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AUSTRALIA: DIRECTORS' DUTIES – NATURE-RELATED RISKS

– THOUGHT LEADERSHIP

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Australian companies are increasingly vulnerable to risks associated with the natural environment. Although climate-related regulation is increasing, the strategic challenges facing companies are developing faster than the law and the regulatory environment, requiring directors to make decisions in an uncertain context. In this article, we explore nature-related risks and the practical steps which can be taken by directors (including representatives of financial investors) to assist with their assessment and mitigation of these risks to avoid consequences such as penalties from regulators and the risk of litigation.

Key issues

- Directors may breach their duty of care and diligence and/or their duty of good faith to act in the best interests of the company if they do not take steps to identify the impact of a company on the climate and environment or consider the nature-related risks that are relevant to the company.
- Financial sponsors and other representatives who exercise effective control of a company may be 'shadow directors' and have the same obligations as appointed directors of a company.
- Determining whether nature-related risks represent a 'foreseeable risk' of harm to a company requires management to identify the company's climate and nature-related dependencies and impacts so that directors may consider potential risks.
- The harm from nature-related risk may not be limited to the company's immediate financial interest and could give rise to 'reputational risk' in later years and be detrimental to a financial investor's ability to exit its investment in the company.
- A company's impact on climate or nature can create or exacerbate climate or nature-dependent risks.

Key actions for directors

There is an increasing risk of litigation against directors (including alternate directors and shadow directors) who fail to perceive, disclose or take steps in relation to foreseeable nature-related risks to the company.

To mitigate this risk directors must take a proactive approach to:

- **Identifying nature-related dependencies and impacts**: Understanding and assessing the company's nature-related dependencies and impacts.
- **Risk management**: Implementing procedures to manage emerging risks, including climate and nature-related risks.
- **Avoiding greenwashing**: Refraining from misleading greenwashing disclosures.
- **ESG strategy review**: Regularly reviewing the company's ESG strategy to address nature-related risks and opportunities.

What are nature-related risks?

Nature-related risks are potential threats to a company that arise from its (and wider society's) dependencies and impacts on nature. Nature will include components such as biodiversity, water, soil, flora and fauna.

Directors need to consider two primary aspects when assessing nature-related risks to a company:

- the company's dependencies on nature; and
- the company's impacts on nature.

Nature-related risks often include:

- **Physical risks** resulting from the tangible effects of climate change. For example, damage to property or assets resulting from longer-term shifts in climate, such as sea level rises and rising mean temperatures;
- **Transitional risks** relating to the transition from a fossil fuel-reliant economy to a low-carbon economy or impacts on supply chains resulting from the deterioration of natural resources. This may take the form of, for example, rising costs of naturally-occurring materials due to extreme weather events, government policies introducing new environmental regulations, innovations relating to circular economies and conservation impacting business models or nature-negative assets or investments becoming stranded.
- **Liability risks** arising from non-compliance with the expanding body of legal and regulatory requirements. Recent developments in Europe indicate this could even extend to alleged criminal liability for harm to biodiversity and people.

To identify a company's dependencies on nature, directors need to understand and assess the supply chain of the company in order to form a view of the ecosystem in which the company operates.

To determine a company's impact on nature, directors need to evaluate the detrimental impacts of the company against the benefits that arise from its business activities.

A failure to properly understand, assess and evaluate these matters in what is a rapidly evolving regulatory and political environment may negatively impact value and the pathway to exit for investors.

Directors' duties: the changing landscape

Generally all directors have the same duties and responsibilities regardless of their title. A person may be a 'de facto' director even if they have not been formally or properly appointed as a director if they act as a director. A person who is not formally appointed as a director, but on whose instructions or wishes a company's board members are accustomed to act, may be a 'shadow' director.

In the ever-evolving landscape of corporate governance, directors face heightened scrutiny.

Sections 180 and 181 of the *Corporations Act 2001* (Cth) (**Corporations Act**) mandate that directors exercise their powers and discharge their duties with care and diligence and act in good faith in the best interests of the corporation. However, the scope has shifted beyond financial considerations to now encompass nature-related risks.

In determining whether a director has breached their duty of due care and diligence, the courts will balance the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question.[1] A risk is 'foreseeable' if it is not 'far-fetched or fanciful'.[2]

In finding whether a director has breached their duty of good faith, the courts will look at what a reasonable person in the director's position would have done in the circumstances.

Nature-related risks

Directors who fail to consider nature-related risks may breach their duty of care and/or duty to act in good faith. This does not necessarily require the company to cease activities linked to these risks. Instead, it requires informed decision-making in a manner that exercises care and diligence considering the interests of the company as a whole. In assessing this, the courts will consider what a director would have reasonably been expected to do in the circumstances.[3] The degree of care and diligence that is required by section 180(1) of the Corporations Act is an objective standard with two elements, being (1) the corporation's circumstances and (2) the office and the responsibilities within the corporation that the officer in question occupied and had (whether or not they were statutory or other responsibilities).[4] This involves a factual inquiry of all the relevant circumstances.

Directors acting in good faith and for proper purposes may be protected from a breach of the statutory duty in section 180 of the Corporations Act under the 'business judgment' rule.[5]

Section 180(3) of the Corporations Act provides that 'business judgment' relates to any decision to take or not to take action in respect of a matter relevant to the business operations of the corporation.

To fall within the business judgment rule, directors must:

1. Make judgments in good faith;
2. Lack material personal interests in the subject matter;

1 *Vrisakis v ASIC* (1993) 9 WAR 395, 449-450 (Ipp J).
2 *Council of the Shire of Wyong v Shirt* (1980) 146 CLR 40, 47-48 (Mason J); *ASIC v Rich* (2009) 236 FLR 1, 139 [7231] (Austin J).
3 *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52.
4 *Shafron v Australian Securities and Investments Commission* [2012] HCA 18; (2012) 247 CLR 465, [18].
5 A 'business judgment' is "any decision to take or not to take action in respect of a matter relevant to the business operations of the corporation": Corporations Act, s 180(3).

3. Thoroughly inform themselves about relevant issues; and
4. Rationally believe that their judgments serve the corporation's best interests.

It will not be sufficient merely to delegate powers to management. Any delegation of powers to the business of the company is to be managed by or under the direction of the directors. Directors must ultimately oversee all decisions made on behalf of the company and accept liability for the outcomes of those decisions. Increasing levels of sophistication are essential as directors move from understanding physical risks to supporting the implementation of transition and nature-positive strategies.[6]

Financial investors

Financial investors may also become exposed to directors' duties in relation to nature-related risks applicable to portfolio companies they control. As well as formal board seat positions, the conduct of financial investors may exert enough control over a portfolio company to deem the financial investor or its representatives to be 'de facto' and/or 'shadow directors'.[7] A body corporate with effective control of a company may also be a shadow director.[8]

This may occur, for example, in instances where the company directors are accustomed to acting in accordance with the financial investor's instructions or wishes unless the advice is given in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation.

Regulatory developments

The landscape of regulatory requirements related to climate and nature is rapidly evolving, with increasing scrutiny from regulators, new reporting obligations for large companies and changing expectations from stakeholders (including supply chain partners and financiers).

Current requirements

Whilst directors' duties under the Corporations Act are principle-based, legislation regarding regulators' expectations in relation to a company's management of and disclosures on nature-related risks already exists and creates exposure to strict liability offences.

'Greenwashing' and ESG-related claims arising under current legislation include:

- **Misleading and deceptive conduct claims**: Prohibitions on misleading and deceptive conduct and statements under the Corporations Act; the ASIC Act regarding financial products or services and the Australian Consumer Law in relation to providing goods and services to consumers;[9]
- **Misleading claims about future projections**: Misleading claims about future projections, such as predicting net-zero carbon emissions without a reasonable basis, are covered under section 796C of the Corporations Act;
- **Claims related to accuracy of financial reporting**: Financial reports prepared under Chapter 2M of the Corporations Act must accurately reflect the company's performance, including material climate-related information. These financial reports must include all material information which could be reasonably expected to influence decisions of primary users of financial statements;[10]

6 The Australian Institute of Company Directors '*Climate Governance Study 2024*', https://www.aicd.com.au/risk-management/framework/climate/climate-governance-study-2024-moving-from-vision-to-action.html.

7 Section 9AC of the Corporations Act extends the definition of director beyond directors validly appointed and includes de facto directors and shadow directors. Further, for characteristics considered in determining whether a person is a 'shadow director', see *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2010) 77 ACSR 410, [241], [242], [244]-[247], [248], [250] and [307].

8 *Standard Chartered Bank of Australia Ltd v Antico* (1995) 38 NSWLR 290.

9 *Corporations Act 2001* (Cth) s 1041; *Australian Securities and Investments Act 2001* (Cth) s 12; *Competition and Consumer Act 2010* (Cth) ss 18, 29, 33 and 34.

10 See the Australian Accounting Standards Board AASB 101 '*Presentation of Financial Statements*'.

- **Claims related to accuracy of emissions reporting**: Further reporting requirements are found under the *National Greenhouse and Energy Reporting Act 2007* on controlling corporations which operate facilities that generate greenhouse gas emissions, produce energy or consume energy; and
- **Claims brought under environmental laws**: At the state and territory level in Australia there are environmental laws which include schemes for reporting pollution and contamination incidents, and monitoring emission limits, which must be adhered to.

Take, for example, the focus by regulators on climate-related risks:

1. Regulatory bodies such as the Australian Securities and Investments Commission (**ASIC**) have emphasized the importance of disclosing and managing climate-related risks as a key director responsibility.[11]
2. Similarly, the Australian Prudential Regulation Authority (**APRA**) has provided guidance on understanding and managing the financial risks of climate change, highlighting the need for robust risk management frameworks.[12]
3. The Reserve Bank of Australia (**RBA**) has also contributed to the discourse by examining the economic and financial stability risks posed by climate change.[13]
4. The ASX Corporate Governance Council has described the significance of climate risks, urging entities to report on any material exposure.[14]

In addition, investor bodies are increasingly advocating for the consideration of climate risks in investment decisions.

For example:

1. The Investment Association has acknowledged climate change as one of the most significant systemic risks, urging collaborative action to bolster sustainable finance.[15]
2. The Investor Group on Climate Change, representing investors with over $35 trillion in global assets under management, is leading efforts to ensure that climate action is integrated into investment practices.[16]

Collectively, these developments reflect an increased scrutiny of the approach that directors adopt with respect to climate-related risks.

Examining how regulators and investor bodies have managed the emergence of climate-related risks suggests a trend that will be replicated for companies and directors with the emergence of nature-related risks.

Known developments

From 1 January 2025, mandatory climate-related financial reporting will be implemented in Australia for large companies, with phased introduction of the reporting requirements in subsequent financial years for medium and then small businesses. Along with the new reporting requirements, a new body is to be formed that will monitor (and enforce) compliance with the standards.[17]

The Australian Accounting Standards Board has released a proposed reporting framework and requirements, which provides guidance to directors on the expected level of disclosures and supporting evidence.[18] Directors should familiarise themselves with the new standards in order to be in a position to challenge and critically analyse the public statements made by the company to

11 See Australian Securities and Investments Commission (ASIC), "Managing climate risk for directors", https://asic.gov.au/about-asic/news-centre/articles/managing-climate-risk-for-directors/.
12 See Australian Prudential Regulation Authority (APRA), "Understanding and managing the financial risks of climate change", https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change.
13 See Reserve Bank of Australia (RBA), "Climate Change and the Economy", https://www.rba.gov.au/publications/bulletin/2023/jun/climate-change-and-financial-risk.html.
14 See ASX Corporate Governance Council, "Corporate Governance Principles and Recommendations", https://www.asx.com.au/documents/asx-compliance/gia-climate-change-guide.pdf.
15 See The Investment Association, "Position paper on climate change", https://www.theia.org/sites/default/files/2020-11/IA%20Climate%20Change%20Position%2011.11.20%20.pdf.
16 See Investor Group on Climate Change, "Global Investor Statement to Governments on Climate Change", https://igcc.org.au/about/.
17 See Clifford Chance Briefing "Mandatory Climate-Related Financial Disclosure": https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2023/11/mandatory-climate-related-financial-disclosure.pdf.
18 See Clifford Chance Briefing "Mandatory Climate-Related Financial Disclosure": https://www.cliffordchance.com/content/dam/cliffordchance/ briefings/2023/11/mandatory-climate-related-financial-disclosure.pdf.

ensure they are accurate (including by not omitting relevant information).

The standards set out in the TCFD have been in circulation since 2017 (being the source of the pillars for the new mandatory reporting standards), but the Task Force on Nature-related Financial Disclosures (**TNFD**) was published in 2021 and updated in September 2023.

The expectation is that nature-related financial reporting will closely follow behind climate-related financial reporting. Delineation between climate and nature may prove difficult in some contexts, so the TNFD framework could implicitly be adopted in complex organisations even sooner.

Emerging regulatory developments

Future regulation or guidance from regulators may address the content of forward-looking statements, the validity of scenarios for net-zero calculations, biodiversity assessment methods, anti-extinction requirements, carbon credit pricing and markets, nature-positive markers, due diligence for climate and nature risks, assurance standards for related disclosures and financier taxonomy and lending requirements.

Expectations will not only be regulator-driven, with directors experiencing pressure from investors, employees, financiers, supply-chain participants, government and civil society groups. Mapping an organisation's stakeholders and how they interact with directors' obligations will require a thoroughly researched and balanced approach.

Litigation: the rise of class action and shareholder activism

Class action claims relating to climate have already been litigated in Australasia. The claims in *Sharma v Minister for the Environment*[19] were based in tort and alleged a breach of duty of care by the government. A recent class action in New Zealand that was brought against large greenhouse gas emitters has been permitted to proceed (following the overturning of an interlocutory application to strike out the claim).[20] That case relies on the torts of public nuisance, negligence and a new tort to prevent climate change. The learnings from the case may be applied in the UK and Australia due to the common law elements of the claim.

There is currently a 'representative-style' claim in the Federal Court of Australia brought by a climate non-government organisation against an energy company in relation to a 'carbon neutral' product sold to customers. It is alleged that the product has been marketed on a misleading or deceptive basis because the energy provided does not come from renewable sources and carbon neutrality is achieved using carbon offsets.[21] This is another example of the kinds of claims that can be levied against companies.

Whilst these examples relate to claims against the company, if there are findings as to failings by the company then it may follow that plaintiffs also consider the availability of claims against one or more of the company's executive or non-executive directors.

Fuelling these claims is the rise of litigation funding and other forms of costs incentives for plaintiff firms, including group costs orders and contingency fees. As of 2022, litigation funders are no longer required to hold an Australian financial services licence. This has created opportunities for an increase in litigation-funded climate or nature-related class actions to be brought in Australian courts. Relief in these claims is not always motivated by financial return and philanthropic litigation funding may provide the means to litigate such claims. In other jurisdictions, similar claims are brought to draw public attention to an issue, to effect social change or to enforce commitments to energy transition or net zero targets.

Claims for a breach of directors' duties are a well-trodden path for class action claimants in Australia. We believe that litigation for breach of directors' duties in respect of nature-related risk is an emerging risk as the expectations of stakeholders, including regulators and the class action ecosystem, evolve.

19 [2021] FCA 560.

20 *Michael John Smith v Fonterra Co-operative Group Limited* [2024] NZSC 5.

21 *Australian Parents for Climate Action v EnergyAustralia* [2023] NSD833.

International perspectives

The UK

English company law has evolved over the last few years in the area of nature-related risk (including from a legal, regulatory, investor and societal perspective). Over the last few years there has also been a notable increase in climate change-related shareholder activism in the UK.

In the UK, directors have been required to consider the impact of their companies' operations on the environment for some time. Section 172 of the *Companies Act 2006* (UK) (**Companies Act**) contains a duty for directors to promote the success of the company. It requires directors to consider the impact of the company's operations on the community and the environment, and any other factors that may be relevant. For the duty of good faith, a director must act as an honest and intelligent person in a director position who reasonably believes that the transaction would benefit the company.[22] Directors are also subject to the duty to exercise reasonable care, skill and diligence.[23] In addition, directors must exercise care when navigating non-financial reporting requirements, including climate-related disclosures, and can incur personal liability in the event of any shortcomings.

In February 2023, ClientEarth (a well-known climate activist non-government organisation and shareholder) brought a derivative claim against directors of an international energy company for alleged breaches of directors' duties.[24] It was alleged that the directors failed to manage the climate change risks facing the company, and that the company's approach to managing climate change risk was unreasonable. The Court did not permit the derivative action to proceed. The judge upheld the long-established principle that the management of a company's business is a matter for the discretion of the directors, acting in good faith. The board of the company had unquestionably taken climate-related issues into account in its decision- making, for example by publishing climate strategies and submitting those strategies to shareholders for an advisory vote. It was held to be incumbent on the directors to discern how to achieve results in the best interests of the shareholders of the company. The decision is not necessarily a bar to similar claims; however, it conforms with the UK approach and is consistent with the business judgment rule which applies in Australia.

Scrutiny of climate change-related risks in the UK is expanding to encompass nature-related risks. It is increasingly accepted that to avoid a breach of directors' duties under company law in England and Wales, directors must consider nature-related risks to a company.[25] Further, a director who 'greenwashes' the company by creating a paper trail falsely purporting to show action in relation to a company's nature-related risks is likely to expose the company to: (i) latent financial risks arising from unaddressed nature-related impacts and dependencies; (ii) the risk of shareholder and investor claims (including for deceit); and (iii) reputational risk.

Singapore

Directors' duties under Singapore law arise under common law and the statutory provisions of the Companies Act 1967 of Singapore. These encompass fiduciary duties (including a duty to act bona fide in the best interests of the company) and also a duty of skill, care and diligence owed to the company. While there is not yet any Singapore case law relating to directors' duties in the context of nature-related risks, it is possible that failure to consider nature-related risks (e.g. climate change issues) which are material to the business or interests of the company may expose a director to a potential breach of their directors' duties.

Nonetheless, it should be noted that if a company suffers losses from nature-related risks despite directors exercising diligence and considering nature-related risks in the best interests of the company, the courts are likely to be slow to find the directors liable. This is a manifestation of

22 *Charterbridge Corp v Lloyds Bank Ltd* [1970] Ch 62 Ch D.
23 *Section 174 Companies Act*.
24 *Sections 172 and 174 Companies Act*.
25 See, for example, the opinion commissioned by Commonwealth Climate and Law Initiative '*Nature-related risks and directors' duties under the law of England and Wales*', 11 March 2024.

the so-called 'business judgment rule'. Singapore courts have noted that "it is the role of the marketplace and not the function of the court to punish and censure directors who have in good faith, made incorrect commercial decisions".[26]

Additionally, we note that directors' liability for nature-related risks may also be established from various environmental legislation. For instance, a director may be liable for breaches of the Environment Protection and Management Act 1999 of Singapore[27] if that breach took place with the consent or connivance of the director, or is attributable to any act or default of the director.[28] The more recent Carbon Pricing Act 2018 of Singapore[29] (**CPA**) further expands the scope of situations where a director might be found liable. Under the CPA, a director shall be guilty of the same offence as the company if the director knows or ought reasonably to have known that the offence would be or is being committed, and failed to take all reasonable steps to prevent or stop the commission of that offence.[30] In view of such provisions, directors will essentially need to inform themselves of the activities of their companies and take appropriate actions to ensure compliance with the various environmental laws.[31]

Directors, in the performance of their duties and functions, must also be mindful of recent developments in respect of climate-related disclosure obligations. For instance, the Accounting and Corporate Regulatory Authority and Singapore Exchange Regulation have provided details on mandatory climate reporting requirements for listed issuers from FY2025 and for non-listed companies with annual revenue of at least $1 billion and total assets of at least $500 million from FY2027.[32]

Practical considerations

There are a number of practical steps that directors and companies can take to manage and mitigate nature-related risks and avoid potential legal challenges. Please reach out to us if you would like to discuss further and we can share our insights based on recent experiences.

26 *Vita Health Laboratories Pte Ltd v Pang Meng Seng* [2004] 4 SLR(R) 162, [17].
27 An Act to consolidate the laws relating to environmental pollution control, to provide for the protection and management of the environment and resource conservation, and for purposes connected therewith.
28 Environment Protection and Management Act 1999 of Singapore, s 71(1).
29 An Act to require the reporting of, and the payment of a tax in relation to, greenhouse gas emissions.
30 CPA, s 68(2).
31 Jeffrey W T Chan, SC *et al*, "Legal Opinion on Directors' Responsibilities and Climate Change under Singapore Law" (14 April 2021), [45]. https://commonwealthclimatelaw.org/wp-content/uploads/2022/05/Legal-Opinion-on-Directors-Responsibilities-and-Climate-Change-under-Singapore-Law.pdf.
32 See https://www.sgxgroup.com/media-centre/20240228-climate-reporting-help-companies-ride-green-transition and https://www.acra.gov.sg/news-events/news-details/id/778.

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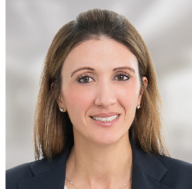

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C H A N C E

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