

Centre for Policy Development

ROUNDTABLE | 10 DECEMBER 2020

Discharging directors' duties relating to climate risk — some practical applications

A roundtable with Noel Hutley SC and colleagues

Agenda — Roundtable: Discharging directors' duties relating to climate risk - some practical applications



Time



Duration



Agenda Item

5:00pm

10 mins

Welcome and introductions

5:10pm

80 mins

Discussion of scenarios by legal panel and participants

6:30pm

20 mins

Discussion of next steps and outputs

6:50pm

10 mins

Conclusion

Participant List

Name	Position & Affiliation
Noel Hutley SC	Senior Counsel, Fifth Floor St James' Hall
Sebastian Hartford Davis	Barrister, Banco Chambers
Sarah Barker	Partner & Head of Climate Risk Governance, MinterEllison
Martijn Wilder AM	Founding Partner, Pollination
Frank Jotzo	Professor, Crawford School of Public Policy & Director, Centre for Climate and Energy Policy, Australian National University
Travers McLeod	CEO, Centre for Policy Development
Angus Armour	CEO, Australian Institute of Company Directors
Bryan Horrigan	Dean, Faculty of Law, Monash University
Catherine Bolger	President, Australian Institute of Superannuation Trustees & Director, Professionals Australia & Director, State Super
Gordon Cairns	Chair, Woolworths Limited & Non-Executive Director, Macquarie Group
Hugo Batten	Managing Director, Aurora Energy Research
Ian Silk	President, Australian Council of Superannuation Investors and CEO, AustralianSuper
Ilana Atlas AO	Non-Executive Director, ANZ & Chair, Coca Cola Amatil
James Pearson	CEO, Australian Chamber of Commerce & Industry
Lucy Thomas	Head of Investment Stewardship, NSW Treasury Corporation
Neil Smyth	General Counsel, QLD Treasury Corporation
Patricia McKenzie	Non-Executive Director, AGL & Chair, NSW Ports & Chair, Sydney Desalination Plant
Richard Watson	Executive Director, WA Department of Treasury
Sam Mostyn	Chair, Citibank & Non-Executive Director, & Transurban & Non-Executive Director, Mirvac Group & Board Member, CPD
Simon McKeon AO	Chair, Australian Industry Energy Transitions Initiative & Non-Executive Director, Rio Tinto & Non-Executive Director, National Australia Bank
Sophie Ismail	Legal & Industrial Officer, ACTU & Director, HESTA
Tim Reed	President, Business Council of Australia & Non-Executive Director, Transurban

DEVELOPMENTS SINCE ORIGINAL LEGAL OPINION ON DIRECTORS' DUTIES & CLIMATE CHANGE

Timeline of key events on climate risk - 2015-2020

2015

- Mark Carney 'Breaking the tragedy of the horizon' speech, Lloyd's of London (September)
- UN Principles for Responsible Investment releases *Fiduciary Duties in the 21st Century* (September)
- FSB announces formation of the **Task Force on Climate-related Financial Disclosures** (TCFD) (December)
- **Paris Agreement announced** by participants at COP21 (December)

2016

- CPD roundtable on directors' duties, climate risk and sustainability (October)
- Release of **Memorandum of Opinion: Climate change and directors' duties**, Noel Hutley SC and Sebastian Hartford Davis (October)
- **Paris Agreement entry into force** (November)

2017

- **APRA's first major statement on climate:** Geoff Summerhayes 'Australia's new horizon' speech, Insurance Council of Australia (February)
- First meeting of Commonwealth Government Secretaries Group on Climate Risk (March)
- Claim filed against **CBA** alleging non-disclosure of material climate risks (August)
- Geoff Summerhayes 'The weight of money' speech, Centre for Policy Development (November)
- Council of Financial Regulators establishes working group on climate risk (December)

2018

- **ASIC's first major statement on climate:** John Price 'Climate change' speech, Centre for Policy Development (June)
- Claim filed against **REST Super** alleging failure to adequately consider climate change risks (July)
- RBA joins the global Central Banks and Supervisors Network for Greening the Financial System (July)
- **ASIC report into climate risk disclosure** by Australia's listed companies (September)
- AASB and AuASB release joint guidance on integration of material climate information into financial disclosures (December)

2019

- ASX Corporate Governance Council Principles and Recommendations updates emphasis on climate-related disclosures (February)
- **RBA's first major statement on climate:** Guy Debelle 'Climate change and the economy' speech, Centre for Policy Development (March)
- APRA releases *Climate change: from awareness to action* information paper (April)
- Release of **Supplementary Memorandum of Opinion: Climate change and directors' duties**, Noel Hutley SC and Sebastian Hartford Davis (April)
- ASIC issues **updated guidance on climate-related risk disclosure** (August)
- RBA includes climate risk for first time in its Financial Stability Report (October)

2020

- APRA announces '**climate financial risk vulnerability assessment**' for Australia's five largest banks (February)
- **NZ Govt introduce mandatory TCFD-aligned** climate disclosure requirements for companies (September)
- Release of industry-led Australian Sustainable Finance Initiative roadmap and recommendations (November)
- Australia's largest super fund **Australian Super** announces commitment to a net zero emissions portfolio by 2050 (November)
- **REST Super** settles with mark McVeigh and publicly commits to increasing (November)
- UK Govt announces intention to mandate TCFD-aligned climate disclosures by large companies (November)

HYPOTHETICAL SCENARIOS

Hypothetical scenario 1 - Insufficient company disclosure?

1. Company A is listed on the ASX. It has a portfolio of carbon-intensive coal and gas energy generators of varying ages and efficiencies across regional Australia, including in the Hunter region in NSW. The company has performed strongly historically.
2. Company A has stated publicly on several occasions, including in its financial statements, that it is managing climate risks in line with best practice and is a leader in its sector. The climate-related disclosures in Company A's financial statements contain:
 - a. high level information on scenario analysis, utilising two different scenarios;
 - i. one incorporating a delayed and insufficient policy response to climate change;
 - ii. one that is broadly aligned with a 2 degrees trajectory;
 - b. express representations that, under both scenarios, the financial outlook is broadly positive for the company, although potential physical impacts and policy-related risks to some older assets in their generation fleet are noted anecdotally;
 - c. express representations that the disclosures are TCFD-aligned;
 - d. a commitment to achieve net zero emissions by 2050 (scope 1 & 2).
3. The true position is that:
 - a. the two scenarios are based upon dated information;
 - b. Company A has not integrated climate-related risks into its impairment calculations;
 - c. Company A has not yet modelled a pathway to achieving net zero emissions by 2050 (scope 1 & 2 or 3). The employees who prepared the financial statements have not spoken to the operational divisions about how that might be achieved.
 - d. Company A has not yet initiated any transition planning covering the management and impacts of the expected closure of their assets.
 - e. Were Company A to undertake sophisticated TCFD modelling in line with international best practice it would show that they have multiple thermal assets that would theoretically close 5-10 years earlier than their technical lives under a 1.5°C or 2°C carbon budget for the Australian National Electricity Market.
4. The non-executive directors on the Board of Company A does not have actual knowledge of the true position as stated at [3].
5. The Board is informed, in advance of an upcoming General Meeting, that a long term shareholder, with a significant minority shareholding, has been persistently writing to Company A, raising concerns about the company's disclosures and asking for more information about the modelling underpinning it.

Question:

- What strategy should the non-executive directors adopt, in order to manage their own legal exposure and that of Company A?

Hypothetical scenario 2 - What does effective discharge of duty look like?

1. Company B is the trustee of a registered superannuation entity. Historically, the fund was a forestry workers industry superannuation fund, but has been open offer for more than a decade (although members are still significantly skewed to regional membership across WA, NSW and Victoria). The fund's membership is relatively evenly spread across age brackets, although the largest cohort are pre-retirees.
2. The fund is a signatory to the Principles for Responsible Investment (PRI), and a member of the Responsible Investment Association of Australasia (RIAA).
3. The fund is presently performing in line with peers. The fund's default balanced product is a diversified international multi-asset portfolio, consisting of approximately 50% listed equities (35% domestic, 15% international), 20% fixed income, 15% alternatives, 10% private equity and 5% cash. The fund's Responsible Investment Policy prohibits investment in companies who derive more than 10% of revenue from tobacco or cluster munitions. All investments are externally managed.
4. In response to comments by APRA about the duties of trustee directors to stress test portfolios against a <2°C scenario, in 2017 the board Investment Committee commissioned the fund's Investment Consultants to undertake climate risk stress testing on the balanced portfolio. The Consultant reported that their analysis revealed no material difference in performance of the fund's strategic asset allocations under a <2°C vs high carbon (4°C) scenario.
5. In the wake of the *REST v McVeigh* settlement, the board of Company B is concerned about the financial impact of climate-related risks, and is also concerned about the reputational consequences of not being seen to act on climate risk. In particular, the board is concerned that its membership base will decline because a recent survey shows that its members are very concerned about climate risk as an ethical issue (which was contrary to management's long-held presumption that their regional membership base would be 'anti-green'). It resolved to revisit the climate risk issue, and asked the Investment Team to identify the 'top' areas of climate risk in their portfolio and report back on the exposures.
6. In response, the Investment Team identified domestic equities and alternatives (including infrastructure and real estate) as presenting the highest potential risk. It assessed the carbon intensity of the domestic equities portfolio, and concluded that it was no more carbon intensive than the ASX benchmark. It reviewed the commercial and retail property investments making up the majority of its alternatives portfolio, and concluded that the fund was not significantly exposed to climate risk as all properties had high NABERS energy efficiency ratings. No analysis was done on the climate risk characteristics of its fixed income portfolio, which contains a high proportion of government bonds issued by subnational jurisdictions.
7. Relieved with the results of the Investment Team's assessment, the trustee board asked the Company Secretary to ensure climate change was added to the board's rotating biennial agenda for consideration.

Question:

- Is the trustee board's conduct on climate-related risk issues likely to discharge its duty of due care and diligence? If so, why? If not, why not – and what elements of robust process may be absent?

Background reading:

- [*Rest reaches settlement with Mark McVeigh*](#) (Rest Super, 2020)

Hypothetical scenario 3 - Collaboration or competition?

1. Leaders from the manufacturing sector have formed an initiative to coordinate learning and action on net zero emissions across their supply chains. Their companies comprise a majority of the main competitors within a single market. They share similar activities, emissions profiles and technology requirements. The sector is highly emissions intensive and faces a significant emissions reduction challenge to achieve net zero emissions by 2050 - the stated commitment of leading firms in the sector and the key state government jurisdictions in which they operate.
2. Corporate leaders and industry associations have concluded that delivering a managed, effective transition and protecting the international competitive position and reputation of the sector will require major players to cooperate to develop an agreed emissions reduction strategy and timeline. They have been encouraged by policymakers to co-invest in the R&D platforms and technological innovations needed to meet ambitious emissions reductions targets for the sector.
3. The group has formed a committee to explore and develop sectoral guidelines for climate scenario analysis, including several illustrative transition pathways for the sector. They are considering co-investing in the development of a low emissions technology that could reduce sectoral emissions by 15%, and in turn reduce operational expenditure. They are also considering collective steps they can take to limit certain supply chain practices which, while legal and lucrative, are carbon intensive and have been the focus of concerted community opposition. Initial work has commenced on a comprehensive net zero pathway for the sector, which would require sharing of more detailed information about current and future investment plans and projects.

Question:

- What is the risk that such industry collaboration contravenes competition law, and are there any strategies that could be adopted to mitigate this risk?

Background reading:

- [*Is competition law a roadblock to sustainability initiatives?*](#) (MinterEllison, 2020)