9-2019

Professors Cynthia Williams (Osgoode) and Janis Sarra (Allard) quoted in speech by Lord Sales of the UK Supreme Court

Anglo-Australasian Law Society

Directors' duties and climate change: Keeping pace with environmental challenges

Anglo-Australasian Law Society, Sydney

Lord Sales, Justice of the Supreme Court[1]

27 August 2019

Climate change poses a challenge for our societies. The climate change emergency, as it is increasingly coming to be called, is already having impacts on the financial and business worlds. Those worlds also make their contribution to the problem. Do they have the ability to change their activities to lessen that contribution? Does the law in relation to the duties of company directors have a role to play?

There have been significant shifts in the global response to climate change following the 2015 Paris Agreement. However, in the UK the Climate Change Act 2008 continues to be the framework legislation. My colleague Lord Carnwath has provided a helpful summary of the key features of that Act in a lecture to the Chancery Bar Association in 2016.[2] The Act has been supplemented by subordinate legislation.[3] Industry players, spearheaded by regulators, have also taken on a much more active role in tackling climate change and lasting environmental damage from business practices. The Bank of England has been particularly prominent in seeking to lead a change in the attitudes of commercial entities.

In September 2015 Mark Carney, the Governor of the Bank of England, gave a speech to the Lloyd's insurance exchange about climate change.[4] He likened the issue for finance and business to the Tragedy of the Commons, the idea that without property interests which define rights and responsibilities in relation to a fixed resource such as land, the commons resources are plundered by all without any eye to the future and are swiftly exhausted, so that everyone loses out. He suggested that climate change risks being a Tragedy of the Horizon. The detrimental effects of climate change lie beyond the horizon of the business cycle and the political cycle and beyond the horizon of the mandates of regulatory authorities such as central banks. The costs of adjusting to climate change will become far greater the later we leave it, but our decision-making structures and

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[1] With thanks to Philippe Kuhn for excellent research assistance.

[2] Lord Carnwath, "Climate Change and the Law after Paris", Chancery Bar Association (15 January 2016).

[3] See e.g. Climate Change Act 2008 (Credit Limit) Order 2016/786, Climate Change Act 2008 (2020 Target, Credit Limit and Definitions) Order 2009/1258 and Climate Change and Sustainable Energy Act 2006 (Sources of Energy and Technologies) Order 2008/1767.

[4] Mark Carney, "Breaking the Tragedy of the Horizon – climate change and financial stability", Bank of England (29 September 2015).

cycles at the moment seem ineffectual as regards taking the decisions now which might reduce impacts and costs tomorrow. The risks which Carney identified for business and finance fall into three categories: 1) physical risks, from flooding, severe weather events and so on, which impose great strain on the insurance markets; 2) liability risks, ie the risks of claims being brought against those responsible for creating climate risks or for failing to deal with their effects; and 3) risks associated with the transition to a low carbon economy, as capital shifts from investing in carbon fuels to low carbon alternatives and the prices of carbon assets reduce. According to Carney, the need is to find ways to bring these future risks into account now, so as to plan to be able to minimise the likely costs associated with them.

The climate change horizon is getting closer. Perhaps that is one factor behind a statement issued by the Business Roundtable group in the US on 19 August 2019, signed by 181 leading CEOs in the US, "on the purpose of the corporation". This was reported just after I arrived in Australia. The statement announced that corporations should no longer only advance the interests of shareholders, but should also invest in employees, deal fairly with suppliers and "protect the environment by embracing sustainable practices across our businesses". Pretty bland stuff, but perhaps the very fact that the Business Roundtable organisation issued this statement is an indication that business leaders are coming to recognise that some kind of action by corporations is called for.

The Bank of England has remained consistent in highlighting the need for serious action. In a March 2019 speech,[5] Carney's prognosis was slightly less bleak, citing the Paris Agreement and the UK Government's Clean Growth Strategy, amongst other national policies, as "creating a potential path to break the Tragedy of the Horizon". He identified three priority areas. First, improved disclosure and reporting of material climate-related financial risks by companies, in particular voluntarily under the auspices of the private sector led Task-Force on Climate-Related Financial Disclosures. Secondly, better climate change risk management in respect of both physical and transition risks, with a particular lead role played by the Bank of England in the UK context. Thirdly, capitalising on the new opportunities associated with the green economy. Carney highlights the estimated US$90 trillion of infrastructure investment expected between 2015 and 2030, green bond issuances and growing market demands for large companies to take environmental, social and governance factors more seriously.

In April 2019, Sarah Breeden, the Bank's Executive Director (International Banks Supervision), provided a fuller account of its current steps in conjunction with other players like the global

[5] Mark Carney, "A New Horizon", European Commission Conference: A global approach to sustainable finance (21 March 2019).

Network for Greening the Financial System and the domestic Climate Financial Risk Forum ("CFRF")[6]. First, the Bank has just pioneered the publication of supervisory expectations that set out how banks and insurance companies under its purview need to develop "an enhanced approach to managing the financial risks from climate change." They cover governance, risk management, scenario analysis and disclosure with a view to "a strategic approach, led by the Board, and with clear accountability." Secondly, the Bank was instrumental in establishing the CFRF, which brings together a wide range of industry participants (banks, insurers, the London Stock Exchange and asset managers) as well as regulators. Thirdly, it supports the disclosure standards set by the Task-Force on Climate-Related Financial Disclosures, with a particular focus on ensuring that "disclosure is forward-looking, speaking to future risks and opportunities and not just current emissions." Fourthly, the Bank is currently considering steps to roll out more sophisticated scenario analysis in tandem with the Network for Greening the Financial System, which plans to set out voluntary guidelines for use of this type of analysis by Central Banks.

On 17 April 2019 Mark Carney returned to the subject, writing with the Governor of the Bank of France to introduce a report of the Network for Greening the Financial System which seeks to promote practices to smooth the reallocation of capital to a low carbon economy. It states that regulators and finance businesses should 1) integrate the monitoring of climate related financial risks into day-to-day supervisory work and risk management by company boards; 2) lead by example – in particular central banks should integrate sustainability into their own portfolio management; 3) collaborate to bridge data gaps in relation to climate risks, and 4) build in-house capacity and share knowledge about climate-related financial risks.

The response of company law to the novel and growing challenges presented by climate change and wider environmental issues is still in its infancy in both England and Australia. However, legislative activity in this area has increased since the early 2000s, particularly in England, and this trend is likely to continue. Regulatory pressure on companies is also growing, as the initiatives by the Bank of England make clear.

The position of directors of companies in relation to climate change can be analysed under three heads.

First, they will have obligations to comply with the various regulatory and legal disclosure requirements now being specified.

Secondly, in so far as the law imposes fines in relation to polluting activities or creates tax incentives to encourage a shift to low carbon activity, directors will have a responsibility in the

[6] Sarah Breeden, "Avoiding the storm: Climate change and the financial system", Bank of England (15 April 2019).

usual way to assess the financial impacts of these on their companies. This is a direct way in which the state can in effect force directors to take account of climate change effects of their companies, through reliance on the duty of directors to safeguard the finances of their companies as part of their obligation to promote the commercial interests of their shareholders.

Thirdly, apart from this regulatory and state action, the general fiduciary obligations of directors owed to their companies - representing as the case may be the interests of shareholders or, in certain circumstances, creditors - may permit directors to have regard to climate change effects as a factor in their decision-making. There is a spectrum of possibilities here. At one end, under directors' fiduciary obligations and obligations to exercise due care in the management of a company's affairs, environmental matters may be something they are permitted to have regard to, if they choose in their discretion to do so. Next, the law may impose an obligation on them to "have regard" to such matters when exercising their managerial powers. But with a "have regard" obligation they would usually be entitled to find that other relevant factors, such as maximising shareholder value, could outweigh climate change considerations. Under certain circumstances, however, their companies' interests may be so implicated by climate change effects that their general fiduciary and due care obligations actually require them to cause their companies to take action to reduce their contribution to climate changing activity.

Since, for the most part, this sort of decision is a permissive rather than obligatory matter so far as the law is concerned, the identity of the directors and their general mind-set and willingness to take into account climate change factors can make a significant difference to the practice of the companies on the ground.

Another relevant factor is the extent to which shareholders may be disposed to take action against directors who ignore environmental considerations, since the relevant obligations of directors here are owed to their companies (and hence, in practice, to shareholders) rather than to third parties who may be affected by the activities of those companies.

Thus, the willingness of a company to take steps to protect the environment can turn to a significant degree on the ethical disposition of directors and shareholders. Combating climate change is therefore a matter for consciousness raising in civil society as well as for action by the state. Hence, the leadership provided by institutions such as the Bank of England and through the initiatives in which it is involved may be as important, if not more important, than state activity in the form of imposing duties on companies and directors.

One possibility which I think is worth mentioning here, however, is whether the imposition of a "have regard" obligation on directors in relation to environmental protection could have an effect in feeding or supporting the imposition of a duty of care on companies in favour of third parties with respect to detrimental environmental effects arising from their activities.

There are parallels between the English and Australian legislative scheme in relation to environmental issues in the corporate context. This is so despite the absence of an express duty on directors in Australia to consider the environmental impacts of board decisions and company activities under the Corporations Act 2001, unlike in England under section 172(1)(d) of the Companies Act 2006.

In England, the wider section 172 duty to promote the success of the company for the benefit of its members as a whole, primarily in the financial sense, is expressly supplemented by the further duty to have regard to the wider factors specified in section 172(1)(a)-(f). By contrast, the Australian Corporations Act 2001 does not contain a similar express provision. However, there is the primary duty under section 180(1) to act with due care and diligence. According to an influential 2016 opinion by Noel Hutley SC,[7] the section 180(1) duty seems sufficiently open-textured to permit consideration of environmental factors (amongst others) in corporate decisions in Australia. This would appear to be particularly relevant in situations where the ultimate effect on the company from poor environmental practices may be financial detriment, say where adverse publicity or higher long-term production or supply costs follow from more short-sighted board decisions driven primarily by immediate profitability and returns on investment. Justice Edelman in *ASIC v Cassimatis (No 8)* suggested that reputational damage might constitute harm to a company's interests for section 180(1) purposes.[8] This point about the close nexus between financial detriment and environmental impact would also seem to apply on a plain reading of the general section 172 duty to promote the company's success in England, independent of the specific duty to have regard to environmental impact under section 172(1)(d). In short, there is growing recognition of the fact that good environmental practices will often be financially prudent, at least in the long term, on top of being laudable from a corporate social responsibility or ethical perspective.

Further, there seems to be force in the view, expressed in the 2016 Hutley Opinion, that well-documented corporate decisions, reflected in annual reports and disclosures, and a culture of seeking specialist advice on the environmental impacts of board decisions, are likely to protect directors from legal sanctions. In Australia, that opinion regards the "business judgment rule" in section 180(2) of the Corporations Act 2001, which is discussed in detail by Geoffrey Nettle (extra-

[7] Noel Hutley SC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties*, Memorandum of Opinion (7 October 2016) at [3.3]-[3.5].

[8] [2016] FCA 1023 at [481]-[483].

judicially) in his 2018 Melbourne University Law Review article,[9] "The Changing Positions and Duties of Company Directors", as leading to that result. In this way the general obligation on directors may have indirect, but significant, procedural effects in relation to directors.

In England, these indirect practical procedural effects in relation to considering environmental impacts in corporate decisions are, as a practical matter, likely to flow even more strongly from the careful phrasing of the additional section 172 duty – a duty *to have regard*. Parliament has deliberately eschewed an outcome-based approach to the wider social and environmental factors specified in section 172(1)(a)-(f) and, in addition, has declined to ascribe any presumptive weight to any of the factors, which are also non-exhaustive (as denoted by the words "amongst other matters" in the header of subsection (1)). This is also borne out by the explanatory notes to section 172, which stress that it "codifies the current law and enshrines in statute what is commonly referred to as the principle of 'enlightened shareholder value'" and is not intended to challenge a director's "good faith judgment".[10] The proviso to this in the explanatory notes is that "[i]t will not be sufficient to pay lip service to the factors, and, in many cases the directors will need to take action to comply with this aspect of the duty."[11]

In addition to the explanatory notes to section 172, useful guidance is provided by GC100,[12] the representative body of FTSE 100 general counsel and company secretaries, and by the 2018 UK Corporate Governance Code prepared by the Financial Reporting Council,[13] the competent authority for auditing in the UK. The GC100 guidance emphasises that the section 172 duty: (1) "involves both judgment and process"; (2) does not require directors "to balance the interests of the company and those of other stakeholders", but to weigh up "all the relevant factors" and decide what "best leads to the success of the company"; and (3) is to be enforced by the company, though the possibility exists for derivative actions under sections 260-269 of the 2006 Act in certain circumstances.

The GC100 guidance also explains that the section 172 duty and the duty in section 174 to exercise due care are interrelated. Under both sections, directors are held to the objective standard of a "reasonably diligent person" in their position *and* to a subjective standard "based on the director's own abilities, of the care, skill and diligence". Practical steps that directors could take to help discharge their section 172 duty are also addressed. This covers the need: (1) to identify what factors are likely to be of strategic importance in achieving the company's long-term success, (2)

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[9] Geoffrey Nettle, "The Changing Positions and Duties of Company Directors" (2018) 41(3) Melbourne University Law Review 1402.

[10] Explanatory notes to section 172 of the Companies Act 2006 at [325]-[327].

[11] Ibid at [328].

[12] GC100, *Guidance on Directors' Duties: Section 172 and Stakeholder Considerations* (October 2018).

[13] Financing Reporting Council, *The UK Corporate Governance Code* (July 2018).

for suitable induction and ongoing training, (3) to review information-gathering (including metrics and reports) so that each of the section 172(1) factors is addressed, and (4) to foster a practice of considering and using those factors in policy-making, directors' terms of appointment and role descriptions, board terms of reference and the submission of board papers, amongst other areas. This drives home the point that environmental impact assessment duties on directors are quite procedural in nature.

That point is also borne out by the emphasis in the UK Corporate Governance Code on providing specific information on the discharge of the section 172 duty in annual reports. Provision 28 of the Code also refers to the necessity of boards carrying out "a robust assessment of the company's emerging and principal risks". Such risks are defined as "events or circumstances that might threaten the company's business model, future performance, solvency or liquidity and reputation". Environmental impacts would seem to fall squarely within this definition.

A procedural focus on reporting and documentation of environmental factors in corporate decision-making is also reflected in other provisions of the Companies Act 2006 (sections 414C, 414CZA and 426B) and relevant secondary legislation applicable in England. Key examples of secondary legislation in the company, trustee and charity contexts are the obligations under the Companies (Miscellaneous Reporting) Regulations 2018,[14] the Occupational Pension Schemes (Investment) Regulations 2005,[15] and the Charities (Accounts and Reports) Regulations 2008.[16]

The regulatory and legislative approach in England, and in practice in Australia, has been to leave directors to make decisions for their companies exercising their business judgment, but to seek to inject environmental consideration into their decision-making processes in various ways: either by imposing obligations on them with regard to reporting, or by creating financial incentives for their companies, or through the operation of a "have regard" obligation when acting as directors.

A helpful account of equivalent regulatory requirements in Australia is found in the 2016 Hutley Opinion. In summary, under the Corporations Act 2001 listed companies are required to prepare and lodge a "financial report and a directors' report" each financial year (s.292(1)-(2)). If the company's operations are subject to any particular significant environmental regulation, the directors' report is required to give details of the company's performance in relation to that regulation (s.299(1)(f)). Further, the ASX Listing Rules require a "corporate governance statement" to be included in annual reports. Rule 4.10.3 provides that these statements must disclose the extent to which the company has followed recommendations set by the ASX

[14] SI 2018/860.
[15] SI 2005/3378.
[16] SI 2008/629.

Corporate Governance Council in the reporting period. The ASX has issued a Guidance Note which recommends that a "listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks".[17] Absent such a disclosure, rule 4.10.3 of the ASX Listing Rules requires the company to "state its reasons for not following the recommendation and what (if any) alternative governance practices it adopted in lieu of the recommendation during that period." These rules have statutory recognition,[18] and the courts have enforcement jurisdiction.[19]

Another elementary but important point is that directors' duties in both England and Australia are owed to the company, not directly to shareholders or other stakeholders. Section 170(1) of the Companies Act 2006 expressly provides for this, including specifically in the application of section 172. In Australia, case law including *Vrisakis v ASIC*[20] and *ASIC v Cassimatis (No 8)*[21] is to the same effect. The upshot, as the Hutley 2016 Opinion rightly identifies, is that the directors "must assess risks, including climate change risks" from that particular perspective. As it explains, "[i]n some cases, the interest of the company will intersect with the interests of shareholders, employees and even creditors of the company and, accordingly, it will be appropriate and proper for a director to take those matters into account." That orthodox analysis shares parallels with the key ethical investment cases of *Cowan v Scargill*[22] and *Harries v Church Commissioners for England*,[23] to which I will come.

A related point is that the approach in both jurisdictions is still driven by risk management, i.e. avoiding negative outcomes for the company. In particular, the main relevant legal duty in Australia, the duty of care and diligence in section 180(1), is framed in minimalist terms which point to that conclusion. As the Hutley 2016 Opinion puts it, "the degree of care and diligence required of a director in any given context will depend upon the 'nature and extent of the foreseeable risk of harm to the company that would otherwise arise'." Similarly, the core section 172 legal duty in England to promote the success of the company, while couched in more positive terms, certainly does not require directors to be at the vanguard of corporate governance either. In my view, that is not necessarily a major legal impediment to greater action based on taking account of environmental impacts, provided more specific requirements (including on disclosure, reporting, information-gathering and risk analysis) supplement these overarching general directors'

[17] ASX Guidance Note 9, "Disclosure of Corporate Governance Practices" (December 2016, as amended), p.5.
[18] See Securities Industry Act 1980 (Cth), ss.14, 42; Corporations Act 2001 (Cth), ss.1101B, 793C.
[19] See *Al Insurances Ltd v Pioneer Concrete Services Ltd (No 2)* (1986) 10 ACLR 801 at 806 (Street CJ).
[20] (1993) 9 WAR 395 at 450 (Ipp J).
[21] at [2016] FCA 1023, [467] (Edelman J).
[22] [1985] Ch 270.
[23] [1992] 1 WLR 1241.

duties. It appears that in both England and Australia such procedural provisions (or at least new regulatory or industry standards) are steadily becoming the norm. A further Opinion by Noel Hutley SC in 2019[24] rehearses the recent flurry of activity on the part of Australian regulators and industry.

Overall, the basic direction of travel in both jurisdictions seems clear. With respect to the legislative scheme, environmental considerations *may* and, increasingly, *must* be taken into account by directors, particularly where there may be financial impacts on the company. That is especially true in England given section 172(1)(d). But it is also in practice so in the Australian context, by application of section 180(1). It is clear that the very traditional view of the undemanding nature of directors' duties is now outmoded in both jurisdictions. The demands of corporate governance in the 21st century are much greater than in the time of Lord Hatherley LC in the case of *The Overend & Gurney Co v Gibb*[25] in 1872 and in 1925 in the decision of Romer J in *Re City Equitable Fire Insurance Co Ltd*.[26] As Sir Geoffrey Nettle comments in his recent article vis-à-vis both Australian and English company law, these influential decisions reflecting a *laissez-faire* approach have been outpaced by successive rounds of more probing standards in both jurisdictions.

The UK Companies Act 2006 and the Australian Corporations Act 2001 reflect the current bare bones statement of general directors' duties. However, although these have made certain limited formal changes as compared with the older statements of those duties, the changing environment in which they operate also has a significant impact upon what the law expects of directors in practice. Taking stock of recent developments, the 2019 Hutley Opinion considers that initiatives at the statutory and voluntary levels "suggest that we are now observers of a profound and accelerating shift in the way that Australian regulators, firms and the public perceive climate risk" and that "these matters elevate the standard of care that will be expected of a reasonable director". In other words, the effect of directors' legal obligations cannot be understood simply by referring to the bald statement of them in the relevant legislation. An assessment of the practical implications of those duties has to take account of the general environment of expectation created by initiatives by regulators and in civil society.

In the remainder of this lecture will discuss more fully the legislative steps which have been taken in England. I will conclude by discussing proposals for reform.

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[24] Noel Hutley SC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties*, Supplementary Memorandum of Opinion (26 March 2019).

[25] (1872) LR 5 HL 480.

[26] [1925] 1 Ch 407.

Legislative steps in England

I have already painted the basic picture of relevant directors' duties in England in the introduction. Section 170 specifies that all directors' duties are owed to the company. Section 172 reflects the principle of "enlightened shareholder value" and provides for a specific duty to have regard to a number of factors, including environmental impact, in discharging the general duty to promote the success of the company under that section. Section 174 is the more general duty to exercise care and skill.

Turning to disclosure and reporting obligations under the Companies Act 2006 and related statutory instruments, the number and extent of these duties as regards environmental matters has increased steadily in England. Section 414C of the Act requires larger companies to report on the implementation of the section 172 duty. Specifically, section 414C(7)(b)(i) requires a "strategic report" to include, to the extent necessary for an understanding of the development, performance or position of the company's business, information about "environmental matters (including the impact of the company's business on the environment)". In addition, there is now a new separate duty under section 414CZA for such strategic reports to include a "section 172(1) statement" which describes how the directors have had regard to the matters set out in section 172(1)(a)-(f). This new provision was brought into force on 1 January 2019. Section 426B requires a "section 172(1) statement" to be made available on a website maintained by or on behalf of the company and which identifies the company. This requirement operates if section 414CZA applies and the company is an unquoted company. It also came into force on 1 January 2019. As to sections 414CZA and 426B, the GC100 guidance stresses that "the direct connection between these reporting and disclosure obligations and how boards address stakeholder considerations will need consideration".

As for secondary legislation, the Companies (Miscellaneous Reporting) Regulations 2018 is the statutory instrument by which the latest amendments to the 2006 Act and some subordinate company legislation was implemented. The thrust of the 2018 regulations is to require directors to explain how they have had regard to various matters in performing their section 172 duty.

Regulation 40(3)(o) of the Charities (Accounts and Reports) Regulations 2008 imposes an annual report duty in relation to a non-parent charity requiring a description of "the extent (if any) to which social, environmental or ethical considerations" have been taken into account in relation to "the selection, retention and realisation of investments for the charity". Regulation 41(3)(o) imposes materially the same duties on qualifying parent charities.

The Occupational Pension Schemes (Investment) Regulations 2005 are the third notable statutory instrument in this area. By regulation 2(3)(b)(vi), much like in the 2008 charity regulations, the trustees' statements of investment policy must include a statement of "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments".

This last provision has attracted interest from the Law Commission and the Government Department formerly called the Department for Business, Innovation and Skills. In a 2014 report,[27] the Law Commission noted and largely accepted the view that, while the pursuit of a financial return should be the predominant concern of pension trustees, the law was sufficiently flexible to allow non-financial factors to be taken into account as long as they were in line with the purpose of the trust.[28] It nonetheless recommended that reg.2(3)(b)(vii) be amended to distinguish more clearly between financial and non-financial factors. It considered that trustees should state their policy on how they evaluate risks to a company's long-term sustainability (including risks relating to governance or environmental or social impact) and on responding to beneficiaries' ethical and other concerns.[29] In response, despite initially welcoming the Law Commission's comments in relation to these points,[30] the Department took the decision to take no further legislative action in relation to the 2005 regulations.

To complete the discussion of the English company law framework on climate change, it is worth saying a little more about the 1980s and 1990s case law on ethical investment decisions by trustees.[31] The seminal case of *Cowan v Scargill*[32] in 1985 addressed the issue of excluding from a coal producer's corporate pension scheme investment policy, investments in any energy companies competing with coal. Sir Robert Megarry VC held that the trustees must put aside their personal interests and simply achieve the best financial return for the beneficiaries. The essence of that approach was followed by Sir Donald Nicholls VC in *Harries v Church Commissioners for England*,[33] which concerned a boycott of investments in companies from, or with an interest in, South Africa. It was held that the commissioners' policy of excluding investments in certain business activities which would be likely to be offensive to some members of the Church of England on moral grounds was proper, because an adequate range of other investments remained open. However, the judge also held that the commissioners were right to refuse to adopt a more restrictive policy,

[27] Law Commission, *Fiduciary Duties of Investment Intermediaries*, No.350 (30 June 2014).
[28] Ibid at [7.9], [7.18].
[29] Ibid at [7.84].
[30] DBIS, *Building a Culture of Long-Term Equity Investment (Implementation of Kay Review: Progress Report)* (October 2014) at [2.64].
[31] For comparison, see *Withers v NY Teachers Retirement System* (1978) 447 F Supp 1248. The Court of Appeals for the Second Circuit approved an investment by the teachers' pension fund in New York City Bonds as part of the plan to stave off the City's bankruptcy. The lower return compared to other investments was justified because of the risk that, if not made, the City would cease being able to contribute to the pension fund.
[32] [1985] Ch 270.
[33] [1992] 1 WLR 1241.

which would have entailed taking non-financial considerations into account to an extent which would give rise to a risk of significant financial detriment to the proper object of the trusts.

These authorities have not arisen for reconsideration since the changes introduced by the Companies Act 2006 and Occupational Pension Schemes (Investment) Regulations 2005. It seems possible that Parliament's express adoption of the wider approach, which requires specific regard to be had to environmental factors, creates a question-mark against the priority given to financial returns under the *Cowan v Scargill* approach. Similar views have been aired in relation to "ethically questionable investments" in the charity context by Christopher McCall QC, in an opinion dated 16 November 2015.[34] Further, the Law Commission's calls for a recalibration of financial and non-financial factors in the trustee context, specifically under the 2005 Regulations, also seem to reflect a similar view.

Reform proposals

I tread carefully in suggesting reform proposals, but do consider certain potential changes to existing company law frameworks in both England and Australia follow quite naturally from the above analysis.

First, an obvious reform proposal in Australia, borne out by the comparison with the English position, would be to adopt explicitly the principle of "enlightened shareholder value" found in section 172 of the Companies Act 2006 into the Australian Corporations Act 2001. That could be done, in particular, by making specific provision requiring consideration of environmental impacts by directors. While it seems that section 180(1) of the Australian Act is capable of being construed so as to have an effect similar to that of the section 172 duty in the English Act, as Noel Hutley SC contends in his Opinions, it might be thought to be unsatisfactory to leave such a significant issue to the subtleties of interpretation and inference.

This is true not least because less well-informed directors or lawyers may overlook the issue, absent an express requirement to "have regard to" environmental impacts. In addition to playing a valuable guidance function, such an express provision also provides good explicit legal cover for directors who wish to have regard to such considerations, safeguarding them against legal action and hence giving them the confidence to act in this way. This would seem a modest extension, and a timely one, in parallel with much more ambitious climate change prevention and mitigation measures being taken in Australia and globally.

[34] Christopher McCall QC, "The Powers and Duties of Charity Trustees as to Ethically Questionable Investments with Specific Reference to Carbon Intensive Assets" (16 November 2015), esp. at [21]-[27].

Secondly, an interesting point raised by the Australian Prudential Regulatory Authority in its March 2019 information paper concerns the need for streamlined disclosure by regulated entities.[35] It would appear that at least some of the concerns raised by the APRA, namely fragmentation, inaccessibility and imprecision in disclosure by regulated entities in Australia are now addressed, in England, by the new section 172 statement disclosure and website publication duties in sections 414CZA and 426B of the Companies Act 2006. That said, even the new English provisions do not go as far as requiring large companies, to which the additional requirements apply, to produce statements that exclusively cover environmental factors and their impact on company decisions. Arguably, by combining the section 172(1)(d) environmental consideration with multiple other factors, both in terms of relevance to board decisions and reporting or disclosure requirements, climate change is not given the clear focus and prominence it deserves. In this respect, further thought should therefore perhaps be given to standalone environmental disclosure duties under English and Australian company law alike. Again, this would only require modest amendments.

This kind of tailored approach to corporate disclosure and reporting on environmental issues, amongst other environmental, social and governance factors, has been promoted by leading academics in Canada, Dr Jana Sarris and Professor Cynthia Williams, in a paper of January 2019 entitled "Time to Act".[36] The idea would be to require specific reporting, with the relevant legislation or a supplementary best practice code providing clear parameters for which aspects of environmental impact should normally be covered. Examples include reporting on supply chain management, corporate waste disposal, company investment profiles, environmental impact assessments for major projects, and energy consumption.

Thirdly, it is, I think, worth considering the introduction of a legislative or, as a preliminary step, regulatory best practice requirement, to appoint a designated board member for environmental impact issues. This director would provide a dedicated voice on the board to ensure that such issues are indeed brought into account by directors when the board acts. The director would be the focal point for the company's environmental responsibilities, and would provide the lead to ensure fulfilment of the company's duties regarding environmental disclosures and reporting. Larger companies are already beginning to appoint senior environmental officers at various tiers in their organisations, so it would seem a natural progression from gradually stricter disclosure and reporting requirements also to increase the benchmark in terms of such role allocation.

[35] APRA Information Paper, *Climate change: Awareness to action* (20 March 2019).

[36] See Dr Janis Sarra and Prof Cynthia Williams, "Time to Act - Response to questions posed by the Expert Panel on Sustainable Finance on Fiduciary Obligation and Effective Climate-related Financial Disclosures" (26 January 2019).

To be clear, the idea behind a specific board member being tasked with this role is to give environmental impact issues due prominence in the decision-making process of the board *as a whole*, rather than siphoning off responsibility for these important issues to one particular board member. Parallels in other areas covered by section 172 include specific appointees to deal with workforce engagement (the section 172(1)(b) factor), which is recommended under Provision 5 of the 2018 UK Corporate Governance Code.

Alternatively, there could be a legislative requirement or best practice provision in a code calling for the appointment of an environmental consultant to the board. Provision 35 of the 2018 UK Corporate Governance Code adopts this model in relation to remuneration for non-executive board members. Depending on the size and resources of the company, another option would be to require the setting up of an internal environmental committee reporting to the board. This is the sort of measure which could first be trialled in a best practice code.

All the proposals I have mentioned are procedural in nature, but would have the objective of raising the profile of consideration of environmental impacts in decision-making by directors. They would accordingly respect the existing basic pattern of legal responsibilities, so that directors would continue to have the freedom and responsibility to take the business decisions for their companies without being compelled to act in particular ways.

Taking a step back from this detail, the tenor of these suggestions is clear. In line with reform proposals in the "Time to Act" report in Canada[37] and regulatory calls for action by the Bank of England and the APRA, the way forward in this area, legally, seems to be ever more tailored and specific duties of a procedural nature. While this might create a risk of over-proceduralisation, possibly at the expense of substance, it would have the clear benefit of imposing concrete procedural obligations at board level. These can be policed effectively, and it is to be hoped that duties to consider specified environmental impacts would also sharpen the attention and awareness of directors regarding environmental factors as a substantive matter.

<u>Conclusion</u>

To conclude, the clear message to be taken away from this lecture is that company law in England and Australia alike is still undergoing a process of coming to terms with the new challenges raised by climate change and wider environmental issues. These challenges are, at present, primarily accommodated within the general framework of wide and open-textured directors' duties, with certain statutory overlays. Those overlays are mainly in the form of the specific duty to have regard to environmental impact under section 172(1)(d), in the case of England, and more procedural

[37] n 36 above.

disclosure and reporting duties in primary and secondary legislation, and at regulatory level, in both jurisdictions.

There is a clear case for these company laws to be modified, by legislation, to provide a greater impetus to boards and individual directors to accord greater attention and weight to climate issues than has until now been considered appropriate.

That said, even as things stand, there is much force in the view that directors may and, increasingly, must take into account and accord significant weight to climate change in their decision-making. This is not least because a failure to act sustainably is more and more likely to have adverse *financial* impacts on companies who are, or are perceived to be, behind the curve on environmental issues. The increasingly high likelihood of financial consequences of inaction may even curb the need, speaking purely pragmatically, for extensive further legislation in England and Australia. This is because, on any view, the old dichotomy between a company's financial success and its environmental profile is collapsing, as reflected in the current critical views on the *Cowan v Scargill* approach. Nonetheless, the positive effects of the specific new legal requirements introduced in both jurisdictions in the last decade or so cannot be underestimated, both in terms of their aspirational effect and in changing corporate cultures. Further amendments would be likely to maintain the impetus in that direction of travel.

Given the gravity of the issue of climate change and the leadership role performed by both the UK and Australia on these issues on the international level, it seems desirable for their company laws to keep pace with and indeed assume a position in the lead in the current trends in favour of disclosure, reporting and risk management.