) lack of critical analysis, unreasonable reliance, lack of oversight or inadequate information.

3.2.1 Total failure to consider a foreseeable risk

The threshold for enlivening a directors' duty to apply due care and diligence is whether the issue in question presents a *foreseeable* risk to corporate performance and/or prospects.⁴² It is then only with the application of a robust process of consideration – due care and diligence – that the *materiality* of that risk, and its potential impact on corporate strategy and risk management et cetera, may be ascertained.

Of course, whether or not a particular issue associated with climate change has potentially material *consequences* in the circumstances, such that it warrants a strategic or risk management-based response, will be a matter that necessarily varies in each unique case. However, with the balance of economic authority summarised in Part 1 above, it is now arguable that a conclusion that the

⁴⁰ See for example discussion in Collins, Paul (2014), 'The best interests duty and the standard of care for superannuation trustees', 88(9) ALJ 632 at 634; and Thornton, Rosy (2008), 'Ethical investments: a case of disjointed thinking', *Cambridge Law Journal* 396 at 410.

⁴¹ Waitzer, Edward and Douglas Sarro (2014), 'Fiduciary Society Unleashed: The Road Ahead for the Financial Sector', *The Business Lawyer*, 9 August 2014, 1081-1116 at 1090-1091.

⁴² Hutley and Hartford-Davis above n1, at [3].



consequences for a fund were *not* materially financial would need to be based on specific, robust analysis, rather than assumption or default to historical norms.

Indeed, it is clear that a reasonable director of a listed public company in Australia should know that an issue of such high profile and potential economic significance as climate change presents a foreseeable risk to corporate performance and prospects. The position in Australia is aptly summarised in the opinion on the application of the duty of due care and diligence to the governance of risks associated with climate change of senior commercial barrister Mr Noel Hutley SC:

*It would be difficult for a director to escape liability for a foreseeable risk of harm to the company on the basis that he or she did not believe in the reality of climate change, or indeed that climate change is human-induced. The Court will ask whether the director should have known of the danger. This would involve an assessment [of] the conduct of the individual director against the standard of a reasonable person, by reference to the prevailing state of knowledge as publicized at the time. The law has often had to deal with liability for negligence in the context of rapidly developing science. At one time, for example, knowledge was such that an employee could be exposed to asbestos without negligence, or a patient could be infected with HIV through an unsafe intravenous blood transfusion. At a certain point, however, ignorant defendants became liable for this risks on the basis that a reasonable person would have known [of] them. When it comes to climate change, the science has been ventilated with sufficient publicity to deduce that this point has already passed...*⁴³

With the evolution of climate change to a foreseeable risk issue, so too directors' obligations to exercise due care and diligence in considering its potential impact on their corporation's risk assessment and management, strategy, asset valuation and liability contingencies or provisions, financial planning and capex, and disclosures, is enlivened.⁴⁴ Accordingly, a failure to consider the risks and/or opportunities presented by climate change for want of the relevant knowledge – either in general, or in relation to material projects or acquisitions⁴⁵ - appears to present grounds for review for breach of the duty of care. This holds whether the director's ignorance is as a result of presumptive climate change denial or scepticism⁴⁶ or a simple absence of consideration due to lack of knowledge.⁴⁷

⁴³ Hutley and Hartford-Davis, *id.*, [34], original emphasis, internal citations omitted.

⁴⁴ For discussion of the legal foreseeability of climate change risks to Australian corporate directors, see Hutley and Hartford-Davis, *id.*

⁴⁵ See for example Loechel, Hodgkinson and Moffat, 473; Louise Rouse, *Pensions funds and climate change: can't act, won't act* (2 July 2013) The Guardian <http://www.theguardian.com/sustainable-business/pension-funds-climate-change-inaction>; Jeffrey A Smith A and Matthew Morreale, 'The Fiduciary Duties of Directors and Officers', in Michael B Gerrard (ed), *Global Climate Change and U.S. Law* (American Bar Association, 2007) 497; Solomon, 13.

⁴⁶ See for example Greg Liddell, *Fiduciary duty and climate change* (24 May 2015) Investment Operations & Custody <http://ioandc.com/fiduciary-duty-and-climate-change/>; Barton Loechel, Jane Hodgkinson and Kieran Moffat, 'Climate Change Adaptation in Australian Mining Communities: comparing mining company and local government views and activities' (2013) 119 *Climate Change* 465, 473; Solomon, 19.

⁴⁷ For example, in *Madoff Securities International Ltd (in liquidation) v Raven* [2013] WL 5338134 at para. 265, the UK High Court held that a failure to exercise reasonable care and skill could arise from a director's failure to turn their minds to the question whether a particular transaction was in the best interests of their company. See also discussion of Australian legal principles in Loechel, Hodgkinson and Moffat, 473; Rouse, Louise, *Pensions funds and climate change: can't act, won't act* (2 July 2013) The Guardian <http://www.theguardian.com/sustainable-business/pension-funds-climate-change-inaction>; and re US law in Jeffrey A Smith A and Matthew Morreale, 'The Fiduciary Duties of Directors and Officers', in Michael B Gerrard (ed), *Global Climate Change and U.S. Law* (American Bar Association, 2007) 497; Solomon, 13.



Importantly, it is no defence that the director was not *provided* with information on climate change risks by their corporation by management. Australian corporate governance law clearly imposes expectations of proactive inquiry: the responsibility to seek adequate advice on material issues where it is not otherwise provided lies squarely with the directors themselves.⁴⁸ The obligation to seek appropriate advice is further considered under the category of *Inadequate Consideration*, below.

Given the profile and magnitude of the issue of climate change, it may seem unlikely that, in practice, a director of an Australian listed public company would not know (or ought to have known) that climate change presents a foreseeable risk to corporate performance and strategy – and thus enlivening their obligation to exercise due care and diligence in relation to that risk. However, analysis of current corporate disclosures suggests that that is not necessarily the case. For example, a recent study by EY of 150 Australian companies (including 130 listed on the ASX200 falling into the ‘high-risk’ categories set out by the TCFD, and the 20 largest superannuation (pension) funds) assessed an average performance score of around 30% on each of the recommended climate governance categories set out in the TCFD (*viz*, governance (31%), strategy (25%), risk management (32%) and disclosure of metrics and targets (31%)).⁴⁹ Whilst a failure to report these corporate governance approaches to climate risk may be an imperfect proxy indicator for the diligence of board deliberations, it may be instructive in relation to an issue of such profile and economic significance. More particularly, such non-disclosure may indicate that *either*: (a) climate change-related risks *have* been robustly considered and interrogated, and assessed as having an immaterial impact on the corporation (a conclusion that does not seem to be likely for such a high proportion of corporations in the sector, given the significance of the relevant risk issues), or (b) that the issue has been considered and interrogated with an appropriate degree of due care and diligence, and assessed as material in the circumstances of the corporation but not disclosed (which raises questions of misleading disclosure, below), or (c) the non-disclosure is a product of a failure to consider (or perhaps adequately consider, this foreseeable financial risk issue as discussed below).

In addition, it is unlikely that defendant directors could rely on the business judgment rule as an exculpatory defence to liability for a failure to consider the foreseeable financial impacts associated with climate change. This rule is not designed to protect directors who are uninformed, who make no conscious decision, or who exercise no judgment.⁵⁰

Accordingly, it is relatively uncontroversial that an abject failure to consider an issue with as significant an economic profile as climate change may comprise a breach of the duty of due care and diligence of directors of listed corporations in Australia.

3.2.2 Inadequate consideration

A more complicated question as to whether a director may have breached their duty of competence arises where a director has in fact considered climate change risks, but that process was inadequate

⁴⁸ See *Centro* [2011] FCA 717, [16], [143] and [162]; *ASIC v Rich* (2009) 75 ACSR 1, [7203].

⁴⁹ EY, *Climate Risk Barometer*, July 2017, pp11-13,

<[http://www.ey.com/Publication/vwLUAssets/Climate_Risk_Disclosure_Barometer_2017/\\$FILE/ey-climate-risk-disclosure-barometer-2017.pdf](http://www.ey.com/Publication/vwLUAssets/Climate_Risk_Disclosure_Barometer_2017/$FILE/ey-climate-risk-disclosure-barometer-2017.pdf)>. See also for example Market Forces, *New research: How have ASX50 companies responded to the TCFD recommendations?*, Super Switch, 5 December 2017, <<http://superswitch.org.au/news/asx50-tcf/>>, accessed 5 January 2018.

⁵⁰ See Hutley and Hartford-Davis, *id.*, [41].

or deficient. However, there are a number of circumstances in which it may be possible to raise a credible claim for a breach:

- whilst having turned their minds to climate change as a foreseeable risk issue and having some information at their disposal, the directors have failed to become adequately informed of relevant material information; the related
- failure to appoint and/or obtain appropriately-qualified independent advice; a
- failure to adequately evaluate the issue, or adequately interrogate the advice received; and/or a
- failure to duly monitor, supervise or oversee delegates.

Each of these circumstances is considered below.

Failure to become (and remain) adequately informed

- *Obligation to proactively inquire*

As outlined above, it is clear that an issue of such high profile and potential economic significance as climate change – one that receives regular prominence in the mainstream financial press - would put a reasonable, yet uninformed, trustee director on notice that further inquiries were warranted.⁵¹

Directors have a positive obligation to apply an inquiring mind to their role, bringing to bear knowledge that they ought reasonably have known about the corporation and its investment and operational context.⁵² It has been clearly established that the duty to exercise care and diligence is not limited by the director's subjective knowledge on material issues (or, by extension, any deficiencies in the breadth, depth or currency of that knowledge) – even where they are acting with subjective honesty and in good faith.⁵³ Relevant failures to exercise due care and diligence may include '*failing to make relevant inquiries or raise matters which ought to have been raised*',⁵⁴ or a failure to '*join the dots*'.⁵⁵ And their knowledge and inquiry must be continuous and dynamic in the context of contemporary investment and market norms.

If analysis of the relevant risks and strategic opportunities were not being presented to the board, it would be incumbent upon the directors to inquire of management (and/or relevant experts), and to query issues such as the impact on the corporate strategy, risk management and disclosures.⁵⁶

⁵¹ *ASIC v Ingleby* (2012) 91 ACSR 66 (appeal to the CAVSC upheld in relation to quantum of penalty, but not liability); *ASIC v Lindberg* (2012) 91 ACSR 640; *Shafron v ASIC* (2012) 286 ALR 612.

⁵² *Centro* [2011] FCA 717.

⁵³ *ASIC v Lindberg* (2012) 91 ACSR 640, [30]. See also *ASIC v Ingleby* (2012) 91 ACSR 66; *AWA v Daniels* (1992) 7 ACSR 759; *Centro* [2011] FCA 717, [189].

⁵⁴ *Centro* [2011] FCA 717, [189]; *Alcoa of Australia Retirement Plan Pty Ltd v Frost* [2012] VSCA 238, Nettle JA at [47-48].

⁵⁵ *ASIC v Ingleby* (2012) 91 ACSR 66 (appeal to the CAVSC upheld in relation to quantum of penalty, but not liability); *ASIC v Lindberg* (2012) 91 ACSR 640; *Shafron v ASIC* (2012) 286 ALR 612.

⁵⁶ *ASIC v Ingleby* (2012) 91 ACSR 66; *ASIC v Lindberg* (2012) 91 ACSR 640; *Centro* [2011] FCA 717; *Alcoa of Australia Retirement Plan Pty Ltd v Frost* [2012] VSCA 238, Nettle JA at [47-48].



- *How much information is enough?*

The inquiry into whether directors have sufficient information in order to duly consider climate change-related risks (and subsequently applied critical assessment to their independent evaluation thereof) is necessarily a question of fact in each particular case. Whilst a board must be reasonably informed, it is not required to be informed of every fact. Whether the board has *sufficient* understanding of the relevant is a question that depends on the nature of the issue, the quality of the information and advice considered. However, the significance the potential financial impacts of climate change risks on corporate performance and prospects suggests that the courts will require a proportionately broad and deep understanding of this issue by directors to obtain assurance that a robust interrogation of climate risks has been undertaken for their corporation.⁵⁷ At a minimum, it is unlikely that the courts would find it demonstrative of due care and diligence that directors turned their minds to the fact that climate change may present a risk to corporate performance and prospects, but then failed to obtain and/or interrogate information regarding the particular potential impacts upon the corporation – particularly in those sectors in which institutions such as the FSB TCFD and SASB have assessed as having a material susceptibility to climate-related risks. Specifically, it is unlikely that the courts would be persuaded that a 'duly careful and diligent' assessment of the issue had been undertaken where a director merely presumed that:

- the impacts on their corporation would be immaterial, would only become relevant over the long term (and beyond the corporation's investment and/or planning horizons), were only physical or economic transition-based in nature (rather than both), or would be limited to the imposition of a statutory price on carbon; or
- the range of potential climate futures (and their impacts) are so vast in scope and scale, and indeterminate in their timing, that the best interests of the company would be served by deferring strategic analysis of the issue to a time beyond the company's investment and/or planning horizons.

The proliferation of 'soft law' instruments that provide guidance to corporations about their disclosure of climate-related risks are likely to be increasingly persuasive indicators of those kinds of information that directors must inform themselves of, and then critically evaluate, in order to discharge their duty of care. Climate change risk exposures have been raised by Australian regulators including the Australian Prudential Regulation Authority. Additional guidance has been promulgated by respected bodies such as the Climate Standards Disclosure Board and the Sustainability Accounting Standards Board and, notably, in the Recommendations of the TCFD. The connection between disclosure standards and boardroom conduct has been well made by the CEO of the UK FRC, Stephen Hadrill:

*'In considering what to report it is worth remembering that reporting serves two purposes. It puts information into the capital markets that enables shareholders and lenders to judge performance and so determine how investment should be directed. But it also shapes the debate in the boardroom. That which is reported is discussed.'*⁵⁸

⁵⁷ See for example *ASIC v Flugge* [2016] VSC 779.

⁵⁸ Stephen Hadrill, CEO UK Financial Reporting Council, presentation on Climate Disclosure Standards Board's – Comply or Explain: Review of FTSE 350 companies, 28 January 2016.



As outlined above, if a director has not been provided with relevant information by management to adequately inform them of the issues associated with climate change and their potential impacts on *their company's interests*, it will be incumbent upon them to proactively inquire into this foreseeable risk issue:

Failure to obtain independent advice

In complex situations requiring specialised knowledge directors are not only permitted, but can be required, to seek out expert or professional advice from within or outside their company in order to satisfy their duty of due care and diligence.⁵⁹ This applies both in their consideration of the *strategic* response to climate-related risks, and as an input into significant capex or acquisition decisions.

In particular, in informing themselves of (and critically evaluating) the risks and opportunities associated with climate change, directors would be likely to require the input of independent, expert advice on this dynamic and specialised area – including in relation to issues such as relevant technological trends and costs of substitute lower-emissions products, carbon pricing regimes, emissions reductions scenarios, the likelihood of each scenario crystallising and the impacts of each on price and demand, asset valuation, strategy and financial planning.

Where advice has been sought, an issue will still arise as to whether the directors' process of delegation, and evaluation of the advice received, will be sufficient to satisfy the duty of care. Relevant concerns may arise in circumstances where the 'expert' advisor was not appropriately qualified or independent, or their advice coloured by a set of biased or inadequate assumptions.⁶⁰ These issues are considered under a *Failure to Critically Evaluate*, below:

Failure to critically evaluate

Directors are entitled to rely on the advice provided by management and experts. However, the entitlement is not absolute. The duty of care requires more than passive acceptance of information provided by management or independent experts. Rather, the law requires directors to assess such information with a 'critical eye' in their pursuit of the best interests of the corporation.⁶¹ 'Complete and sole reliance'⁶² on the conclusions of appointed experts are unlikely to satisfy the directors' duty of care. The obligation may conceivably extend to interrogation of the scope of the advisor's instructions, or related limitations/assumptions, where those parameters indicate that the brief may have been engineered to produce a conclusion that is consistent with a pre-determined outcome or course of action.⁶³

A failure of critical evaluation may also arise where directors fail to assure themselves that the delegate or advisor was reasonably competent to provide the relevant advice (by reference either to

⁵⁹ Hutley and Hartford-Davis, above n1.

⁶⁰ See for example ASIC Regulatory Guide RG111 *Content of Expert Reports* and RG112 *Independence of Experts*.

⁶¹ See *Van Gorkom*, 488 A.2d at 872.

⁶² *ASIC v Healey & Ors* [2011] FCA 717, [569], [580] and [582].

⁶³ See for example *ASIC v Hellicar* [2012] HCA 17; *Shafroon v ASIC* [2012] HCA 18; *ASIC v Macdonald (No 11)* [2009] NSWSC 287; *ASIC v Macdonald (No 12)* [2009] NSWSC 714; *Morley v ASIC* [2010] NSWCA 331; *James Hardie Industries NV v ASIC* [2010] NSWCA 332 (collectively, the '**James Hardie cases**').



their qualifications or independence). In particular, it is conceivable that directors may not discharge their duty of care where they obtain advice *only* from advisors who, by their mission or articulated policies, may have interests skewed towards a particular outcome (such as the Minerals Council of Australia on the one hand, or Australian Conservation Foundation on the other).⁶⁴

Further analogies may be drawn to other cases where directors have breached their duty of due care, such as where:

- directors failed to make inquiries, and were satisfied with superficial or inadequate answers, in relation to issues critical to the risks of a proposed transaction.⁶⁵ In a climate change risk context, this may arise where (for example) the advice to directors is based on outdated data or methodologies, or limited only to overly optimistic assumptions; or where
- directors deferred, without independent review, to the conclusions of management and external auditors in relation to whether financial statements presented a true and fair view of company performance and prospects.⁶⁶ In a climate risk context, this may include a failure to ensure that stranded asset risks have been considered in the preparation of financial statements (to avoid any material overstatement of assets or under-provisioning of liabilities), and/or adequately disclosed in the accompanying management reports.

To the latter point, scenario analysis and stress testing (including against the sub-2°C scenario contemplated under the Paris Agreement) are rapidly emerging as benchmark tools to aid the formulation of a corporation's strategic response to climate-related risks, their management and disclosure. The disclosure of this information (with the implicit presumption that it would reflect underlying strategy and risk management) has in fact been the primary focus of shareholder resolutions seeking disclosure by fossil fuel companies (and the financial services companies that finance their operations) in recent years. It is increasingly the subject of 'soft-law' guidance by regulators such as the Australian Prudential Regulation Authority, and influential, industry-led frameworks such as that promulgated by the TCFD. It is also a central requirement of mandatory disclosure regimes emerging in Europe, and in US states such as California. Accordingly, the courts may, increasingly, be persuaded such analysis is essential to the discharge of directorial due care and diligence where climate change presents a foreseeable risk.

Failure to monitor / duly oversee / supervise

Directors may also breach their obligation to exercise due care and diligence where the process of deliberation on climate-related risks is compromised by a failure to monitor – that is, to assure themselves that management has implemented a compliance, risk and reporting system that effectively identifies and manages climate change-related risks. This may be a product of 'negligent oversight' of corporate systems, or in the supervision of management. The relevant oversight omission

⁶⁴ For example, in the Australian case of *ASIC v Citofresh International Ltd (No 2)* (2010) 77 ACSR 69; [2010] FCA 27 at [54]–[59] misleading disclosures were prepared in reliance on the advice of two consultants who were not experts in the relevant subject matter, nor otherwise held technical or scientific qualifications or experience that may have justified such reliance.

⁶⁵ *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109; 12 ACLC 674.

⁶⁶ *ASIC v Healey & Ors* [2011] FCA 717, [175].



may also include a failure to ensure that management has considered the resilience of business plans against a sub-2°C scenario, as outlined above.

There is in fact specific authority under the Australian law that suggests that a failure to exercise due care and diligence may manifest in the director's failure to interrogate the material assumptions on which advice or reports to them are based. For example, in the *James Hardie* series of cases,⁶⁷ the board of directors were held to have contravened their duty of care by approving an announcement to the market that they ought to have known was misleading in a material respect. That announcement misrepresented that an offshore special-purpose vehicle, which had been set up to house liabilities accruing from asbestosis claims against the company, was 'fully funded' (whereas in reality it was chronically under-funded). Relevant factors that contributed to the directors' lack of diligence included their unquestioning acceptance of management's assertions that the vehicle was fully funded, when a critical evaluation of the actuarial report on which it was based would have revealed that the analysis did not account for superimposed inflation (a factor which had a material bearing on the conclusion that the funding was adequate), and that the review of the actuarial cash flow estimates commissioned from PriceWaterhouseCoopers and Access Economics were too limited in scope to be reliable 'audits' of the veracity of the actuarial models. In that case, Gzell J (at first instance) held that the market announcement was '*a key statement in relation to a highly significant restructure of the James Hardie group*'.⁶⁸ Therefore, management having brought the matter to the board, none of the directors was entitled to '*abdicate responsibility by delegating his or her duty to a fellow director*'. Nor was this a case where non-executive directors could avoid liability by pleading reliance on management or expert advisers, for '*the task of approving the draft ASX announcement involved no more than an understanding of the English language used in the document*'. The Court of Appeal expressed a broadly similar view. The circumstances of the case '*were not circumstances in which a non-executive director, exercising due care and diligence, could accept the draft announcement without application of his or her mind*' to the draft (at [809]). The non-executive directors, familiar with the importance of sufficiency of funding and the question whether an assurance of sufficiency could be given, '*could not properly accept the say-so of management*' (at [821]).

Similarly, in *ASIC v Flugge & Geary*⁶⁹ the Supreme Court of Victoria found that the former Chair of the Australian Wheat Board had breached his duty of due care and diligence under section 180(1) of the *Corporations Act* due to his failure to make adequate inquiries into the propriety of the company's payment of inland transportation fees to the Iraqi government (which resulted in his failure to prevent AWB from making payments that were illegal under prevailing UN sanctions). The court found that despite having been informed in March 2000 that the UN was inquiring into whether AWB was making any inappropriate payments of transportation fees to Iraq, Mr Flugge failed to discharge his obligation of due care and diligence by failing to make any (or any adequate) inquiries as to whether the UN had been fully informed by AWB of the circumstances surrounding AWB's payment of inland transportation fees, in the circumstances where he knew:

- of the Oil-For-Food-Program (**OFFP**) and the UN sanctions against Iraq;

⁶⁷ *ASIC v Hellicar* [2012] HCA 17; *Shafron v ASIC* [2012] HCA 18; *ASIC v Macdonald (No 11)* [2009] NSWSC 287; *ASIC v Macdonald (No 12)* [2009] NSWSC 714; *Morley v ASIC* [2010] NSWCA 331; *James Hardie Industries NV v ASIC* [2010] NSWCA 332 (collectively, the '**James Hardie cases**').

⁶⁸ [260]-[261].

⁶⁹ [2016] VSC 779.



- that AWB was making payments of inland transportation fees to the Iraqi government under the OFFP; and
- that AWB was doing so in the belief that the UN had approved the payments of the inland transportation fees even though they involved the payment of internationally traded currencies to Iraq.

By analogy in a climate change context, directors may fail to discharge their duties to the statutory standard of care in relation to a material decision in which climate-related risks are (or should have been) a material factor, where they fail to interrogate the methodologies and assumptions on which management recommendations regarding climate risk strategy and management are based. This may include, for example, decisions regarding corporate strategy or disclosure that are based on reports that address only 'business as usual' emissions trajectories, or that are based only on bullish fossil fuel price/demand assumptions, without concomitant analysis across a broader range of potential, realistic futures.

A note re 'stepping stones' – corporate statutory breach as a failure of directorial due care and diligence

The directors' duty of due care and diligence does not impose any general obligation upon directors to ensure that the affairs of the company are conducted in accordance with the *Corporations Act* (or any other law).⁷⁰ However, in some circumstances it can be a breach of section 180(1) where the director authorises or permits the company to contravene the *Corporations Act* (or other relevant laws).⁷¹ Such 'stepping stone' directorial liability may be particularly relevant in a climate risk context where the corporation breaches misleading disclosure laws. This is discussed further under Part 7 below.

3.3 Due care and diligence – conclusion

It is likely that a director who is uninformed as to the risks associated with climate change, or who makes no conscious decision or judgment on this issue in their consideration of corporate strategy, planning and risk management, or in their consideration of transactions coming before them for approval, would fail to discharge their duty of due care and diligence under section 180 of the *Corporations Act*. The board is required to inquire where information is not presented to them, and to seek advice on specialist and complicated issues.

It is also likely that inadequate consideration of climate-related risks will breach the duty. Australian courts tend to hold directors to particularly high standards of proactivity, professionalism and robust process. When considered in concert with the magnitude of climate-related risks for companies in the predominant sectors of the Australian economy (including energy and resources, financial services,

⁷⁰ See for example *ASIC v Warrenmang Ltd* (2007) 63 ACSR 623; 25 ACLC 1589; [2007] FCA 973; at [22]; *ASIC v Maxwell* (2006) 59 ACSR 373; 24 ACLC 1308; [2006] NSWSC 1052; at [104]; *ASIC v Mariner Corp* (2015) 241 FCR 502; 327 ALR 95; 106 ACSR 343; [2015] FCA 589; at [444]–[447]; *ASIC v Cassimatis (No 8)* (2016) 336 ALR 209; [2016] FCA 1023; at [526]–[532]. See generally Ford, [8.305.15].

⁷¹ *ASIC v Warrenmang*, above, at [25]; *ASIC v Rich* (2009) 236 FLR 1; 75 ACSR 1; [2009] NSWSC 1229; at [7238]; *ASIC v Citrofresh International Ltd (No 2)* (2010) 77 ACSR 69; [2010] FCA 27; at [40]–[60]; *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 48 WAR 1; 285 FLR 121; 98 ACSR 615; [2014] WASC 102; at [247]–[252]; *ASIC v Sino Australia Oil and Gas Ltd (in liq)* (2016) 115 ACSR 437; [2016] FCA 934; *Australian Securities and Investments Commission v Padbury Mining Ltd* (2016) 116 ACSR 208; [2016] FCA 990; *ASIC v Cassimatis*, above.



agriculture, real estate, infrastructure and tourism), the courts are likely to hold directors to higher standards of proactive inquiry, expert advice (from management or independent specialists) and board evaluation of relevant issues. Moreover, Australian courts have shown a specific propensity to hold directors liable for deficiencies in the parameters or assumptions on which the advice or reports of delegates are based.

Particular circumstances that may be suggestive of a failure to apply due care and diligence to climate change-related risk issues include:

- lack of awareness of the material physical and economic transition risks to the corporation arising from climate change (whether due to climate change denial or honest ignorance);
- a failure to ascertain whether advisors are appropriately qualified, competent and independent;
- blind or unquestioning reliance on the recommendations of advisors;
- a failure to scenario plan / stress test business plans and transactional outcomes against a range of potential climate futures (including 'adverse' scenarios, such as the <2°C warming ceiling agreed to by the parties to the Paris Agreement); and, particularly in Australia
- a failure to interrogate the parameters, assumptions and methodologies on which advice is based.

4. Duty of disclosure

4.1 Disclosure and reporting requirements

There is no separate *fiduciary* 'duty of disclosure' under the Australian corporate governance law. However, a number of statutory provisions provide for the liability of directors in relation to misleading corporate disclosures to the market - either in a financial, prudential and/or commercial context.

In addition, directors may be liable as an *accessory* to their company's breach of its disclosure obligations, where they are 'involved' in such contravention within the meaning of section 79 of the Corporations Act. Section 79 provides that a person will be 'involved' in a contravention where they have:

- (a) aided, abetted, counselled or procured;
- (b) induced;
- (c) directly or indirectly knowingly concerned in; or
- (d) conspired with others in relation to –

the contravention.

Depending on the nature and context of the relevant disclosure, relevant prohibitions against misleading statements include:

Issue or fundraising documents

Specific provisions apply to regulate disclosures made in certain fundraising documents (including, for example, prospectuses) under Chapter 6D of the *Corporations Act*. For example, section 710(1) sets out the general disclosure test for prospectuses, which '*must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment*' of matters set out in that section (including, for example, the rights and liabilities attaching to the securities offered, and the financial position and performance of the issuing entity). The disclosure requirements are limited to information:

- (a) *To the extent to which it is reasonable for investors and their professional advisers to expect to find the information in the prospectus; and*
- (b) *Only if a person whose knowledge is relevant [which includes, pursuant to ss (3), the issuing company's directors]:*
 - i. Actually knows the information; or*
 - i. In the circumstances ought reasonably to have obtained the information by making enquiries.*

Section 728 prohibits a person from making a misleading or deceptive statement in a Chapter 6D disclosure document, or an omission of the information prescribed in section 710 (or, where relevant, sections 711-715). Section 728(2) provides that '*A person is taken to make a misleading statement*



about a future matter (including the doing of, or refusing to do, an act) if they do not have reasonable grounds for making the statement. Conduct in breach of section 728(1) is specifically excluded from liability under the general misleading disclosure prohibition in section 1041H discussed below (see Note to section 729).

Damages are recoverable from the directors of the issuing entity by any person who suffers loss by virtue of a breach of section 728(1) – *‘even if the person [ie the director] did not commit, and was not involved in, the contravention’* (section 729(1)). Proceedings may be brought within 6 years after the day on which the cause of action arose (section 729(3)).

Pursuant to section 728(3), a person commits an offence if the misleading or deceptive statement or omission is *‘materially adverse from the point of view of an investor’* (emphasis added).

Section 731 provides a due diligence defence to liability in relation to misleading statements or omissions made in prospectuses. Specifically, it provides that a person does not commit an offence under section 728(3), nor are they liable to pay damages for a breach of section 728(1) pursuant to section 729, *‘if the person proves that they:*

- (a) Made all inquiries (if any) that were reasonable in the circumstances; and*
- (b) after doing so, believed on reasonable grounds that the statement was not misleading or deceptive.’*

Annual reports

Section 297 of the *Corporations Act* requires that the financial statements and notes for a financial year must give a true and fair view of the corporation’s financial position and performance. Under section 295 of the *Corporations Act*, the financial reports must include a directors’ declaration: a statement made in accordance with a board resolution (and signed by a director) that states (amongst other things) that, in the directors’ opinion, the financial statements and notes present a true and fair view as required under section 297.

In addition, section 299A of the *Corporations Act* sets out specific information that must be included in the form of a directors’ report accompanying the financial statements. Such information relevantly includes that which shareholders would reasonably require to make an informed assessment of the corporation’s business strategies, and prospects for future financial years. This inherently requires discussion of material risk factors that may impact on the company’s future financial performance.

In addition to the specific disclosure requirements relating to the annual financial reporting suite, directors’ general obligations in relation to misleading and deceptive conduct are imposed under sections 1041E and 1041H of the *Corporations Act*, and section 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**). Specifically, section 1041H of the *Corporations Act* prohibits conduct in relation to financial products or services (including equities, derivatives, bonds et cetera), that is misleading or deceptive or is likely, to mislead or deceive. Concurrently, section 12DA of the *ASIC Act* provides that:

‘a person must not, in trade and commerce, engage in conduct in relation to financial services that is misleading or deceptive, or is likely to mislead or deceive’.



Section 1041E prescribes the related *offence* of making *materially false or misleading* statements or information that are likely to induce dealing in financial products or to impact on their traded price. However, unlike section 1041H, a director making such a false statement will only contravene section 1041E where it can be demonstrated that (i) they did not care whether the statement or information was true or false, or (ii) the person knew, or (objectively)⁷² ought reasonably to have known, that the statement or information was false in a material particular or was materially misleading.

Directors can either be primarily 'engaged' in the misleading conduct (for example, in the making of statements in the financial statements and annual report, to which directors are specifically required to attest), or accessorially 'involved' in their corporation's misrepresentation where they have aided, abetted, counselled or procured the contravention, or otherwise been knowingly concerned in it (section 79 *Corporations Act*).

The threshold of liability for misleading disclosure under Australian law – particularly under section 1041H (although not section 1041E) - is considerably lower than that prevailing under the *Companies Act 2006* in the UK, or under the *Securities Exchange Act 1934* in the US (although, notably, not significantly lower than misleading disclosure thresholds under US State-based 'blue-sky' securities laws, such as New York's *Martin Act*). In particular, the plaintiff does not need to establish knowledge or intent to mislead on the part of the director to establish liability under section 1041H: the misleading character of the representation is assessed by the impression that the statement (or omission), in its particular context, conveys (or would be likely to convey) to a reasonable person in the audience class.⁷³ Australian courts have emphasised that a person may in fact have acted both honestly and reasonably in making the relevant statement (or omission), and still be exposed to liability where the impression that it conveys (or would be likely to convey) to an ordinary or reasonable member of the audience is misleading.⁷⁴ Moreover, demonstration of loss is also not an element of breach: all that needs to be established is that the representation would be likely to mislead or deceive a (hypothetical) reasonable person. In practical terms, it is unlikely that a private plaintiff would pursue a claim against a director without having suffered loss. However, it remains a theoretical option for an activist shareholder plaintiff to seek declaratory or injunctive relief. Moreover, proceedings may also be issued by ASIC, who are not constrained by evidentiary requirements to demonstrate causation and loss. This is discussed further in Parts 6 and 7 below.

Continuous disclosure to the market

Companies listed on the ASX are subject to continuous disclosure obligations under the Listing Rules, which are in turn given statutory force under the *Corporations Act*. Specifically, Listing Rules 3.1 and 3.1A provide:

⁷² *Australian Securities Commission v Macleod* (2000) 22 WAR 255, reversed on other grounds *MacLeod v Australian Securities and Investments Commission* (2002) 211 CLR 187.

⁷³ *Campomar Sociedad Limitada v Nike International Limited* (2000) 202 CLR 45; *Forrest v ASIC, Fortescue Metals Group Ltd v Australian Securities and Investments Commission* [2012] HCA 39 at [43].

⁷⁴ *Yorke v Lucas* (1985) 158 CLR 661; *ASIC v Forrest & Ors*



3.1 Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.

3.1A Listing rule 3.1 does not apply to particular information while each of the following requirements is satisfied in relation to the information:

3.1A.1 One or more of the following 5 situations applies: • It would be a breach of a law to disclose the information; • The information concerns an incomplete proposal or negotiation; • The information comprises matters of supposition or is insufficiently definite to warrant disclosure; • The information is generated for the internal management purposes of the entity; or • The information is a trade secret; and

3.1A.2 The information is confidential and ASX has not formed the view that the information has ceased to be confidential; and

3.1A.3 A reasonable person would not expect the information to be disclosed.

If a listed entity breaches Listing Rule 3.1, it may also breach section 674(2) of the *Corporations Act*, which imposes civil and criminal penalties. The company may also be liable to pay damages to any person who suffers loss or damage as a result of the breach. A director or officer who is involved in a breach of the continuous disclosure obligations may infringe section 674(2A) of the *Corporations Act*, punishable by a civil pecuniary penalty of up to \$200,000 per offence.

In addition, if ASIC has reasonable grounds to suspect a breach it may, by administrative action, issue an infringement notice imposing a penalty of up to \$100,000. The officer may also be liable to pay damages to anyone who suffers loss or damage as a result of the breach, although there is a due diligence defence in section 674(2B), which protects officers of a listed company from civil penalties and damages claims if they can demonstrate that they took all steps that were reasonable in the circumstances to ensure that the entity complied with its continuous disclosure obligations and, after doing so, believed on reasonable grounds that the entity was complying with those obligations.

A director, officer or employee of a listed entity who gives, or authorises or permits the giving of, materially false or misleading information to ASX under Listing Rule 3.1 (including in response to any enquiry ASX may make of the company under that rule) may commit a criminal offence under section 1309 of the *Corporations Act*.

Conduct in trade or commerce

Corporations are prohibited from engaging in conduct that is misleading or deceptive, or likely to mislead or deceive, pursuant to section 18 of the *Australian Consumer Law* (which forms Schedule 2 to the *Competition and Consumer Act 2010* (Cth)). This prohibition is augmented by section 29 of the *Australian Consumer Law*, which sets out prohibitions against specific misrepresentations in the sale of goods or services. Section 29 is a civil penalty provision, but is mirrored in section 151 as a criminal offence of strict liability which may be prosecuted by the Australian Competition and Consumer

Commission (in conjunction with the Commonwealth Director of Public Prosecutions). These provisions are mirrored in respect of *financial products and services* under the *ASIC Act*.

Directors or officers who are involved in, party to, knowingly concerned in, or aid or abet the corporation's misleading conduct may also be pursued (attracting the same sanctions as primary liability) pursuant to section 75B of the *Competition and Consumer Act*.

Statements and conduct will be misleading if they have a 'tendency to lead into error'.⁷⁵ The Courts will consider whether:

- there is a 'real' (ie not a 'remote') chance or possibility that⁷⁶
- an ordinary and reasonable person in the audience to whom the statements are directed⁷⁷
- would be led into error⁷⁸
- by the overall impression that is conveyed.⁷⁹

This is a question of fact to be determined on a consideration of conduct as a whole. Intention to deceive is not a necessary element.⁸⁰ Accordingly, even though directors act honestly and reasonably, they still may engage in conduct that is misleading or deceptive, or likely to mislead or deceive. Further, it is not necessary to prove that any person has actually been misled or suffered loss or damage for a breach to be established. The deception may equally result from silence or omission as it may from a positive statement.⁸¹

Where the statement that is made is an 'unbidden intrusion' to the audience – that is, advertising on television, radio, print, billboard, online or public transport, the *dominant impression* will be a crucial determinant of its overall impression. This is because a reasonable viewer of advertisements '*cannot have been expected to pay close attention*' and '*many...will only absorb the general thrust*'.⁸² The dominant impression conveyed must therefore be accurate, in and of itself, without requiring qualification or further information.

Contravention of section 18 of the ACL may have any or all of the following consequences:

- (a) liability for damages to any person who suffers loss as a result of the contravening conduct;
- (b) other remedial orders such as injunctions or declaratory relief; and
- (c) adverse publicity and corrective advertising orders.

⁷⁵ *ACCC v TPG Internet Pty Ltd* (2013) 304 ALR 186 at [39].

⁷⁶ *Global Sportsman Pty Ltd v Mirror Newspaper Ltd* (1984) 2 FCR 82 at 87.

⁷⁷ *ACCC v TPG Internet Pty Ltd* (2013) 304 ALR 186 at [72] – [84].

⁷⁸ *Ibid*.

⁷⁹ *Ibid* at [52]. See also Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 199; *Campomar Sociedad, Limitada v Nike International* (2000) 74 ALJR 573.

⁸⁰ *Ibid* at [56].

⁸¹ *Ibid* at [48] – [50].

⁸² *Ibid* at [47], [52].



No pecuniary penalties can be imposed for a breach of section 18, but they can be for breach of the parallel provision (section 29) relating to false or misleading representations about goods or services. The courts also have the power to impose fines for offences under section 151 of the ACL (which relates to false or misleading representations about goods or services) of:

- (a) up to \$1.1 million per contravention; and
- (b) up to \$220,000 for each of its officers or employees who were 'knowingly concerned' in the contravention.

4.2 What forms of climate change risk disclosure are likely to be misleading?

Materiality and 'soft law'

It must be emphasised that, in relation to disclosures made to financial markets in particular, only *material* matters must be disclosed, and that only material misstatements will be actionable. 'Materiality' is an inherently company-specific, and context specific, concept. However, it is not a 'bright line' quantitative assessment, but a fact-specific inquiry into whether the source, content and context of the reports could reasonably influence data users' decision-making about whether to invest (or divest or maintain an interest) in the company.⁸³

Although they have yet been called upon to consider misleading disclosure of climate-related risks, the Australian courts may look to the mandatory disclosure obligations on corporations in other jurisdictions as a persuasive touchstone as to that disclosure (and underlying assessment) necessary to ensure that all material information is presented to the market. This includes requirements imposed by the California Insurance Commission on insurers operating in that jurisdiction, and under Article 173 of the French Energy and Ecology Transition Law. Article 173, which came into force on 1 January 2016, obliges the Chairperson of each company listed on a French stock exchange to "account for financial risks linked to the effects of climate change and the measures that the company takes to reduce them by implementing a low-carbon strategy in all components of its business". French asset managers, insurers and pension funds are subject to additional prescriptions on how they must report the integration of 'environmental, social and governance' (**ESG**) issues into their investment processes. The French Treasury's *Implementation Decree* gives further specificity to the information that must be included in that report – including:⁸⁴

- engagement policies (and assessment of their implementation) and methodologies applied in the companies' analysis of climate risk and its results; and
- specific information regarding the projected impacts of (amongst other things):

⁸³ See for example in a continuous disclosure context sections 674-677 *Corporations Act*; ASX Listing Rule 3.1, Guidance Note 8; AASB 1031 (Materiality). See also *Australian Securities Commission v Macleod* (2000) 22 WAR 255, reversed on other grounds *MacLeod v Australian Securities and Investments Commission* (2002) 211 CLR 187.

⁸⁴ Based on the (unofficial) English translation of the Implementation Decree by the 2^o *Investing Initiative* available <http://2degrees-investing.org/#!/page_News>.



- changes in the availability and price of natural resources and the consistency of their exploitation with climate and environmental goals;
- the coherence of capital expenditure issues with low carbon strategies, and in particular for actors involved in the development of fossil fuel resources, the underlying hypothesis supporting such expenditures;
- any policy risk related to the implementation of domestic and international climate targets; and
- measures of past, current or future greenhouse gas emissions directly or indirectly associated with emitters included in the investment portfolio, including the way the measure is used for risk analysis.

In addition to these mandatory standards, there are now a number of voluntary standards that may be applied in the courts' consideration of whether climate risk assessment and disclosure is adequate to present a 'true and fair view' of corporate performance and prospects.⁸⁵ These include those promulgated by the US-based Sustainability Accounting Standards Board and the UK-based Climate Disclosure Standards Board (**CDSB**).⁸⁶ In a recent high-profile example, on 29 June 2017 the G20 Financial Stability Board's Taskforce for Climate-Related Financial Disclosures (**TCFD**), Chaired by Michael Bloomberg, published its final Recommendations for climate risk governance, strategy, risk management and disclosure.

The TCFD was charged with the development of '*voluntary, consistent climate-related financial disclosures*' that would be '*useful to investors, lenders and insurance underwriters in understanding material risks*'.⁸⁷ Rather than external regulators or standard-setting boards, its membership comprised a 'who's who' of corporate data preparers (commercial corporations, including BHP Billiton, Unilever, Tata Steel, Air Liquide, Daimler, Dow Chemical and Eni), institutional users of that data (including Banco Bradesco, AXA, JP Morgan Chase, HSBC, UBS, Barclays, Aviva, Tokio Marine Holdings, Swiss Re, Industrial & Commercial Bank of China and BlackRock) and accounting, finance and auditing advisory houses (including Mercer, global credit ratings agencies Moody's and S&P, and each of the 'Big 4' accounting firms KPMG, Deloitte, EY and PwC).

The Recommendations of the Bloomberg Taskforce purport to provide guidance on those forms of financial analysis and disclosure that are likely to be necessary in order for corporations to present a true and fair view of a company's financial position – in terms of both performance and prospects. The Recommendations place specific emphasis on forward-looking disclosures and the impact of climate change on corporate strategy, recognising that climate change presents prospective issues that are '*without historical precedent*'.⁸⁸ Accordingly, the Recommendations emphasise the importance of *scenario planning* in corporate strategy and planning.

The Recommendations are expressly:

- universal in their application across corporations, industries and statutory disclosure regimes;

⁸⁵ Note that the Explanatory Memorandum to section 299A (Annual Directors Report) explicitly contemplated reference to extraneous industry 'best practice' instruments. CLERP 9 Bill paras 5.299–5.311 makes clear that the content of the disclosure requirements for listed public companies is to be assessed by reference to 'best practice guidance such as that prepared and published by the Group of 100 Inc' - viz its *Guide to Review of Operations and Financial Condition* (2003).

⁸⁶ The author is a member of the Technical Working Group of the Climate Standards Disclosure Board.

⁸⁷ TCFD Recommendations, iii.

⁸⁸ TCFD Recommendations, 10.



- Relevant to information included in financial filings;
- Designed to solicit decision-useful, forward-looking information on financial impacts; with a
- Strong focus on risks and opportunities associated with the transition to a lower-carbon economy.⁸⁹

The TCFD also sets out additional disclosure Recommendations ('Supplementary Guidance') for a number of sectors that it identifies as highly-exposed to climate change risks, as set out in Part 1 above.

Compliance with the Recommendations is 'voluntary'. However, they are likely to be particularly influential in informing (a) the forms of analysis that a 'reasonable director' would require in order to assure themselves that the corporation was adequately managing the financial risks to their business and its strategy associated with climate change (ie the content of a director's standard of due care and diligence), and (b) whether a corporation's mandatory disclosures, including strategic reports issued by its directors, provide all information that is material to investors and lenders (ie that is decision-useful to them), and thus whether such disclosures are misleading or deceptive – particularly in those sectors identified in the Recommendations as being at high-risk. This is for a number of reasons. First, at a minimum, the presumptive adoption of the Recommendations by the corporations and institutions represented on the Taskforce, and their commendation to all G20 countries by the Financial Stability Board who commissioned the Taskforce, suggest that it will be difficult for financial institutions and non-financial corporations (at least in the 'high risk' sectors named in the report) to argue against the proposition that a reasonable director in their position would have regard to the Taskforce's Recommendations in discharging their strategic obligations in overseeing corporate risk and strategy with regard to the financial risks associated with climate change, and in considering whether their reports present a true and fair view of their organisation's performance and prospects. Secondly, it is likely that the Taskforce members will also seek disclosures from their investees and supply-chain members in accordance with the Recommendations. Thirdly, the credit ratings agencies involved in the Taskforce (S&P and Moody's) are likely to have regard to the Recommendations in their assessment of climate change-related financial risks. Finally, with the 'Big 4' accounting firms all participating in the Taskforce, there will presumably be significant pressure for their audit and advisory teams to actively apply the Recommendations in their review of corporate accounts.

Failure to present a true and fair view of climate-related financial risks?

Circumstances in which directors may be liable for misleading disclosures relating to climate change may include where, for example, the company's account do not present a true and fair view of its financial position due to the failure to account for climate-related factors, and:

- directors failed to make proper inquiries as to whether climate-related risk factors had been accounted for;⁹⁰ or
- directors failed to properly and promptly detect and assess climate-related issues that had an adverse impact on corporate financial position or performance.⁹¹

⁸⁹ TCFD Recommendations, iii.

⁹⁰ ASIC v Loiterton (2004) 50 ACSR 693; [2004] NSWSC 897; ASIC v Loiterton [2004] NSWSC 172.

⁹¹ Australian Securities and Investments Commission v Rich (2004) 50 ACSR 500; 22 ACLC 1232; [2004] NSWSC 836.



The directors' lack of knowledge or understanding of the relevant issues will be no excuse.⁹² As a financial risk/return issue, climate change is particularly notable for the fact that historical exposures are not representative of current and forward-looking risks (or, in the words of the TCFD, present prospective issues that are '*without historical precedent*'). This gives rise to particular litigation risk exposures for both companies and their directors.

Stranded asset issues of particular relevance in the context disclosures include:

- quantitative – asset valuations and revaluations, bad debt provisioning, growth forecasts, methodologies and assumptions; and
- qualitative – notes to the financial statements, risk reporting (sources, assessment, management), forward-looking disclosures.

Disclosures that are *unlikely* to provide a true and fair view of a company's exposure to climate change risks are considered below. This list does not purport to cover all categories of climate risk reporting (or omission) that may be subject to challenge under misleading disclosure laws. Rather, it focuses on a number of relevant pressure points – including examples where regulatory investigation or litigation has already commenced in Australia or other common law jurisdictions with similar misleading disclosure regimes, such as the UK and US:

1) Asset over-valuation (including capitalised fossil fuel reserves at risk of 'stranding') or liability under-valuation (e.g. financial institutions under-provisioning for bad debts where loans are secured against potentially-stranded assets).

For example, in the United States, reports emerged in October 2016 that the SEC had opened investigations into whether ExxonMobil's annual reports present a true and fair view of its financial position. The investigation reportedly focuses on two issues: first, whether ExxonMobil's annual reports accurately conveyed the extent of the risk to its business from climate change (including regulatory and technological risks) and second, whether balance sheet materially overstated the value of its proven oil reserves, which had at that time not been adjusted despite a fall in oil commodity prices of around 60% since 2014.⁹³ This lies in contrast to the revaluations of other oil and gas majors, who have responded by writing US \$50 billion off the stated value of their reserves. ExxonMobil's shares slumped by 1.5% upon the report, wiping more than US\$5.3 billion from its market value. In the following weeks, on 28 October ExxonMobil announced that it was likely to 'de-book' (i.e. write down) approximately 4.6 million barrels from North American 'proven reserves' stated on its balance sheet (around 20% of total proven reserves) at the year end, on the basis that they would not be economically recoverable under SEC definitions at prevailing commodity prices.⁹⁴ ExxonMobil shares fell a further 2.8% by the close of trade compared to their opening price on 27 October. On 7 November 2016, a plaintiff law firm announced that it had filed a shareholder class action against ExxonMobil and a number of its directors alleging securities fraud in their misrepresentation of the

⁹² Australian Securities and Investments Commission v Sino Australia Oil and Gas Ltd (in liq) (2016) 115 ACSR 437; [2016] FCA 934.

⁹³ From a range between \$US80 and \$115 per barrel during 2011-2014, to a range largely between US\$40 and US\$60 per barrel since the start of 2015.

⁹⁴ ExxonMobil (2016), *ExxonMobil Earns \$2.7 billion in Third Quarter of 2016*, Press Release, 28 October 2016 <http://news.exxonmobil.com/press-release/exxonmobil-earns-27-billion-third-quarter-2016> .



robustness of the company's assessment and management of climate change-related financial risks, including stranded asset exposures.⁹⁵ Whilst not driven solely by climate risk-related factors, the reserve revaluation aspect of the SEC's investigation and subsequent shareholder class action is of particular interest in a stranded asset risk context: *viz*, the proposition that fossil fuels may be rapidly re-priced as the global economy recalibrates to a low-carbon norm, with booked reserves becoming unrealisable at historical valuations.

2) Silence, omission or de-emphasis of climate-related risks

The *absence* of commentary in relation to a material risk may be misleading, where such omission creates the erroneous impression that the risk is not material. This is sometimes referred to as the failure to disclose "material adverse facts". These material facts may include '*not only information disclosing the earnings and distributions of a company but also the facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell or hold the company's securities*'.⁹⁶

Facts that *are* contained in a disclosure document (and initial offer documents in particular) may also be misleading if the information is '*presented in such a way as to obscure or distort their significance*'⁹⁷ – for example where the document '*buries [material factual information] beneath other information, or treats [such information] cavalierly*'.⁹⁸

For example, in a stranded assets context, misleading omissions may include the failure of an upstream oil and gas producer to disclose the potential impact of policies introduced pursuant to Paris Agreement commitments, or regulatory, technological and production trends that impact on petrol-to-electric vehicle fleet displacement. For example, in August 2016, public-interest law firm Client Earth filed formal complaints with the UK Financial Reporting Council in relation to the adequacy of risk disclosures made in the annual reports of two oil and gas exploration companies listed on the London Stock Exchange, Cairn Energy Plc and SOCO International Plc. The investigations focused on whether the two companies failed to inform the market about material economic transition risks, and physical risks, associated with climate change relevant to their strategies and business models – in breach of their disclosure obligations under the UK *Companies Act 2006*.

3) Denial, or material understatement of risk exposure, or material overstatement of strategic preparedness/risk management

The preceding Parts of this paper have demonstrated the extraordinary increase in both understanding and expectations associated with the identification, analysis and management of

⁹⁵ Robbins Geller Rudman & Dowd (2016), 'Robbins Geller Rudman & Dowd LLP Files Class Action Suit Against ExxonMobil Corporation', *PR Newswire*, 7 November 2016 available at www.prnewswire.com/news-releases/robbins-geller-rudman-dowd-llp-files-class-action-suit-against-exxon-mobil-corporation-300358768.html; Poon, Ashley (2017), 'An Examination of New York's Martin Act as a Tool to Combat Climate Change', *Boston College Environmental Affairs Law Review*, 44(1), 115.

⁹⁶ *In Re Worldcom Inc. Securities Litigation* (S.D.N.Y. 2004) 303 F.Supp 2d. 385, 9, citing *Meyer Pincus Assocs., P.C. v. Oppenheimer Co.*, 936 F.2d 759, 761 (2d Cir 1991).

⁹⁷ *Ibid.*

⁹⁸ *Ibid.*



stranded asset risks in recent years. Baseline market expectations regarding the standard of diligent management of such risks can be taken to have increased accordingly. Corporate disclosures relating to those risks must therefore mirror this evolution in standards. So for example, a statement that a coal company 'Acknowledges the need for the global economy to transform to a low-carbon norm, and embeds a shadow price on carbon into its rigorous stress-testing of all long-term investment projects' may be misleading where that input price is manifestly and unrealistically low in the context of the necessary transformation. Similarly, it may be misleading for a financial institution to claim that it is a 'leader in climate change' where it manages (and discloses) only the emissions footprint of its office operations, but fails to account for the carbon intensity of its loan book or integrate stranded assets and other climate risks into its credit risk assessments.

4) Selective disclosure (i.e. of only favourable factors within a set of variables) - disclosures or projections selectively optimistic in their parameters or assumptions

Such claims are already being pursued in a stranded assets context. In a high-profile example, in November 2015 the New York Attorney-General announced an 'Assurance of Discontinuance' with Peabody Coal following an investigation into whether its SEC report filings between 2011 and 2014 contravened State misleading disclosure laws.⁹⁹ The Attorney-General determined that by filing annual reports that cited only favourable IEA energy and fuel-mix projections in support of its coal demand growth projections, without also disclosing the existence of other, less favourable IEA long-term demand scenarios, Peabody's filings were incomplete, false and misleading in contravention of New York's *Martin Act*.¹⁰⁰ Peabody Energy did not admit or deny the allegations of breach.¹⁰¹

5) Inconsistency between internal assessments on climate risk and external disclosures

Regulators have already begun to investigate whether corporations' public disclosures concerning climate risk may be in breach of applicable disclosure laws where they are inconsistent with the corporation's internal assessments on point. For example, in the New York Attorney-General investigation of Peabody referred to above, the regulator also determined that Peabody's repeated denials in its annual reports that it had the ability to predict the impact that potential regulation of climate change pollution would have on its business were misleading,¹⁰² given that Peabody and its consultants had actually made projections that such regulation would have severe impacts on the company.

In addition, in late 2015 and early 2016, more than a dozen US State Attorneys-General launched investigations into whether ExxonMobil's regulatory filings had misrepresented the financial risks to their business from climate change. The investigations focus on whether Exxon and its auditors, PwC, have committed securities fraud by publicly emphasising that the risks and impacts associated with

⁹⁹ Article 23-A, Section 352 *et seq.* of the New York General Business Law (the '*Martin Act*') and Section 63(12) of the New York Executive Law.

¹⁰⁰ Attorney General of the State of New York Environmental and Investor Protection Bureaus, *In the Matter of Investigation by Eric T Schneiderman, Attorney General of the State of New York of Peabody Energy Corporation, Respondent*, Assurance 15-242; Article 23-A, Section 352 *et seq.* of the New York General Business Law (the '*Martin Act*') and Section 63(12) of the New York Executive Law.

¹⁰¹ *Ibid.*

¹⁰² Article 23-A, Section 352 *et seq.* of the New York General Business Law (the '*Martin Act*') and Section 63(12) of the New York Executive Law.



climate change are inherently uncertain, when it had itself conducted significant investigations that demonstrated the phenomenon's scientific certainty over a number of decades.¹⁰³

Whilst it does not allege misleading disclosure as a cause of action *per se*, it is also relevant to note that allegations of systemic misleading public statements (and, in particular, inconsistency between internal climate risk knowledge and positioning and external representations) are a key element of the tortious and product safety-based claims filed by three Californian municipalities against 37 'carbon majors' and their directors in July 2017.¹⁰⁴

6) Forward-looking disclosures are subject to special rules, but uncertainty in itself is no defence

In recognition of the inherent tension between future uncertainties and informed analysis / relevant disclosure, specific rules apply to forward-looking statements. Sections 670A(2), 728(2) and 769C of the *Corporations Act* (and section 12BB *ASIC Act*) provides that statements with respect to any future matter will be deemed to be misleading under their respective Parts (which relate to acquisitions and takeovers, fundraising and financial services and markets, respectively) of the Act if the representor does not have reasonable grounds for making it. The assessment of 'reasonable grounds' applies to the prevailing circumstances as at the time the statement was made. Significantly, section 12BB of the *ASIC Act* (although not, apparently, its equivalent provisions under the *Corporations Act*) provides for a *reverse onus of proof*: under sub-section (2) the representor is *presumed not* to have had reasonable grounds on which to base the representation unless evidence is adduced to the contrary. In practice, liability exposure for forward-looking statements will also be influenced by the adequacy of any concurrent disclosure of associated limitations or uncertainties that materially impact on the statement's achievement.¹⁰⁵

In relation to the 'reasonable grounds' requirement, the law does not provide a 'free pass' to corporations and their directors to use future uncertainty as an excuse for not exercising appropriate due diligence today, based on the best information available. In crude terms, the law will not punish directors who make an educated assessment of future risks and opportunities, but it will not tolerate those who make uneducated guesses.

Forward-looking disclosures are sometimes framed as statements of opinion or belief, rather than fact, in an attempt to deflect liability for predictions that fail to materialise. However, the High Court of Australia has suggested that it is unhelpful to draw a bright line between statements of fact and opinion, preferring instead to assess the misleading character of the representation in accordance with the universal test.¹⁰⁶ Within this general rubric, the courts have also stated that a representation which purports to be a statement of opinion may still be misleading if (a) the representor does not genuinely

¹⁰³ Barrett and Philips 2016.

¹⁰⁴ *Country of Marin et al v Chevron, ExxonMobil, BP, Shell, Citigo Petroleum, ConocoPhillips, Peabody Energy, Arch Coal, Total, Eni, Rio Tinto, Statoil, Anadarko Petroleum, Occidental Petroleum, Repsol, Marathon Oil, Hess Corporation, Devon Energy, Encana Corp, Apache Corp and Does 1-100* Case No. CIV1702586 (Cal. Super. Ct., filed 17 July 2017); *County of San Mateo et al v Chevron et al* Case No. 17CIV03222 (Cal. Super. Ct., filed 17 July 2017); and *Imperial Beach et al v Chevron et al* Case No. C17-01227 (Cal. Super. Ct., filed 17 July 2017).

¹⁰⁵ For example, in the United States, a 'safe harbour' from liability applies to liability under section 10(b) of the *Securities and Exchange Act* statements that are identified as forward-looking and are 'accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ'.

¹⁰⁶ *Forrest v ASIC* (2012) HCA.



hold that opinion or (b) they have no reasonable basis for doing so.¹⁰⁷ Accordingly, directors will be unable to neutralise their exposure to liability by labelling bullish projections as 'opinions' where those projections are based on selectively-optimistic assumptions, or are not the product of a genuine process of consideration.

In relation to the ability of cautionary statements to neutralise the impact of any inaccurate prediction, 'motherhood' qualifications are increasingly unlikely to comprise adequate caveats. The courts require such statements to be meaningful and specific: relevant, current and considered, rather than boilerplate, and fit for purpose for the particular disclosure (e.g. earnings guidance vs a transaction announcement). And cautions must be tailored to the predictions being made.¹⁰⁸

In a climate risk context, the inherent uncertainty in the scope, distribution and timing of the future impacts of climate change have led many corporations to disclose stranded asset risks (if at all) via broad, high level or boilerplate language. Such disclosures are rarely decision-useful for investors, and are increasingly recognised as potentially presenting a misleading picture of a company's financial position. Accordingly, as exemplified in the Peabody Coal case discussed above, regulators such as the New York Attorney-General have already begun to demand that climate change-related disclosures are both specific to the performance indicator on which they may impact, and to account for uncertainty via stress-testing across the range of plausible climate futures. Such expectations are being increasingly reinforced with the proliferation of 'soft-law' instruments (such as the Recommendations of the TCFD) that acknowledge the role of scenario planning and stress-testing to both robustly analyse, and present a true and fair view of, forward-looking risks associated with climate change.

4.3 Relationship to other duties

As outlined above, the fact that a corporation has contravened the *Corporations Act* (or any other law) does not automatically render its directors liable for the breach. However, there is a significant body of recent case law that recognises that misleading corporate disclosures, in particular, can be a 'stepping stone' to establishing liability for a breach of the directors' duty of care under section 180(1) of the *Corporations Act*.¹⁰⁹ In particular, there is a significant body of authority holding that directors may breach their duty of care and diligence where they have caused,¹¹⁰ permitted¹¹¹ or failed to take reasonable steps to prevent¹¹² their corporation from making misleading statements to the market

¹⁰⁷ *ASIC v Fortescue Metals Group Ltd* (2011) 190 FCR 364 FFC at [112-113].

¹⁰⁸ For an overview of US case law in relation to forward-looking statements and the scope of the 'cautionary safe harbour', see *In Re: Harman International Industries, Inc. Securities Litigation* No. 14-7017 (D.C. Cir. 2015) (the US Supreme Court declined to consider an appeal from the D.C. Circuit's judgment, without comment, in February 2016).

¹⁰⁹ See for example *Australian Securities and Investments Commission v Padbury Mining Ltd* (2016) 116 ACSR 208; [2016] FCA 990; *Australian Securities and Investments Commission v Sino Australia Oil and Gas Ltd (in liq)* (2016) 115 ACSR 437; [2016] FCA 934; *Australian Securities and Investments Commission v Citofresh International Ltd (No 2)* (2010) 77 ACSR 69; 28 ACLC 10-002; [2010] FCA 27. See generally Teele-Langford, Rosemary (2016), 'Corporate Culpability, Stepping Stones and Mariner – contention Surrounding Directors' Duties Where Companies Breach the Law', 34 *Company & Securities Law Journal* 75.

¹¹⁰ *ASIC v Citofresh International Ltd (No.2)* (2010) 77 ACSR 69.

¹¹¹ *ASIC v Sydney Investment House Equities Pty Ltd & Ors* (2008) 69 ACSR 1.

¹¹² *ASIC v Elm Financial Services Pty Ltd* [2005] NSWSC 1033; *ASIC v MacDonald (No. 11)* (2009) 256 ALR 199.



(including misrepresentation by silence or non-disclosure).¹¹³ Although yet to be tested in court in a climate change context in Australia, it is not inconceivable that a material misstatement of a corporation's management of the risks and opportunities associated with climate change (for example, in its annual reports to members or in fundraising documents) would be actionable against its directors as a failure to exercise their duty of due care, skill and diligence.

It is also worth noting section 299(1)(f) of the *Corporations Act*, which requires the directors' report to provide details of the entity's performance in relation to 'any particular and significant environmental regulation'. Whilst of limited application at present (in the absence of specific climate mitigation or adaptation legislation), this provision may assume greater significance as government introduces regulations directed towards the achievement of Australia's Paris Agreement commitments.

4.4 Conclusion: misleading disclosure

Representations (whether express or by omission) about the extent of climate-related risk to a corporation or its business strategy, or relating to the sophistication of its risk management approach to the issue, are being tested against increasingly high regulatory awareness and investor concerns, and 'soft law' guidance on material disclosures. Issues presenting significant risk of misleading disclosure include:

Financial disclosures

- asset over-valuation (including capitalised fossil fuel reserves at risk of 'stranding') or liability under-valuation (eg financial institutions under-provisioning for bad debts where loans are secured against potentially-stranded assets);
- silence, omission or de-emphasis of stranded asset risks;
- denial, or material understatement of risk exposure, or material overstatement of strategic preparedness/risk management;
- selective disclosure (i.e. of only favourable factors within a set of variables);
- inconsistency between internal assessments on climate risk and external disclosures; and
- forward-looking risk statements (including statements of opinion or belief) that are:
 - not supported on reasonable grounds, as at the time it was made; and/or
 - not accompanied by adequate, specific disclosures of associated limitations or uncertainties that materially impact on its achievement.

Disclosures relating to the sale of goods or services

¹¹³ As was alleged in the *Fortescue* series of cases against its managing director, Andrew 'Twiggy' Forrest, in which the High Court of Australia ultimately found that the company had not made a misleading disclosure to the market: see *ASIC v Fortescue* (2011) 274 ALR 731, *Forrest v ASIC* [2012] HCA 39.



- Overstatement of the 'green credentials' of a particular product or service (eg energy efficient or emissions intensity).

5. Duties applicable to directors in other contexts

The analysis to date has focused on the duties of directors of 'ordinary' commercial corporations under the *Corporations Act*. The Australian law also applies additional, concomitant duties upon other specific categories of corporate director – notably including directors of managed investment schemes, and those of superannuation funds regulated by the Australian Prudential Regulation Authority. In short, the duties applicable under the *Corporations Act* apply *a fortiori* to directors of these entities – particularly in relation to the standard of conduct required to satisfy the standard of due care and diligence. It is particularly notable that, in a keynote speech given by APRA Executive Board Member Geoff Summerhayes to the Annual Forum of the Insurance Council of Australia in February 2017, APRA *explicitly referred* to the opinion of Noel Hutley SC and its conclusion that: '*company directors who fail to properly consider and disclose foreseeable climate-related risks to their business could be held personally liable for breaching their statutory duty of due care and diligence under the Corporations Act.*'¹¹⁴ In a subsequent speech to the Centre for Policy Development in November 2017, Mr Summerhayes went further to state that '*sophisticated scenario-based analysis of climate risks at the firm level*' is the 'new standard' for risk management.¹¹⁵

Registered / managed investment schemes

Section 601FD of the *Corporations Act* imposes specific duties on the officers of the responsible entity of a registered managed investment scheme, *viz*:

(1) *An officer of the responsible entity of a registered scheme must:*

(a) *act honestly; and*

(b) *exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position; and*

(c) *act in the best interests of the members and, if there is a conflict between the members' interests and the interests of the responsible entity, give priority to the members' interests; and*

(d) *not make use of information acquired through being an officer of the responsible entity in order to:*

(i) *gain an improper advantage for the officer or another person; or*

(ii) *cause detriment to the members of the scheme; and*

(e) *not make improper use of their position as an officer to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme; and*

¹¹⁴ Summerhayes 2017a, above n1.

¹¹⁵ Summerhayes 2017b, above n1.



(f) take all steps that a reasonable person would take, if they were in the officer's position, to ensure that the responsible entity complies with:

(i) this Act; and

(ii) any conditions imposed on the responsible entity's Australian financial services licence; and

(iii) the scheme's constitution; and

(iv) the scheme's compliance plan.

(2) A duty of an officer of the responsible entity under [subsection \(1\)](#) overrides any conflicting duty the officer has under Part 2D.1.

(3) A person who contravenes, or is involved in a contravention of, [subsection \(1\)](#) contravenes this [subsection](#).

The courts have held that section 601FD imposes a 'more exacting' standard of care on the 'reasonable' directors of registered schemes (as against that of 'ordinary' company directors) – by virtue of both their particular professional expertise, and the specific vulnerabilities of fund members.¹¹⁶

Superannuation trustee directors

Additional statutory obligations apply to fund trustee directors under the *Superannuation Industry (Supervision) Act 2009 (Cth) (SIS Act)*, again reflecting the primary fiduciary precepts. In particular, section 52A of that Act sets out a series of 'covenants' that are taken to be implied into the fund's governing rules.¹¹⁷ These covenants include requirements to:

- 'perform the director's duties and exercise the director's powers as director of the corporate trustee in the best interests of the beneficiaries' (section 52A(2)(c)); and
- 'exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation entity director would exercise in relation to an entity

¹¹⁶ *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs apptd) (in liq) (controllers apptd) (No 3)* [2013] FCA 1342 at [643]: **[536]** *I consider that the standard of care applicable where a corporation is a professional trustee, holding itself out to the public and being paid as such, will often be more exacting. The requirement that a professional trustee exercise a higher standard of care and take a cautious approach was discussed by Finn J in ASC v AS Nominees at 516–517 where his Honour usefully set out and considered the relevant authorities: see Speight v Gaunt (1883) 9 App Cas 1; King v Talbot (1869) 40 NY 76; Re Whiteley; Whiteley v Learoyd (1886) 33 Ch D 347 at 355 per Lindley LJ; Scott, The Law of Trusts (4th ed, Little Brown & Company, 1988) at 432....[643] The Explanatory Memorandum (at para 8.8) indicates that these duties are intended to reflect the fundamental duties of a fiduciary and the special nature of the relationship between an RE and the members of a scheme. The duties exist largely for the protection of the members.'*

¹¹⁷ Section 52A(6) provides that the covenants in section 52A 'operate as if the director were a party to the governing rules'.



*where he or she is a director of the trustee of the entity and that trustee makes investments on behalf of the entity's beneficiaries' (section 52A(2)(b)).*¹¹⁸

Trustee directors have concurrent duty obligations under the general law (including the significant bodies of trust law and equity) statute (including the *Corporations Act* and State and Territory *Trustee Acts*) – although the obligations implied under the SIS Act generally prevail in the case of inconsistency.¹¹⁹ These concurrent bodies of law are instructive in the interpretation of the SIS Act covenants.¹²⁰

'Prudent' in this context is not to be equated with an inherent conservatism *per se*, but a wise, careful and astute exercise of sound judgment.¹²¹ A 'superannuation entity director' is defined as '*a person whose profession, business or employment is or includes acting as director of a corporate trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity*'¹²² - in other words, as a prudent *professional trustee*. This standard of care, which has applied since 1 July 2013, has yet to be judicially considered. Nor has its scope been subject of specific guidance from the relevant regulator, the Australian Prudential Regulation Authority.¹²³ However, the Explanatory Memorandum makes it clear that Parliament's intention was to *heighten* the standard of conduct expected of superannuation fund directors above that expected of the 'ordinary' prudent person – and above that of a director of an 'ordinary' trading company.¹²⁴ This is reinforced by the

¹¹⁸ As these covenants are implied into the trusts' governing rules under section 52A(2) of the SIS Act, they are effectively duties *owed directly to beneficiaries* as well as the corporate trustee. However, the analysis in this paper presumes that the interests of the corporate trustee and its beneficiaries are materially aligned. This is not to suggest that the strategic objective of a particular *member* may not be to maximise short-term returns (eg given impending retirement), or even of the fund itself in particular circumstances (eg of a defined benefit fund to meet current pension payment requirements). However, this paper focuses on the objective of a solvent fund in the ordinary course of its business.

¹¹⁹ An exception to this general proposition applies in relation to the trustee's covenants regarding the avoidance, disclosure and management of conflicts under sections 52(2)(d) and 52A(2)(d) which, under sections 52(4) and 52A(3), prevail over any obligations to the contrary under Part 2D.1 of the *Corporations Act*.

¹²⁰ *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs apptd) (in liq) (controllers apptd) (No 3) [2013] FCA 1342, 525; ASC v AS Nominees (1995) 62 FCR 504, 517*. See also general discussion in *Australian Superannuation Commentary*, ¶2-810, ¶2-835.

¹²¹ See for example *Re VCA and APRA* (2008) 105 ALD 236; [2008] AATA 580, 347, 50, [347].

¹²² SIS Act, section 29VO(3).

¹²³ Section 34C of the SIS Act empowers APRA to promulgate binding prudential standards. It also issues (non-binding) statements of expectation in the form of prudential practice guides. APRA's Prudential Practice Guide on Investment Governance (SPG 530), issued in 2013, states that a trustee may adopt an 'ethical investment option' with an ESG focus, subject to appropriate supporting analysis that demonstrates that same will not expose beneficiaries' interests to undue risk. ESG factors are referred to in SPG530 as 'non-financial'.

¹²⁴ *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012*, Explanatory Memorandum, paragraph 1.42: '*[The reform] also heightens existing requirements in relation to the degree of care, skill and diligence required of trustees. The overall effect of these changes [introducing the covenants in section 52]...will be to hold trustees to a higher standard.*' See also *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs apptd) (in liq) (controllers apptd) (No 3) [2013] FCA 1342* at [542] re the higher standard of care owed by trustee directors (as against directors of 'ordinary' corporations). *Trustee Act 1958* (Vic), section 6(1); *Trustee Act 1925* (NSW), section 14A(2); *Trustee Act 1973* (Qld), section 22(1); *Trustee Act 1936* (SA), section 7(1); *Trustee Act 1898* (Tas), section 7(1); *Trustee Act 1925* (ACT), section 14A(2); *Trustee Act 2007* (NT), section 6(1). The only decided case that has considered the content of these duties is *Gardner & Anor v Mattila* [2015] NTCA 1, in which the Court of Appeal of the Supreme Court of the Northern Territory considered the content of the duty in the second limb of the test of due care and diligence under section 6(1)(b), *viz*, the duty owed by *non-professional* trustees to exercise '*the care, diligence and skill that a prudent person of business would exercise in managing the affairs of other people*'. Even in respect of this *lower* standard of care (one arguably akin to the 'ordinary prudent person' standard that applied under the *SIS Act* until 2013), their Honours held that the appellant had

Courts' view that a '*more exacting*' standard of care is imposed on the 'reasonable' directors of registered schemes (as against that of 'ordinary' company directors) under the Corporations Act – by virtue of both their particular professional expertise, and the specific vulnerabilities of fund members.¹²⁵

Section 52 also contains additional covenants that require the corporate trustee to (amongst other things) formulate, review regularly and give effect to:

- an **investment strategy** for the whole of the entity and for each investment option offered, and to exercise due diligence in doing so (sub-section (6)). The trustee must have regard to factors such as risk (of making, holding and realising the investments in the strategy) and likely return in the context of the fund's investment objectives, cash flow and liquidity requirements, diversification, availability of reliable valuation information and other relevant matters; and
- a **risk management strategy** that relates to the trustee's activities in the exercise of its powers or the performance of its duties and functions (sub-section (8)).

The covenants in relation to investment strategy and risk management apply to the corporate trustee itself, rather than its directors. However, the duties implied under section 52A(2)(f) of the SIS Act require trustee directors to exercise due care and diligence in ensuring that the corporate trustee discharges those obligations.

breached his fiduciary duty of care: '[35] Unfortunately for those with little education and skill who take on the duties of a trustee, the standard is an objective one, independent of the skill and prudence the trustee in question personally possesses... [36] ... Mr Gardner discharged none of these duties. ... no consideration was given by Mr Gardner to the best use of Mr Mattila's money, no alternative use or investment was considered, no business plan was prepared, no legal or financial advice was sought on Mr Mattila's behalf, and the risk of overcapitalization (which eventuated) was not considered.' . Prior to 2013, the trustee directors' SIS Act duties did not materially add to those applicable under the general law – see for example *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204. See also discussion in Collins, above n40, at 645-46.

¹²⁵ See the mirror provisions to section 180(1) in sections 601FC(1)(b) and FD(1)(b) of the Corporations Act; *ASIC v Australian Property Custodian Holdings Ltd (recs and mgrs apptd) (in liq) (controllers apptd) (No 3)* [2013] FCA 1342 at [643]; [536] *I consider that the standard of care applicable where a corporation is a professional trustee, holding itself out to the public and being paid as such, will often be more exacting. The requirement that a professional trustee exercise a higher standard of care and take a cautious approach was discussed by Finn J in ASIC v AS Nominees at 516–517 where his Honour usefully set out and considered the relevant authorities: see Speight v Gaunt (1883) 9 App Cas 1; King v Talbot (1869) 40 NY 76; Re Whiteley; Whiteley v Learoyd (1886) 33 Ch D 347 at 355 per Lindley LJ; Scott, The Law of Trusts (4th ed, Little Brown & Company, 1988) at 432....[643] The Explanatory Memorandum (at para 8.8) indicates that these duties are intended to reflect the fundamental duties of a fiduciary and the special nature of the relationship between an RE and the members of a scheme. The duties exist largely for the protection of the members.'*

6. Establishing liability

6.1 Evidentiary requirements

Standard and onus of proof

The plaintiff bears the onus of proof in establishing the elements of their claim under the Australian law. The standard of proof in civil claims is 'the balance of probabilities' (i.e. more likely than not). The standard in criminal cases is 'beyond reasonable doubt'.

Interlocutory hurdles

One of the most significant hurdles to the bringing of a (civil) claim for breach of directors' duties under the *Corporations Act* is the fact that shareholders must seek the court's leave to bring a derivative action to stand in the shoes of the company (to whom the duties are owed). The criteria applicable to the granting of such leave is discussed in Part 7 below.

Substantive elements

Even where leave is obtained, the elements of loss, causation and remoteness of damage appear to remain significant barriers, at least in theory, to shareholder plaintiffs successfully litigating a claim for either breach of duty - or for misleading disclosure. In practice, however, those barriers have not prevented the filing of securities class actions (in particular). In this regard, it is relevant to note:

- Of the scores of securities class actions filed since 1992, only 4 have proceeded to trial, and none have yet been litigated to final judgment;¹²⁶
- Plaintiff firms and litigation funders are extremely active in the Australian market;
- Australia's securities class action regime is relatively permissive, and (unlike in relation to shareholders' derivative actions for breach of duty) the leave of the court to commence such an action is not required;
- Enforcement proceedings (for both breach of duties and/or misleading disclosure) may be (and are regularly) brought by the securities regulator, ASIC;
- Barriers to establishing causation in private damages claims have recently been lowered by a number of cases on market-based causation; and
- Both private litigants and ASIC have the option to bring an action seeking only *declaratory or injunctive relief*.

These factors are discussed in turn below.

¹²⁶ Morabito, Vince, 'An Empirical Study of Australia's Class Action Regimes', Fifth Report, *The First Twenty-Five Years of Class Actions in Australia*, July 2017, at 20. Available at SSRN: <https://ssrn.com/abstract=3005901> or <http://dx.doi.org/10.2139/ssrn.3005901>



Causation and loss

Proof of loss, causation and reliance are commonly cited as barriers to claim – particularly in relation to shareholder derivative claims for breach of directors’ duties, and securities class action claims for breach of misleading disclosure provisions. The burden of establishing the requisite causal link between corporate or shareholder loss (ie due to a negative material impact on corporate share value) and the directorial breach complained of has recently been significantly lowered under the Australian corporate law – under a series of cases on ‘market-based causation’. Formerly, plaintiffs were required to prove specific (direct) reliance on the misrepresentation in order to demonstrate causation of their loss. This made proof of reliance far more challenging in civil damages claims in that jurisdiction – particularly in class claims. This barrier appears to have been lifted with the recent decisions of the Full Federal Court in *Caason Investments Pty Ltd v Cao* (2015) and *In re HIH (in Liq) & Ors* (20 April 2016) (SCNSW at 1st instance), which flagged and found (respectively) that an indirect (market-based) theory of causation could be applied to establish compensable loss.

In addition, evidentiary barriers relating to proof of causation and loss may be circumvented completely where an action for breach of duty or misleading disclosure (a) is brought by the regulator, ASIC, or (b) seeks only declaratory or injunctive relief:

Injunctive and declaratory relief

It is notable that the Australian duties regime may present the greatest liability exposure for directors vis-à-vis other common law jurisdictions. This is primarily due to the duality of prosecution avenues – by the company (derivatively via its shareholders) and the securities regulator, ASIC. ASIC has the power to investigate and prosecute directorial breaches of duty. Although its means are not unlimited, ASIC is a well-resourced litigant, with a history of proactive investigation supported by statutory powers to compel information disclosure and production. In addition, its enforcement activities are not constrained by the derivative action standing requirements faced by shareholders seeking to bring a breach of duty claim on behalf of the corporation, nor the need to prove causation, reliance and loss.

Shareholders may also bring an action seeking only declaratory and/or injunctive relief from the court in relation to a breach of directors’ duties (under a shareholders’ derivative action) or misleading corporate disclosures. Whilst demonstrable financial loss (and the accordant potential for damages) may appear to be a rational practical precondition for aggrieved shareholders to initiate expensive and protracted legal proceedings, in reality ‘activist shareholders’ who seek to use the corporate law as a mechanism to drive corporate action on climate risk management may be content to seek a declaration of directorial breach. This was recently exemplified in the filing of a misleading disclosure claim against Commonwealth Bank of Australia (**CBA**) (although not, in that case, its directors) by public interest lawyers Environmental Justice Australia on behalf of two CBA shareholders.¹²⁷ The claim alleged that, by failing to disclose the risks associated with climate change that may impact on lending and investment activities, strategies and prospects, the CBA 2016 Annual Report failed to present a true and fair view of its position and prospects. Specifically, the claim alleged that CBA had contravened:

¹²⁷ *Abrahams v Commonwealth Bank of Australia*, Federal Court of Australia, case no. V879/2017, Concise Statement of Claim filed 8 August 2017.



- (a) sections 292(1)(b), 295 and 297 of the *Corporations Act* (requirement that financial reports present a true and fair view of financial position and performance); and
- (b) sections 298(1) and (1AA) (requirement that the Directors' Report disclose all information that shareholders would reasonably require in order to make an informed assessment of its operations, financial position, business strategies and prospects).

The claim was discontinued in September 2017 following the filing of the defendant's 2017 annual report, which contained additional statements regarding climate related financial risks. Furthermore, in practice, securities shareholder class actions have invariably failed to proceed to final judgment in Australia to date.¹²⁸ Accordingly, even though plaintiffs may face technical challenges in discharging the evidentiary burdens associated with proof of causation and/or loss, a *credible* (rather than 'strong') claim may provide sufficient grounds to negotiate a settlement agreement (including compensatory damages).

6.2 Possible defences

In relation to defences available to duties-based claims, please refer to discussion of the Business Judgment Rule and Reliance/Delegation in Parts 2 and 3 above.

Defences that may be raised to misleading disclosure-based claims vary depending on whether the proceeding is civil or criminal in nature, and the nature of the subject disclosure. A number of defences apply, in particular, to misleading disclosures made in initial offer documents. For example, it is a defence to a civil action for loss or damage and/or a criminal proceeding arising from a misleading prospectus where the defendant made all inquiries that were reasonable in the circumstances, and in doing so believed on reasonable grounds that the statement was not misleading or deceptive (section 731). Section 732 provides a defence where the director can prove that they did not know that a statement (or omission) in the offer information statement or profile was misleading or deceptive. In addition, section 733 provides a defence where a misleading statement in a disclosure document was made due to the director's reasonable reliance on information given to them by someone other than their agent or employee.

In contrast, there are defences to the general misleading disclosure provisions under Part 7 of the *Corporations Act* that are extremely limited (including the general prohibition on conduct in relation to a financial product or service that is misleading or deceptive or likely to mislead or deceive under section 1041H). Given that limitation, it may provide little comfort to a defendant director that liability for civil loss or damage may be calculated on a proportionate basis— see for example section 1041I and Part 7.10 Div 2A. Other provisions in that Part prescribe offences of strict liability, including (for example) section 1041E.

¹²⁸ Morabito, Vince, 'An Empirical Study of Australia's Class Action Regimes', Fifth Report, *The First Twenty-Five Years of Class Actions in Australia*, July 2017, at 20. Available at SSRN: <https://ssrn.com/abstract=3005901> or <http://dx.doi.org/10.2139/ssrn.3005901>

6.3 Personal liability and availability of D&O insurance

Corporate indemnity

Section 199A of the *Corporations Act* specifically prohibits corporations from indemnifying directors in relation to liability *to the company* (other than in relation to legal costs, in certain circumstances). Such conduct, may, however, be *insured* against in certain circumstances. This is discussed further below:

Insurance

Companies typically acquire 'Directors' and Officers' (D&O) insurance on behalf of its directors. Such insurance typically has three 'sides':

- 'Side A' cover provides an indemnity to directors for liabilities and costs of defending claims against them against the company or third parties where there is no other indemnification available (such under a Deed of Indemnity with the corporation);
- 'Side B' cover, which indemnifies the corporation for indemnifications of liabilities and costs it has provided to directors for claims made by third parties.
- 'Side C' cover, which may be acquired as an extension by publicly-listed companies to insure its' liabilities arising out of securities market conduct breaches.

'Standard' D&O cover commonly excludes liability for misleading statements made in prospectuses, subject to any specific policy extensions. Other exclusions typically include:

- Acts or omissions occurring prior to the policy period which the director knew or ought reasonably to know was likely to give rise to a claim;
- deliberate acts of fraud or dishonesty;
- failures to take all reasonable precautionary measures to avoid or lessen the chance of any claim being made;
- 'insured vs insured' – i.e. claims relating to directors' liabilities to the corporation itself. As outlined above, section 199A of the *Corporations Act* specifically prohibits corporations from indemnifying directors in relation to such claims (other than in relation to legal costs, in certain circumstances). Whilst some such conduct may be *insured* against (other than, pursuant to section 199B, conduct that involves a wilful breach or a breach of sections 182 (misuse of position) or 183 (misuse of information)), this is commonly included only as a specific extension (or 'endorsement').

Policy extensions that cover the corporation for risks including breaches of securities laws (Side C) have the potential to erode the amount of cover available to directors within indemnity limits.

6.4 Plausible scenarios for how liability risk might emerge

Refer to Part 8 (Conclusion), below.

7. Procedural considerations

7.1 Introduction

As will be evident from the preceding Parts of this paper, different avenues of enforcement against directors may apply, depending on the nature of the alleged breach. Different procedural issues attend each avenue of enforcement. This Part focuses on those associated with:

(a) **standing** (i.e. the causes of action for which company members (shareholders), the securities regulator (in the case of 'ordinary' company directors, ASIC) and/or third parties may have standing to bring a claim against a director, and any procedural forms that such an action must take (for example, as a members' derivative action, standing in the shoes of the company itself); and

(b) **remedies** (i.e. the forms of redress that may be sought against defendant directors by each relevant plaintiff).

It concludes with discussion of **statutory limitation periods**, and the role of **third-party litigation funding** in relevant proceedings.

i. Action for breach of duty – section 180 (due care and diligence), sections 181-184 (good faith, best interests, proper purposes)

Private enforcement

As outlined above, directors' duties under the Corporations Act are owed *to the corporation*, rather than to its shareholder members. Accordingly, (private) enforcement of those duties is at the right of the company itself. However, current or former shareholders may apply for the leave of the court to bring a *derivative action*, whereby they stand in the shoes of the corporate entity to bring an action against the directors for a breach of the civil duty provisions (section 236 of the Corporations Act).¹²⁹

The criteria applied by the court in determining whether to grant such leave are set out in section 237(2). The plaintiff bears the onus of proof to satisfy the court in relation to each criterion, on the balance of probabilities:

- (a) the company itself will not bring the proceedings;
- (b) the applicant is acting in good faith;
- (c) the proceedings are in the best interests of the company;
- (d) there a serious question to be tried; and
- (e) the company been given the appropriate notice.

¹²⁹ A member may also have standing to bring proceedings directly against a director for *oppression, unfair prejudice or unfair discrimination* pursuant to Part 2F.1 of the Corporations Act. However, such an action is extremely rare against directors of a public company – particularly where the company remains solvent – see for example *Noble Investments Pty Ltd v Southern Cross Explanation NL* (2008) 174 FCR 301.



In practice, applicants find it most challenging to satisfy criterion (b) (good faith) and (c) best interests).¹³⁰ These are discussed further below.

Section 237(2)(b) – the applicant must be acting in good faith

The issues of good faith is 'a question of fact as to the applicant's motives in bringing the action'.¹³¹ Further guidance as to the assessment of good faith was provided in *Swansson v Pratt*¹³², Palmer J set out two interrelated (although not exhaustive) factors that the court will consider:

- whether the applicant *honestly believes* that a good cause of action exists and has a reasonable prospect of success. The facts of each case are considered subjectively, although an objective gloss applies where the applicant's belief is one that '*no reasonable person in the circumstances could hold*';¹³³ and
- whether the applicant has a *collateral purpose* that would amount to an abuse of process.¹³⁴ Even in circumstances where the applicant has good prospects of success, the applicant will not be acting in good faith if they are using the action for some type of personal advantage. The proceedings should be brought for the benefit of the company as a whole, not for the advantage of the applicant. In *Vicad Pty Ltd – Pottie v Dunkley & Ors*,¹³⁵ Wade J clarified that '*a derivative action...for the purpose of restoring value to ...shares in the company would not be an abuse of process even if the applicant is spurred on by an intense animosity, even malice, against the defendant*'.¹³⁶

In a departure from the *Swansson* criteria, in *Vinciguerra v MG Corrosion Consultants Pty Ltd*¹³⁷ the Federal Court considered the question of good faith by reference to the circumstances of the case and conduct of the parties more broadly, finding that both parties were '*less than mutually co-operative*'.¹³⁸ It rejected the respondent's argument that the applicant had not acted in good faith due to factors such

¹³⁰ See for example *Deangrove Pty Ltd (Rec and Mgrs Apted) v CBA* [2001] FCA 173 ; *Swansson v R A Pratt Properties Pty Ltd* (2002) NSWSC 583. See also discussion in Frawley, Nance, 'The Costs of Bringing a Statutory Derivative Action in Australia – Is It Time to Reconsider the Terms of section 242 of the Corporations Act 2001?', available at <http://www.clta.edu.au/professional/papers/conference2007/2007NF_CBSDAA.pdf>, accessed 3 January 2018; and Black, Justice Ashley, 'Some parallel duties and remedies in equity and common law.' *Paper delivered to the New South Wales Bar Association*, 25 March 2017; and Thai, Lang, *Australian Statutory Derivative Action – Defects, Alternative Approaches and Potential For Law Reform*, in *Picker, C and Seidman (eds.)*, *The Dynamism of Civil Procedure – Global Trends and Developments*, *Ius Gentium: Comparative Perspectives on Law and Justice* 48, Chapter 12, p237-254, (Springer 2016), at 239.

¹³¹ *Fiduciary v Morningstar Research* [2009] NSWSC 664 at [29].

¹³² (2002) NSWSC 583 at [36].

¹³³ *Maher v Honeysett Maher Electrical Contractors* [2005] NSWSC 859 at [31]

¹³⁴ *Carpenter v Pioneer Park Pty Ltd (In Liq)* [2004] NSWSC 1007

¹³⁵ [2011] NSWSC 166.

¹³⁶ [2011] NSWSC 166 at [43]. In that case, which involved a family-held company in which the personal relationship between shareholder siblings was beyond repair, the applicant was held (at [58]) to be '*acting in good faith even though she may bear some personal animosity towards her brother and even though she may have commenced these proceedings due to dissatisfaction with the succession arrangements within the family...*'.

¹³⁷ [2010] FCA 763.

¹³⁸ [2010] FCA 763 at [64].



as an unreasonable rejection of an offer to buy-back their shares, a refusal to engage in discussion to settle the matter, and the issue of a threat to wind the company up.

Section 237(2)(c) – it must be in the best interests of the company

In determining whether the proceedings are in the best interests of the company, the Courts will be concerned for the company's 'separate and independent welfare'.¹³⁹ The issue will turn on context in which the leave is being sought.¹⁴⁰

The courts have considered the following to be of relevance when considering whether if an application is in the best interests of the company:

- whether the application highly speculative;¹⁴¹
- the effect of the litigation on the company's business;¹⁴²
- the size of the company and the relationship between the applicant and the other members and officers of the company;¹⁴³ and
- the likely cost and the likely recovery if the proceedings are successful, and the consequences if they are not.¹⁴⁴

The court may also consider whether the company has made a business decision not to bring the action.¹⁴⁵

In addition to the procedural hurdles to obtaining leave to bring a shareholder derivative action, one of the primary barriers to private enforcement of rights against directors is, of course, cost.¹⁴⁶ Whilst the courts may award costs against the unsuccessful party to a derivative application (section 242 Corporations Act), it is very much a discretionary matter. Even where leave is granted, applicant shareholders are by no means assured of being awarded the costs of the application against the defendant directors.¹⁴⁷ Where costs are awarded, this is rarely on a full indemnity basis, but by reference to the 'party-party' costs incurred in the adversarial aspects of the claim. And unsuccessful plaintiffs bear the very real risk of significant orders being made against them for the costs of exonerated defendants.

Remedies

Where leave is granted, shareholders may seek civil remedies for a breach of duty including an injunction (section 1324) or compensation (payable to *the corporation*) (sections 1317H and 1324(10)).

¹³⁹ *Jeans v Deangrove P/L* [2001] NSWSC 84 at [52].

¹⁴⁰ *Charlton v Baber* [2003] NSWSC 745 at [45].

¹⁴¹ *Herbert & Ors v Redemption Investments Ltd* [2002] QSC 340 at [38].

¹⁴² *McLean Anor v Lake Como Venture P/L Anor; Lake Como Venture P/L & Ors v Progressive Projects P/L & Ors* [2003]

¹⁴³ *Swansson v R A Pratt Properties Pty Ltd* (2002) NSWSC 583 at [53].

¹⁴⁴ *Swansson v R A Pratt Properties Pty Ltd* (2002) NSWSC 583; and *Maier v Honeysett Maher Electrical Contractors* [2005] NSWSC 859 at [44]

¹⁴⁵ Frawley, above n130 at 9

¹⁴⁶ See for example Yang, Kenny, 'Evolution of the Australian Derivative Action; Floodgates to Shareholder Activism', *International Trade and Business Law Review*, 16 (2013), 419-432, at 428.

¹⁴⁷ As was the case in, for example, *Rach v Winnote Pty Ltd* [2006] NSWSC 231;



Shareholders have no standing to bring proceedings seeking a pecuniary penalty order (section 1317G), a disqualification order (section 206C) or criminal proceedings against directors for a breach of duty under the offence provision under section 184.

Regulatory enforcement and remedies

ASIC may also bring a civil action against a director for a breach of their duties under sections 180-183, or a criminal action for a breach of the best interests offence provision under section 184 (which applies where the director has acted recklessly or with intentional dishonesty in their failure to act in good faith and for proper purposes in the best interests of the company). It may seek civil remedies including declarations (section 1317E), a pecuniary penalty order (section 1317G), compensation orders (section 1317H) and/or management banning (or 'disqualification') orders (section 206C). Criminal remedies also include the imposition of fines (of up to 2,000 penalty units (currently \$420,000) per offence), and/or terms of imprisonment of up to 5 years), pursuant to section 1311(1). The Corporations Act applies the general principles of criminal responsibility set out in Chapter 2 of the *Criminal Code*.

An interesting avenue of enforcement available to ASIC for a breach of the (civil) duty of due care and diligence under section 180(1) of the Corporations Act bears particular note: *viz*, 'stepping stones'. In short, ASIC may allege that the directorial failure to ensure that the company did not breach another provision of the Corporations Law (or any other law) in turn comprises a failure to exercise due care and diligence. Whilst the courts have been clear that a corporate breach does not *ipso facto* suggest a failure of directorial care, they have recognised that it may do so in some cases – including in some cases involving the corporation's breach of its market disclosure obligations. The application of misleading disclosure as a 'stepping stone' to a breach of section 180(1) is discussed in Part 4.2 above.

Third party standing

Third-party private litigants (i.e. non-shareholder stakeholders) generally have no standing to bring an action against directors for a breach of their duties to the company (although it should be noted that, in addition to shareholders, current or former company *officers* may also seek leave to bring an action under section 236 of the Corporations Act).

ii. Misleading disclosure

As discussed above, directors may be held primarily or accessorially liable for misleading disclosures to the market under numerous statutory provisions. Within the limited scope of this paper, this Part focuses only on liability for misleading disclosures *to financial markets*, as opposed to (for example) misleading disclosures made *in* markets, in trade or commerce (e.g. misleading disclosure of the 'green credentials' of goods or services under the Australian Consumer Law). In the interests of brevity, discussion focuses on the general prohibitions under Part 7 of the Corporations Act (esp. sections 1041A-I), rather than procedural issues associated with breach of *specific* market regulations (such as those relating to defective fundraising or offer documents (section 728), and continuous disclosure (section 674), under Parts 6-6D of the Corporations Act), or the mirror prohibitions that may apply under the *ASIC Act*.



Private enforcement

The barriers faced by shareholder litigants in pursuing duties-based relief by means of derivative action discussed above (including the criterion for leave under section 237 and uncertainty in costs exposure), mean that shareholders of larger companies often see **securities class actions** as a more straightforward means to seek redress.¹⁴⁸

A representative class action may be filed by seven or more persons who have a claim(s) arising from the same, similar or related circumstances, under Part IVA of the *Federal Court of Australia Act 1974* (Cth). Under section 33J of that Act, the class action operates on an 'opt out' basis, such that the representative plaintiff is responsible for not only their own interests but those of all other members of that class, whether they are known or unknown to the plaintiff.

Shareholder class actions are typically filed in circumstances where a company publishes a positive market announcement (or restatement of prior positive news) ('good news'), which is then followed by a negative market announcement ('bad news') with corresponding share price drop. Plaintiffs'/funders' working assumption is that there was no reasonable basis for the good news, and/or it should have been corrected sooner, such that the shareholders bought shares on the basis of misleading information, and at a higher price than they ought otherwise have paid. This typically gives rise to a claim for misleading or deceptive conduct in relation to financial products (contrary to the Corporations and/or ASIC Acts) and/or non-compliance with continuous market disclosure requirements under ASX Listing Rule 3.1 (in contravention of section 674 of the *Corporations Act*).

Australia is one of the most active jurisdictions for securities class actions in the world, behind the United States. A total of 513 such actions filed since the commencement of the Federal class actions regime in 1992, and an average more than 30 class actions filed per annum in the last five years.¹⁴⁹ More than half of the class actions filed in Australia in the past 12 years have been on behalf of investors and shareholders.¹⁵⁰

The potential for shareholder class actions to be brought in Australia may recently have been bolstered even further by a number of court decisions relating to the application of the 'fraud on the market' theory of causation under Australian law, discussed in Part 6 above.

It bears noting that, *where a (listed) company remains solvent*, securities class actions are ordinarily filed against *the company* itself. In such cases, directors are not usually pursued as primary defendants, nor joined as accessories to the company's breach. This is likely to be for a number of reasons – including the availability of 'Side C' insurance cover (commonly acquired as an extension by publicly-listed companies to insure its' liabilities arising out of securities market conduct breaches) – which of itself may erode the amount of cover available to directors within indemnity limits; and the

¹⁴⁸ See for example discussion in Thai, above n130, at 249 *et seq.*

¹⁴⁹ Five years to 3 March 2017 – see Morabito, Vince, 'An Empirical Study of Australia's Class Action Regimes', Fifth Report, *The First Twenty-Five Years of Class Actions in Australia*, July 2017, at 20. Available at SSRN:

<https://ssrn.com/abstract=3005901> or <http://dx.doi.org/10.2139/ssrn.3005901>

¹⁵⁰ *Id.*, at 28.



additional procedural and evidentiary burden on litigating a claim against multiple directorial defendants rather than a single corporate entity.

However, this 'usual course' does not undermine the applicability of the relevant *Corporations Act* provisions to directors - nor does it indicate that directors are unlikely to be pursued in a given factual circumstance. Indeed, liquidators commonly allege that directors have breached their duties in an effort to recover insurance proceeds to the benefit of the company (and its creditors). A claim against the directors of a solvent corporation may be of particular utility to private (shareholder) litigants seeking declaratory or injunctive relief in relation to a significant transaction where material climate-related risks have not been adequately considered (or seeking damages where the transaction has been concluded, and detriment crystallised). And shareholders almost invariably seek to leverage a successful ASIC prosecutions of directors with a subsequent private damages claim (as was the case, for example, in the high-profile *Centro* case). Finally, the potential for 'activist shareholder' claims against directors, where litigation is employed as a strategic tool to influence climate-related behaviours, cannot be underestimated.

Even where the corporate entity is the sole named defendant, it should be borne in mind that litigation is an inherently costly and unpleasant process, and the actions (or inaction) of directors are often central to disputes relating market (mis)information.

Remedies

Shareholders may seek civil remedies for a director's primary breach of the prohibition against false or misleading statements in relation to financial products or services under section 1041H of the *Corporations Act* (mirrored in section 12DA of the *ASIC Act*). Remedies that may be sought include injunctions (section 1324) and/or recovery of loss or damage (section 1041I).

Regulatory enforcement

ASIC may also bring civil proceedings for a breach of the misleading disclosure prohibitions set out in sections 1041E and 1041E (amongst others), seeking declaratory or injunctive relief. As discussed in Part 6 above, ASIC's enforcement activities are not necessarily constrained by the need to prove causation, reliance and loss – factors commonly cited as significant barriers to private litigants claiming damages under similar causes of action.

In addition, ASIC may bring *criminal proceedings* for an offence committed under section 1041E. The remedies that may be sought in a criminal proceeding are particularly onerous. An individual director may be imprisoned for up to 10 years per offence, and/or fined *the greater* of (a) AU\$ 945,000 (b) three times the value of benefits obtained by the individual from the contravention (see Schedule 3 *Corporations Act*).

Although not covered in detail in this Part, it bears note that misleading disclosure contrary to the relevant continuous disclosure (section 674) and offer document (section 728) provisions may also be prosecuted criminally. Maximum fines and terms of imprisonment are set out in Schedule 3 to the *Corporations Act*.



7.2 Limitations of action

The statutory limitation period applicable to a claim against directors will vary depending on both the jurisdiction in which the claim is filed and the particular cause(s) of action pleaded. For the purposes of the main subject of this paper, a proceeding alleging a breach of the *Corporations Act* must be filed within 6 years from the time a cause of action arises as a result of relevant misconduct (see for example sections 1041I(2), 1317K and 1325(4)). The limitation periods applicable to a class action will be the same as if the proceeding had been filed by an individual claimant.¹⁵¹

7.3 A note re professional litigation funding in Australia

Commercial litigation funding arrangements ordinarily involve an agreement for the funder to provide finance for a court action, and bear the risk of liability for costs in the event that the claim is unsuccessful, in return for an agreed percentage of any court-awarded compensation (or settlement proceeds) (which arrangements are prohibited for *law firms* themselves – Australian law firms are precluded from entering retainers on a 'percentage of recovery' basis).¹⁵² The court must approve any proposed class action settlement – and may in fact reduce a funding commission agreed between the parties that it considers to be excessive or exorbitant.¹⁵³

Since the High Court of Australia approved the use of litigation funding in 2006,¹⁵⁴ commercial litigation funding has become a significant underwriter of Australian securities class action claims. However, the procedural barriers to obtaining leave to bring a statutory derivative action, and this uncertainty in the award of costs, may be factors that have led to a reluctance by litigation funders to fund statutory derivative action cases (as opposed to a class action).¹⁵⁵ Thai¹⁵⁶ in fact suggests that class actions are more commercially attractive to litigation funders than statutory derivative actions for four main reasons, *viz*:

- (a) such claims generally involve large numbers of shareholders, which increase the size of any potential award;
- (b) (unlike derivative actions) there are no procedural leave hurdles involved in filing a class action;
- (c) the litigation funder can expect to recover both costs and profit share in the event of a successful claim;
- (d) the involvement of a deep-pocketed commercial litigation funder places additional pressure on defendants to settle.¹⁵⁷ The import of this pressure may be demonstrated by the fact that, as discussed above, only four securities class actions have reached trial in

¹⁵¹ The application of the limitation period to a representative or class member is a matter to be decided separately with respect to each claimant – see for example *Giles v Commonwealth of Australia* [2014] NSWSC 83 [148]–[186]).

¹⁵² *Bolitho v Banksia Securities Limited* [2014] VSC 582.

¹⁵³ *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433, para 157 (per Murphy J).

¹⁵⁴ *Campbells Cash and Carry v Fostif Pty Ltd* (2006) 229 CLR 386.

¹⁵⁵ Thai, above n130, at 249.

¹⁵⁶ Thai, above n130, at 250-251.

¹⁵⁷ See also Morabito, above n149, at 37.



Australia, and two full trial. Significantly, *no shareholder class action in Australia has proceeded to final judgment.*

8. Conclusion

8.1 Assessment of materiality of liability risk

It is difficult to deny that directors ought to be aware of climate change's contemporary status as a foreseeable financial risk issue. As such, it is difficult to deny that their core duties in relation to trust/loyalty, competence and disclosure are enlivened. The form and substance of governance activities that will *satisfy* (or, conversely, contravene) those duties, and the materiality of the relevant litigation risk(s), will depend on each unique circumstance. However, observations on the following features of the Australian legal framework can be offered as preliminary proxies of materiality:

- (a) those sectors or industries in which the financial risks associated with climate change may be particularly acute;
- (b) the content of directors' obligations, and the kinds of governance actions (or omissions) that are unlikely to satisfy them; and
- (c) the practical elements of the legal framework that may indicate litigation is more (or less) likely to manifest in practice.

These features are considered in turn, below.

High-risk sectors

The Australian economy is heavily concentrated into sectors that are highly susceptible to climate-related financial risks (as indicated by the TCFD and others): *financial services* (banks, insurance companies, asset owners and asset managers), *energy* (coal, oil and gas extraction, utilities), *transportation* (air (freight and passenger), maritime, rail, trucking, automobile and components), *materials and buildings* (metals and mining, chemicals, construction materials, capital goods, real estate development and management), and *agriculture, food and forest products* (beverages, agriculture, packaged foods and meats and paper and forest products).

Analysis cited in this paper suggests that the quality of climate risk disclosure (and, by imperfect extrapolation, governance, risk management and strategy) by corporations (and investors) in these high-risk sectors is highly variable – with a widening gulf between leaders (including, for example, BHP, AGL and Westpac) and laggards. Laggard directors may find that a continuation of 'business as usual' climate risk governance and disclosure make them obvious targets for both shareholder activism and potential litigation – a risk that will only increase as markets continue to integrate climate change into their risk-return pricing analysis.

High-risk governance actions/omissions

The Australian corporate governance law is relatively stringent in its demands of director conduct on corporate directors. The primary fields of obligation under the *Corporations Act* – best interests, due care and diligence, and disclosure – can each be prosecuted as civil claims, with limited defences. Directors can be found either primarily or accessorially liable. And Australian courts have demonstrated a preparedness to hold directors to increasingly-high standards of proactivity and professionalism.



Within that general landscape, it is conceivable that a director may breach their **duty(s) of trust/loyalty** (specifically, to exercise powers and discharge duties in good faith in the best interests of the corporation and for a proper purpose under section 181(1)) where:

- the director consciously disregards, or is wilfully blind to, the financial risks associated with climate change and their potential impact on corporate risk management and strategy; or
- the director's ability to make an independent judgment in the best interests of the corporation conduct is compromised by a material conflict of interest. This may arise, for example, where the director holds an extraneous position that requires them to adhere to a position of climate change denial or obfuscation, or where their financial incentives aligned with 'business as usual' carbon-intensive business strategies (such as remuneration in the fossil fuel extractives sector tied to reserve replacement ratios).

Particular circumstances that may be suggestive of a failure to apply **due care and diligence** contrary to section 180 of the *Corporations Act* include:

- lack of awareness of the material physical and economic transition risks to the corporation arising from climate change (whether due to climate change denial or honest ignorance);
- a failure to ascertain whether advisors are appropriately qualified, competent and/or independent;
- blind or unquestioning reliance on the recommendations of advisors;
- a failure to scenario plan / stress test business plans and transactional outcomes against a range of potential climate futures (including 'adverse' scenarios, such as the <2°C warming ceiling agreed to by the parties to the Paris Agreement); and
- a failure to interrogate the material parameters, assumptions and methodologies on which advice is based.

Finally, actions for **misleading disclosure** are most likely to emerge in relation to:

- asset over-valuation (including capitalised fossil fuel reserves at risk of 'stranding') or liability under-valuation (eg financial institutions under-provisioning for bad debts where loans are secured against potentially-stranded assets);
- silence, omission or de-emphasis of stranded asset risks;
- denial, or material understatement of risk exposure, or material overstatement of strategic preparedness/risk management;
- selective disclosure (i.e. of only favourable factors within a set of variables);



- inconsistency between internal assessments on climate risk and external disclosures; and
- forward-looking risk statements (including statements of opinion or belief) that are:
 - not supported on reasonable grounds, as at the time it was made; and/or
 - not accompanied by adequate, specific disclosures of associated limitations or uncertainties that materially impact on its achievement.

Practical and procedural factors

There are a number of features of the Australian litigation framework that suggest it is relatively 'plaintiff-friendly'. These include:

- a multiplicity of enforcement avenues: both shareholders and the securities regulator, ASIC, have procedural avenues available to (and do regularly) bring claims against directors for a breach of their duties and/or misleading disclosure;
- a permissive securities class actions regime, with no interlocutory leave hurdles (although such hurdles do prevail for shareholder derivative claims for breach of duty);
- active professional litigation funders, which significantly reduces cost-related barriers to litigation - particularly for large securities class actions. This is likely to contribute to:
- significant pre-trial settlement pressures. The fact that the overwhelming majority of such cases settle prior to trial (let alone final judgment) may, in turn, embolden plaintiffs to commence claims that, whilst credible, are not necessarily strong.

On the other hand, there are factors that may mitigate against a 'floodgate' of litigation against directors, in practice. Shareholders face interlocutory and cost-based hurdles to derivative claims for breach of duty. Whilst ASIC has significant statutory powers, its litigation resources are not unlimited. And securities class actions are ordinarily filed against *the company* itself – at least where the company is listed and remains solvent. In those cases, directors are not usually pursued as primary defendants, nor joined as accessories to the company's breach.

However, this 'usual course' does not undermine the applicability of the relevant *Corporations Act* provisions to directors - nor does it indicate that directors are unlikely to be pursued in a given factual circumstance. Indeed, liquidators commonly allege that directors have breached their duties in an effort to recover insurance proceeds to the benefit of the company (and its creditors). A claim against the directors of a solvent corporation may be of particular utility to private (shareholder) litigants seeking declaratory or injunctive relief in relation to a significant transaction where material climate-related risks have not been adequately considered (or seeking damages where the transaction has been concluded, and detriment crystallised). Whilst ASIC is yet to pursue any director for a climate change-related failure, APRA continues to raise the regulatory stakes with a series of unequivocal, public statements about climate change as a foreseeable financial risk issue, and the implications for directors' duties and disclosure obligations. And shareholders almost invariably seek to leverage



successful regulatory prosecutions with a subsequent private damages claims (as was the case, for example, in the high-profile *Centro* directors' duties case). Finally, the potential for 'activist shareholder' claims against directors, where litigation as employed a strategic tool to influence climate-related behaviours, cannot be underestimated.

Taken together - the significant exposure of Australian corporations to financial risks associated with climate change, the failure of many corporations to proactively analyse, manage or disclose those risks, the relatively onerous statutory obligations on company directors under the *Corporations Act*, and an active regulatory and private enforcement landscape - suggest that, on balance, litigation risk exposures cannot be dismissed as *de minimus* for directors in this jurisdiction.

8.2 Implications of liability risk for company and investor decision making

In short, directors must now approach their governance of climate change in the same way as they would any other financial matter. The only safeguard against liability exposures will be a proactive, dynamic and considered approach to the impact of climate change on strategy, risk-management, oversight and reporting, in the unique context of their corporation (or fund). A failure to do so – a continuation of a 'business usual' approach to governance of climate change as a marginal, long-term, singularly regulatory or non-financial 'ethical' issue - may not only result in a loss of competitive position but, as this paper has demonstrated, expose both companies and their directors to a real risk of litigation. And directors who continue to obfuscate their responsibilities on point may face increasing resistance to their tenure from members, and a reluctance to provide D&O coverage from insurers.

8.3 Concluding remarks

Whilst not without enforcement challenges, the analysis in this paper demonstrates that the prospect of directors' liability exposure for a failure to govern for the risks associated with climate change under Australian corporate governance laws cannot be dismissed. The potential for such an action is credible, the stakes mean that incentives for directors and their insurers to settle is high, and the capacity of determined litigants – whether driven by economic loss or environmental belief - should not be underestimated.¹⁵⁸

To conclude with the words of Noel Hutley SC:

*'It is likely to be only a matter of time before we see litigation against a director who has failed to perceive, disclose or take steps in relation to a foreseeable climate-related risk that can be demonstrated to have caused harm to a company (including, perhaps, reputational harm).'*¹⁵⁹

¹⁵⁸ Barker, Sarah, 'Lifting The Corporate Veil: An Introduction To Directors' Liability Exposures For Stranded Asset Risks', in Caldecott, Ben (ed.), *Stranded assets and the environment: risk, resilience, and opportunity*, Chapter 9, Routledge (forthcoming, 2018).

¹⁵⁹ Hutley and Hartford-Davis above n1 at 51.



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