

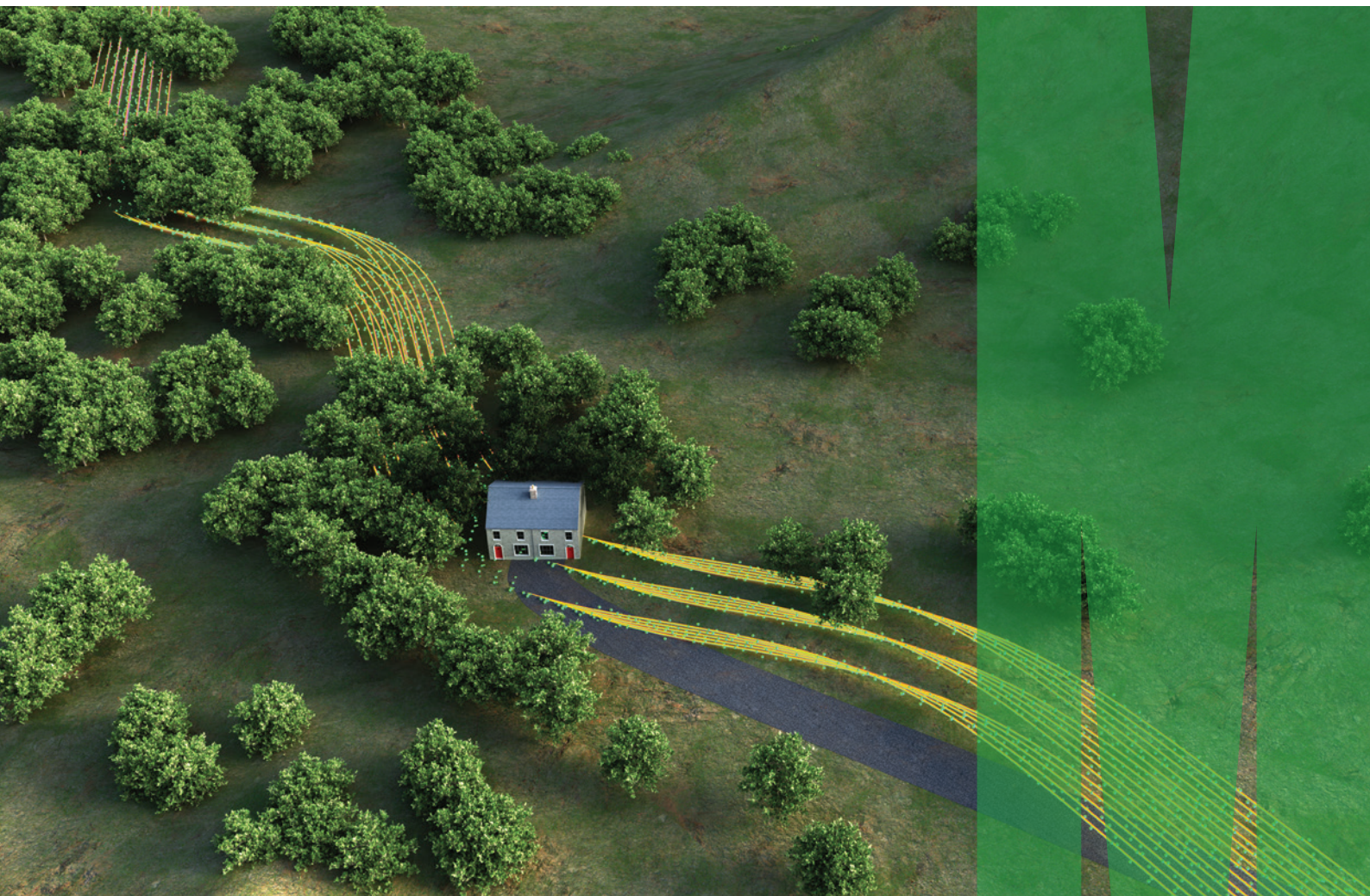


# NET ZERO, NATURE POSITIVE AND SOCIALLY RESPONSIBLE? EXPLORING CORPORATE LAW REFORM OPPORTUNITIES IN AUSTRALIA

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# Executive Summary and Recommendations

Corporations law and associated business regulation offer important tools to influence the social and environmental performance of companies, particularly where the risks and impacts posed to people and to the environment by business activities are not sufficiently constrained by substantive environmental protection, human rights, and other related laws. Corporations law is important because it governs and regulates the way in which corporate entities make decisions, develop strategies, and allocate resources, and because it provides avenues to hold company directors accountable for their decisions and actions.

This report surveys opportunities to reform Australian Corporations law and associated business regulation in ways which would strengthen requirements to consider social and environmental risks and impacts in corporate decision-making and which might better incentivise the prevention and mitigation of social and environmental harms associated with corporate activities. The discussion considers three main areas of social and environment impact: climate change, biodiversity loss, and the rights of Australia's First Nations peoples.

In exploring opportunities to reform Corporations law, the analysis focuses on shifting the way in which companies address social and environmental issues from an inward, narrow focus on financial risks posed to company interests, to an outward, longer-term focus on mitigating risks and impacts to people and the environment.

Two main areas of Corporations Law are considered: disclosure and reporting, and the duties of company directors. To complement and broaden the discussion, the paper also explores an emerging form of transnational business regulation – human rights and environmental mandatory due diligence – which seeks to address adverse social and environmental impacts across corporate value chains.

There is already strong momentum in Australia for reforming corporate disclosure and reporting frameworks and immediate opportunities to strengthen these in ways which can contribute to improved corporate social and environmental performance. Yet a stronger disclosure regime focused on impacts and performance (not just financial risks) is just one part of the puzzle. Reforming directors' duties would involve more fundamental changes to the existing regime but could have far-reaching effect in strengthening incentives to address and prevent adverse impacts of company activities. Going beyond Corporations Law, mandatory due diligence laws which focus explicitly on preventing and mitigating social and environmental harms in corporate value chains, have considerable potential to complement corporate law reform and help shift corporate social and environmental performance.

The reforms considered in this report are no substitute for strong, substantive laws to directly address climate change, loss of biodiversity and the protection of First Nations rights. However, together they can fill gaps and address weaknesses in these regimes and help to align business activity with global social and environmental norms.

A summary of recommendations made throughout this report is set out below, rated according to their potential impact on corporate social and environmental performance.

Recommendation	Impact
<b>Recommendation 1 (Disclosure) – Introduce mandatory sustainability reporting, including reporting of impacts and alignment with global sustainability goals</b> – Following the introduction of mandatory climate risk disclosure, Australia should introduce mandatory sustainability reporting that encompasses biodiversity, human rights (including First Nations rights) and other sustainability matters. Companies should be explicitly required to report on their social and environmental <b>performance</b> and <b>impacts</b> (following a double materiality approach) and, where relevant, align their risk management activities with global goals.	Low-medium Impact <i>Partially underway, with opportunities to strengthen.</i>

Recommendation	Impact
<p><b>Recommendation 2 (Disclosure) – Australian reporting standards for First Nations rights</b> – Australia should develop standards for corporate reporting on engagement with, and respect for the rights of First Nations peoples. This should recognise that investors and other stakeholders increasingly seek evidence that companies respect the rights of indigenous peoples in alignment with international standards, even where this may not be required by domestic legal frameworks.</p>	<p>Low-medium Impact</p>
<p><b>Recommendation 3 (Disclosure) – Mandatory Transition Planning for Climate and Biodiversity</b> – As part of new mandatory climate risk reporting obligations and associated standards, Australia should explicitly mandate the development and disclosure of climate transition plans and provide best practice standards that set an overarching directive for transition plans to align with the temperature goals of the Paris Agreement. Over time, transition plans should also be required to detail corporate strategy to address biodiversity risks, reduce adverse impacts and enhance positive impacts on biodiversity in alignment with relevant global and national goals.</p>	<p>Medium Impact <i>Partially underway, with opportunities to strengthen.</i></p>
<p><b>Recommendation 4 (Directors’ Duties) – A sustainability judgement rule</b> – To reinforce the relevance of current and future social and environmental performance and other longer-term considerations to the best interests of the company, a sustainability judgement rule could be added to the Corporations Act. This would provide that company directors would not be liable for a breach of directors’ duty for making a decision to improve the company’s current and future social and environmental performance even in situations where this may not directly align with short-term profit generation goals.</p>	<p>Medium Impact</p>
<p><b>Recommendation 5 (Directors’ Duties) – A general sustainability duty (linked to global goals and planetary boundaries)</b> – An additional, stand-alone sustainability duty could be added to the Corporations Act to require company directors to take all reasonable steps to prevent social and environmental harms and to improve social and environmental performance. This could be accompanied by provision in law that the overarching purpose of a corporation is to create sustainable value by balancing the interests of shareholders and other stakeholders and by operating in accordance with agreed social and environmental parameters (e.g., net-zero and nature-positive parameters derived from global sustainability agreements). In acting in the best interests of the company, directors would have a clear obligation to promote this purpose and ensure the company’s impacts do not exceed these parameters. A corporate sustainability regulator could be responsible for monitoring performance and enforcing compliance.</p>	<p>High Impact</p>
<p><b>Recommendation 6 (Mandatory Due Diligence) – A Mandatory Human Rights and Environmental Due Diligence Law in Australia</b> – Strong mandatory due diligence obligations have the potential to complement corporate law reforms and enhance incentives for improved corporate social and environmental performance. However, careful evaluation and modification of existing and proposed models internationally will be needed, as well as close analysis of the interaction between any proposed new law and existing modern slavery and other frameworks. To ensure such a law maximises positive impacts while mitigating or avoiding unintended consequences, attention must be paid to the scope and coverage of the law, substantive requirements, compliance and enforcement, and remedy.</p>	<p>High Impact</p>

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CONTENTS	PAGE
<b>1 Introduction</b>	<b>5</b>
<b>2 Disclosure and Reporting</b>	<b>7</b>
2.1 How is disclosure and reporting relevant to corporate social and environmental performance?	7
2.2 Current Australian Frameworks	7
2.2.1 Legal obligation to disclose material risks	7
2.2.2 Climate Risk Disclosure – current practice	10
2.2.3 Biodiversity and First Nations Reporting – current practice	10
2.2.4 Likely Developments	12
2.3 Limits and Challenges with Existing Legal & Regulatory Framework	17
2.4 Alternative Models	18
2.5 Reform Opportunities	20
<b>3 Directors’ Duties</b>	<b>23</b>
3.1 How are Directors’ Duties relevant to corporate social and environmental performance?	23
3.2 Current Australian Frameworks	24
3.2.1 Legal Obligations	24
3.2.2 How do directors’ duties apply to social and environmental risks and impacts? – current practice	25
3.2.3 Likely Developments	27
3.3 Limits and Challenges with Existing Legal & Regulatory Framework	29
3.4 Alternative Models	31
3.5 Reform Opportunities	33
<b>4 Mandatory Human Rights and Environmental Due Diligence Laws</b>	<b>35</b>
4.1 How do human rights and environmental due diligence laws influence corporate social and environmental performance?	35
4.2 Current Australian Frameworks – potential, limits and challenges	36
4.3 Alternative Models	39
4.4 Reform opportunities	42
<b>Appendix A: Mandatory HREDD laws in Europe</b>	<b>44</b>
<b>Appendix B: EU Directive on Corporate Due Diligence and Corporate Accountability</b>	<b>46</b>

# 1 Introduction

This report surveys opportunities to strengthen and reform Australian Corporations Law (**Corporations Law**) and associated business regulation to drive improved corporate social and environmental performance in the areas of climate change, biodiversity, and the rights of Australia's First Nations peoples.

To provide a foundation for considering these opportunities, the report explores:

- how Corporations Law influences the social and environmental performance of companies; and
- alternative legal and regulatory models emerging in comparative jurisdictions and discussed in the academic literature that have the potential to improve corporate social and environmental performance.

The report focuses on two areas of Corporations Law<sup>1</sup> that exert a powerful influence on company decision-making and behaviour because they directly influence the underlying objectives of companies, the interests that are considered by company directors, and how and by whom those directors are held accountable:

- Disclosure and Reporting (Part 2)
- Directors' Duties (Part 3)

In addition, Part 4 explores a complementary form of business regulation – mandatory due diligence – which seeks to address adverse social and environmental impacts of corporate activities across corporate value chains.

This report focuses on shifting the way that companies address social and environmental issues from an inward, narrow focus on material financial risks posed to company interests, to an outward, longer-term focus on mitigating adverse social and environmental risks and impacts. As such, the analysis is underpinned by the concept of *positive corporate social and environmental performance*, which has the following key elements:

- *More than entity risk management* – Positive corporate social and environmental performance involves addressing risks and impacts posed by business to people and the environment, thereby helping to address the systemic risks posed by climate change, biodiversity loss and social inequities and harms.
- *Beyond compliance* – Positive corporate social and environmental performance is distinct from, and typically more than, compliance obligations under existing domestic environmental, human rights, indigenous cultural heritage protection and other laws designed to constrain the adverse social and environmental impacts of corporate activities. These laws do not effectively address cumulative, complex problems such as climate change and biodiversity loss, nor do they comprehensively recognise and protect the rights of First Nations peoples.<sup>2</sup> They are often procedural, reactive, and poorly implemented. Further, they do not generally apply to the extra-territorial impacts of corporate activities.
- *Aligned with international norms and planetary boundaries* – Positive corporate social and environmental performance involves aligning company decision-making and behaviour with social and environmental norms and objectives articulated in international sustainability instruments. These are increasingly based on planetary boundaries which recognise the biophysical (and social) limits to human activity.<sup>3</sup> Aligning corporate activity to these norms will help maximise the potential contribution of the private sector to meeting global sustainability goals and can help address systemic risks posed by sustainability issues. For current purposes, the relevant international instruments (**global sustainability agreements**) are:

<sup>1</sup> There are other areas of corporate law, not covered in this report, that could usefully be reformed to also support improved corporate sustainability performance in Australia, including reforms to streamline the use of advisory resolutions and enhance stakeholder voices in corporate decision-making.

<sup>2</sup> Shelley Marshall et al, *First Peoples and Land Justice Issues in Australia: Addressing Deficits in Corporate Accountability* (2021); UNSW Australian Human Rights Institute and Australian Human Rights Commission, *At the Crossroads: 10 years of implementing the UN Guiding Principles on Business and Human Rights in Australia* (2021), 22-26.

<sup>3</sup> The Paris Agreement's temperature goals are based on best available scientific opinion on global planetary boundaries in relation to the atmosphere and climate. See generally, J Rockstrom et al, 'A safe operating space for humanity' 461(7263) (2009) *Nature* 472-475; Lenton et al, 'Climate tipping points – too risky to bet against' 575(7784) (2019) *Nature* 592-595. More recent planetary boundaries scholarship has introduced social and equity boundaries alongside biophysical boundaries: Rockstrom et al, 'Safe and Just Earth System Boundaries', *Nature* (31 May 2023).

- The *2015 Paris Agreement* (United Nations Framework Convention on Climate Change, UNFCCC) – which seeks to limit global warming to well below 2°C above pre-industrial temperatures (and pursue efforts to limit warming to 1.5°C above pre-industrial temperatures).<sup>4</sup>
- The *2022 Kunming-Montreal Framework* (Convention on Biological Diversity, CBD) – which sets out global biodiversity goals including to halt extinctions, to ensure at least 30% of terrestrial, inland water and coastal and marine ecosystems are effectively conserved and managed, and at least 30% of degraded systems are under effective restoration. The framework recognises the role of the private sector in reducing negative impacts and increasing positive impacts on biodiversity.<sup>5</sup>
- The *2007 United Nations Declaration on the Rights of Indigenous Peoples* (UNDRIP) – which articulates international human rights standards as they apply to indigenous peoples, including rights to self-determination; rights to maintain, control, protect and develop cultural heritage, traditional knowledge, and traditional cultural expressions; and rights to free, prior and informed consent (FPIC) for developments that affect indigenous peoples or their lands.<sup>6</sup>
- The *2011 UN Guiding Principles on Business and Human Rights* – which articulates the responsibility of the private sector to respect human rights by avoiding infringing on human rights and addressing any adverse impacts with which they are involved.<sup>7</sup>

Social and environmental goals do not always align; conflicts and trade-offs are common. For example, without explicit attention to justice, the transition to clean energy to achieve global climate goals is likely to have disproportionately adverse impacts on different groups within society. Depending on their design, climate change responses can also negatively impact biodiversity (e.g., carbon offsets, location of renewable energy infrastructure). However, with increasing recognition of the human rights implications of climate change and biodiversity loss – and the human rights implications of different regulatory and policy responses – there are strong arguments for addressing social and environmental impacts associated with corporate activities in tandem.<sup>8</sup>

The analytical framework used to survey law reform opportunities in this report is set out in Box 1 below.

### Box 1. Framework for Analysis

#### How is this area of law relevant to corporate social and environmental performance?

Considering legal obligations, regulatory guidance, evidence from current practice (including stakeholder engagement with the law through litigation and other interventions) and likely developments:

- Does this area of law allow, incentivise, or require *consideration of social and environmental risks and impacts in company decision-making*, or does it disincentivise or disallow such consideration?
- Does this area of law allow, incentivise, or require *prevention and mitigation of adverse social and environmental risks and impacts associated with the company's activities*, or does it disincentivise or disallow such actions?

#### What are the limits and challenges with existing Australian legal and regulatory frameworks?

Are there alternative legal and regulatory models which have the potential to better align corporate decision-making and behaviour with social and environmental norms and objectives?

<sup>4</sup> United Nations Framework Convention on Climate Change – *Paris Agreement*, Art 2.1(a), Art 4.1.

<sup>5</sup> United Nations Convention on Biodiversity – *Kunming-Montreal Global Biodiversity Framework*, Goal A and Targets 2, 3, 15.

<sup>6</sup> The rights of First Nations people in Australia are protected across three international human rights instruments – the International Convention on the Elimination of all forms of Racial Discrimination, the International Covenant on Civil and Political Rights and UNDRIP. The first two are incorporated into Australian domestic law to varying degrees, whereas UNDRIP is not. UNDRIP was endorsed by the Australian Government in 2009, however it is not a treaty and does not contain formal mechanisms to report breaches to the UN. Considering its potential legal effect in Australia, the Law Council of Australia notes, 'While the UNDRIP is not a treaty and therefore does not itself create legally binding obligations, many of its articles have been recognised as reflecting customary international law. Its articles also echo many of the rights articulated in legal binding human rights treaties, but with a specific focus on indigenous peoples. Insofar as the UNDRIP relies on and elaborates well-established human rights obligations in international treaty and customary law, it is binding on Australia' (Law Council of Australia, Submission to the Senate Legal and Constitutional Affairs References Committee Inquiry into the Application of the UNDRIP in Australia, 24 June 2022). See also, Shelley Marshall et al, *First Peoples and Land Justice Issues in Australia: Addressing Deficits in Corporate Accountability* (2021) – 'in relation to corporate accountability, the UNDRIP offers a guide to business engagement with First Peoples, without a binding mechanism' (p10).

<sup>7</sup> The UN *Protect, Respect and Remedy: A Framework for Business and Human Rights* (2008) and the *UN Guiding Principles on Business and Human Rights* (UNGPs) (2011) are international human rights instruments adopted by the UN Human Rights Council. The Framework sets out the duty of states under international law to protect against human rights abuses by third parties including business enterprises through appropriate policies, regulation, and adjudication; and the corresponding responsibilities of business entities to respect human rights. The UNGPs set a standard for the corporate responsibility to respect human rights (understood as doing no harm).

<sup>8</sup> See e.g., *UN Framework Principles on Human Rights and the Environment*, which highlight the interdependence of human rights and environmental protection and recognise that environmental harm interferes with the enjoyment of human rights.

## 2 Disclosure and Reporting

### 2.1 How is disclosure and reporting relevant to corporate social and environmental performance?

If companies are legally required to report on their social and environmental performance and disclose how they address the risks and impacts of their business activities on people and the environment, this can focus board and management attention on avoiding and mitigating these risks and impacts.

Disclosure and reporting also allows external actors – civil society, future employees, consumers, lenders, insurers, investors – to determine and compare corporate social and environmental performance across businesses and sectors and use this information to guide their own decision-making and activities that thereby indirectly influence companies. However, these external actors will have differing motivations and varying capacities to integrate and apply such information, which will ultimately affect the impact of disclosure obligations on corporate behaviour.

### 2.2 Current Australian Frameworks

#### 2.2.1 Legal obligation to disclose material risks

The disclosure obligations set out in the *Corporations Act 2001* (Cth) (**the Corporations Act**) focus on reporting *material risks* posed to companies. There are currently no specific legal requirements for a company to report on its social and environmental *performance*, nor how it addresses the risks and impacts of its business on people and the environment. However, companies may be required to do so if the social and environment risks and impacts of their business activities can be framed as a material risk to the company itself.

Annual Reports – All companies listed on the Australian Securities Exchange (**ASX**) and all large proprietary companies<sup>9</sup> must prepare an annual report each financial year, which includes financial statements and a director's report. Table 1 notes the key disclosure requirements and their potential application to social and environmental risks. Similar disclosure obligations apply to other company disclosures such as fundraising documents.<sup>10</sup>

**Table 1: Disclosure Obligations for Australian Companies**

Legal Obligation	Application to social and environmental risks
<p><b>Financial Statements</b></p> <p>Company directors (and external auditors) sign off on the annual report to attest that it accords with the prescribed accounting standards and presents a 'true and fair representation' of the company's financial position and performance (ss295-97, 307-8).</p> <p>The Australian Accounting Standards Board (<b>AASB</b>), which prescribes accounting standards, provides that <i>'information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.'</i> The primary users of financial statements are understood as <i>'existing and potential investors, lenders and other creditors.'</i><sup>11</sup></p>	<p>In joint guidance, the AASB and the Auditing and Assurance Standards Board (<b>AUASB</b>) states that climate related-risks and other emerging risks may pose financial implications through asset impairment, changes in the useful life of assets and their fair valuation, increased costs or reduced demand for products and services, potential liabilities, and changes in expected credit losses. Accordingly, the AASB and AUASB recognise climate-related risks could be material to a company and may need to be disclosed in financial statements.<sup>12</sup></p> <p>Specific guidance for other social and environmental risks is not provided.</p>

<sup>9</sup> A proprietary company is considered large if the company and any of the entities it controls satisfies two of the following criteria: (1) they have a consolidated gross operating revenue of \$10 million or more in the relevant financial year; (2) the value of their consolidated gross assets is \$5 million or more at the end of the financial year; or (3) they have 50 or more employees at the end of the financial year. See *Corporations Act 2001* (Cth) s 45A(3).

<sup>10</sup> Companies seeking to raise funds via prospectuses are required to disclose all information that investors and their professional advisers would reasonably require to make an informed assessment of the prospects of the company (*Corporations Act* s710, *ASIC Regulatory Guide* 288 (2016)).

<sup>11</sup> AASB, *Amendments to Australian Accounting Standards – Definition of Material* (Dec 2018); *Amendments to AASB 101 Presentation of Financial Statements*, para 7.

<sup>12</sup> AASB and AUASB, *Climate-related and Other Emerging Risks Disclosures: Assessing Financial Statement Materiality Using AASB/IASB Practice Statement 2* (April 2019).

Legal Obligation	Application to social and environmental risks
<p><b>Director's Report</b></p> <p>The Annual Report must include a review of the company's operations and results, details of significant changes in the company's state of affairs, and details of any matter or circumstance that has arisen since the end of the year that has or may significantly affect the company's operations, the results of those operations, and the company's state of affairs in future financial years (s299(1)).</p> <p>Listed companies must also disclose information that would enable shareholders to make an informed assessment of the company's operations, financial position, and the business strategies, and prospects for future financial years in the form of an Operating and Financial Review (<b>OFR</b>) (s299A(1)).</p> <p>The Director's Report is not subject to the same degree of external assurance as the financial statements – assurance focuses on identifying any material inconsistency with the financial statements or material misstatements of fact and is not taken to be an assurance of the other information within the annual report.<sup>13</sup></p>	<p>The Australian Securities and Investment Commission (<b>ASIC</b>) <i>Regulatory Guide 247</i> provides that <i>'it is likely to be misleading to discuss prospects for future financial years without referring to the material business risks that could adversely affect the achievement of the financial prospects described for those years' and that the OFR should 'include a discussion of environmental, social and governance risks that could affect the entity's' financial performance or outcomes disclosed.'</i></p> <p>It further recognises that climate change is a systemic risk that could have a material impact on the future financial position, performance, and prospects of listed companies.</p> <p>ASIC does not acknowledge the risks associated with biodiversity loss or First Nations and human rights. Nevertheless, company directors are encouraged to consider disclosing additional information that would be relevant for sustainability reporting or to meet the recommendations of the Task Force for Climate-Related Disclosures (<b>TCFD</b>).</p>

### Guidance on Social and Environmental Risk Disclosures – for listed companies

The *ASX Corporate Governance Principles and Recommendations (the Governance Principles)* sets out the following additional recommendations for listed companies in relation to environmental and social risk disclosures:<sup>14</sup>

- A listed entity *'should disclose whether it has any material exposure to environmental or social risks, and if it does, how it manages or intends to manage those risks,'* either within its annual report or through a separate, cross-referenced sustainability report (rec 7.4).
- **Environmental risks** are defined as the potential negative consequences (including systemic risks and the risk of consequential regulatory responses) *to a listed entity* if its activities adversely affect the natural environment or if its activities are adversely affected by changes in the natural environment. This includes the risks associated with the entity polluting or degrading the environment, adding to carbon levels in the atmosphere, or threatening a region's biodiversity or cultural heritage. It also includes the risks for the entity associated with climate change, reduced air quality and water scarcity.
- **Social risks** are defined as the potential negative consequences (including systemic risks and the risk of consequential regulatory responses) *to a listed entity* if its activities adversely affect human society or if its activities are adversely affected by changes in human society. This includes the risks associated with the entity or its suppliers engaging in modern slavery, aiding human conflict, facilitating crime or corruption, mistreating employees, customers, or suppliers, or harming the local community. It also includes the risks for the entity associated with large scale mass migration, pandemics or shortages of food, water, or shelter.
- **Material exposure** is defined as a real possibility that the risk in question could materially impact the listed entity's ability to create or preserve value *for security holders* over the short, medium, or longer term.

### Enforcement Options

The Corporations Act prohibits conduct which is misleading or deceptive or which is likely to mislead or deceive (s1041H),<sup>15</sup> and specifically provides that where a person makes a representation about a **future matter** without having reasonable grounds to do so, then the representation is 'taken to be misleading' (s769C).<sup>16</sup>

<sup>13</sup> This is by reason of the fact that company auditors have limited obligations to review and provide assurance on such 'other information' – Australian Auditing Standard 720, *The Auditors Responsibility Relating to Other Information*, provides that a listed entity's annual report will generally be subject to review by its auditor but this review is undertaken for limited purposes and is not an assurance of the annual report (see paragraph 8).

<sup>14</sup> ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations (4th Edition)* (2019), 2; ASX Listing Rules (see rule 4.10.3). These are recommendations, not mandatory requirements. A company board is free to decide not to adopt a particular recommendation if it is not considered appropriate to their circumstances, however, must explain the reasons for this.

<sup>15</sup> Similar prohibitions are set out in the *ASIC Act 2001* (Cth) (s12DA) and section 18 of the Australian Consumer Law. Litigation about misleading or deceptive conduct in relation to express or implied representations made in annual reports and financial statements is common in Australia. For a full discussion of relevant case law, see Noel Hutley QC and Sebastian Harford-Davis, *Climate Change and Directors' Duties: Further Supplementary Memorandum of Opinion* (23 April 2021), 11-15.

<sup>16</sup> See also parallel provisions in the *ASIC Act* (s12BB) and the *Australian Consumer Law* (s 4).

In the situation where there has been a failure to disclose, or misleading or deceptive disclosure, there are two main avenues for enforcing compliance:

- **Public enforcement by regulators:** ASIC has a range of powers and enforcement options available to pursue breach of disclosure obligations, and serious penalties and sanctions can apply (ss 674, 1311, 1317E). In 2022, ASIC begun scrutinising sustainability disclosures for misleading and deceptive claims and has both required corrective disclosures and issued infringement notices. For example, ASIC raised greenwashing concerns with mining companies over statements in prospectus, websites, investor presentations and other company disclosures that projects were 'low carbon', which led to the companies removing the terms.<sup>17</sup>
- **Private enforcement by shareholders:** Company shareholders can seek a declaration that a breach has occurred and/or an injunction to prevent future breaches (Box 2 provides an Australian example). They can also bring claims for compensation for losses suffered as a result of misleading disclosure, either as individuals or as a class of shareholders under Australia's securities class action regime (Corporations Act Part IVA; *Federal Court of Australia Act* (1976)) (see Box 3 for United States examples).

Disclosure breaches may also be pursued as part of broader claims for breach of director's duties (see Part 3.2.1).

### **Box 2. Shareholder litigation – misleading disclosure – Australia**

**Abrahams v Commonwealth Bank of Australia** – In 2017, retail shareholders of the Commonwealth Bank of Australia (CBA) filed a claim alleging the bank had failed to disclose climate-related financial risks in its 2016 Annual Report.<sup>18</sup> They argued that CBA knew or ought to have known that the impacts of climate change were material, and accordingly might have major impacts on CBA's operations, financial position and prospects for future financial years, and that CBA ought to have one or more business strategies to manage such risks. They further alleged that CBA ought to have known that the Adani Carmichael coal mine was a matter of substantial controversy and the provision of funding to that mine posed material reputational risks to its business.

The applicants sought a declaration that CBA had contravened Corporations Act ss 292(1)(b), 295, 297, 298(1), 298(1AA), and 299A(1) and an injunction restraining CBA from continuing to fail to report on its climate risks and requiring it to report on its climate risks in its annual reports. The claim was ultimately settled before judgment with CBA releasing a 2017 annual report acknowledging the risks of climate change and pledging to undertake climate change scenario analyses.

### **Box 3. Shareholder litigation – misleading disclosure – United States**

**Ramirez v Exxon Mobil Corp** – In 2016, a shareholder class action was commenced in the Federal District Court (Northern District, Texas) against Exxon Mobil (the company and various executive officers) on behalf of purchasers of Exxon shares (during the period Feb–Oct 2016). The complaint, which is ongoing, alleged that Exxon's public statements during the period were materially false or misleading because they failed to disclose that internally generated reports recognised material financial risks posed by climate change; that due to these risks, Exxon would not be able to extract existing oil and gas reserves; and that Exxon had used an inaccurate price on carbon to calculate the value of certain oil and gas reserves. Further, as a result of these positive statements, the share price was artificially inflated. In Oct 2016, Exxon disclosed it might have to write down the value of its oil and gas assets by 20%, and as a result the share price dropped significantly. Shareholders are claiming for these losses.<sup>19</sup>

**Fagen v Enviva Inc** – In 2022, a shareholder class action was commenced in the Federal District Court in Maryland against Enviva (the company and various executive officers) on behalf of purchasers of Enviva shares (during the period Feb 2019 – Oct 2022). Enviva develops, constructs, acquires, and owns and operates wood pellet production plants. This ongoing complaint alleges that Enviva misrepresented the environmental sustainability of its wood pellet production and procurement and its business prospects, and that shareholders suffered a 13% loss in share price when a public report detailing these issues was released.<sup>20</sup>

<sup>17</sup> ASIC, *ASIC's Recent Greenwashing Interventions* (Report 763, May 2023).

<sup>18</sup> Guy Abrahams, 'Concise Statement', Submission in *Guy Abrahams v Commonwealth Bank of Australia*, VID879/2017, 8 August 2017, 4-5.

<sup>19</sup> For a summary of this case, see: <http://climatecasechart.com/case/ramirez-v-exxon-mobil-corp/>

<sup>20</sup> For a summary of this case, see: <http://climatecasechart.com/case/fagen-v-enviva-inc/>

## 2.2.2 Climate Risk Disclosure – current practice

The financial materiality of climate-related risks to company interests is now well established and has been recognised by Australian regulators. In the absence of mandatory reporting standards, best practice standards developed by industry (e.g., TCFD) and associated investor engagement initiatives (e.g., Climate Action 100+) have emerged as dominant drivers of corporate risk disclosure and management expectations in relation to climate change.

These industry standards and initiatives frame the risks and impacts of business activities on climate (e.g., GHG emissions) as a material risk to the company itself and set out expectations for companies to report on how they are addressing these risks including by addressing adverse impacts (e.g., reducing GHG emissions). To some degree, they also acknowledge the systemic and collective nature of problems like climate change and seek to drive corporate responses which contribute to addressing these problems in a timely and proportionate way (e.g., by aligning to global climate goals as set out in the Paris Agreement).

For example, the TCFD recommends that entities disclose detailed information on the direction and ranges of potential financial implications to the company under different climate-related scenarios, including emissions reduction scenarios that align to the Paris Agreement.<sup>21</sup> The TCFD has set out climate-relevant metrics to track risk exposure over time,<sup>22</sup> and urged entities to set quantified targets which align with these metrics, to set out comprehensive business transition strategies to meet targets, and to report regularly on progress.<sup>23</sup> A wide range of targets and metrics are proposed, which cover GHG emissions (scope 1, 2 and 3), but also other areas of risk exposure. Climate Action 100+, through its *Net Zero Company Benchmark*, also urges companies to disclose in line with TCFD, to set science-based emissions reduction targets aligned to Paris goals, to disclose decarbonisation strategies to deliver on these targets, and to report regularly on progress.<sup>24</sup>

In Australia, climate risk disclosures have significantly increased in volume in recent years, with many companies now providing disclosures in the annual report or dedicated climate change reports.<sup>25</sup> While there is ostensibly high uptake of TCFD standards in Australia,<sup>26</sup> in practice, companies only partly implement the TCFD recommendations, and there is considerable variation in reporting.<sup>27</sup> Specifically, companies are not always providing comprehensive disclosures of the financial implications of climate risk. Nor are they setting out transition strategies, using relevant targets and metrics to measure and compare progress and performance.<sup>28</sup> Further, while companies are providing more qualitative discussion of climate risk in the director's report, these risks remain under-reported and unquantified in financial statements.<sup>29</sup>

Investors and civil society stakeholders have raised consistent concerns about the quality and usefulness of climate disclosures, including in relation to the limited disclosure of overall emissions footprints and reduction targets for Scope 3 emissions, scenario analyses underpinning strategic decisions (particularly in sectors with high exposure to transition risks) as well as the assumptions and inputs used in scenarios, physical risks, and evidence of how climate risk assessment informs strategic and capital allocation decisions.<sup>30</sup>

## 2.2.3 Biodiversity and First Nations Reporting – current practice

Unlike climate change, other sustainability issues (including biodiversity and First Nations rights) are not yet firmly established as financially material risk issues in Australia and tend to be reported, if at all, in voluntary sustainability reports. There have been improvements in the quality of sustainability reporting over time, with many companies adopting standardised frameworks which set out metrics and targets for different sustainability themes (e.g., reporting against the Sustainable Development Goals (SDGs)). Nonetheless, as discussion in Box 4 highlights, reporting quality remains variable. Sustainability reporting is not mandatory in Australia, and companies have considerable scope to tailor and control the information reported and target this to potential audiences.

<sup>21</sup> TCFD, *Final Report: Recommendations of the Taskforce on Climate-related Financial Disclosures* (2017), pp 7-12, 25-32. See also TCFD, *Implementing the Recommendations of the Taskforce on Climate-related Financial Disclosures* (Oct 2021).

<sup>22</sup> TCFD (2017) above, 16-17.

<sup>23</sup> TCFD (2017) above, 7-12, 14. See also TCFD, *Guidance on Metrics, Targets and Transition Plans* (October 2021).

<sup>24</sup> Climate Action 100+ (2021), 'Climate Action 100+ Net Zero Company Benchmark'.

<sup>25</sup> Luisa Unda and Anita Foerster, 'Climate risk disclosure, compliance and regulatory drivers: a textual tone analysis' 39(1) (2022) *Company and Securities Law Journal* 47-72.

<sup>26</sup> Australian Council of Superannuation Investors, *Promises, Pathways & Performance: Climate Change Disclosures in the ASX200* (Report, July 2022) 6.

<sup>27</sup> Anita Foerster and Michael Spencer, 'Corporate Net Zero Pledges: a triumph of private climate regulation or just more greenwash?' 32(1) (2023) *Griffith Law Review*, 110-142.

<sup>28</sup> TCFD, *2021 Status Report: Taskforce on Climate-Related Financial Disclosures* (2021).

<sup>29</sup> AASB and AUASB above n 12.

<sup>30</sup> Investor Group on Climate Change, CDP and Principles for Responsible Investment, *Confusion to Clarity* (Report, June 2021) 4; Market Forces, *Investing in the Dark* (Updated Report, 2019).

#### Box 4. Sustainability Reporting in Australia

The Australian Council of Superannuation Investors (ACSI) produces an annual assessment of the quality of Environmental, Social and Governance (ESG) reporting by ASX200 companies, focused on ESG governance, management, and monitoring of material ESG risks and opportunities. Highlights from the 2022 assessment include:<sup>31</sup>

- **Improvements:** In 2021, 140 ASX200 companies were disclosing *detailed*<sup>32</sup> or *comprehensive*<sup>33</sup> information on ESG risks compared to 39 companies in 2008. In 2021, all ASX200 companies were providing at least basic reporting and only in the broader ASX were there companies not providing any meaningful reporting. Only 12 companies in the ASX200 provided no reports.
- **Sectors:** In 2021, reporting quality was strongest in the utilities, consumer staples, materials and real estate sectors. ACSI attributed this to regulatory and stakeholder expectations as well as benefits from ESG opportunities. Health care and information technology sectors lagged, with fewer than 40% of companies having detailed or comprehensive reporting.
- **SDGs:** The SDGs is the dominate reporting framework with 64% of the ASX200 reporting against specific SDG goals – an increase from 10% in 2016. The top five SDGs referenced by companies are: Goal 13 – Climate Action (~115); Goal 8 – Decent Work & Economic Growth (~110); Goal 12 – Responsible Consumption (~95); Goal 5 – Gender Equality (~90), and Goal 3 – Good Health & Well Being (~85). Goal 2 – Zero Hunger, Goal 14 – Life Below Water, and Goal 1 – No Poverty were referenced the least. **However, in 2021, only 43% of ASX150 companies disclosed a materiality analysis that embedded the SDGs, a decline of 5% from 2019.**

Since the establishment of Reconciliation Australia in 2001,<sup>34</sup> and its program of Reconciliation Action Plans (**RAPs**) introduced in 2006, corporate reporting on engagement with First Nations peoples has become more common within sustainability reports. Yet as the discussion in Box 5 illustrates, current reporting practice tends to focus on a limited range of Corporate Social Responsibility (**CSR**)-style activities. It also reflects common problems with voluntary sustainability reporting, namely poor consistency, strategic information management, and limited transparency.

#### Box 5. Reconciliation Action Plans (RAPs)

The RAP program is an example of a voluntary reporting and commitment framework – it provides a standardised format for companies to commit to engage with and respect First Nations rights and to report annually on outcomes. This format is endorsed and managed by an external organisation (Reconciliation Australia), but participation is entirely voluntary, and all commitments are determined by companies themselves. Corporate activities that commonly feature in RAPs include partnerships with First Nations organisations and provision of pro-bono services to indigenous communities, internal cultural awareness training and ceremonies, employment of indigenous peoples, procurement and other business activities with indigenous-owned companies, and contributions to education scholarships and training opportunities for indigenous peoples.

A 2020 study of corporate commitments to reconciliation in the Australian resources sector explored the quality and nature of reporting on reconciliation actions taken by companies with and without RAPs.<sup>35</sup> Resource sector companies have been early adopters of RAPs. They also often have legal obligations to engage with First Nations peoples under native title and land rights legislation that underpins other reconciliation activities.

Yet the findings of this study suggest that while RAPs provide a standardised format for reporting, the program permits considerable flexibility in disclosure detail and progress reporting, allowing companies to strategically manage information. Companies with RAPs were generally found to provide better quality reporting on reconciliation than those without. However, few RAPs included clear targets with timelines for achievement, and accountability measures (e.g., responsible officers). While the program requires that regular progress reports are submitted to Reconciliation Australia, there is no requirement to publicly report progress. Available progress reporting did not generally provide useful information.

The case of mining company Rio Tinto highlights the potential disconnect between voluntary CSR-style commitments made through RAPs and respect for First Nations rights in line with international standards, even where these are not fully reflected in the Australian legal system. In June 2020, following the destruction of Juukan Gorge, Reconciliation Australia suspended Rio Tinto from participation in the RAP program as the company's conduct was judged to be inconsistent with its RAP status.

<sup>31</sup> ACSI, *ESG Reporting Trends* (Report, June 2022).

<sup>32</sup> According to ACSI, *detailed* information includes coverage of a range of material ESG risks, supported by performance data for multiple risks and including at least one target for a material risk.

<sup>33</sup> According to ACSI, *comprehensive* information including coverage of material ESG risks and mitigation strategies, demonstrates performance against a substantive number of material risks and discloses processes for identifying why ESG risks are important. Targets and performance data must also be provided for a range of different risk areas.

<sup>34</sup> Reconciliation Australia is an independent, non-profit organisation established in 2001 by the Federal Government.

<sup>35</sup> Daniel Schepis, 'Understanding Indigenous Reconciliation Action Plans from a corporate social responsibility perspective' 69 (2020) *Resources Policy* 1.

Stakeholder expectations regarding corporate performance in relation to First Nations peoples are increasing, with growing recognition that businesses which fail to respect First Nations rights and build strong relationships with indigenous communities, face material business risks.<sup>36</sup> For example, ACSI's 2021 *Policy on Company Engagement with First Nations People* recognises that '*significant financial costs can arise from unconstructive relationships with First Nations people*' including production implications, project cancellations or delays, legal fees, reputational damage, difficulties retaining employees, and that '*a company's long-term success and ability to operate can be undermined.*'<sup>37</sup> Further, ACSI states, '*investors need assurance that the companies in which they invest are mitigating this risk by respecting First Nations people's rights and culture.*'

ACSI's expectations of investee companies in relation to risk management and disclosure place some emphasis on alignment with international standards such as UNDRIP and ensuring a rights-based approach, even where this may not be required by Australian legal frameworks. ACSI expects companies to: undertake robust risk assessments of relevant risks to the company *and to First Nations people*; ensure alignment with international standards (including UNDRIP and UNGPs); engage in good faith including ensuring FPIC is obtained and maintained for projects impacting indigenous peoples or their land; ensure board oversight of risk management; provide dispute resolution and grievance mechanisms to ensure the company remedies adverse impacts it has caused or contributed to; and undertake ongoing performance monitoring using targets and indicators.

On disclosure, ACSI states: '*Companies should provide sufficient information to enable investors to assess the quality of a company's engagement with First Nations people. Disclosure should provide a genuine explanation of a company's risks and approach, and how its policies are implemented in practice. This should include the system in place to enable the board to assess risk, as well as targets and performance over time. Disclosure should also include the nature and scope of agreements, timelines, and any key challenges. Where a company has relied on government approval or a dispute resolution determination that does not reflect the position of First Nations people, this should be disclosed.*'<sup>38</sup>

## 2.2.4 Likely Developments

Australian legal and regulatory frameworks are fast evolving. Emerging developments which have the potential to strengthen the legal regime for corporate risk disclosure, to broaden its application to a wider range of sustainability risks, and to increase the focus on social and environmental impacts of corporate activities (not just financial risks posed to companies) are discussed in Table 2.

**Table 2. Emerging Regulatory Developments in Australia**

Regulatory Initiative	Potential impact on corporate reporting
<p><b>Mandatory Climate Risk Disclosure</b></p> <p>Treasury is currently consulting on mandatory climate-related financial disclosures,<sup>39</sup> with new rules expected to commence in 2024, and the first reports required for the 2024–25 financial year.</p> <p><b>Covered Entities:</b> A three-phased approach is likely, starting with very large entities, then expanding over time to encompass additional, large entities, with thresholds based on consolidated revenue, assets and number of employees (similar to financial reporting thresholds set out in the Corporations Act).<sup>40</sup> Entities which do not meet these thresholds but are otherwise required to report scope 1 and 2 GHG emissions under the <i>National Greenhouse and Energy Reporting Act 2007</i> (Cth) (NGER Act) would also be required to provide climate risk disclosures.</p>	<p>The focus of reforms is predominantly on reporting financially material risks posed to company interests. However, there are some aspects which shift and broaden the emphasis to encompass corporate climate performance and impacts, and associated systemic risks:</p> <p><b>Less discretion on materiality:</b> covered entities will have clear obligations to report on climate-related governance, strategy, risk management and metrics irrespective of their own materiality assessments.</p> <p><b>Reporting on impacts and risk management:</b> Proposed reporting metrics cover some corporate climate impacts (e.g., disclosure of scope 1, 2 and 3 emissions) and require entities to report on progress against self-determined transition targets.</p>

<sup>36</sup> Global Compact Network, KPMG, UTS, *The Australian Business Guide to Implementing the UN Declaration on the Rights of Indigenous Peoples* (Nov 2020), 14.

<sup>37</sup> ACSI *Policy on Company Engagement with First Nations People* (2021), 2.

<sup>38</sup> *q*ibid, p 4.

<sup>39</sup> The Treasurer, the Hon. Dr Jim Chalmers MP, 'Address to the Australian Sustainable Finance Institute, Sydney' (Speech, Australian Sustainable Finance Institute, 12 December 2022); Australian Government Treasury, *Climate-related Financial Disclosure* (Consultation Paper, December 2022); Australian Government Treasury, *Climate-related Financial Disclosure* (Consultation Paper, June 2023).

<sup>40</sup> Group 1 (reporting 2024-5 onwards) includes any company required to lodge a financial report under Chapter 2M of the Corporations Act that fulfills 2 of the 3 thresholds (over 500 employees, consolidated assets at \$1 bill or more, consolidated revenue at \$500 mill or more). Group 2 (reporting 2026-7 onwards) includes any company required to lodge a financial report under Chapter 2M of the Corporations Act that fulfills 2 of the 3 thresholds (over 250 employees, consolidated assets at \$500 mill or more, consolidated revenue at \$200 mill or more). Group 3 (reporting 2027-8 onwards) includes any company required to lodge a financial report under Chapter 2M of the Corporations Act that fulfills 2 of the 3 thresholds (over 100 employees, consolidated assets at \$25 mill or more, consolidated revenue at \$50 mill or more). Note this final threshold reflects the current definition for a large proprietary company under the Corporations Act.

## Regulatory Initiative

## Potential impact on corporate reporting

**Disclosure Standards:** Draft standards have been developed by the AASB (**AASB's Draft Climate Standard**). The draft standards incorporate the conceptual foundations and general requirements for disclosure of climate-related financial information contained within the International Sustainability Standards Board (ISSB)'s final **IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (ISSB's General Sustainability Standard)** as a baseline. Specific disclosures within the draft standards are based on the ISSB's final **IFRS S2 Climate-related Disclosures Standards (ISSB's Climate Standard)** which has drawn heavily on the TCFD Framework. This requires disclosure against the four themes of governance, strategy, risk management and metrics.

**Additional Requirements:** Building upon Treasury's recommendations and the ISSB standards, the AASB's Draft Climate Standard proposes that reporting entities will be required to disclose their climate resilience assessments against two possible future states, one of which must be consistent with the 1.5°C temperature goal of the Paris Agreement. An upper-temperature scenario has not been specified. Although Treasury proposed to include an obligation to develop and disclose transition plans, the AASB's Draft Climate Standard reflects the language of the the ISSB's Climate Standard, which would only require companies disclose a transition plan where they have one.

**Legislative Reforms:** Reforms to the Corporations Act will likely include an obligation on covered entities to disclose climate information within annual reports. However, listed entities may be permitted to report on their climate-related metrics and targets in a separate sustainability report provided it is referenced in the annual report.

**Liability Safeguards:** Treasury has proposed a modified liability approach that would limit the application of misleading and deceptive conduct provisions in relation to disclosures of scope 3 emissions and forward-looking statements to regulator-only actions for a fixed period of three years. As such, private enforcement pathways to address misleading disclosure or greenwashing behaviour (see examples in Box 2, 3 and 6) would not be available in the first three years, with the intention of encouraging fulsome and useful disclosures and supporting companies to develop their reporting capacity.

While the AASB's Draft Climate standard would only require disclosure of transition plans where companies have chosen to develop these and does not set out any detail on plan content or indicators, Treasury will likely mandate the development and disclosure of transition plan requirements for **large** companies and financial institutions through a separate framework. Treasury note that ASIC will inform the market of its key expectations in relation to transition plans once Australia's disclosure standards are finalised.<sup>41</sup> Treasury is not currently proposing that transition plans be aligned with any specific goal or climate scenario because (1) it could increase corporate greenwashing and (2) while doing so may incentivise further emissions reductions, Treasury considers that investors should drive ambitious transition plans as opposed to any disclosure regime.<sup>42</sup> The requirements in the immediate term will not go further than the requirements in the ISSB standards in order to ensure a **"smooth introduction of new climate disclosure requirements"** and provide an opportunity for industry and investors to identify measures to support credible transition planning. Sectoral pathways, taxonomies and other frameworks will be used as building blocks for enhanced transition planning in the medium-term.<sup>43</sup>

### ISSB Standards

In 2023, the ISSB released two new reporting standards: **IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (ISSB's General Sustainability Standard)** and **ISSB's Climate Standard** (discussed above). All ISSB standards are intended to be a baseline that individual jurisdictions can tailor by including additional requirements where relevant for the local market.

In addition to mandatory climate risk disclosure reforms, Treasury has indicated the potential to phase in reporting requirements and standards for other sustainability issues, including biodiversity, in the future.<sup>44</sup>

<sup>41</sup> Australian Government Treasury, *Sustainable Finance Strategy* (Consultation Paper, November 2023).

<sup>42</sup> Australian Government Treasury, *Climate-related Financial Disclosure* (Consultation Paper, June 2023).

<sup>43</sup> Australian Government Treasury, above n 41.

<sup>44</sup> The Treasurer, the Hon. Dr Jim Chalmers MP, 'Address to the Australian Sustainable Finance Institute, Sydney' (Speech, Australian Sustainable Finance Institute, 12 December 2022); Australian Government Treasury, above n 41.

The ISSB's General Sustainability Standard is intended to set the foundation for reporting on broader sustainability matters that can be built upon through the introduction of subsequent thematic standards. It requires companies to disclose *"material information"* about sustainability-related risks and opportunities across their value chain.<sup>45</sup>

A standard definition of financial materiality is used: *"information is material if omitting, obscuring or misstating it could be reasonable expected to influence investor decisions."*<sup>47</sup>

The General Sustainability Standard takes a similar format to the TCFD, requiring disclosures on governance, strategy, risk management and the use of metrics and targets.

In May 2023, the ISSB released a consultation seeking feedback on its priorities for its future work plan, including whether to prioritise research on (1) biodiversity, ecosystems and ecosystem services, (2) human capital, (3) human rights, or (4) integrated reporting. Research on the first three topics will be used to inform future standards development in conjunction with input from global stakeholders.

The Government is monitoring international developments in sustainability disclosure frameworks, referencing both the TNFD's work and the potential for the ISSB to develop a nature-related standard based on this emerging framework.<sup>45</sup> Accordingly, like the proposed climate disclosure rules, any future nature-related standards are likely to be based on ISSB standards. The ISSB standards focus on reporting financially material risks to company interests, not reporting corporate impacts or sustainability performance *per se*. The ISSB has not adopted the double materiality approach now used in Europe (see Example 1 below). However, as the ISSB develops more detailed standards for biodiversity and other matters, it is possible that these standards will broaden and shift in emphasis in a similar way to climate standards in order to address systemic risks and require some reporting of impacts (see further discussion of the TNFD below).

#### Taskforce for Nature-Related Financial Disclosures (TNFD)

Following the model of the TCFD, a coalition of financial institutions, corporates and market service providers is developing a risk management and disclosure framework to address nature-related risks, with the goal of supporting a redirection of global financial flows away from activities that harm nature, towards activities that benefit nature. The final TNFD recommendations are expected in September 2023, and will inform the subsequent development of biodiversity disclosure standards by the ISSB and their adoption by individual jurisdictions.<sup>48</sup>

The 4th beta version of the TNFD framework covers nature-related issues defined as dependencies, impacts, risks and opportunities (**DIRO**) and follows four disclosure themes based on the TCFD: governance, strategy, risk and impact management, metrics and targets. It explicitly covers value-chain risks including upstream, downstream, and financed activities and assets, as well as direct operations. Three categories of nature-related risks are set out – physical, transition and systemic. Systemic risks arise from the breakdown of the whole system and involve cascading interactions of physical and transition risks.

Like the climate change context, industry guidance on targets and metrics and target certification platforms are emerging. For example, the **Science-based Targets Network** is developing methods for companies to align targets with a number of nature objectives (including land use change, resource

Like the TCFD, the TNFD (4th beta version) focuses on how nature-related issues impact corporate entities and how these entities should manage such issues. Dependencies and impacts on nature are therefore relevant primarily to understanding the entity's risk exposure.

However, TNFD does place some emphasis on assessing and responding to the organisation's **impacts** on nature, considering systemic risks of biodiversity loss and ecosystem collapse, and the potential mismatch of biodiversity impacts with understandings of financial materiality particularly at the entity scale. For example:

**Location-based responses:** As part of strategy disclosures, TNFD recommends location-based assessment and responses for nature-related issues, and guidance is provided on how an organisation should evaluate the integrity and importance of ecosystems in different locations and its impacts on these.

**Stakeholder engagement and addressing grievances:** Draft guidance for disclosing how an organisation has engaged affected stakeholders in its assessment of and response to nature-related DIROs recommends *inter alia*, that an organisation disclose: a statement of its efforts to comply with international standards of responsible business conduct as set out in the **UNGPs** and **OECD Guidelines For Multinational Enterprises** (see Part 5); the organisation's approach to identifying and addressing grievances related to potential and actual impacts on nature; and where indigenous peoples are involved,

<sup>45</sup> Australian Government Treasury, above n 41.

<sup>46</sup> The ISSB notes that a value chain encompasses "the activities, resources and relationships an entity uses and relies on to create its products or services from concept to delivery, consumption and end-of-life. Relevant activities, resources and relationships include those in the entity's operations, such as human resource; those along its supply, marketing and distribution channels, such as materials and service sourcing and product and service sale and delivery; and the financing, geographical, geopolitical and regulatory environments in which the entity operates."

<sup>47</sup> ISSB, IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (Standards, June 2023) [18].

<sup>48</sup> This discussion is based on the latest available draft recommendations at the time of writing: TNFD, *The TNFD Nature-related Risk and Opportunity Management and Disclosure Framework, Final Draft – Beta v0.4* (March 2023).

Regulatory Initiative	Potential impact on corporate reporting
<p>exploitation – water and ocean, ecosystems and species), with work on biodiversity metrics and targets ongoing.<sup>49</sup></p>	<p>efforts to comply with UNDRIP and particularly whether FPIC has been attained for projects and activities that impact upon indigenous peoples and their lands.</p> <p>Early guidance on nature targets released by the <i>Science-based Targets Network</i> also emphasises the importance of location specific assessment of impacts, response options and progress; and recommends a prioritisation of impact areas of high materiality (from a societal perspective, not a financial materiality perspective).</p>
<p><b>Activity Reporting – Sustainable Finance Taxonomy</b></p> <p>Sustainable finance taxonomies are a classification system to help investors and broader stakeholders understand whether <i>economic activities</i> undertaken by a company are environmentally and socially sustainable.<sup>50</sup> The rationale is to direct capital flows into economic activities that substantially contribute to climate mitigation and other sustainability objectives.</p> <p>The Australian Sustainable Finance Institute (ASFI) are coordinating the development of an Australian taxonomy. This will initially set out taxonomy criteria for climate mitigation, but over time ASFI intends to incorporate broader environmental and social criteria including in relation to: climate adaptation; environmental management (i.e., protection and restoration of health ecosystems, sustainable use and protection of water, and pollution prevention and control); resource resilience; the circular economy transition; and social objectives (e.g., First Nations rights, participation, and reconciliation).<sup>51</sup></p> <p>Sustainable Finance Taxonomies introduced around the world include reporting obligations for finance sector entities and associated companies. For example, under the EU Taxonomy, investment funds that have sustainable investment objectives or promote social or environmental characteristics must report their portfolio alignment with the EU taxonomy. Further, each of the entities required to disclose broader sustainability information under the EU’s Corporate Sustainability Reporting Directive must also report against the taxonomy.</p> <p>ASFI has recommended similar reporting requirements for finance sector entities in Australia.<sup>52</sup> The Australian Government has not yet committed to mandate financial institutions to use the sustainable finance taxonomy. If this occurs, additional reporting obligations on companies may also be needed.</p>	<p>Activity reporting under sustainable finance taxonomies is distinct from other sustainability reporting initiatives and can help to shift the focus of corporate reporting beyond financial risks posed to company interests, to how company activities align with, support a transition to, or detract from sustainability objectives set out in the taxonomy.</p> <p>However, experience in developing the EU Taxonomy highlights the practical challenges in delineating activities that substantially contribute to sustainability objectives based on best available scientific evidence (rather than policy or energy market considerations). For example, as a result of political pressure, the ‘significant contribution’ screening criteria for certain activities associated with fossil gas and nuclear energy have been lowered to classify those activities as ‘sustainable’ in a ‘transitional activity’ category, despite their adverse climate change / environmental impacts.</p> <p>The Australian Treasury has indicated a preference for including transition activities within an Australian taxonomy, noting the need for ‘rigorous, science-based criteria to define activities that can credibly support the transition – and on what timeframes.’<sup>53</sup></p>

<sup>49</sup> The SBTN aims to develop targets methods for companies to align with planetary boundaries and associated societal goals. To date, SBTi-approved climate change targets are the only official SBTs available to companies, but methods are developing for other areas including for land use change (especially deforestation and conversion), resource exploitation (water quantity and quality) and ecosystem integrity of working land. See, SBTN, *Science-based Targets for Nature: Internal Business Guidance* (Sept 2020), 35-39.

<sup>50</sup> Principles for Responsible Investment, World Bank Group, Chronos, *Implementation Guide for Sustainable Investment Policy and Regulation Tools: Taxonomies of Sustainable Economic Activities* (Toolkit, 2022).

<sup>51</sup> ASFI, *Designing Australia’s Sustainable Finance Taxonomy* (Report, March 2023) recs 1-4.

<sup>52</sup> *Ibid*, rec 15.

<sup>53</sup> Australian Government Treasury, above n 41, 13-17.

For investors to accurately report on their portfolio alignment, they need to understand whether their investee companies and other assets' economic activities contribute to, or harm, each of the taxonomies' objectives. Accordingly, companies should also disclose information on taxonomy alignment. In the EU, this is achieved through disclosure of the proportion of companies' turnover, capital expenditure and operating expenses that are taxonomy aligned.<sup>54</sup>

The Australian Treasury has recently committed to support the development of an Australian taxonomy, indicating this will initially have no regulatory status, but may be embedded into Australia's regulatory architecture in the future (e.g., requiring large firms to disclose the degree of alignment of their activities with the taxonomy as part of sustainability reporting and requiring financial entities to disclose the degree of alignment of their investment products or portfolios with the taxonomy).<sup>55</sup>

### Rise in Greenwashing Litigation

Many Australian companies have made voluntary commitments to net zero emissions, and are expected to increasingly set broader sustainability targets, especially if sustainability reporting becomes mandatory. Such targets can constitute a representation about *future matters*. Therefore, if there were no reasonable grounds to imply that the company could achieve these targets at the time of making them, both the company and their directors may be liable for misleading and deceptive conduct.<sup>56</sup> It is anticipated that both retail and institutional investors may bring greenwashing litigation where they consider such targets have been misleading and deceptive either as a strategic approach to hold companies accountable for their sustainability commitments or as a compensatory mechanism for losses incurred by relying upon such statements (see Box 3).

Two relevant examples of strategic litigation are:

**Abrahams v Commonwealth Bank of Australia 2021** – In 2021, retail shareholders brought proceedings against CBA to seek access to internal company documents under the Corporations Act (s 247A), to examine the truth of the bank's commitments on climate.<sup>57</sup> In 2019, CBA had stated that *"We ensure our business lending policies support the responsible transition to a net zero emissions economy by 2050, by only providing Banking and Financing activity to new oil, gas or metallurgical coal projects if supported by an assessment of the environmental, social and economic impacts of such activity, and in line with the goals of the Paris Agreement."*

Liability risk is an important driver of robust sustainability disclosures. Increased scrutiny from corporate regulators and shareholder litigation can help to boost corporate accountability for climate risk management.

Recent shareholder litigation addressing corporate climate commitments (net zero targets and transition plans) seeks to hold companies and directors to account on their social and environmental performance.

However, in the wake of increased regulatory scrutiny and the emergence of greenwashing litigation in Australia, it has been observed that companies are *greenhushing* – removing or watering down public disclosures of climate and other ESG targets for fear of regulatory scrutiny.

ASIC recently warned that non-disclosure of material sustainability information can also be seen as a form of greenwashing or misleading disclosure.<sup>58</sup>

Further, as the 2021 Noel Hutley opinion on greenwashing and directors' duties argues, risks of director liability for greenwashing in relation to net-zero commitments should not be used to justify avoiding making such commitments where to do so is in the best interests of the company (see Box 8).

<sup>54</sup> In particular, there have been significant challenges in implementing the EU taxonomy where obligations for investors to report their portfolio's alignment with the taxonomy were introduced before companies were required to report alignment of their business activities. See Principles for Responsible Investment, *Addressing the EU Taxonomy Usability Issues* (Blog Page, 2 February 2023); Principles for Responsible Investment *Implementing the EU Taxonomy*, (Report, 28 April 2022) 6.

<sup>55</sup> Australian Government Treasury, above n 41, 13-17.

<sup>56</sup> Corporations Act (ss 796C, 1041H), ASIC Act 2001 (Cth) (ss 12BB, 12DA), or Australian Consumer Law (ss 4, 18) – See, Noel Hutley QC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties: Further Supplementary Memorandum of Opinion* (Legal Opinion, 23 April 2021).

<sup>57</sup> Guy Abrahams & Kim Abrahams, 'Originating Process', Submission in *Abrahams & ors v Commonwealth Bank of Australia*, NSD864/2021, 26 August 2021.

<sup>58</sup> Jonathan Barret, 'Companies greenhushing to avoid scrutiny of climate goals, ASIC says' (The Guardian, 5 June 2023), <<https://www.theguardian.com/australia-news/2023/jun/05/companies-greenhushing-to-avoid-scrutiny-of-climate-goals-asic-says>>.

Regulatory Initiative	Potential impact on corporate reporting
<p>The applicants sought documents relating to several of the bank's gas and other fossil fuel projects. The Federal Court granted the application ordering CBA to produce the documents for inspection in February 2022. In finalising the proceedings in April 2023, the Federal Court ordered that the applicants could use certain documents to pursue further litigation against the bank and could forward such documents to both ASIC and the Australian Prudential Regulation Authority. No further litigation has been brought against CBA at this time.</p> <p><b>Australasian Centre for Corporate Responsibility vs Santos</b> – In 2022, the Australasian Centre for Corporate Responsibility (ACCR) brought proceedings against Santos for breaching the Corporations Act and Australian Consumer Law on the basis that it had engaged in misleading and deceptive conduct relating to claims made in its 2020 Annual Report, including that: (1) it had a clear and credible pathway to achieve net zero scope 1 and 2 emissions by 2040; (2) it had a clear and credible pathway to reduce its scope 1 and 2 emissions by 26–30% by 2030 from its 2019–20 financial year baseline; (3) Santos is a producer of “clean energy” and that natural gas is a “clean fuel; and (4) hydrogen produced from natural gas with carbon capture and storage is “clean” and “zero emissions.”</p> <p>In relation to the first two claims, ACCR alleges that Santos failed to disclose that it intends to pursue oil and gas growth beyond 2025, which would increase its overall emissions. Additionally, Santos failed to disclose that its net zero plans depend on a range of undisclosed and unreasonable qualifications or assumptions. In relation to representations about gas, ACCR alleges that they falsely convey that natural gas has no material adverse effect on the environment nor releases material greenhouse gas emissions. On hydrogen, ACCR alleges that Santos has failed to disclose how its hydrogen production activities will increase its scope 1 and 2 emissions and that it is not practically or commercially viable to capture all emissions with carbon capture and storage.</p>	

### 2.3 Limits and Challenges with Existing Legal & Regulatory Framework

There are reforms on the table which will potentially expand and strengthen obligations to disclose environmental and social risks (and potentially to some degree environmental and social impacts).

Nonetheless, the nature of the current (and anticipated) disclosure obligations discussed above limits the extent to which they incentivise companies to improve their social and environmental *performance* and minimise harmful impacts. This is largely due to a focus on *risks to company interests* (which does not necessarily align with risks and impacts for people and the environment), and narrow understandings of *materiality* (which emphasise financial materiality at the entity scale, only partly tempered by an investor focus on longer-term and systemic issues).

Companies are not required to report on their own social and environmental impacts and performance unless it can be framed as a material business risk. This style of legal obligation allows companies the latitude to take their own context into account and exercise their judgment in assessments of materiality and reporting of risks. An assessment of materiality will always be company and context specific. Accordingly, companies have considerable discretion to define when the impacts of business activities on external matters will constitute material risks and can therefore avoid comprehensively disclosing social and environmental performance.

As detailed in Table 2, the anticipated regime for mandatory climate disclosures, will limit such discretion by requiring disclosures irrespective of a company's materiality assessment. However, for social and environmental issues beyond climate change, where specific reporting standards have not been mandated, companies will retain the discretion to identify whether their impacts are material and disclose their performance. Where reporting is based on *financial materiality*, sustainability disclosures will only need to encompass social and environmental performance where that is relevant to investor returns or financial considerations for lenders and other creditors.

Many social and environmental impacts of corporate activities are not easily understood and quantified as financially material risks, particularly at the entity scale. For example, as Irvine-Broque and Dempsey explain, some biodiversity dependencies and impacts (e.g., pollinator collapse) pose clear financial risks to companies in some sectors, but others (e.g., ecosystem decline and species extensions) might pose minimal financial risks, especially in the short term.<sup>59</sup> Further, there is generally a lack of comprehensive data on biodiversity impacts, and models to translate this data into measurements of financial risk are in their infancy.<sup>60</sup>

Biodiversity loss<sup>61</sup> and social issues like rising inequality are increasingly recognised as systemic or economy-wide risks. For diversified investors (e.g., superannuation funds), financial returns depend on the overall performance of the economy, not only profits of an individual asset.<sup>62</sup> Diversified investors therefore have a financial imperative and implied duty to mitigate sustainability-related systemic risks through capital allocation and stewardship.<sup>63</sup> In theory, diversified investors should place expectations on companies to disclose information about their environmental and social impacts that threaten the stability of the economy. However, the financial imperative to address sustainability-related systemic risks is not fully understood across the financial sector. For companies, these risks are often considered as long-term issues irrelevant to their activities and are unlikely to be broadly picked up by the processes they use to assess financial materiality, which focus on their own strategy and context and tends to adopt relatively short (3–5 year) timeframes. To compel relevant disclosures on biodiversity and First Nations issues, stakeholders would need to demonstrate how a company's biodiversity impacts and activities offending First Nations' rights would create material reputational or policy risks to the company in the short term.

Material issues are dynamic and evolve over time, and there is growing recognition of the financial materiality of biodiversity loss and, increasing discussion of the materiality of First Nations rights among investors and other stakeholders.<sup>64</sup> However, the experience with climate risk reporting in Australia suggests that until specific reporting standards are introduced and mandated for biodiversity impacts and human rights (including First Nations rights), the quantity and quality of corporate disclosures on these broader social and environmental issues will remain inadequate.

Further, unless disclosure of corporate sustainability *performance* and *impacts* is required and unless companies are obliged to contribute to addressing systemic risks by aligning their risk management with relevant global goals, these tools are unlikely to contribute significantly to positive corporate social and environmental performance.

## 2.4 Alternative Models

Recent developments in the European Union (EU) and the United Kingdom (UK) offer alternative models which have the potential to strengthen incentives for companies to consider and to address sustainability risks *and impacts*.

### Example 1 – Double Materiality – EU Corporate Sustainability Reporting

The EU recently enacted its Corporate Sustainability Reporting Directive (CSRD)<sup>65</sup>, which strengthens existing corporate sustainability reporting requirements. The CSRD applies to large, listed and non-listed EU companies, listed EU small-medium enterprises and non-EU companies with at least one EU subsidiary or branch (that meet prescribed employee and financial thresholds).

<sup>59</sup> Audrey Irvine-Broque and Jessica Dempsey, 'Risky Business: Protecting nature, protecting wealth?' *Conservation Letters*, 2023; e12969.

<sup>60</sup> Almeida et al, *Building Blocks for Central Banks to develop Nature Scenarios* (INPSIRE Central Banking Toolbox – Policy Briefing no 11 (2023).

<sup>61</sup> World Economic Forum, *Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy* (Report, January 2020) 8; Australian Conservation Foundation, *Pollination, Australian Ethical, The Nature-Based Economy: How Australia's Prosperity Depends on Nature* (Report, September 2022).

<sup>62</sup> Rick Alexander, Holly Ensign-Bartstow, Lenore Palladino and Andrew Kassoy, *From Shareholder Primacy to Stakeholder Capitalism* (Report, 2020) 16.

<sup>63</sup> Principles for Responsible Investment, *A Legal Framework for Impact: Australia* (Policy Report, September 2022); Freshfield Bruckhaus Deringer, *Principles for Responsible Investment*, United Nations Environment Programme Finance Initiative, and the Generation Foundation, *A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making* (Legal Report, July 2021); Frederick Alexander, *The Law in Anti-ESG Logic: Financial Interests of Companies like Meta don't Always Align with Those of its Shareholders* (Blog Post, 5 December 2022).

<sup>64</sup> Global Compact Network, KPMG, UTS, *The Australian Business Guide to Implementing the UN Declaration on the Rights of Indigenous Peoples* (Nov 2020), 14; ACISI *Policy on Company Engagement with First Nations People* (2021), 2.

<sup>65</sup> Directive (EU) 2022/2464 of The European Parliament and of The Council, [2022] OJ L 322/15

Covered entities must report sustainability information in accordance with European Sustainability Reporting Standards (**ESRS**). Obligations on financial entities are separately imposed through the Sustainable Finance Disclosure Regulation. The European Financial Reporting Advisory Group (**EFRAG**) is responsible for developing reporting standards. EFRAG has so far developed general standards and specific standards for climate change, pollution, water and marine resources, biodiversity and ecosystems, resource use and circular economy, company workforce, workers in the value chain, affected communities, consumers and end-users, governance, risk management and internal controls, and business conducts.

Unlike the ISSB, the ESRS apply the concept of *double materiality* as the basis for sustainability disclosures. Double materiality encompasses both impact materiality and financial materiality. It requires disclosure of matters that meet either of these materiality thresholds, rather than both.

From an impact materiality perspective, a sustainability matter is material for a company if it *“is connected to actual or potential significant impacts by the undertaking on people or the environment over the short-, medium- or long-term” and includes impacts “directly caused or contributed to by the [company] in its own operations, products or services and impacts which are otherwise directly linked to the [company’s] upstream and downstream value chain...”* The materiality of an actual impact is determined by its severity (i.e., scale, scope, and irremediable character) while materiality of a potential impact is determined by its severity and likelihood.<sup>66</sup> The examples below illustrate how the concept applies to human rights and biodiversity:

**Human rights impact disclosures** – A manufacturing company that produces batteries for electric vehicles uses cobalt purchased from a smelter and minerals trader. The cobalt used in its products was mined using child labour. Even though the manufacturing company did not cause or contribute to child labour and has no contractual relationship with the cobalt mine itself, it is still required to disclose this negative impact as it is directly linked to the manufacturing company’s products through the supply chain.

**Biodiversity impacts disclosures** – An agricultural company grazes cattle and produces crops on three separate sites near a river classified as a ‘biodiversity sensitive area’. As part of its operations, the company both clears land in order to graze more cattle and seeds crops using fertiliser that potentially runs off into the nearby river. The company must therefore disclose the number and hectares of its sites near the river and, if it has concluded that its operations have a direct impact on the drivers of freshwater-use change, the company must report on the changes over time in the management of the ecosystem as well as the spatial configuration, structural connectivity, and functional connectivity.

Some European jurisdictions have already implemented this double materiality approach in national frameworks. For example, under the reformed *French Law on Energy and Climate*, financial institutions (banks, insurers and investors) must disclose how their financial activities depend on climate and biodiversity as well as how their financial activities impact on climate and biodiversity. They must also disclose their strategy for reducing biodiversity impacts, including specific targets and a measure of alignment with international biodiversity goals. There is limited information on the impact of these reforms as they have only recently come into force in 2022. Disclosure obligations will be further expanded to include the share of financing activities aligned with the EU Taxonomy in 2023.<sup>67</sup>

## Example 2 – Regulatory Guidance for Mandatory Transition Plans

In the UK, listed companies and large, regulated asset owners and managers are required to disclose climate-related transition plans as part of mandatory TCFD reporting on a comply-or-explain basis.<sup>68</sup> Transition plans provide stakeholders with additional qualitative information about a companies’ forward-looking climate risks and impacts. They are intended to also encourage companies to centre climate in decisions about future business strategies and activities. To incentivise credible and robust plans, the UK Government established a Transition Plan Taskforce (TPT) to develop a best practice standard for transition plans.

The TPT standard requires transition plans to set out a plan *“to contribute to and prepare for a rapid global transition towards a low greenhouse gas emission economy”*.<sup>69</sup> However, there is currently no overarching directive for transition plans to align with the UK Government’s 2050 net zero target. Instead, the TPT encourages entities’ transition plans to be informed by national commitments and latest international agreements on climate change and to also outline ambitious objectives and priorities to contribute to a *“rapid and orderly economy-wide net zero transition”*.

The TPT has developed a draft, sector-neutral framework and implementation guidance for transition plans that is designed to be consistent with, and build on, the ISSB Climate Standard. The TPT recommends transition plans cover:

<sup>66</sup> European Financial Reporting Advisory Group, *ESRS 1 General Principles* (Exposure Draft, April 2022) 12-13.

<sup>67</sup> Beate Triantafyllidis, ‘France’s Article 29: biodiversity disclosure requirements sign of what’s to come’ (*Global Canopy*, 17 March 2021), <<https://globalcanopy.org/insights/insight/frances-article-29-biodiversity-disclosure-requirements-sign-of-whats-to-come/>>.

<sup>68</sup> Financial Conduct Authority, *Enhancing Climate-Related Disclosures by Standard Listed Companies* (Policy Statement, December 2021).

<sup>69</sup> Transition Plan Taskforce, *The Transition Plan Taskforce Disclosure Framework* (Consultation Paper, November 2022) 8.

- **Ambition:** high-level ambitions to mitigate, manage and respond to climate change and leverage opportunities, including greenhouse gas emission reduction targets;
- **Actions:** short-, medium-, and long-term actions planned to achieve strategic ambition alongside details of how those steps will be financed;
- **Accountability:** governance and accountability mechanisms that support the delivery of the plan and robust periodic reporting; and
- **Additional Interconnected Considerations:** other measures to address risks to the natural environment and stakeholders such as workforce, supply chains, communities or customers that arise from the company's intended actions.

The TPT encourages companies to include material transition plan information in their Annual Financial Report whilst also publishing a single standalone transition plan that is updated at least every three years or earlier if there are significant changes.<sup>70</sup>

The EU Parliament and Council are also currently negotiating a directive to require EU member states to ensure select companies within their respective jurisdictions develop and implement transition plans (further discussed in Part 5.3 below). If implemented, this would require covered entities to ensure their business model and strategy are aligned or compatible with the transition to a sustainable economy and achieving climate neutrality by 2050, as well as *with limiting global warming to 1.5°C* in line with the Paris Agreement.<sup>71</sup> EFRAG's draft *ESRS E1 – Climate Change* also sets out requirements that covered entities disclose transition plans in line with these objectives. Meanwhile, the draft *ESRS E4 – Biodiversity and Ecosystems* mandates covered entities to disclose a transition plan that demonstrates how their business model and strategy is or will become compatible with the planetary boundaries of biosphere integrity and land-system change as well as relevant targets with the *Kunming-Montreal* Global Biodiversity Framework and the EU's own biodiversity strategy.

## 2.5 Reform Opportunities

Reforms to disclosure frameworks in Australia are well advanced and appear to be aligning closely with emerging global reporting standards developed by the ISSB. While this is an improvement on the current situation, there are nonetheless opportunities to further strengthen regulatory frameworks by placing more emphasis on addressing adverse social and environmental impacts in a manner which aligns with global sustainability goals and by developing standards and guidance for sustainability matters beyond climate change.

### ***Recommendation 1 – Introduce mandatory sustainability reporting, including reporting of impacts and alignment with global sustainability goals***

Mandatory sustainability reporting that goes beyond climate risk reporting and encompasses biodiversity, human rights (including First Nations rights) and other sustainability matters would significantly expand on and improve current Australian frameworks. However, the extent to which companies are explicitly required to report on their social and environmental *performance* and *impacts* and align their risk management activities with global goals is important in strengthening incentives to address, prevent, and mitigate adverse impacts.

The EU's *double materiality* approach which encompasses impact materiality has significant potential in this regard. Although the Australian Treasury has so far ruled out adopting a double materiality approach for climate risk disclosure, further consideration is warranted, particularly for emerging sustainability risk issues such as biodiversity, which pose systemic risks, but are harder to quantify as financially material risks at the entity scale. While the development of sustainability standards in Australia is likely to be led by the AASB, broad stakeholder involvement (beyond market actors) is important if standards are to appropriately encompass corporate impacts, performance and emerging systemic risks.

Explicit requirements to conduct regular stakeholder engagement in relation to corporate social and environmental performance and to report on this stakeholder engagement in annual reports or sustainability reports could also help to reinforce pressure on companies to address adverse social and environmental impacts and improve corporate social and environmental performance (see also Recommendation 6). This could potentially include a requirement to disclose complaints and grievances relating to social and environmental matters and the way in which they have been addressed by the company.

<sup>70</sup> Ibid.

<sup>71</sup> Council of the European Union, *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive – 4 Column-Table* (Proposal, 6 June 2023) art.15.

It is important to ensure that reporting thresholds appropriately capture entities that not only face material risks but that cause significant impacts. Beyond climate change, different and potentially lower thresholds may be appropriate (albeit more impracticable) to ensure sustainability reporting requirements apply to entities with significant potential environmental and social impacts. In order to inform the setting of thresholds, separate analysis should be undertaken to determine the standard corporate structure of entities in sectors with significant impacts on biodiversity and First Nations peoples and to clarify the financial and employee metrics of the entities with the greatest impacts in those sectors.

Protecting company directors from liability for misleading disclosure in relation to sustainability disclosures would undermine the strength of the emerging mandatory reporting regime and reduce opportunities to hold companies and directors to account on their social and environmental performance. While protection from liability for misleading statements may encourage more comprehensive disclosures, existing requirements to have 'reasonable grounds' when disclosing information provides an appropriate amount of protection for directors. If used at all, liability safe harbours should be time-bound, with a clear sunset date.

Sustainability disclosures should, in due course, be subject to external assurance and should be signed off by company directors to ensure rigour in data collection and presentation, as well as options for enforcing obligations in cases of false or misleading disclosure. There are ongoing considerations about which practitioners should assure sustainability information (i.e., audit firms or other sustainability service providers), what expertise they should be required to have, and whether a sustainability assurance licensing regime should be adopted. Additionally, while over 90% of assurance is performed by audit firms in Australia and nearly 70% of Australian companies disclosing ESG data obtained assurance in 2021, there are concerns about a lack of skilled assurance practitioners in Australia and capacity constraints if assurance is mandated immediately when mandatory climate-disclosures are introduced. Efforts may need to be made to upskill existing audit and assurance professionals on sustainability disclosures. A staggered approach to the introduction of independent assurance requirements would help address these concerns.

### ***Recommendation 2 – Australian standards for reporting on First Nations rights***

Following the release of the ISSB general standard on sustainability reporting, attention will shift to the development of more detailed standards for risks associated with biodiversity loss and human rights, including the rights of indigenous peoples.

Alongside these potential international developments, in recognition of the emerging materiality of indigenous rights issues and the ongoing and potential adverse impacts of corporate activities on indigenous rights in Australia, standards for corporate reporting on engagement with and respect for the rights of Australia's First Nations peoples should be developed. This should significantly expand upon the foundations for reporting initiated by Reconciliation Australia's RAP program. It should recognise that investors and other stakeholders increasingly seek evidence that companies recognise the rights of indigenous peoples in alignment with international standards such as UNDRIP, even where this may not be required under existing domestic law.

A disclosure standard would need to be developed in close consultation with relevant First Nations organisations. It could cover matters such as:

- How a company's business model and/or specific projects may impact First Nations rights and the names and locations of all First Nations communities and lands/waters that may be impacted; and
- A list of grievances or complaints brought by First Nations peoples against the company, with information on the company's response and any resolution; and
- A list of consultation processes carried out in the last year in which the company is seeking to obtain consent from First Nations communities that would be impacted by a business activity and the results of these processes.<sup>72</sup>

It could also set out best practice expectations for risk and impact management including engagement and agreements with First Nations people, relevant targets and metrics, regular performance reporting and overarching risk governance and accountability.

<sup>72</sup> These matters are drawn from a 2021 submission to the US Securities and Exchange Commission on the SEC's public consultation on Climate Change Disclosures, compiled by 22 US civil society groups including indigenous rights organisations: <https://amazonwatch.org/assets/files/2021-06-14-sec-esg-risk-comment-letter-indigenous-rights.pdf>

### ***Recommendation 3 – Mandatory Transition Planning for Climate (and Biodiversity)***

Transition plans provide stakeholders with qualitative information about a company's strategy to transition towards a sustainable future and can be used to require companies to develop goals, actions, and accountability measures to align their business activities (and associated impacts) with global goals and best practice expectations.

Following the developing EU model, selected companies could be mandated to prepare and disclose climate transition plans aligned with a specific temperature goal (e.g., 1.5°C). If this is not immediately feasible in Australia, the UK model (Example 2) provides an alternative template for mandating transition plans and providing associated best practice standards to ensure entities contribute to an economic transition that accounts for the Paris Agreement and a jurisdiction's own NDC. The UK approach could easily be adopted in Australia as part of mandatory climate risk disclosure standards developed by the AASB.

Given the likely introduction of broader mandatory sustainability reporting and specific standards for biodiversity risk reporting, as well as the Australian Government's strong support for the TNFD, there is also an opportunity to develop expectations in relation to biodiversity risk management, including requiring companies to prepare transition plans detailing their strategy to address biodiversity risks, reduce adverse impacts and enhance positive impacts on biodiversity in alignment with relevant global and national goals. Such an approach could build off the expectations set out in the draft EFRS E4 (Example 2 above).

Regular progress reporting on the implementation of sustainability transition plans would be expected as part of mandatory sustainability disclosures.

# 3 Directors' Duties

## 3.1 How are Directors' Duties relevant to corporate social and environmental performance?

The Board of Directors is the highest decision-making body within a company with a pivotal role in setting business strategy and overall monitoring. The courts have recognised that directors' actions can have profound effect on the community, as well as shareholders, employees, and creditors.<sup>73</sup>

The legal duties which govern directors in the exercise of their powers and functions are an important influence on the company's social and environmental performance to the extent that they establish:

- Requirements for directors to consider social and environmental risks and impacts; or
- Mandates or directions that allow or require directors to consider (and/or prioritise) the interests of various stakeholders in their decision-making and strategy development.

How directors consider different stakeholder interests is particularly important where short term, profit-driven considerations conflict with longer term considerations of the social and environmental impacts of particular decisions (especially where these impacts are not sufficiently covered by substantive environmental laws, modern slavery laws, cultural heritage protection and native title laws etc.).

For example, if directors' duties are framed and understood to oblige them to maximise profits for shareholders in the short term, directors will have little scope and incentive to take account of the social and environmental impacts of the company's activities or to make decisions in the long-term interests of the company.

If directors have discretion to take broader considerations into account, or are required or incentivised to do so, they may make decisions on business strategy that contribute positively to social and environmental outcomes even at the expense of short-term profits. This is particularly so if parties other than company shareholders have standing to enforce these duties.

There is a long running debate among Anglo-American corporate law scholars about the extent to which current legal duties require (or should require) company directors to:

- focus exclusively on (or at least prioritise) the interests of shareholders who provide financial capital to the company, which can serve to focus attention on short term considerations of maximising shareholder returns (this is commonly referred to as *shareholder primacy*); or
- consider the interests of a broader view of parties (e.g., employees, customers, creditors/lenders, the broader community, and the environment) either affected by the company or with a stake in the company and some influence over its success, which can serve to focus attention on broader, longer-term considerations of value creation that may place more emphasis on social and environmental performance (this is commonly referred to as *stakeholder theory or stakeholder capitalism*).<sup>74</sup>

More recent academic debate considers whether corporations laws should more explicitly **require** directors to prioritise the prevention and minimisation of social and environmental impacts above other considerations, in order to overcome the limitations of shareholder primacy and stakeholder capitalism and to meet evolving international norms and objectives for responsible business conduct, including those expressed through global sustainability agreements.<sup>75</sup>

<sup>73</sup> *ASIC v Healey* (2011) 196 FCR 291, 297.

<sup>74</sup> Shelley Marshall and Ian Ramsay, 'Stakeholders and Directors' Duties: Law, theory and evidence' (2012) 35(1) *UNSW Law Journal* 291, 292-293.

<sup>75</sup> Nick Grant, 'Mandating Corporate Environmental Responsibility by Creating a New Directors' Duty' (2015) 17(4) *Environmental Law Review* 252; Julia Maskill, 'Extending Directors' Duties to the Natural Environment: Perfect Timing for Greener Companies in Aotearoa New Zealand?' (2016) 22, *Auckland University Law Review* 281; Sarah E Light, 'The Law of the Corporation as Environmental Law' (2019) 71(1) *Stanford Law Review* 137, 141; Jacqueline Peel et al, 'Governing the Energy Transition: The Role of Corporate Law Tools' (2019) 36(5) *Environmental and Planning Law Journal* 459, 461-464; Christopher Bruner, 'Corporate Governance Reform and the Sustainability Imperative' (2022) 131(4) *The Yale Law Journal* 1217-1277, 1221; Shelley Welton, 'Neutralizing the Atmosphere' (2022) 132(1) *The Yale Law Journal* 171; The British Academy, *Principles for Purposeful Business: How to Deliver the Framework for the Future of the Corporation* (Report, 2019); Jim Chalmers, 'Capitalism after the Crises', *The Monthly* (online, February 2023) <<https://www.themonthly.com.au/issue/2023/february/jim-chalmers/capitalism-after-crises#mtr>>.

## 3.2 Current Australian Frameworks

### 3.2.1 Legal Obligations

The Corporations Act sets out several legal duties for company directors,<sup>76</sup> including the core duties described in Table 3.

**Table 3. Directors' duties under Australian Corporations Law**

Duty of Care and Diligence	Best Interests Duty	Duty of Disclosure
<p>Section 180(1) requires company directors to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable company director would exercise.</p> <p>This requires directors to inform themselves of foreseeable risks to company interests so that they can guide and monitor the management of the company, including considering and, in some cases, taking steps to address such risks. The degree of care and diligence required, and the types of measures expected, will depend on the nature, extent and foreseeability of the risks, as well as potentially competing considerations (e.g., expense and difficulty of counter measures). As such, the standard of care is a dynamic concept, shifting as the materiality of business risks changes over time.</p> <p>This duty does not require directors to take a particular course of action, nor does it impose liability for an incorrect commercial judgement. It focuses on the robustness of processes of information gathering and deliberation.<sup>77</sup></p> <p>A director who takes action (or decides not to act) based on an informed, rational assessment of the company's best interests, may be protected from liability for breach of the s180(1) duty by the statutory defence – the business judgement rule (s180(2)).</p>	<p>Section 181(1)(a) provides that directors must exercise their powers and discharge their duties in <b>'good faith in the best interests of the corporation,' and for a 'proper purpose.'</b></p> <p>In Australia, the High Court has interpreted the 'best interest of the corporation' to mean the best interests of shareholders as a general body.<sup>78</sup></p> <p>However, this does not preclude a director from considering the legitimate interests of non-shareholder stakeholders, if this is undertaken in the context of the company's long-term interests, including with a view to avoiding reputational harm.<sup>79</sup></p> <p>In certain limited contexts (e.g., where a company is facing insolvency) courts have held that the duty to act in the best interests of the company includes an explicit obligation to take into account the interests of creditors despite this not necessarily being in the best interests of shareholders.<sup>80</sup></p>	<p>As discussed in Part 2, company directors are required to sign off on financial statements and reports as complying with accounting standards and amounting to a 'true and fair representation' of the affairs of the company (ss295-7).</p> <p>Further, the Director's Report must be adopted by a resolution of directors, dated and signed, and constitutes a representation made by directors (s295(1)(c)).</p> <p>Representations of this nature made by directors (or indeed non-disclosure of material information) will often become the focus of allegations of misleading and deceptive conduct in company litigation. Directors can be directly liable (or liable as an accessory) for misleading disclosure in annual reports or in relation to other additional disclosure requirements.</p> <p>Misleading corporate disclosures can also be a 'stepping stone' to establishing liability for a breach of s180(1),<sup>81</sup> including in situations where directors have caused, permitted, or failed to take reasonable steps to prevent their corporation from making misleading statements (or omissions) to the market.<sup>82</sup></p>

<sup>76</sup> The core statutory duties noted in Table 3, along with s 182 (improper use of position) and s 183 (improper use of information) largely codify the common law on directors' duties.

<sup>77</sup> For a review of the relevant case law see Noel Hutley QC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties: Memorandum of Opinion* ('Hutley Legal Opinion (2016)'), (7 October 2016) 6-16; Sarah Baker, *Director's Liability and Climate Risk: Australia Country Paper* (Commonwealth Climate and Law Initiative Report, April 2018).

<sup>78</sup> *Ngurli Ltd v McCann* (1953) 90 CLR 425, 438 citing *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, 291; *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 135; *Pilmer v Duke Group Ltd* (in liq) (2001) 207 CLR 165, 178-179

<sup>79</sup> Bret Walker and Gerald Ng, *Australian Institute of Company Directors – the Content of Directors' "Best Interests" Duty: Memorandum of Advice* ('Walker and Ng Legal Opinion (2022)'), (24 February 2022); *Bell Group Ltd (in liq) v Westpac Banking Corporation* [2008] WASC 239, 534 (n.b. this decision was ultimately overturned on separate grounds); Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (Report, December 2006). Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (Report, June 2006).

<sup>80</sup> *Bell Group Ltd (in liq) v Westpac Banking Corporation* (No 9) (2008) 39 WAR 1.

<sup>81</sup> See, Noel Hutley QC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties: Further Supplementary Memorandum of Opinion* ('Hutley Legal Opinion (2021)'), (23 April 2021) 15.

<sup>82</sup> *Australian Securities and Investments Commission v Hellicar* [2012] HCA 17.

## Enforcement Options

There are three main avenues for enforcing compliance with directors' duties in Australia:

- **Public enforcement by regulators:** ASIC can bring enforcement actions for breach of duty (or misleading disclosure). Civil remedies (e.g., injunctions), civil penalties (pecuniary penalties, disqualification, compensation, and relinquishment orders) and criminal sanctions (e.g., imprisonment and substantial fines) are available (Corporations Act, Part 9.4, 9.4B).
- **Private enforcement by the company:** The company (or the company's liquidator if it is in liquidation) can apply to the court for a compensation order if a director has breached s 180(1) or s 181(1)(a) duties (Corporations Act, s 1317J).
- **Private enforcement by shareholders:** Shareholders have the option to seek the leave of the court to bring a derivative action against directors for breach of duty on behalf of the corporation (Corporations Act, s 236-7). Remedies may include an injunction ordering directors to remedy the breach of duty, or compensation payable to the corporation. Alternatively, a class of shareholders may bring a representative class action under Australia's securities class action regime, for example, for an award of damages for misleading disclosure (Corporations Act, Part IVA; *Federal Court of Australia Act* (1976)) (see also Part 2.2.1).

In cases which have considered directors' duties, Australian courts have typically been unwilling to intervene or second guess the judgement of directors on business issues. Instead, they have focused on processes of decision-making to determine whether directors have acted with reasonable care and diligence (s180 duty),<sup>83</sup> or the directors' motivation for reaching a decision to determine whether they were acting in the best interests of the company and for a proper purpose, with only particularly egregious behaviours (fraud, bad faith, or other serious failures) considered to amount to a breach of the s181 duty.<sup>84</sup>

### 3.2.2 How do directors' duties apply to social and environmental risks and impacts? – current practice

As recognition of the materiality of social and environmental risks like climate change has rapidly increased in recent years, so too has awareness about how directors' duties apply to these risks.

Much of the commentary in Australia has focused on how the s180 duty of care and diligence applies to climate-related material risks. Although this has not yet been directly tested in court, there is consensus among leading commercial law barristers,<sup>85</sup> regulators<sup>86</sup> and industry bodies,<sup>87</sup> on the general point that company directors, as part of their duty of due care and diligence, are required to inform themselves of foreseeable risks posed to company interests by climate change and must take proportionate measures to manage these risks. A failure to do so could expose directors to liability for breach of duty.<sup>88</sup> Legal opinions issued by Noel Hutley and Sebastian Hartford-Davis since 2016 (Box 8 below) illustrate the evolving standard of care in relation to climate-related risks.

#### Box 8. Climate Change – an evolving standard of care

In 2016, commercial law barristers, Noel Hutley and Sebastian Hartford-Davis, published their first opinion on directors' duties and climate change. This recognised increasing evidence of the extent and foreseeability of climate risks for a range of companies and sectors and argued that the s180 duty obliged directors to identify and assess climate-related risks where they were material to the company. It foreshadowed that company directors who fail to perceive, disclose, or take steps in relation to foreseeable climate-related risks that could be demonstrated to have caused harm to the company would face increasing litigation risk. The opinion noted that while in some cases directors should take further actions to manage material climate-related risks, the duty did not necessarily require directors to act in any particular way. When determining if the duty of care and diligence has been breached, a court will balance the potential benefits of the offending activity against the

<sup>83</sup> *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395, 449-50; *Australian Securities & Investments Commission v Cassimatis* (No. 8) [2016] FCA 1023 [479]-[487]; *Australian Securities & Investments Commission v Drake* (No. 2) [2016] FCA 1552 [395]-[401].

<sup>84</sup> *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 218 (pp J); *Westpac Banking Corporation v Bell Group Ltd (in liq)* (No. 3) (2012) 44 WAR 1, 170 [933] (Lee AJA), 353 [1988], 362 [2027], 371 [2073] (Drummond AJA) 566-7 [2923] (Carr AJA).

<sup>85</sup> Hutley Legal Opinion (2016); Noel Hutley and Sebastian Hartford-Davis, *Climate change and directors' duties* (Supplementary Memorandum of Opinion, Centre for Policy Development (*Hutley Legal Opinion (2019)*)) (26 March 2019); Hutley Legal Opinion (2021).

<sup>86</sup> See e.g. Australian Securities and Investment Commission (ASIC), *Climate risk disclosure by Australia's listed companies* (Report 593, 20 September 2018) 3; Cathie Armour, 'Managing Climate Risks for Directors' (*Australian Institute of Company Directors*, 1 Feb, 2021), <<https://aicd.companydirectors.com.au/membership/company-director-magazine/2021-back-editions/february/managing-climate-risk-for-directors>>. ASIC strongly advises directors to follow four high-level recommendations regarding climate risk disclosure and management: fully consider climate related risks in decision-making processes; develop and maintain strong and effective governance of climate related risks; comply with legal requirements to disclose climate-related risks (in the OFR) and other fora such as prospectus and continuous disclosure as appropriate; and consider reporting in line with TCFD recommendations to ensure the provision of useful information to investors.

<sup>87</sup> See e.g. Australian Institute of Company Directors (AICD), 'Coming to terms with the global climate crisis' (*Company Director Magazine*, AICD, 1 April 2020) <https://aicd.companydirectors.com.au/membership/company-director-magazine/2020-back-editions/april/coming-to-terms-with-climate-change>.

<sup>88</sup> Hutley Legal Opinion (2016).

risk of harm to the company, including considering “*the magnitude of the risk, the degree of probability of its occurrence, the expense, difficulty and inconvenience of taking alleviating action, and any other conflicting responsibilities which the director may have.*”<sup>89</sup>

A 2019 supplementary legal opinion articulated a range of emerging policy developments, increasing investor and community expectations, and scientific projections which evidenced that climate risks may manifest in the short- to medium-term (i.e., within 10 years), and which therefore elevated the standard of care expected of a reasonable director.<sup>90</sup> The opinion concluded: ‘*company directors who consider climate change risks actively, disclose them properly and respond appropriately will reduce exposure to liability. But as time passes, the benchmark is rising.*’

A further 2021 update noted that the standard of care expected of company directors continues to rise, and that there had been a discernible shift in focus from risk identification and assessment to risk management: ‘*it is no longer safe to assume that directors adequately discharge their duties simply by considering and disclosing climate-related trends and risks; in relevant sectors, directors of listed companies must also take reasonable steps to see that positive action is being taken: to identify and manage risks, to design and implement strategies, to select and use appropriate standards, to make accurate assessments and disclosures, and to deliver on their company’s public commitments and targets.*’<sup>91</sup> In particular, directors should take care to carefully align any public commitments on climate change (including net zero emissions targets) with the company’s operational strategy, as a failure to do so may expose directors for liability for misleading and deceptive conduct.<sup>92</sup>

Empirical research exploring company directors’ understanding of the links between their legal duties and social and environmental risks in Australia is limited. One study, reported in 2018, explored emerging stakeholder perceptions of directors’ duties to respond to climate change.<sup>93</sup> This study highlighted the growing acceptance that directors’ duties extend to identifying whether climate change poses material risks to a business and where such risks are identified, to consider and assess appropriate courses of action to manage them. However, it also underscored that the duty does not require directors to take any particular course of action to manage these risks. Participants highlighted a tendency at the time for directors to consider climate change as a long-term concern that did not affect shareholders’ immediate interests. Addressing climate change risks was not always seen as well aligned to the best interests of the company and particularly its shareholders – suggesting a *shareholder primacy* approach to understanding directors’ duties.

An earlier 2006 study reported that Australian directors claim to adopt a *stakeholder capitalism* approach when determining the best interests of the company in discharge of their duties, however shareholder interests were typically prioritised over those of other stakeholders.<sup>94</sup> Of 367 Australian directors surveyed, 44% prioritised the interests of shareholders above that of stakeholders (including the company, employees, customers, suppliers, lenders/creditors, the community, the environment, and the country) whilst 40.4% prioritised the interests of ‘*the company.*’ Only 0.6% and 0.3% of directors prioritised the environment and the community respectively. Whilst the researchers did not define ‘*the company,*’ participants seemingly considered it to be broader than shareholders given 55% said that acting in the company’s best interests meant balancing the interests of all stakeholders. Most directors (94.3%) considered that the law allows them to account for non-shareholder interests. This research separately showed that actions directly impacting the business (e.g., business growth, employee morale and productivity, reducing costs, fair treatment of employees) were the most important to directors, and contributing to society was of second lowest importance.

More recently, through a consultation with members undertaken in 2019, the Australian Institute of Company Directors (AICD) found that 49% of directors balance the interests of shareholders and stakeholders in fulfilling the best interests duty, noting that 32% of directors (or 44% for listed companies) consider stakeholder impacts are relevant to the interests of shareholders generally.<sup>95</sup> Expanding on these findings, the AICD has subsequently provided guidance for directors on how to practically act in the best interests of their companies (Box 9).

<sup>89</sup> Hutley Legal Opinion (2016), 16-17.

<sup>90</sup> Hutley Legal Opinion (2019), 3-8.

<sup>91</sup> Hutley Legal Opinion (2021), 2-3.

<sup>92</sup> Ibid, 11-15. ASIC has also alerted company directors to their potential liability exposure for greenwashing: Cathie Armour (ASIC Commissioner), ‘What is greenwashing? and what are its potential threats?’ (News article) <<https://asic.gov.au/about-asic/news-centre/articles/what-is-greenwashing-and-what-are-its-potential-threats/>> accessed 26 July 2022.

<sup>93</sup> Jacqueline Peel et al., ‘Governing the Energy Transition: The Role of Corporate Law Tools’ (2019) 36(5) *Environmental and Planning Law Journal* 459; Brett McDonnell et al., ‘Green Boardrooms?’ (2021) 53(2) *Connecticut Law Review* 335.

<sup>94</sup> Meredith Jones et al., ‘Corporate Governance, Shareholder Primacy and the Interests of Employees: Evidence from a Survey of Australian Directors’ in Shelley Marshall, Ian Ramsay and Richard Mitchell (eds), *Varieties of Capitalism, Corporate Governance and Employees* (Melbourne University Publishing, 2009) 130.

<sup>95</sup> Australian Institute of Company Directors, *Forward Governance Agenda: Results of Member Consultation* (Report, August 2019) 12.

### **Box 9. AICD Guidance to Directors on Company and Stakeholder Interests**

Practice Statement on Bests Interests Duty in Practice – AICD acknowledges that while certain shareholders may focus on short-term financial returns, most investors take a long-term view and prioritise sustainable value creation. Accordingly, although directors do not owe a specific duty to broad company stakeholders, the long-term interests of the company (including the interests to avoid reputational harm) mean “*employees, customers, suppliers, creditors, Traditional Owners, the environment and broader community are legitimate concerns of company directors.*” AICD highlights that shareholder and stakeholder expectations for companies to reduce their environmental impacts, respect Traditional Owners’ rights, and address modern slavery risks as examples of long-term company interests. Despite noting that there will be times that shareholders and stakeholder interests may conflict, AICD does not provide specific guidance on how to reconcile, balance, or otherwise respond to those conflicts. Rather, it asserts that as a guiding principle, directors should take a long-term view of where the company’s interests lie while maintaining a collegiate and open relationship with stakeholder groups.

### **3.2.3 Likely Developments**

Emerging developments in climate litigation and legal opinion highlight the broadening scope of environmental and social issues considered relevant to directors’ duties and the evolving standard of care expected in relation to these issues which increasingly requires directors to act to address and mitigate risks and impacts. These developments strengthen incentives for directors to address and improve corporate social and environmental performance.

#### **Litigating Directors Duties and Climate Change**

Litigation is emerging internationally that seeks to enforce directors’ duties as a pathway to hold directors accountable for their companies’ climate impacts and compel companies to reduce their GHG emissions in line with global climate goals (Box 10 below). This litigation is based on the argument that climate-related transition and reputational risks have manifested in the short term, and it would be a breach of directors’ duties to fail to address these risks.

### **Box 10. Client Earth v Shell’s Board of Directors**

In 2023 after purchasing shares in Shell, public interest environmental law group ClientEarth filed a derivative action against Shell’s board, alleging that the company’s 11 directors breached their duties under UK corporate law by failing to ‘*adopt and implement an energy transition strategy*’ in line with the Paris Agreement. Like Australia, under UK law, company directors have duties to promote the success of the company and to act with due care and diligence.

Shell claims that the company strategy, which includes a net zero emissions plan with a 2050 target, is consistent with the Paris Agreement’s goals of limiting temperature rise to 1.5°C. However, independent assessments by *ClimateAction100+* highlight that the strategy excludes short to medium-term targets to reduce the companies’ scope 3 emissions that equate for 90% of its overall emissions. Further, the net emissions of the Shell group are calculated to only fall by 5% by 2030. This is inconsistent with an order issued by the Hague District Court in the Netherlands against Royal Dutch Shell in 2021 to reduce emissions by a net 45% by 2030 across its own operations and scope 3 emissions. This case – *Milieudefensie et al v Royal Dutch Shell* (2021) – found Shell’s failure to take adequate and proportionate action to curb GHG emissions was in breach of the duty of care owed under the Dutch Civil Code and European human rights obligations.

ClientEarth alleged therefore that Shell’s directors are failing to properly manage the company’s climate risks. They sought a declaration ordering the board to adopt a strategy to manage climate risk in line with the UK directors’ duties and with the order of the Hague District Court.

In May 2023, the UK High Court dismissed the case on the grounds that Shell did have a plan to manage climate-related risks and, ultimately, it is for the directors to consider how best to promote the success of a company. The judge also noted that ClientEarth was a minority shareholder, holding only 27 shares, and claimed its ‘*real interest is not in how best to promote the success of Shell for the benefit of its members as a whole.*’ ClientEarth has subsequently been granted an oral hearing to ask the judge to reconsider the issues.

## Biodiversity Impacts & Directors Duties

Biodiversity loss is beginning to be understood and treated by markets as a potential material risk to companies. As such companies' impacts on biodiversity and nature are gradually being recognised as relevant considerations for company directors in the exercise of their duties (see e.g., Boxes 11 and 12).<sup>96</sup>

### Box 11. Directors Duties to manage Nature-related Risks, Impacts and Dependencies in Australia

Barrister, Sebastian Hartford-Davis, and lawyer, Zoe Bush, released a legal opinion in early November 2023, examining the extent to which the s180 duty of care and diligence extended to considering, disclosing, and managing nature-related risks.<sup>97</sup> **Nature-related risks** were defined to include the “*potential threats posed to an organisation that arise from its and wider society’s dependencies and impacts on nature.*” Relying on TNFD definitions, nature-related dependencies were defined as the “*aspects of ecosystem services that a company relies on to function;*” and nature-related impacts were defined as “*changes in the state of nature, which may result in changes to the capacity of nature to provide social and economic functions, including ecosystem services.*”

The opinion noted that Australia’s economy was broadly exposed to risks from nature degradation and, although risks will differ depending on a company’s sector and unique circumstances, nature-related dependencies and impacts were capable of posing a foreseeable risk to company interests. Recent international developments, including the Global Biodiversity Framework and TNFD, were noted as relevant catalysts for potential, local regulatory developments and shifting market expectations.

The opinion concluded that at a general level directors should be requiring management to identify nature-related dependencies and impacts so that they can consider the potential risks posed to the company. Directors were cautioned against assuming that nature-related impacts and financial interests were distinct from each other. It was further noted that risks to the company were not limited to short-term financial interests but extended to any interests of the company.

Similar to the Hutley and Hartford-Davis’ opinions on climate change (Box 8 above), this opinion concluded that the duty of care and diligence does not necessarily require that companies cease any of the activities that give rise to nature-related risks. However, depending on the company and its circumstances, some action beyond merely considering the risks will be required. At a minimum, directors must make an informed decision in light of nature-related risks.

Further, regardless of what action is taken to manage or mitigate nature-related risks, directors should consider disclosing identified nature-related dependencies or impacts. Even if these risks are not found by the company to be financially material, disclosure would be required where such information would (or would be likely to) influence investor decisions to acquire or dispose of company securities. Additionally, the opinion referred to the potential application of the EU’s CSRD to approximately 600 Australian companies which may require them to disclose nature-related impacts regardless of materiality (Example 1 above). Directors could potentially be liable for breach of s 180 where their company contravenes such requirements as a consequence of a failure to exercise reasonable care and diligence.

### Box 12. Directors Duties to manage Nature-related Risks in New Zealand

Law firm, Chapman Tripp, released a legal opinion in March 2023 which highlighted the dependency of NZ’s economy on natural capital and the vulnerability of primary production, tourism, and manufacturing sectors to the degradation of natural capital.<sup>98</sup> Two general categories of nature-related risks were identified:

**Dependency risks:** companies may face risks to their value or viability where they are directly or indirectly dependent on nature and there is a failure, interruption, or reduction in the natural services on which they rely.

**Transition risks:** companies may face risks from regulatory and policy changes, technological advancements or market consumer preferences resulting from increased awareness of the biodiversity loss and nature crisis. Notably, this may create risks for companies with direct or indirect impacts on nature (i.e., adverse effects on habitats, species ecosystems and associated cultural values) where policy and regulatory reforms seek to address these impacts.

Chapman Tripp concluded that NZ’s duty of care and diligence requires directors to ensure that their companies identify and manage nature-related risks, including risks to natural capital, where those risks are foreseeable and potentially material to the business.

<sup>96</sup> Australian Conservation Foundation, Pollination, and Australia Ethical, above n 61, 33. This report argues that nature-related risks may be relevant to the duty of care and diligence and directors should therefore consider both physical and transition risks from nature loss.

<sup>97</sup> Sebastian Hartford David and Zoe Bush, *Nature-related risks and Directors’ Duties – Joint Memorandum of Opinion* (24 October 2023)

<sup>98</sup> Chapman Tripp, *New Zealand Directors Duties to Manage Nature-Related Risk and Impact on Natural Capital* (Legal Opinion, March 2023).

It noted that the emergence of TNFD and other reporting frameworks would propel companies understanding of risk to natural capital, and this would be complimented by growing investor concern (e.g., from Nature Action 100+) as well as increasing litigious and regulatory action on biodiversity. Formal shareholder complaints to ANZ bank about the need to report on nature risks and impacts provide an emerging example.<sup>99</sup>

Notably, Chapman Tripp argued that directors' duties currently only extend requirements to identify, understand, and manage risks *to the company* and while a company may adversely impact nature and biodiversity, those impacts may not yet rise to the level of materiality to trigger the duty of care and diligence. However, this may change as biodiversity policies develop and shareholder understanding of nature-related impacts increases.

Briefly addressing the intersection of nature-related risks and NZ's equivalent 'best interests' duty, Chapman Tripp argued that proceedings could potentially be brought against a director under this provision if they deliberately did not engage with a foreseeable and material nature-related risk.

### First Nations and Human Rights Abuses & Directors Duties

Investor expectations regarding corporate performance in relation to First Nations rights and related risk management have increased recently, with growing recognition that businesses which fail to respect First Nations rights face material business risks.<sup>100</sup> Investor reactions to the destruction of Juukan Gorge by Rio Tinto is illustrative, but also highlights that breaches of First Nations and broader human rights are commonly only addressed after they have occurred and only particularly egregious impacts will trigger investor responses.<sup>101</sup>

Nonetheless, with the increasing recognition of materiality, comes the potential to rely on directors' duties to prevent companies from engaging in, or continuing, activities or projects that harm or could harm First Nations rights. For example, a recent complaint to Australia's four largest banks, alleging human rights grievances in conjunction with bank loans issued to Santos for the development of the Barossa and related oil and gas projects in the waters of the Northern Territory, could pave the way for future breach of duty claims (Box 13).<sup>102</sup>

#### Box 13. First Nations Complaint – Santos loans

In April 2023, Equity Generation Lawyers issued letters complaining of human rights grievances to Australia's Big Four Banks in relation to loans granted to Santos that can be used by Santos to develop gas fields in waters of the Northern Territory as well as an LNG extension project. The claimants, who are leaders, elders, members and Traditional Owners of the Tiwi Islands and Larrakia country, allege that the projects threaten several sacred sites, marine resources and seabed and therefore will violate their economic, social and cultural rights as First Nations peoples recognised under international treaties, such as UNDRIP and the International Covenant on Civil and Political Rights. It is further alleged that the claimants never provided FPIC for the projects as required under UNDRIP and the *Indigenous and Tribal Peoples Convention 1989* (No. 169). The claimants allege that the banks are contributing to adverse human rights impacts by providing loans to Santos in breach of their responsibilities under the United Nations Guiding Principles on Human Rights and their own internal policies.

Although the grievance letters are not currently couched as a breach of directors' duties, it is foreseeable that if the banks progress these loans, further litigation may be brought on the basis that the directors did not consider the reputational risks from funding the project and failed to act in the best interests of the company in the long term.

### 3.3 Limits and Challenges with Existing Legal & Regulatory Framework

**Material Risk Framing** – The way in which directors' duties are legally defined and interpreted in Australia has the effect of imposing limited requirements on directors to consider social and environmental issues only where they pose material risks to company interests, with considerable discretion afforded in terms of responding to these issues. The section 180 duty of care and diligence is procedural in nature: it requires directors to be able to demonstrate that they have considered social and environmental risks to the company and taken steps to manage those risks, as opposed to obligating them to take certain actions to mitigate those risks.

<sup>99</sup> James Eyers, 'ANZ under pressure to reveal biodiversity risk', *Australian Financial Review* (online, 29 August 2022) <<https://www.afr.com/companies/financial-services/anz-under-pressure-to-disclose-biodiversity-risk-in-annual-report-20220826-p5bd2r>>.

<sup>100</sup> Global Compact Network, KPMG, UTS, *The Australian Business Guide to Implementing the UN Declaration on the Rights of Indigenous Peoples* (Nov 2020), 14.

<sup>101</sup> For example, investor scrutiny of Rio Tinto's governance processes in relation to First Nations issues only occurred following Rio Tinto's destruction of the Juukan Gorge.

<sup>102</sup> See for example, Equity Generation Lawyers, *Human Rights Grievance to ANZ* (Complaint Letter, 4 April 2023).

For matters like climate change, where company risks increasingly intersect with company impacts (i.e., heavy emitters potentially face greater transition and reputational risks), directors should now arguably be considering a range of activities to avoid and mitigate those impacts (i.e., reducing emissions). However, what is legally required is a thorough consideration and assessment of appropriate course of action with respect to the company's interests. The duty of care and diligence and associated business judgment rule defence provides directors with relatively large discretion concerning responses to climate risks.

As such, it is reasonably open for directors to decide to continue to pursue climate-damaging activities as part of their business model if the risks associated with these activities can be appropriately managed (e.g., through sufficient diversification of business activities, and investment of resources and capital in developing alternatives over time). Indeed, as the initial decision in *ClientEarth v Shell's Board of Directors* (Box 10) shows, courts may consider it sufficient that directors have taken some action in response to the risks rather than taking a course of action to align business activities with the goal of limiting temperatures to 1.5°C. There is a potentially very significant mismatch between the pace and scale of change required to meet climate change targets established by the international Paris Agreement and the pace and scale of risk management approaches that an individual company engaged in climate-damaging activities may adopt to manage the risks posed to their business by climate change.

Greater limitations arise for biodiversity loss and human rights impacts, as these issues are not broadly accepted by the market as systemic risks and the impacts of offending business activities do not yet easily translate to material risks posed to company interests.

**Shareholder primacy** – The current legal position on the section 181 'best interests' duty is that directors have the scope and discretion to make decisions to improve corporate social and environmental performance if they can establish that such a course of action is beneficial and generates wealth for the company in the long term. As a matter of law, directors are not confined to maximising profits or shareholder returns *in the short-term*.<sup>103</sup> Indeed, the best interest duty *allows* directors to consider stakeholder interests and provides considerable discretion over the factors they consider when determining the company's best interests (e.g., the environment and impacted communities).<sup>104</sup>

Nevertheless, the available empirical evidence set out in Part 3.2.2 corroborates arguments that a narrow, short-term focus on profit maximisation has become the social norm,<sup>105</sup> and seemingly suggests that Australian company directors prioritise shareholder interests above taking actions to positively contribute to social and environmental outcomes. Indeed, where public facing and heavily scrutinised companies are proceeding with expansionary fossil fuel projects in conflict with the goals of the Paris Agreement, it is apparent that the permission to consider stakeholder interests is insufficient to incentivise improved corporate social and environmental performance at the extent and pace necessary to achieve global climate goals.

Even where directors claim to consider broader stakeholders' interests to inform their consideration of the long-term interests of the company, there is limited evidence of how they balance and trade-off short-term against longer term considerations in various decision-making contexts. With the pool of relevant stakeholders expanding,<sup>106</sup> boards are expected to manage and balance an increasing number of matters including but not limited to sustainability. Multiple expectations can overwhelm a board and lead to insufficient resourcing to address social and environmental impacts.<sup>107</sup>

**Enforcement challenges** – The above limitations are further compounded by the ways in which directors' duties can be enforced and which parties have standing to bring a claim for breach of duty (i.e., ASIC or company shareholders). Given the legal and practical hurdles associated with bringing a shareholder derivative action, there are perhaps few situations where shareholders are likely to bring an action against directors for a failure to consider long term and broader considerations in ways which have affected their interests. Strategic public interest litigants are an exception, as the recent Shell case illustrates, however may struggle to establish that they are acting in the interests of shareholders 'as a whole' (Box 10).

ASIC has in the past issued civil penalty proceedings against directors for breach of duty where their actions have exposed their companies to potential breaches of the law in circumstances where the so-called victim is not the company itself, nor its shareholders. For example, in *ASIC v Cassimatis (No 8)*, the directors of Storm Financial Limited, a financial advice company, were found to have breached the s

<sup>103</sup> Beate Sjøfjell, 'Beyond Climate Risk: Integrating Sustainability into the Duties of the Corporate Board' (2018) 23 *Deakin Law Review* 41, 49.

<sup>104</sup> Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (Report, December 2006); Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (Report, June 2006).

<sup>105</sup> Beate Sjøfjell et al, 'Shareholder Primacy: The Main Barrier to Sustainable Companies' in Beate Sjøfjell and Benjamin J. Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, 2015).

<sup>106</sup> Governance Institute of Australia, *The Future of the Governance Professional* (Report, April 2019) 10.

<sup>107</sup> Governance Institute of Australia, *Future of the Board* (Report, November 2021) 8-11.

180 duty of care and diligence by permitting their company to provide advice to its clients in breach of the Financial Services Disclosure provisions of the Corporations Act.<sup>108</sup> Arguably ASIC's action in this matter was designed to seek redress for the purchasers of Storm's financial products, who suffered significant losses, rather than for the company itself or its shareholders, even though the directors' action or inaction would contribute to indirect, longer term and reputational harms.

ASIC is yet to bring such an action alleging that directors have breached their duty of care by exposing their company to the risk of breaching environmental protection legislation. While ASIC's strategic priorities have recently expanded to encompass sustainable finance and it has received additional budget to resource such work, ASIC appears to be narrowly focusing on scrutinising greenwashing by financial institutions and regulating sustainability disclosures. It appears unlikely that ASIC would consider bringing an action against directors in relation to the breach of environmental laws in the near future. In any case, given the limitations of substantive environmental and other relevant law in Australia, such an action would be unlikely to drive improved corporate social and environmental performance which is more focused on moving companies beyond-compliance to align with emerging social and environmental norms and objectives.

### 3.4 Alternative Models

Australian corporations law shares many similarities with other Anglo-American jurisdictions, including a dominant shareholder primacy approach to the interpretation of the 'best interests' duty. This can be distinguished from some European and Asian countries where stakeholder capitalism is more dominant. The alternative models profiled here draw largely on Anglo-American jurisdictions but include examples which depart (to varying degrees) from the shareholder primacy model in ways which may incentivise improved corporate social and environmental performance.

#### **Example 3. United Kingdom – an enlightened shareholder value approach?**

Directors' duties under the *Companies Act 2006* (UK) were reformed in the early 2000s with the aim of shifting corporate governance beyond a shareholder primacy approach. The directors' duty to promote the success of the company now explicitly adopts an **enlightened shareholder value** approach, requiring directors to consider other stakeholders in any assessment of the company's best interests.

Section 172 requires a director to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole (i.e., shareholders). In doing so, directors are required to have regard to:

- the likely consequences of any decision in the **long term**,
- employees' interests,
- the need to foster business relationships with suppliers, customers and others,
- **the impact of the company's operations on the community and the environment**,
- the desirability of maintaining a reputation for high standards of business conduct, and
- the need to act fairly between company members.

This approach mirrors how Australian company directors purport to interpret and discharge their duty in practice. However, it codifies these interpretations by explicitly including a statutory direction to account for broader stakeholder and longer-term considerations and referencing social and environmental impacts as relevant to directors' duties.

Obligations to produce an annual, strategic report are also explicitly linked to the duty to promote the success of the company. The purpose of the strategic report is to inform members on how directors discharged their s 172 duty. It must contain information about the impact of a company's activities on environmental matters, employees, social matters, respect for human rights, anti-corruption and anti-bribery matters (ss 414A-414CB). The *UK Corporate Governance Code* (2018) (which operates similarly to the *ASX Corporate Governance Principles and Recommendations*) further provides that the board should understand the views of the company's key stakeholders (beyond shareholders) and describe in the annual report how their interests and the matters set out in s 172 of the Companies Act have been considered in board discussions and decision-making.

<sup>108</sup> ASIC v Cassimatis (No 8) [2016] FCA 1023. This decision was upheld on appeal: Cassimatis v ASIC [2020] FCAFC 52.

There is some evidence that the practical impact of these reforms has been minimal and that UK directors still consider their overriding objective is to maximise shareholder profits.<sup>109</sup> This can be explained by the broad scope of the duty and the way the additional considerations are expressed in a hierarchy, effectively placing longer term, community and environmental considerations subordinate to the overarching duty to promote the company's success for its members' benefit, as well as providing no guidance on how directors should balance competing considerations.<sup>110</sup>

Furthermore, non-shareholder stakeholders are provided with no remedy in cases where directors fail to take account of their interests. Accordingly, unless shareholders or the company bring an action against directors, there is limited legal recourse for impacted communities and civil society to hold directors accountable for adverse impacts.<sup>111</sup>

#### **Example 4. Canada – an entity theory model**

At first instance, the legislative text of Canada's equivalent 'best interests' duty reflects a similar approach to Australia. However, judicial interpretations of the duty present a modest evolution away from shareholder primacy.

Section 122(1)(a) of the *Canada Business Corporations Act* RSC 1985, c 44 states that every director, in exercising their powers and discharging their duty shall act honestly and in good faith with a view *to the best interests of the corporation*. Section 122(1.1), notes that directors can consider the interests of shareholders, employees, the environment, and the long-term interests of the corporation when acting in it is best interests but are neither required to nor limited to only considering these stakeholders.

In interpreting this duty, the Canadian Supreme Court has held that a company's best interests are not confined to those of its shareholders<sup>112</sup> and directors should not solely pursue short-term profit.<sup>113</sup> Rather than prescribing how to resolve stakeholder conflicts, the court articulated that company directors should treat stakeholders fairly in alignment with companies' *'duties as a responsible corporate citizen'*.<sup>114</sup>

Notably, however, standing to bring an action for breach of this duty does not extend to environmental groups or affected communities. Like Australia, shareholders can bring a derivative action on behalf of the company to enforce a breach of duty.

No available study has examined the practical implications of these judicial interpretations of directors' duties. However, by expanding companies' interests to those of the environment alongside shareholders, and requiring directors to consider societal objectives, Canada's framework may establish broader grounds for shareholders to hold directors accountable for adverse social and environmental impacts and aligning corporate social and environmental performance with global sustainability agreements.

#### **Example 5. EU – rejected proposal to clarify directors' duties**

Following a comprehensive study into the application of directors' duties in the EU, the European Commission recognised a tendency across European states for directors to favour maximising value for shareholders in the short term over making their businesses more sustainable in the long-term in line with sustainability objectives of the EU.<sup>115</sup> The study analysed a variety of reforms that would have the effect of requiring directors to balance stakeholder interests and identify and mitigate sustainability risks and impacts (including through explicit directors' duties).

The European Commission subsequently proposed that a directive should be introduced to clarify that directors' duties to act in the best interest of the company requires them to consider human rights, climate change and environmental consequences in the short-, medium- and long-term. This proposal was supported by the European Parliament but rejected by the European Council. Whether or not it is passed will be determined by ongoing negotiations.

<sup>109</sup> David Collison et al, *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence* (Report, 2011) 41-42.

<sup>110</sup> Andrew Keay, "Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado about Little?" (2011) 26 *European Business Law Review* 1; John Lowry, "The Duty of Loyalty of Companies Directors: Bridging the Accountability Gap through Efficient Disclosure" (2009) 68 *The Cambridge Law Journal* 607; Janet Dine, "Corporate Regulation, Climate Change and Company Law: Challenges and Balances in an International and Global World" (2015) *European Business Law Review* 173-202.

<sup>111</sup> Andrew Keay, "Tackling the Issue of Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'" (2007) 29(4) *Sydney Law Review* 577, 605-608.

<sup>112</sup> *Peoples Department Stores Inc. (Trustee of) v Wise* [2004] 3 SCR 461, [42].

<sup>113</sup> *BCE Inc. v 1976 Debentureholders* [2008] 3 SCR 560, [38].

<sup>114</sup> *Ibid*, [81]-[83].

<sup>115</sup> European Commission and EY, *Study on Directors' Duties and Sustainable Corporate Governance* (Final Report, July 2020).

## Novel sustainability duties

Legal scholars have argued that explicit sustainability duties for company directors could help overcome the challenges associated with shareholder primacy and stakeholder capitalism and better align corporate decision-making and activities with the goals of global sustainability agreements.

For example, Ben Richardson proposed that Australian Corporations Law be amended to ensure that company directors would not be found liable for a breach of duty for making a decision to improve the company's current and future social and environmental performance even in situations where this may not directly align with the short-term profit generation goals of certain shareholders (an environmental judgement rule). He also proposed that a general environmental duty be added to the Corporations Act to require Australian company directors to take all reasonable steps to prevent environmental harm and to improve their environmental performance.<sup>116</sup>

Julia Maskill has proposed similar reforms to NZ corporate law to include a statutory duty on company directors to avoid causing or contributing to environmental degradation even where there may be negative financial impacts for the company, in addition to codifying that acting in the best interests of the company requires directors to accord appropriate weight to the interests of environmental sustainability, includes considering the long-term interests of the company and does not oblige directors to maximise profits.<sup>117</sup>

In arguing against the social norm of shareholder primacy, Beate Sjøfjell (and various colleagues) proposed that corporate laws globally should be reformed to integrate sustainability into the duties of boards.<sup>118</sup> More specifically in the context of Nordic corporate law, she proposed that corporate legislation should specify that companies' overarching purpose is to create sustainable value through the balancing of the interests of shareholders and other stakeholders *within planetary boundaries*. She further proposed that directors' duties be reformed to stipulate a clear obligation to promote the redefined purpose of the company and ensure its impact stays within planetary boundaries. Additionally, she proposed that legislation should state that the duties of the board include setting the company's strategy and supervising management of which the latter requires the board to establish, implement and maintain due diligence systems throughout the company, the entities, and activities it controls, and its regular suppliers and supply chains to ensure the business remains safely within planetary boundaries.<sup>119</sup>

Building on this concept, John Quinn suggested that any new directors' duty focused on sustainable value creation should apply an objective standard (e.g., would a reasonable director honestly believe the decision was taken to promote sustainable value creation) to ensure directors are aware of the reasonable limits placed on discretionary decision-making. To further disrupt the cultural norm of shareholder primacy, he suggests that this duty should be enforceable by public authorities whose consideration extends beyond economic concerns to environmental and social sustainability.<sup>120</sup>

Nick Grant, writing in the context of US corporate law, proposed that a separate directors' duty be legislated that requires directors to *'take their best endeavours'* to achieve specific environmental targets set by an external, environmental regulator. Under this approach, the regulator would be responsible for monitoring compliance with the relevant targets.<sup>121</sup> Such an approach could offer a mechanism to more closely link the goals of global sustainability agreements and their national interpretations to expectations of corporate performance.

For the above duties to be more than symbolic, consequences for breaches would need to be introduced including either provisions to disqualify directors for improper social or environmental conduct or third-party enforcement rights for social or environmental advocacy organisations or an external sustainability regulator alongside shareholders.

### 3.5 Reform Opportunities

The building momentum around sustainable finance reform in jurisdictions around the world, including Australia,<sup>122</sup> and the increasing focus on the role that the private sector must play in achieving the global sustainability goals, offers an important window of opportunity to consider and debate reforms to directors' duties. Indeed, in its initial consultation on a sustainable finance strategy, the Australian Government has sought feedback on whether directors' duties present any barriers or challenges to companies integrating sustainability-related issues in financial decision making.<sup>123</sup>

<sup>116</sup> Ben Richardson, *The Private Sector, Business Law and Environmental Performance* (2007)

<sup>117</sup> Julia Maskill, above n 75.

<sup>118</sup> Beate Sjøfjell et al, above n 105; Beate Sjøfjell, above n 103 58-61.

<sup>119</sup> Beate Sjøfjell and Jukka Mähönen, 'Upgrading the Nordic Corporate Governance Model for Sustainable Companies' (2014) 11(2) *European Company Law* 58, 59-60.

<sup>120</sup> John Quinn, 'The Sustainable Corporate Objective: Rethinking Directors' Duties' (2019) 11(23) *Sustainability* 6734.

<sup>121</sup> Nick Grant, above n 75.

<sup>122</sup> Jim Chalmers, above n 75; Jim Chalmers, 'Address to the Australian Sustainable Finance Institute' (Speech, 12 December 2022).

<sup>123</sup> Australian Government Treasury, above n 41. Treasury earlier articulates that, in the Government's view, company directors' duties to act in the best interests of the company enable, and in many circumstances require, directors to actively integrate sustainability considerations into corporate decision-making and governance.

The recommendations below represent progressive levels of ambition. Recommendation 3 seeks to reinforce the existing legal position in Australia that directors can legitimately consider environmental and social risks and impacts and make decisions to improve corporate social and environmental performance where this is in the best interests of the company (consistent with *stakeholder capitalism*). Recommendation 4 draws on the work of scholars such as Ben Richardson, Beate Sjøfjell, John Quinn and Nick Grant, and sets out a more ambitious reform which would require more proactive consideration of adverse environmental and social risks and impacts by directors, as well as taking steps to prevent such impacts occurring and to align company business with global sustainability goals.

#### **Recommendation 4 – Provide for a sustainability judgement rule**

Under the current legal framework, company directors certainly have the scope to consider social and environmental risks and impacts in acting in the best interest of the company. However, pressures to focus on short-term financial interests are pervasive.

The current business judgement rule (s180(2)) protects company directors from liability for breach of the duty of due care and diligence where they act (or decide not to act) based on an informed and rational assessment of the company's best interests. To reinforce the relevance of current and future social and environmental performance and other longer-term considerations to the best interests of the company, a sustainability judgement rule could be added to the Corporations Act. This would provide that company directors would not be liable for a breach of duty for making a decision to improve the company's current and future social and environmental performance even in situations where this may not directly align with the short-term profit generation goals of certain shareholders. This would further protect directors from any challenge by the company, the company's liquidator or shareholders via a derivative suit claiming that directors were failing to act in their best (short term) interests. It would also provide additional signalling to directors and to courts around what is expected of directors in relation to the integration of sustainability considerations in decision-making.

#### **Recommendation 5 – A general sustainability duty (linked to global goals and planetary boundaries)**

An additional, stand-alone sustainability duty could be added to the Corporations Act to require company directors to take all reasonable steps to prevent social and environmental harms and to improve their social and environmental performance. Such a duty could help to address emerging environmental and social issues not well covered by current substantive environmental, human rights and other substantive laws, as well as encourage a more precautionary risk management approach focused on preventing harms. A similar outcome may be possible through mandatory due diligence laws depending on their design and implementation (Part 4.3).

A general sustainability duty could be modelled on the statutory duty of care that has now been legislated in various Australian state jurisdictions under environmental protection legislation (e.g. *Environment Protection Act 2017* (Vic)). It would go beyond the existing duty for all company directors to ensure compliance with relevant environmental laws, and otherwise report any non-compliance (s299(1)(f)) and would specifically target *beyond compliance* concepts of managing risks and preventing harm.

For example, the Victorian 'general environmental duty' requires 'people engaging in activities that may give rise to risks of harm to human health or the environment from pollution or waste to understand those risks and take reasonably practicable steps to minimise them.' Breaches of the duty attract civil and criminal penalties, with more serious penalties available in cases of intentional or reckless conduct. The duty is supported by best practice guidelines focused on risk management and harm prevention, which set out how a duty-holder can establish they have taken all reasonably practicable steps to minimise harm.

Such a duty could be further strengthened by explicitly specifying in law that a company's overarching *purpose* is to create sustainable value by balancing the interests of shareholders and other stakeholders and operating in accordance with social and environmental parameters (e.g., net-zero and nature-positive parameters as set out in global sustainability agreements), and that in acting in the best interest of the company, directors have a clear obligation to promote this purpose and ensure the company's impacts do not exceed these parameters.

**Enforcement** – Relying on shareholders to enforce the duty may not be effective, unless investors have sufficient incentives to monitor whether an investee company is operating within social and environmental parameters. ASIC would also arguably need a broader mandate and additional, internal expertise to scrutinise and enforce such a duty. It may be more appropriate for a separate, corporate sustainability regulator to be responsible for monitoring performance and enforcing compliance. Third party enforcement rights could also be considered.

# 4 Mandatory Human Rights and Environmental Due Diligence Laws

## 4.1 How do human rights and environmental due diligence laws influence corporate social and environmental performance?

Mandatory human rights and environmental due diligence (mHREDD) laws are an emerging form of business regulation focused on transnational supply chains.

In contrast to existing disclosure obligations and directors' duties under Corporations Law (Parts 2 and 3), HREDD involves companies focusing on actual and potential risks and impacts posed to *people* and to *the environment*, not on the associated financial risks posed to the company or the best interests of the company. Further, in principle, the scope of a company's due diligence responsibilities extends beyond its own operations to cover adverse human rights or environmental impacts that companies cause or contribute to through their own activities, or which may be directly linked to the company through its business relationships.

mHREDD laws draw on the concept of human rights due diligence (**HRDD**), developed in two interrelated instruments adopted by the UN Human Rights Council: '*Protect, Respect and Remedy*' Framework and UN Guiding Principles on Business and Human Rights (**UNGPs**). These instruments are organised according to three pillars: (1) the state duty under international law to protect against human rights abuses by third parties including business enterprises through appropriate policies, regulation, and adjudication; (2) the corporate responsibility to respect human rights, which means business should 'avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; and seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts';<sup>124</sup> and (3) the need for effective access to judicial and nonjudicial remedies for victims.

Under the UNGPs, HRDD is framed as the means through which business entities can 'know and show' they are meeting their responsibility to respect human rights.<sup>125</sup> HRDD includes four steps: assessing actual and potential adverse impacts in an entity's own activities, supply chains and business relationships; acting upon the findings; tracking the effectiveness of responses; and communicating how impacts are addressed.

As originally formulated in the UNGPs, HRDD requires companies to consider actual and potential adverse impacts on internationally recognised human rights. These include, at a minimum, those rights recognised in the *International Bill of Human Rights and the ILO Declaration on Fundamental Principles and Rights at Work*.<sup>126</sup> However, international standards on responsible business conduct such as the *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (OECD Guidelines)*<sup>127</sup> and emerging national and regional regulatory initiatives (both discussed further below) are increasingly integrating various forms of environmental and climate due diligence into the HRDD obligations of both states and corporations.<sup>128</sup>

As articulated in the UNGPs and other international frameworks like the OECD Guidelines, HRDD is not a legally binding obligation for business. However, mandatory HREDD is gradually being integrated into regional and national laws. These laws can be divided into three categories, according to their scope, application, and the nature of obligations imposed (Table 4).<sup>129</sup>

<sup>124</sup> An 'adverse human rights impact' is defined by the Office of the UN High Commissioner for Human Rights (OHCHR) as an impact that 'occurs when an action removes or reduces the ability of an individual to enjoy his or her human rights': OHCHR Interpretive Guide on the Corporate Responsibility to Respect Human Rights' Q10 at 15; 'Business relationships' refer to 'business partners, entities in its value chain, and any other non-State entity directed linked to its business operations, products or services.' UNGP 13, Commentary.

<sup>125</sup> For an overview of the key features of the Framework and UNGPs, see UNSW Australian Human Rights Institute and Australian Human Rights Commission, *At the Crossroads: 10 years of implementing the UN Guiding Principles on Business and Human Rights in Australia* (2021), 14-16.

<sup>126</sup> UNGPs, Guiding Principle 12.

<sup>127</sup> OECD, *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct* (OECD Publishing, Paris, 2023).

<sup>128</sup> See, e.g., Chiara Macchi, 'The Climate Change Dimension of Business and Human Rights: The Gradual Consolidation of a Concept of 'Climate Due Diligence,' (2021) 6 *Business and Human Rights Journal* 93; and 'Essential Elements of Effective and Equitable Human Rights and Environmental Due Diligence Legislation', policy brief prepared by David R. Boyd, UN Special Rapporteur on human rights and the environment, and Stephanie Keene, Independent Consultant, International Human Rights Lawyer (Policy Brief No. 3, June 2022).

<sup>129</sup> This typology is based on Nicolas Bueno and Claire Bright, 'Implementing Human Rights Due Diligence through Corporate Civil Liability' (2020) 69 *International and Comparative Law Quarterly* 789, 800-801.

**Table 4. Three categories of mHREDD laws**

Group 1 Mandatory disclosure	Group 2 Mandatory disclosure with due diligence	Group 3 Mandatory due diligence with civil liability
<p>Require companies that meet threshold criteria to disclose information on their due diligence efforts with respect to specified human rights risks in their operations and supply chains.</p> <p>May impose some form of administrative or civil liability for failure to comply with the reporting requirements.</p> <p><b>Examples</b></p> <p>UK – <i>Modern Slavery Act 2015</i></p> <p>Australia – <i>Modern Slavery Act 2018</i></p> <p>Canada – <i>Fighting Against Forced Labour and Child Labour in Supply Chains Act 2023</i></p> <p>EU – <i>Non-Financial Reporting Directive (2014/95/EU)</i></p>	<p>(In addition to disclosure), also require the exercise of due diligence in certain circumstances.</p> <p>Accompanied by enforcement mechanisms, but no clarification of liability conditions where harm does occur.</p> <p><b>Examples</b></p> <p>US – <i>Dodd-Frank Act 2010, s.1502</i></p> <p>EU – <i>Conflict Minerals Regulation 2017</i></p> <p>Netherlands – <i>Child Labour Due Diligence Law 2019</i></p> <p>Germany – <i>Supply Chain Due Diligence Act 2021</i></p> <p>Norway – <i>Transparency Act 2022</i></p>	<p>Broader scope (sectors and types of rights covered) (In addition to disclosure), include mechanisms to promote due diligence and monitor due diligence efforts, and remediation.</p> <p>Also provide an associated civil liability regime in case of harm.</p> <p><b>Examples</b></p> <p>France – <i>Corporate Duty of Vigilance Law 2017</i></p> <p>EU – <i>Directive on Corporate Sustainability Due Diligence (proposed 2022)</i></p>

**By mandating reporting on due diligence efforts (all three categories),** these laws may incentivise improved corporate social and environmental performance by:

- Encouraging companies to focus attention internally on preventing and mitigating social and environmental risks and impacts; and
- Enabling external actors – civil society, consumers, lenders, insurers and investors – to use the information provided to guide their own decision-making, advocacy and engagement with companies, which can also pressure companies to adopt more stringent practices; and
- Encouraging large companies to use their leverage with suppliers (e.g., through contracts with suppliers and service providers and independent multi-stakeholder certification systems) to promote adherence to human rights and environmental standards throughout their value chains.

**By mandating reporting and due diligence (Groups 2 and 3),** these laws may enhance these incentives by:

- Requiring companies to take steps to identify, address, prevent and mitigate actual and potential adverse impacts on human rights and the environment; and
- Where accompanied by appropriate supervisory and enforcement mechanisms, providing some degree of regulatory oversight and accountability as to the quality of due diligence undertaken.

**By mandating reporting, due diligence and providing remedy (Group 3),** these laws may help improve corporate social and environmental performance by:

- Providing greater incentives for companies to engage in meaningful and effective due diligence through heightening the consequences of failing to do so; and
- Improving access to remedy for those who have experienced harm as a result of a failure to act with due care.

## 4.2 Current Australian Frameworks – potential, limits and challenges

Progress implementing the UNGPs in Australia – including implementation of HRDD – has been slow and fragmented and there is little evidence of a comprehensive approach.<sup>130</sup> Table 5 outlines two pieces of Australian legislation – the *Illegal Logging Prohibition Act 2012* (Cth) and the *Modern Slavery Act 2018* (Cth) – which draw on HREDD to varying degrees to regulate specific environmental and social harms in transnational supply chains.

<sup>130</sup> UNSW Australian Human Rights Institute and Australian Human Rights Commission above n 1.

**Table 5. HREDD Instruments in Australia**

Instrument, Aims and Objectives	Scope, Obligations and Enforcement
<p><b>Illegal Logging Prohibition Act 2012 (Cth)</b></p> <p>Criminalises downstream activities ancillary to illegal logging where due diligence has not been undertaken.</p> <p>Aims to strengthen legal compliance in timber supply jurisdictions, by breaking down the market for goods and services that are created or provided unlawfully.</p>	<p>Standards for due diligence are articulated in regulations. Importers and domestic timber processors can use third party certification schemes to assess risks associated with regulated timber products (however due diligence is still required).</p> <p>Illegal logging is broadly defined in relation to any legal breach that occurred in the place the timber was harvested – thereby encompassing potential breaches of environmental protection, planning, employment, workplace health and safety and human rights protection laws in force in the country where timber is harvested.</p> <p>The criminal penalty regime includes fines and imprisonment. Any timber products found to be imported in breach of the Act must be forfeited. There is also a civil penalty regime for minor contraventions.</p> <p>Contractual risk allocation means that a supplier engaged in illegal logging beyond Australia may be subject to liability for breach of contract where an importer or processor suffers loss in Australia. However, this will not protect the company or its officers from criminal liability.</p>
<p><b>Modern Slavery Act 2018 (Cth)</b></p> <p>Requires large entities to report publicly on modern slavery risks in their supply chain and what they are doing to manage these risks.</p> <p>Aims to incentivise companies to take steps to address modern slavery risks and impacts in supply chains.</p>	<p>Annual modern slavery statements must address 7 mandatory reporting criteria, including modern slavery risks in the entity’s operation and supply chains, actions taken to assess and address those risks including due diligence and remediation, and a description of the effectiveness of actions taken. The statement must be approved by the principal governing body of the reporting entity and signed by a responsible member.</p> <p>Reports are publicly available online. The Minister is required to report annually to parliament each year outlining the implementation of the Act, including on compliance and best practice reporting. The government does seek to support entities to comply, raise awareness of best practice responses and operates the online registry.</p> <p>No offense or civil penalty provisions are provided.</p>

Evidence from the implementation of these regimes highlights their narrow scope and weaknesses in their design and implementation which have resulted in limited impact on corporate performance:

- While the *Modern Slavery Act* has raised awareness of modern slavery risks in transnational supply chains for Australian companies, there is little evidence that mandatory disclosure has led to the desired changes in company behaviour at scale. Analysis of reporting practice over the first few years of operation shows that many companies are failing to comply with the requirements of the Act. Further, the quality of statements is low, with many incomplete and superficial. There has also been a failure to disclose obvious risks and impacts, and very few companies are reporting on effective actions taken to address risks.<sup>131</sup> These outcomes can be partially explained by the lack of enforcement mechanisms, very little focus on remediating risks and impacts, and insufficient regulatory oversight and support. Further, the Act focuses narrowly on a set of particularly egregious human rights violations. Other human rights abuses in the supply chain remain unaddressed through this regime.
- While the *Illegal Logging Act* provides a stronger due diligence model which includes compliance, enforcement, and a penalty regime, it focuses exclusively on one type of adverse environmental impact – deforestation. Further, the standard of responsible business conduct is determined by laws in place to govern forestry activities in diverse supply jurisdictions (which may not align with global biodiversity goals and the concept of positive social and environmental performance used as a reference point for this analysis). Evidence of the law’s practical effect is also limited. Available evidence suggests it has not had the desired impact of reducing the circulation of illegally logged timber in the Australian market, partly because of practical implementation challenges with compliance and enforcement.<sup>132</sup>

<sup>131</sup> See discussion in: Olivia Dean and Shelley Marshall, ‘A race to the middle of the pack: an analysis of slavery and human trafficking statements submitted by Australian banks under the UK Modern Slavery Act 2015’ (2020) *Australian Journal of Human Rights*, 46-73; Jolyon Ford and Justine Nolan, ‘Regulating transparency of human rights and modern slavery in corporate supply chains: the discrepancy between human rights due diligence and the social audit’ 26(1) (2022) *Australian Journal of Human Rights* 27-45; Paul Redmond, ‘Regulating through reporting: an anticipatory assessment of the Australian Modern Slavery Acts 2015’ (2020) *Australian Journal of Human Rights* 5-26; Freya Dinshaw et al, *Broken Promises: Two years of corporate reporting under Australia’s Modern Slavery Act* (Human Rights Law Centre, 2022); Amy Sinclair, Freya Dinshaw et al, *Paper Promises? Evaluating the early impact of Australia’s Modern Slavery Act* (Human Rights Law Centre, 2022); Shelley Marshall et al, *Australia’s Modern Slavery Act: is it fit for purpose?* (Human Rights Law Centre, 2023).

<sup>132</sup> See discussion in Ryan J Turner, ‘Transnational Supply Chain Regulation: Extraterritorial Regulation as Corporate Law’s New Frontier’ 17 (2016) *Melbourne Journal of International Law* 189-209; Aust. Gov. Dept. Agriculture, Fisheries and Forestry, *Sunset review of the Illegal Logging Prohibition Regulation 2021 Regulation Impact Statement* (2022).

## OECD Guidelines – Australian application

The OECD Guidelines recommend companies conduct ‘risk based due diligence’ in relation to a wide range of adverse human rights and environmental impacts in the *value chain* of multi-national enterprises. Recent reforms to the Guidelines introduced in June 2023 have strengthened the standards addressing environmental harms. Climate change standards are now closely aligned with emerging best practice climate risk disclosure and management standards which explicitly reference global climate goals (e.g., science-based targets, transition plans, attention to just transition) (discussed in Part 2). Standards addressing biodiversity impacts are less concrete, with entities recommended to avoid and address ecosystem degradation and contribute to restoration and remediation efforts. Damaging biodiversity should be avoided in the first instance. Where avoidance is not possible, damage should be reduced, mitigated, or minimised, with offsets only used as a last resort.<sup>133</sup>

While these guidelines are not legally binding on Australian companies, Australia is legally bound to establish a National Contact Point (NCP) to promote the guidelines and to receive complaints regarding any non-compliance. This complaint mechanism is designed to help parties resolve issues through dialogue, conciliation and/or mediation. NCPs issue statements on the outcomes of these processes and may make recommendations on the implementation of the Guidelines. A company is not legally obliged to participate, or indeed to adhere to any recommendations made.

Until recently, there was low engagement by civil society with the NCP complaints mechanism and much critique of its operation around the world including in Australia (e.g., inconsistent procedures and decision-making, lengthy delays, restrictive policies on transparency, and an unwillingness to produce determinations where conciliation fails or companies choose not to participate). However, engagement with the mechanism has increased, with a particular focus on scrutinising financial sector conduct regarding the indirect impacts of lending and investment activities.<sup>134</sup> While neither the standards nor the outcomes of complaints are binding on companies, there are examples of companies committing to improved practices and some rare examples of victims obtaining remedy (Box 14). However, companies are likely to participate only where they are subject to sustained public pressure and reputational risk. Monitoring the implementation of any commitments made also relies largely on third parties.

### Box 14. OECD Guidelines – Australian Complaints

**Human Rights complaint against ANZ – Equitable Cambodia and Inclusive Development International** lodged a complaint against ANZ Group and the ANZ Royal Bank (Cambodia) Ltd in 2014 alleging contravention of the guidelines through their financing of a Cambodian company (Phnom Penh Sugar) which was involved in numerous human rights violations including forced displacement of communities. AusNCP issued a statement requesting ANZ to strengthen its due diligence systems to manage risks associated with lending, and to establish an effective grievance mechanism to support the operation of its corporate standards on human rights. The parties negotiated an agreed outcome which included public acknowledgement by ANZ of the inadequacy of its due diligence on the project and payment of all gross profit earned on the loan to the affected communities.

**Climate Change complaint against ANZ – Friends of the Earth, together with a group of Black Saturday bushfire survivors,** lodged a complaint against ANZ Group in 2020 alleging that the bank was in breach of the guidelines due to poor disclosure of GHG emissions associated with its lending and investment activities; continued lending to and investment in major fossil fuel industries; and misleading the public and consumers by publicly supporting the targets of the Paris Agreement while continuing to invest in fossil fuel projects which undermine the meeting of those targets. No agreement was reached between the parties. The AusNCP issued a statement in 2021 finding no breach of the guidelines. The statement noted that the guidelines merely require due diligence regarding environmental impacts of lending and investment decisions (and urge companies to continually improve their environmental performance) and do not mean that any lending/investment which leads to GHG emissions is in breach of the guidelines. The statement did however note that the expectations set out in the guidelines regarding environmental impacts, such as GHG emissions, were ambiguous and that the 2021 OECD stocktake on implementation of the guidelines provided an opportunity to address this. Following 2023 reforms, it is possible that a similar complaint leads to a different outcome.

<sup>133</sup> See OECD Watch, ‘Updated OECD Guidelines Give Civil Society More Grounds to Demand Corporate Accountability’, Briefing Paper, June 2023; OECD Centre for Responsible Business Conduct, *Consultation Draft: Targeted update of the OECD Guidelines for Multinational Enterprises and their Implementation Procedures* (Public Consultation 13 Jan – 10 Feb 2023).

<sup>134</sup> Anita Foerster and Ingrid Landau, ‘A new tool to address corporate climate wrongdoing: OECD complaint against ANZ fossil fuel financing’ (July 2020) *Australian Environment Review* 26-31.

## First Nations Rights and Due Diligence

There remain notable gaps in the implementation of UNGPs in Australia in relation to the recognition and protection of the rights of Australia's First Nations peoples.<sup>135</sup> For example, while governments have duties to protect against human rights abuses by third parties including business enterprises, the protection of key rights set out in UNDRIP, including the right to FPIC for developments impacting indigenous peoples and their land, is not well embedded in Australian law.<sup>136</sup> Further, businesses are not always discharging their (voluntary) responsibility to ensure that HRDD is conducted in a way that respects indigenous peoples rights, including their right to FPIC. The lack of strong legal protections and well-developed due diligence practices is well illustrated by the recent destruction of ancient rock shelters at Juukan Gorge by mining company Rio Tinto,<sup>137</sup> the failure of Santos Ltd to consult with Tiwi Islanders over proposed gas developments in the Torres Strait (Barossa Project),<sup>138</sup> and many other similar incidents.<sup>139</sup>

### 4.3 Alternative Models

Several European jurisdictions have recently introduced mHREDD laws. **Appendix A** provides a comparison of four examples – France, Netherlands, Germany, Norway, as well as the proposed EU *Corporate Sustainability Due Diligence Directive* – outlining their scope, substantive duties, compliance, and enforcement measures, and (where relevant) provision for civil liability for harms suffered as a result of a failure to conduct due diligence. Of these examples, the French 'Duty of Vigilance' law and proposed EU Directive fall into Group 3 (mandatory disclosure, due diligence, and remedy), whereas the Dutch, German and Norwegian examples fall into Group 2 (mandatory disclosure and due diligence) (see Table 4). There are however notable differences in approach across these examples and the final form of the EU Directive remains uncertain given ongoing negotiations (**Appendix B**).

Evidence of the impact of these laws on corporate behaviour is limited. The Dutch, German and Norwegian laws are very new; analysis of their implementation is premature. It is possible however to consider the early impacts of the French law, drawing on monitoring by NGOs.<sup>140</sup> Early assessments have found that despite clear statutory direction, company vigilance plans are highly heterogenous, and more focused on risks to companies than risks to third parties or the environment,<sup>141</sup> although there has been a gradual improvement in reporting quality.<sup>142</sup> There have been several enforcement actions initiated by NGOs under the French law, illustrating pathways to hold companies accountable for poor vigilance and associated harms, although, as Box 15 illustrates, these are yet to lead to concrete remedy.<sup>143</sup>

#### Box 15. Enforcement actions under the French 'Duty of Vigilance' law

**Total Energies** – The first example to progress to court relates to oil projects developed by French multinational *Total Energies* in Uganda, which have allegedly impacted local communities through forced eviction and threats to traditional livelihood. French and Ugandan NGOs alleged that *Total's* vigilance plan did not adequately identify and address these risks. When *Total* failed to respond to the notice within the statutory timeframe, this case progressed to court for an application for injunction in 2019. There followed a lengthy dispute about jurisdiction to hear the claim. The claim was ultimately dismissed on procedural grounds in early 2023, with no ruling on the core issue of whether there had been a breach of the duty of vigilance.<sup>144</sup>

**Casino Group** – In 2021, 11 NGOs brought a case alleging that *Casino*, the French supermarket chain, was in breach of its duty of vigilance in relation to sourcing meat from cattle farms located in deforested areas or from farms established on indigenous territories in Brazil. They argue that *Casino's* vigilance plan does not appropriately address risks to human rights and the environment associated with these suppliers, and request a court order that the company establish, implement, and publish a detailed compliant vigilance plan, and, based on a lack of vigilance, also compensate indigenous groups for related impacts.<sup>145</sup>

<sup>135</sup> UNSW Australian Human Rights Institute and Australian Human Rights Commission above n 1, 22-26.

<sup>136</sup> There are many challenges associated with the legal regime related to land rights and native title in Australia. Land and country play a critical role in First Nations people's lives. Extractive and other developments can prevent First Nations peoples from accessing, caring for and protecting country including cultural heritage sites, and thereby impact adversely on the exercise of their rights to cultural practices and other rights protected by UNDRIP.

<sup>137</sup> Deanna Kemp, John Owen, Rodger Barnes, 'Juukan Gorge Inquiry puts Rio Tinto on notice, but without drastic reforms, it could happen again' *The Conversation* (9 December 2020).

<sup>138</sup> In December 2022, the Full Federal Court upheld a ruling that Santos had failed to consult with the Tiwi people about potential impacts to their sea country, as part of its consultation about the gas drilling project as required by law, thereby invalidating Santos' approval for the project: *Tipakalippa v National Offshore Petroleum Safety and Environmental Management Authority* [2022] FCA 1121 and *Santos NA Barossa Pty Ltd v Tipakalippa* [2022] FCAFC 193.

<sup>139</sup> Nia Emmanouil and Carla Unger, *First Peoples and Land Justice Issues in Australia: Addressing Deficits in Corporate Accountability* (17 March 2021), which addresses the need for reform of consent processes in major resource projects.

<sup>140</sup> Duty of Vigilance Radar, <https://vigilance-plan.org/>

<sup>141</sup> Juliet Renaud et al, *The Law on Duty of Vigilance of parent and outsourcing companies – year 1: Companies must do better* (2019) available at, <https://respect.international/the-law-on-duty-of-vigilance-of-parent-and-outsourcing-companies-year-1-companies-must-do-better/>

<sup>142</sup> 'Vigilance Plans 2018-2019: Application of the Law on the Duty of Vigilance', 14 Jun 2019, available at <https://www.business-humanrights.org/en/latest-news/france-study-of-companies-2018-2019-vigilance-plans-highlights-challenges-of-application-of-law/>

<sup>143</sup> Duty of Vigilance Radar – Cases, <https://vigilance-plan.org/court-cases-under-the-duty-of-vigilance-law/>

<sup>144</sup> Friends of the Earth France, 'Total's Tilenga and EACOP projects: the Paris Civil Court dodges the issue', (28 Feb 2023, Business and Human Rights Watch Blog) <https://www.business-humanrights.org/en/latest-news/total-lawsuit-re-failure-to-respect-french-duty-of-vigilance-law-in-operations-in-uganda/>

<sup>145</sup> *Envol Vert et al v Casino*, <http://climatecasechart.com/non-us-cases/evol-vert-et-al-v-casino/>.

**BNP Paribas** – In 2023, Oxfam and other NGOs lodged a claim against **BNP Paribas** before the French Civil Court (which has jurisdiction to hear this claim and adjudicate on the merits). The claimants allege that the bank is in breach of its duty of vigilance by continuing to lend to and finance fossil fuel projects, despite their contribution to climate change and related harms.<sup>146</sup>

There is a rapidly growing literature on the potential and limitations of due diligence as an approach through which to improve corporate social and environmental performance, as well as on the relative strengths and weaknesses of specific and proposed laws.<sup>147</sup> Drawing on this expert opinion, the following key considerations emerge:

**Scope (material and personal)** – A key consideration for emerging mHREDD laws relates to the nature and extent of environmental standards that are included within the scope of due diligence obligations and whether it is sufficient to frame environmental issues as human rights or whether more specific provision is needed. While the interrelationship between human rights and environmental protection is well-recognised, framing environmental protection as a human rights issue, either by mobilising existing human rights or by promoting the recognition of the human right to a healthy environment, may be limiting.<sup>148</sup>

While the material scope of the French, German and proposed EU-wide laws all extend to encompass environmental concerns, these laws adopt different approaches to environmental standards. For example, the German law limits the scope of mHREDD to certain environmental standards that are closely linked to public health and pollution. This approach renders it easier for companies and others to determine precisely which standards are within the scope of the law. However, this formulation has also been criticised by German civil society for being too narrow.<sup>149</sup> The EU Directive's approach, in which reference is made to a set of environmental agreements annexed to the instrument, has also been criticised for being 'problematically narrow' and failing to make any reference to the right to a clean, healthy and sustainable environment.<sup>150</sup> The French law imposes more general environmental obligations on companies. While this formulation may capture a broader range of corporate impacts on the environment, it remains unclear as to whether certain environmental concerns (such as greenhouse gas emissions) fall within scope.<sup>151</sup>

For climate change particularly, articulating specific due diligence responsibilities has proven challenging, given the causal complexities and nature of the climate change problem which is the result of the cumulative effects of acts (and omissions) carried out by a large number of public and private actors over decades. As such, it is difficult to use the 'cause, contribute' and 'directly linked' conceptual framework that is set out in the UNGPs and drawn upon in many mHREDD laws.<sup>152</sup> The German Act clearly does not extend to climate change risks and impacts. While the French law does not explicitly mention climate change, it has been suggested that the broad approach adopted in the law 'opens up more opportunities for environmental activists to use the law in their struggles against global environmental problems such as climate change and biodiversity loss',<sup>153</sup> and indeed the recent case against BNP Paribas seeks to test this scope (Box 15). The draft EU Directive takes a different approach and addresses climate change separately by requiring covered entities to take specific measures to address climate change impacts through the preparation of Paris-aligned transition plans including emissions reduction objectives and financial incentives for company directors linked to climate performance (Example 2, Part 2).<sup>154</sup> However these requirements are excluded from the core HREDD duties in the draft Directive, and therefore appear unenforceable.<sup>155</sup>

<sup>146</sup> Friends of the Earth France, 'France: 3 NGOs file climate lawsuit against BNP Paribas over alleged failure to comply with French duty of vigilance law' (23 Feb 2023, Business and Human Rights Watch Blog), <https://www.business-humanrights.org/en/latest-news/france-3-ngos-file-climate-lawsuit-against-bnp-paribas-over-alleged-failure-to-comply-with-french-duty-of-vigilance-law-refusal-to-stop-financing-expansion-of-fossil-fuels/>

<sup>147</sup> See, e.g., David R Boyd and Stephanie Keen, 'Policy Brief No 3: Essential Elements of Effective and Equitable Human Rights and Environmental Due Diligence Legislation' (Special Rapporteur on Human Rights and the Environment, June 2022); Surya Deva, 'Mandatory Human Rights Due Diligence Laws in Europe: A Mirage for Rightsholders?' (2023) 36 *Leiden Journal of International Law* 389; Ingrid Landau 'Human rights due diligence and the risk of cosmetic compliance' 20 (2019) *Melbourne Journal of International Law*.

<sup>148</sup> Lucie Chatelain (Sherpa) and Paul Mougeolle (Notre Affaire à Tous), 'Toward EU Legislation on Corporate Accountability: the Need to Address Environmental Harms' in BHRRC Compendium, 'Toward EU Mandatory Due Diligence Legislation: Perspectives from Business, Public Sector, Academia and Civil Society', 59, 60. Chatelain and Mougeolle argue that the corporate duty of vigilance should encompass the risk of environmental harms such as biodiversity loss, irrespective of any direct or immediate impact on human rights on the basis that cumulative environmental degradation might lead to irreparable harm to our human societies...

<sup>149</sup> See, eg, Initiative Lieferkettengesetz, 'What the new Supply Chain Act Delivers – And What It Doesn't', Briefing, < <https://corporatejustice.org/news/german-supply-chain-act-comes-into-force/>>. It is noted in this briefing that a general clause relating to environmental damage (that covers biodiversity loss and climate change) should also be introduced.

<sup>150</sup> Boyd and Keene (2022) (n160), 9.

<sup>151</sup> Machi (n 141) and Mikko Rajavouri et al, 'Mandatory Due Diligence Laws and Climate Change Litigation: Bridging the Accountability Gap?' (2023) *Regulation & Governance* 4-5.

<sup>152</sup> For discussion, see Machi (n 141) 110 – 112.

<sup>153</sup> Maria-Therese Gustafsson et al, 'Foreign Corporate Accountability: The Contested Institutionalisation of Mandatory Due Diligence in France and Germany (2022) *Regulation & Governance*.

<sup>154</sup> Draft EU Directive, para 50 and 51

<sup>155</sup> 'Essential Elements of Effective and Equitable Human Rights and Environmental Due Diligence Legislation', policy brief prepared by David R. Boyd, UN Special Rapporteur on human rights and the environment, and Stephanie Keene, Independent Consultant, International Human Rights Lawyer (Policy Brief No. 3, June 2022) 12.

With respect to personal scope, existing mHREDD laws typically limit their application to large companies even though the UNGPs clearly state that all business enterprises have a responsibility to respect human rights.

**Substantive requirements** – Many experts have expressed concerns over the extent to which certain regulatory approaches, particularly those embodied in Group 1 and 2 laws, risk fostering ‘tick-the-box’ type responses from companies rather than meaningful change.<sup>156</sup> Group 3-type laws appear to have the most potential for positive impact.

While mHREDD laws generally impose obligations on corporate entities, there is also the potential for these laws to be complemented by reforms to directors’ duties. The EU Commission, for example, has proposed additional, complementary reforms to directors’ duties in company law in EU member states, to ensure that HREDD becomes integral to corporate governance. This includes a clear assignment of responsibility and oversight for due diligence to company directors, including for putting in place and overseeing required due diligence actions, adopting the company’s due diligence policy, taking into account stakeholder and civil society input, and ensuring steps are taken to adapt corporate strategies to account for impacts identified from due diligence processes.<sup>157</sup> However, this proposal remains contentious in negotiations (**Appendix B**). Introducing mHREDD with associated directors’ duty reforms could have a similar effect to introducing novel sustainability duties in corporate law (Part 3, Recommendation 5).

**Compliance and enforcement** – Establishment of a strong enforcement and compliance regime is essential to ensure that companies take their obligations seriously and remedy is available to those harmed by corporate action or inaction. Yet to date, compliance and enforcement have been identified as weaknesses within mHREDD laws.<sup>158</sup> To be effective, these laws need to be enforceable by (1) a dedicated and appropriately resourced regulator; *and* (2) a direct cause of action for people who are impacted by the breach of the due diligence duty.<sup>159</sup>

Leaving enforcement exclusively to the courts would appear sub-optimal. The concept of HREDD is relatively novel and challenges prevailing and long-entrenched legal doctrines and approaches. Further, mHREDD laws are necessarily ambiguous to some degree, in that what constitutes due diligence must be determined on a case-by-case basis. It is questionable whether courts will resolve these ambiguities in a way that challenges prevailing corporate practices, especially in jurisdictions like Australia without an extensive human rights jurisprudence.<sup>160</sup> French NGOs are already expressing concern over the potential of the Duty of Vigilance law to be undermined by emerging narrow and formalistic interpretations by the French judiciary. They have also expressed concern over the tactics being used by companies to prolong legal proceedings and frustrate the pursuit of justice for affected individuals and communities by way of challenging jurisdiction or raising ‘endless procedural issues.’<sup>161</sup>

The nature of the responsible regulator is also important. Empirical analysis of implementation of due diligence-related laws to date show that certain authorities may refrain from strong enforcement due to a lack of interest and/or expertise, or because of conflicting regulatory objectives such as promotion of international competitiveness.<sup>162</sup> The authority that is assigned with the task of providing independent oversight and powers to monitor and enforce any mHREDD law must be ‘a body that empathizes with the social goals instead of one that begrudgingly takes on the duties’.<sup>163</sup> The nature and extent of the regulator’s investigative and enforcement powers are also important.

If mHREDD laws are to facilitate access to remedy where harm has occurred, they must create a clear cause of action against those responsible, as well as enabling significant state sanctions for violations. In determining the circumstances under which businesses may be held liable for damages and penalties, consideration must also be given to the extent to which a defence of adequate due diligence should be available to companies.<sup>164</sup> Experience with the French law also underscores the need for any mHREDD law to include additional measures to promote access to justice, such as adjustment of the burden of

<sup>156</sup> See, eg, Landau (n 160); Joseph Wilde-Ramsing, Ben Vanpeperstraete and David Hachfield, ‘Legislating Human Rights Due Diligence: Respecting Rights or Ticking Boxes?’, Clean Clothes Campaign, ECCHR, Public Eye and SOMO, January 2022.

<sup>157</sup> Draft EU Directive, para 64.

<sup>158</sup> Gabriela Quijano, & Carlos Lopez, ‘Rise of Mandatory Human Rights Due Diligence: A Beacon of Hope or a Double-Edged Sword?’ (2021) 6(2) *Business and Human Rights Journal* 241; Almut Schilling-Vacaflor and Andrea Lenschow, A. ‘Hardening Foreign Corporate Accountability through Mandatory Due Diligence in the European Union? New Trends and Persisting Challenges’ (2023) 17 *Regulation & Governance* 677-693.

<sup>159</sup> See generally, Human Rights Law Centre, ‘Brief: A Corporate “Duty to Prevent” Modern Slavery’, November 2022; Landau (n 160);

<sup>160</sup> For a discussion of judicial reluctance to hold companies accountable in the context of labour rights violations in supply chains, see Judy Fudge and Guy Mundlak, ‘Peeling the Onion: On Choices Judges Make in Transnational Labour Litigation’ in Brian Langille and Anne Trebilcock (eds) *Social Justice and the World of Work: Possible Global Futures* (Hart, 2023) 249.

<sup>161</sup> Sandra Cossart and Roula Mamlouk, ‘10 Years On From Rana Plaza: Is France’s Duty of Vigilance Law Living Up to Its Promise?’ *Business and Human Rights Journal Blog*, 6 June 2023.

<sup>162</sup> David Wehrauch et al, ‘From Voluntary to Mandatory Corporate Accountability: The Politics of the German Supply Chain Due Diligence Act’ (2022) *Regulation & Governance*; Jeff Schwartz, ‘The Conflict Minerals Experiment’ (2016) 6(1) *Harvard Business Law Review* 129.

<sup>163</sup> Schwartz (n 175) 182.

<sup>164</sup> On civil liability and the availability of a defence, see eg Nicolas Bueno and Claire Bright, ‘Implementing Human Rights Due Diligence through Corporate Civil Liability’ (2020) 69 *International and Comparative Law Quarterly* 789; Lise Smit, Claire Bright and Stuart Neely, ‘Muddying the Waters: The Concept of a “Safe Harbour” in Understanding Human Rights Due Diligence’ (2023) 8 *Business and Human Rights Journal* 1; Irene Pietropaoli, Lisa Smit, Julianne Hughes-Jeannett and Peter Hood, A *UK Failure to Prevent Mechanism for Corporate Human Rights Harms* (British Institute of International and Comparative Law (BIICL), February 2020).

proof.<sup>165</sup> Existing and proposed mHREDD laws take a range of different approaches with respect to penalties, sanctions and remedies including in relation to the nature of penalties (civil and/or criminal) and in relation to the circumstances that such penalties should extend to individuals within the company such as directors and officers.

#### 4.4 Reform opportunities

A comprehensive, best practice mHREDD law that provides for disclosure, due diligence, and remedy (Group 3), has considerable potential to complement the corporate law reforms proposed in Parts 2 and 3. Indeed, a strong mHREDD law could potentially achieve much of what could be achieved through reforms to directors' duties (Recommendations 4 and 5). However, given the potential difficulties in incorporating environmental harms into the due diligence model, and the fact that this model assumes all business activities and models can continue as long as due diligence measures are undertaken, mHREDD laws are not considered as a complete alternative to directors' duty reforms.

There is considerable momentum towards mHREDD laws internationally. However, to date, there has been a notable divergence between the Anglo-American and continental European approach, with EU countries adopting laws that are broader in their material scope and impose much stronger due diligence obligations beyond disclosure. It is notable that the US has not yet embraced mHREDD: rather, it has relied on a limited disclosure-based approach and a federal prohibition on the importation of goods produced with the use of forced and child labour.<sup>166</sup>

In Australia, civil society organisations and the Australian Human Rights Commission have previously called on the Australian Government to legislate for mHRDD.<sup>167</sup> The Human Rights Law Centre has also released a detailed proposal for amending the *Modern Slavery Act 2018* to introduce a substantive duty 'to prevent' modern slavery, accompanied by stronger enforcement mechanisms and a right for affected individuals to directly sue the company.<sup>168</sup>

The impending adoption of the EU Directive is also likely to prompt broader debate about mHREDD laws in Australia from the perspective of maintaining international competitiveness as the Directive will have significant implications for Australian companies. This includes entities that are among the estimated 4,000 non-registered EU entities to fall within its scope by virtue of their financial and employee thresholds; or that are subsidiaries of either an EU or non-EU entity that fall within the Directive's scope; or that have an established business relationship with an EU or non-EU entity that falls within the Directive's scope.

In this context, Recommendation 6 supports the development of an Australian mHREDD law. However, this will require further evaluation and modification of existing and proposed models internationally, as well as close analysis of the interaction of any proposed new law with existing modern slavery and other frameworks.

#### **Recommendation 6 – An Australian Human Rights and Environmental Due Diligence Law**

A comprehensive, best practice mHREDD law could play an important role in driving improved corporate social and environmental performance by Australian companies including in transnational value chains. To ensure such a law maximises positive impacts while mitigating or avoiding unintended consequences, close attention must be paid to:

**Material scope** – While the application of due diligence obligations to human rights impacts is well established and understood, and there are strong arguments for including environmental harms within the material scope of these laws, best practice approaches to environmental due diligence are still developing. Indeed, emerging mHREDD laws in Europe address environmental harms in quite different ways and many take a narrow approach. Further consideration of international models and their application to the Australian context is required.

**Personal scope** – Following EU jurisdictions, it appears most workable to initially target mHREDD laws to large companies and those operating in high-risk locations and sectors.<sup>169</sup>

<sup>165</sup> Cossart and Mamlouk (n 174).

<sup>166</sup> See, for an overview of the US disclosure framework, Rachel Chambers and Jena Martin, 'Reimagining Corporate Accountability: Moving Beyond Human Rights Due Diligence' (2022) 18(3) *New York University Journal of Law & Business* 773, and for an overview of the use of forced labour bans, Temisan Fanou, 'Literature Review: Forced Labour Import Bans', GFLC, 5 January 2023 < <https://gflc.ca/wp-content/uploads/2020/10/Forced-Labour-Import-Bans.pdf> >.

<sup>167</sup> See, eg, Human Rights Law Centre, 'Nowhere to Turn: Addressing Australian Corporate Abuses Overseas' December 2018; Australian Human Rights Commission, 'Business and Human Rights: Australia's Third UPR 2021'.

<sup>168</sup> Human Rights Law Centre, (n172).

<sup>169</sup> See also, Human Rights Law Centre (n 172) and Australian Human Rights Commission (n 180).

**Substantive requirements** – Laws which only require *disclosure of* human rights and environmental risks and impacts, and company approaches to address these (Group 1), have been shown to have minimal impact on corporate behaviour, especially where there is insufficient provision for compliance and enforcement. Best practice approaches include mandatory disclosure, due diligence and remedy (Group 3). Providing explicit obligations for company directors in Corporations Law to oversee due diligence and ensure steps are taken to respond to risks and impacts would further embed HREDD in corporate governance and strengthen accountability.

**Compliance, enforcement, and remedy** – In an Australian context, leaving enforcement solely to the courts would be sub-optimal. A strong HREDD regime requires a dedicated, appropriately resourced independent regulator with adequate investigative and enforcement powers. Further consideration of the penalty regime, including the nature of penalties (civil and/or criminal) and in what circumstances (if any) such penalties should apply to company directors and officers, is required. A civil liability regime that provides access to remedy for victims of harm suffered because of a failure to conduct adequate due diligence is an important feature of best practice mHREDD laws.

# Appendix A: Mandatory HREDD laws in Europe

	Material scope	Personal Scope	Application to supply chain	Statutory duty	Compliance and enforcement	Civil liability
<p><b>French 'loi de vigilance' (loi no. 2017-399) 2017 (Duty of Vigilance Law)</b></p> <p>Mandatory due diligence with civil liability (Group 3)</p>	Risks and severe impacts on human rights and fundamental freedoms, on the health and safety of persons, and on the environment. <sup>170</sup>	French companies with at least 5 000 employees in France or at least 10 000 employees globally and a subsidiary in France. <sup>171</sup>	Due diligence obligations extend to all directly or indirectly controlled subsidiaries, as well as contractors or suppliers with which the company has an 'established business relationship' (commercial relations that are stable and regular, with or without contract with certain volume of business, creating a reasonable expectation that relationship will last).	Covered entities must develop and implement a vigilance plan on human rights and environmental risks. This plan should be developed in consultation with stakeholders and trade unions. The plan should identify and analyse the risks and set out appropriate measures to mitigate these risks. Companies must implement and monitor the effectiveness of their plan. The plan and implementation reports must be made publicly available.	Companies that fail to publish or implement vigilance plans are subject to court-ordered injunctions or penalty payments. A party with standing (e.g., affected party or NGO) can serve the company a 3-month official notice for breach of vigilance obligations irrespective of whether actual harm has occurred. If there is continued non-compliance, the party can apply to a court for an injunction, with a potential penalty payable.  No regulatory authority responsible for monitoring or enforcing the law.	Civil liability where victims can demonstrate that the company: (1) failed to respect its duty of vigilance; and (2) this failure caused the
<p><b>Dutch Wet zorgplicht kinderarbeid 2019 (came into effect mid-2022)</b></p> <p>Mandatory disclosure with due diligence (Group 2)</p>	Child labour	Dutch companies that sell or deliver goods or services to Dutch end-users; or other companies that systematically delivers goods or services to Dutch end-users.	Due diligence obligations extend to the supply chain.	Covered entities must investigate whether their goods or services have been produced using child labour, and where there are reasonable grounds to suspect child labour in the supply chain, they must develop an action plan to prevent child labour in the supply chain.  Entities must submit a declaration to the regulator affirming they have exercised an appropriate level of supply chain due diligence.	The regulator does not have powers to actively investigate or initiate enforcement but relies on affected parties and stakeholders to bring violations to its attention. Initially, complainants must file a complaint with the offending company requesting a response. If the company does not resolve the issue in 6 months, the regulator will step in to act as a mediator. If the regulator determines that there has been a violation, they can issue legally binding directions to the company to address the breach. Failure to comply within the allotted time, may result in significant administrative fines, criminal sanctions for non-compliance.  Companies that fail to comply with the Act can be fined up to 10% of a company's total worldwide revenue. If a company receives two fines within 5 years, the responsible company director is liable for up to 2 years imprisonment.	No direct civil cause of action for third party victims to sue a company for harms suffered as a result of human rights violations.
<p><b>German Supply Chain Due Diligence Act 2021</b></p> <p>Mandatory disclosure with due diligence (Group 2)</p>	Human rights  Three environmental standards: prohibition on the production of mercury-added products, use of mercury and treatment of mercury waste; prohibition on production and use of toxic chemicals; and prohibition of export and import of certain hazardous waste. <sup>172</sup>	Companies with more than 3000 employees (from 2023) and companies with more than 1000 employees (from 2024).	Risk analysis need only extend to direct contractual partners. However, in case of substantiated knowledge of a possible violation', risk analysis must extend further upstream.	Companies must comply with 9 specific due diligence obligations: (1) establishment of risk management system; (2) internal designation of responsibilities (e.g., human rights officer); (3) regular risk analysis and assessment; (4) adoption and communication of human rights policies; (5) preventative measures in own business and vis-à-vis direct suppliers (6) remedial action; (7) complaints procedure; (8) implementation of due diligence measures with regard to risks at indirect suppliers; and (9) documentation and reporting.	The German Federal Office for Economic Affairs and Export Control (BAFA) is given monitoring and investigative powers under the Act.  Administrative sanctions (penalty fines) apply for failure to comply, up to 2% of a company's global revenue. Companies that have already been fined can be excluded from public procurement contracts for up to three years.	No express provision for civil liability but introduces capacity for affected parties to authorise trade unions and NGOs to represent them in German courts.

<sup>170</sup> The term 'severe impacts' is not defined in the law. The law does not specify the precise nature or scope of the subjects to be included in a vigilance plan (including with respect to the environment), but most commentators have relied on the parliamentary debates to suggest that reference should be made to established international standards: See, eg, Elsa Savourey and Stéphane Brabant, 'The French Law on the Duty of Vigilance: Theoretical and Practical Challenges since its Adoption' (2021) 6 *Business and Human Rights Journal* 141, 145-46.

<sup>171</sup> Some uncertainties remain about scope of application.

<sup>172</sup> These standards are based on three international conventions ratified by Germany that focus on environmental pollution and protecting human health: the prevention of the use of persistent organic pollutants (Persistent Organic Pollutants Convention or Stockholm Convention) and mercury emissions (Minamata Convention) as well as the control of transboundary movements of hazardous wastes (Basel Convention).

	Material scope	Personal Scope	Application to supply chain	Statutory duty	Compliance and enforcement	Civil liability
<p><b>Norway's Transparency Act 2021</b></p> <p>Mandatory due diligence (Group 2)</p>	Human rights and 'decent working conditions'	'Larger enterprises' <sup>173</sup> that are resident in Norway and offer goods and services in or outside Norway, as well as to larger foreign enterprises that offer goods and services in Norway and are liable to pay tax to Norway.	Due diligence obligations extend to 'supply chains and business partners.'	Covered entities to 'carry out due diligence in accordance with the OECD Guidelines for Multinational Enterprises.'	Consumer Authority may issue prohibitions and orders to ensure compliance. Administrative penalties are available in cases of non-compliance with such orders.  Includes a novel 'right to information' for any person regarding how the enterprise addresses actual and potential adverse impacts.	No express provision for civil liability.
<p><b>European Commission's proposal for EU Directive 2022</b></p> <p>Mandatory due diligence with civil liability (Group 3)</p> <p>Note: given ongoing negotiations between the EU Commission, EU Parliament and the Council of the EU, the final form of this Directive remains uncertain. Key unresolved issues are noted in <b>Appendix B</b>.</p>	Human rights  Adverse environmental impacts resulting from violation of internationally recognised objectives & prohibitions included in certain environmental conventions. <sup>174</sup>  Certain large companies must also have plan to ensure their business strategy is compatible with limiting global warming to 1.5 °C in line with Paris agreement.	Large EU limited liability companies:  Group 1: 500+ employees & net EUR 150 million+ turnover worldwide.  Group 2: 250+ employees & net EUR 40+ million turnover worldwide, & operating in defined high impact sectors (e.g. resource extraction, processing & manufacturing).  Non-EU companies: active in the EU with turnover threshold aligned with Group 1 & 2, generated in the EU.	Refers to the company's own operations, their subsidiaries, & value chain operations (upstream, or downstream) carried out by entities with whom the company has an established business relationship.	Covered entities must:  Art 5 – integrate due diligence into all corporate policies, establish a due diligence policy setting out the company approach, code of conduct and processes in pace to implement DD.  Art 6 – take appropriate measures to identify actual or potential adverse human rights and environmental impacts in their own operations, subsidiaries and at the level of established direct or indirect business relationships in the value chain.  Art 7 – take appropriate measures to prevent potential adverse impacts or to adequately mitigate those impacts where prevention is not possible or requires gradual implementation.  Art 8 – take appropriate measures to bring an end to actual adverse impacts, or where this is not possible, to minimise the extent of the impact.  Art 9 – provide a grievance mechanism to hear complaints regarding potential or actual adverse impacts, including the company's value chain (including from persons affected or who may be affected by adverse impacts, trade unions and other employee representation organisations, and civil society organisations active in the area concerned).  Art 10 – periodically assess the implementation of DD measures and the effectiveness of these measures.  Art 11 – report publicly on the matters above.	Member States to designate authority to supervise and impose effective, proportionate, and dissuasive sanctions, including fines and compliance orders.  At European level, the Commission will set up a European Network of Supervisory Authorities that will bring together representatives of the national bodies to ensure a coordinated approach.	A company will be liable for damages if (a) it failed to comply with the due diligence obligations and (b) as a result of this failure, an adverse impact that should have been identified, prevented, mitigated, brought to an end or its extent minimised through the appropriate measures occurred and led to damage (Art 22).  It is left up to national law to determine who should prove that the company's action was reasonably adequate in the circumstances of the case.  Where harm has occurred at the level of an indirect business relationship, civil liability is subject to specific conditions.

<sup>173</sup> Larger enterprises are defined in s 3 of the Act to mean 'enterprises that are covered by Section 1-5 of the Accounting Act' or which satisfies two of the following three conditions: sales revenues of NOK70 million, balance sheet total of NOK35 million, and average number of employees in the financial year is 50 full-time equivalent.

<sup>174</sup> Part II of the Annex to the Directive enumerates twelve such violations, which correspond to environmental instruments which include prohibitions and concrete obligations (e.g., treaties covering the treatment and handling of industrial waste; the production, and consumption of ozone-depleting substances; and transboundary movement of hazardous waste). It is understood that the Global Biodiversity Framework has recently been added to the Annex.

# Appendix B: EU Directive on Corporate Due Diligence and Corporate Accountability

In February 2022, the EU Commission released its proposal for a *Directive on Corporate Due Diligence and Corporate Accountability*.<sup>175</sup> If adopted, member states will have 2 years to transpose the Directive into national laws. The Directive is framed as complementary to other EU-wide measures, recently introduced or proposed, to foster sustainable corporate governance (e.g., CSRD, example 1, Part 2) and contribute to the EU's broader environmental and social sustainability agenda.<sup>176</sup>

Key features of the proposal are included in Appendix A. It is important to note that given ongoing negotiations between the European Commission, European Parliament and the Council of the European Union, the final form of this Directive remains uncertain. Important features of the draft Directive remain unsettled, with the EU Commission, the Council of the European Union and the European Parliament all adopting different negotiating positions.<sup>177</sup> Unresolved issues include:

- **Material scope** – whether the due diligence requirements should apply to a narrow definition of ‘chain of activities’ (EU Council) or also to the sale, distribution, transport, storage and waste management of products and services (EU Commission and Parliament).
- **Application to finance sector** – whether financial sector companies should be classified as a high-risk sector for the purposes of the due diligence obligation. While the European Council (December 2022) proposed that the inclusion of financial institutions be left up to member states, the European Parliament’s position (June 2023) provides that, ‘where relevant, institutional investors and asset managers shall be required to engage with the investee company and exercise voting rights... in order to induce the management body of an investee company to bring the actual [negative climate impact] to an end or minimise its extent.’<sup>178</sup>
- **Associated duties for company directors** – whether the Directive should impose duties on directors to implement and oversee the due diligence process, including adopting the company’s due diligence policy, taking into account stakeholder and civil society input, and ensuring steps are taken to adapt corporate strategies to account for impacts identified from due diligence processes (not supported by the European Parliament and Council).
- **Performance measures for company directors** – whether company directors’ variable remuneration should be tied to their contribution to their company’s sustainability. The European Parliament supports this measure only for companies with more than 1000 employees and only in relation to the climate-related transition plan. The European Council has not endorsed either proposal.
- **Access to justice and remedy** – whether the Directive will include stronger requirements to improve access to justice for victims and requirements for companies to remediate harm caused due to their activities (as proposed by the European Parliament).

<sup>175</sup> European Commission, ‘Just and Sustainable Economy: Commission lays down rules for companies to respect human rights and environment in global supply chains’ (23 Feb 2022 Press Release), [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_22\\_1145](https://ec.europa.eu/commission/presscorner/detail/en/IP_22_1145)

<sup>176</sup> European Commission, *Proposal for A Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence 2022/0051* (‘Draft EU Directive’). Consistency with other policy provisions is discussed at pp 3-7, including the Non-Financial Reporting Directive and proposed new Corporate Sustainability Reporting Directives, the Taxonomy Regulation, a proposed new instrument to prohibit sale of products made by forced labour, including forced child labour, and a proposed regulation on deforestation-free supply chains. The latter is likely to be more prescriptive than the general DD directive and includes a prohibition on selling certain commodities and products in the EU market if standards of ‘legal’ and ‘deforestation free’ cannot be ascertained through due diligence.

<sup>177</sup> While the EU Council finalised its common positions on the draft Directive in late 2022, the EU Parliament did not do so until 1 June 2023.

<sup>178</sup> Article 8a of the European Parliament’s Report on Corporate Sustainability Due Diligence (1 June 2023).

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