THE UNIVERSITY OF MELBOURNE

Corporate Energy Transition Part 2 – Directors' Duties

The Role of Directors' Duties

'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)' (Hutley & Hartford-Davis 2016, para. 51).*

Australian company directors, similar to other jurisdictions such as the UK, the US and Canada, have certain legal obligations under the *Corporations Act 2001* (Cth) and at general law. While Australian courts have yet to consider the application of these directors' duties to climate change risks, widely endorsed legal opinion published by barristers Noel Hutley QC and Sebastian Hartford-Davis has strongly indicated that the **failure to consider climate risks could give rise to a breach of these duties**.

Interpretations of directors' duties that enable or require consideration of climate risk can affect corporate energy transition by:

focusing directors' attention internally on the financial risks posed by climate change and spurring the development of business strategy to manage these risks, including through asset divestment and reinvestment

providing **external parties, such as shareholders and civil society actors, with potential avenues to enforce** directors' duties to consider and manage climate risks

Directors' Duties and Climate Change Risks

Under section 180(1) of the Corporations Act, company directors must exercise their powers and discharge their duties with the degree of **care and diligence** that a reasonable person in their circumstances would exercise. In their 2016 opinion, Hutley and Hartford-Davis considered that there was ample evidence that climate change could pose foreseeable harm to the interests of a company. As such, at a minimum, they advised that:

'*directors should consider and, if it seems appropriate, take steps to inform themselves about climate-related risks to their business, when and how those risks might materialise, whether they will impact the business adversely or favourably, whether there is anything to be done to alter the risk, and otherwise to consider how the consequences of the risk can be met. In complex situations requiring specialist knowledge, a director is permitted to and should seek out expert or professional advice pursuant to s 189 of the Act*' (Hutley & Hartford-Davis 2016, paras. 36-37).

Hutley and Hartford-Davis' updated 2019 opinion not only reaffirmed their earlier opinion that a negligence suit was only a matter of time but also considered that **the benchmark for compliance is rising**, with significant shifts in the expectations of regulators, investors and the public and in the state of scientific knowledge (para. 4). Referring to the Intergovernmental Panel on Climate Change's 2018 report, *Global Warming of 1.5℃*, they indicated that these **scientific developments bear upon the 'gravity and probability of climate risks which directors need to consider'** (para. 10).

These opinions have received widespread endorsement. For example, ASIC Commissioner John Price described the opinion as **'legally sound and … reflective of our understanding** of the position under the prevailing case law in Australia in so far as directors' duties are concerned'.

In addition, directors could be found liable for a breach of their duty of care and diligence where, for example, they allowed the company to breach a provision of the Corporations Act including through misleading statements (or omissions) to the market, **'stepping stones' liability** (Barker 2018, pp. 37-38).

Shifting understandings

Interviews undertaken in 2018 reflected that there is **increasing understanding of how directors' duties relate to climate change,** but variability remains depending on the nature of the company/sector (e.g. sectors where climate risks are perceived to be material in the immediate and near term), as well as the personal characteristics of directors. Given the complexity, uncertainty and long-term timeframes of climate risks and the tendency to focus materiality assessments on the short-term, some Australian company directors were perceived to have remained **focused on short-term, profit-driven interests** of shareholders (rather than broader perspectives of other stakeholders).

Nevertheless, shifts in understanding have been **linked to prominent legal opinion**, outlined above, and reinforced by regulators and industry associations such as the Australian Institute for Company Directors. Moreover, the **threat of personal liability is a significant driver**. Although proceedings against an Australian company director have not yet occurred, other cases filed in Australia and abroad may influence the consideration and management of climate-related risks by company directors (see box below). In Australia, a breach of directors' duties suit could be pursued through:

1. **Public Enforcement:** ASIC bringing enforcement actions for breach of duty (or misleading disclosure). Both civil (e.g. disqualification, pecuniary penalty, compensation) and/or criminal (e.g. imprisonment and substantial fines, but not for the duty of care) remedies are available (Corporations Act, Part 9.4, Part 9.4B).
2. **Private Enforcement:** Shareholders seeking the leave of the court to bring a derivative action against directors for breach of duty on behalf of the corporation (ss 236-7). Remedies may include an injunction or compensation payable to the corporation. Alternatively, a class of shareholders may bring a representative class action, for example, for an award of damages for breach of duty or misleading disclosure (*Federal Court of Australia Act 1974* (Cth), Part IVA).

The extent to which existing obligations adequately require directors to consider and manage climate change risks, including considering the longer-term interests of stakeholders beyond shareholders, may become apparent pending proceedings such as those below and also any action taken by ASIC following their increased regulatory oversight. In any event, consideration may be given to developing **best practice guidelines to assist directors in establishing oversight practices of climate-related risks**.

McVeigh v REST

In October 2018, Mark McVeigh, filed a claim against the corporate trustee of his superfund, REST, for breaching its duties on climate change. The claim alleges that REST's corporate trustee failed to act with care, skill and diligence when investing for McVeigh, and failed to act in his best interests, by not properly considering the risks climate change poses to the fund's investments. The claim is seeking a declaration that climate risks must be taken into account by corporate trustees for superfunds like REST in the management of investments for their beneficiaries. The claim alleges that to satisfy the corporate trustees' duties, REST must seek information from its investment managers about climate risks and comply with the recommendations of the TCFD. In an interim ruling, Perram J described the case as being of a 'public interest nature' raising 'a socially significant issue about the role of superannuation trusts and trustees in the current public controversy about climate change' (*McVeigh v Retail Employees Superannuation Pty Ltd* [2019] FCA 14 at [9]). Trial proceedings are scheduled for November 2020.

O'Donnell v Commonwealth

In July 2020, Kathleen O'Donnell filed a claim against the Australian government, including named officials in the Australian Office of Financial Management and Treasury, relating to disclosures in information documents for investors in Australian government bonds or sovereign bonds. Sovereign bonds are fixed term loans by investors to governments with regular interest payments. The claim alleges that the named officials breached their statutory duty of care and diligence (similar to the duty directors owe under the Corporations Act) and that the Commonwealth engaged in misleading and deceptive conduct by failing to disclose climate change risks to investors in information documents for these bonds.

References cited

Barker, S. (2018). *Director's Liability and Climate Risk*: *Australia Country Paper*. Commonwealth Climate and Law Initiative. https://www.smithschool.ox.ac.uk/research/sustainable-finance/publications/CCLI-Australia-Paper-Final.pdf.

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