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THE CENTRE FOR POLICY DEVELOPMENT

“Climate Change and Directors’ Duties”

FURTHER SUPPLEMENTARY MEMORANDUM OF OPINION

23 April 2021

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and

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Further Supplementary Memorandum of Opinion

Introduction

1. On 31 October 2016 and 29 March 2019, the Centre for Policy Development published our written opinions on the extent to which the duty of care and diligence imposed upon company directors by s 180(1) of the *Corporations Act 2001* (Cth) permits or requires Australian company directors to respond to climate change risks.

2. Our 2016 opinion indicated that, in our view, company directors who failed to consider climate change risks then could be found liable for breaching their duty of care in the future. We said company directors *can*, and in some cases, *should*, be considering the impact on their business of climate change risks. In our 2019 opinion, we observed "a profound and accelerating shift in the way that Australian regulators, firms and the public perceive climate risk", and concluded that these matters had considerably elevated the standard of care that would be expected of a reasonable director. We said it was "increasingly difficult in our view for directors of companies of scale to pretend that climate change will *not* intersect with the interests of their firms" and that exposure of individual directors to liability was increasingly exponentially.

3. Various developments since that time have contributed to what we perceive to be a growing sense of regulatory, investor and community pressure for directors to understand, and to *convey* that they understand, that the financial risks of a changing climate are to be taken seriously as economic and operational risks. This pressure is reflected in ever-increasing levels of climate risk disclosure in financial statements, and, relevantly for present purposes, in a proliferation of commitments by Australian companies to achieving "net zero" carbon emissions by particular points in time (e.g. 2050 or earlier).

4. It is clear the benchmark for directors on climate change and attendant risks and opportunities continues to rise. Firms and sectors with significant exposures to a decarbonising global economy are facing pressure from their shareholders and stakeholders to consider net zero strategies and commitments of this nature. The COVID-19 pandemic has elevated a focus on how firms and sectors prepare and act in respect of other foreseeable systemic risks like climate change. In our opinion, 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.

5. These matters were the subject of a December 2020 roundtable convened by the Centre for Policy Development, attended by senior Australian businesspeople, lawyers and policy-makers. The roundtable focused on a range of legal and practical challenges pertaining to directors' duties and climate risk, upon which further legal advice and guidance is desirable. Importantly, these included emerging issues of "greenwashing", which we understand to mean inaccurate climate-related statements and disclosures, including flawed climate scenario analysis and "net zero" commitments that are misleading or made without a reasonable basis.

6. The increasing number of "net zero" commitments brings into focus an acute litigation risk, namely that a company (e.g. through its financial statements and disclosures) may make *future representations* concerning climate risk and risk-mitigation, which it may not have a reasonable basis to make at the present time, and which may therefore be taken to have misled or deceived, or to be likely to mislead or deceive, the users of those financial statements. It appears to us that this dynamic may not be adequately appreciated within corporate Australia, although it is certainly appreciated by ASIC.[1]

7. To that end, we have been asked to update our earlier opinions on climate change and directors' duties, and analyse the litigation risks relating to greenwashing in the particular context of "net zero" commitments. In summary, and for reasons set out below, our opinion is that:

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* The authors acknowledge the brief provided by MinterEllison, research assistance provided by Mr Nicholas Young, and thank the many experts whose insights helped to inform the development of this opinion.

[1] Australian Securities & Investments Commission (ASIC), *Corporate Finance Update – Issue 4* (March 2021), available here; ASIC, *Corporate Plan 2020-24* (August 2020), available here.

7.1 The standard of care to be exercised by directors with respect to climate change has risen and continues to rise.

7.2 "Net zero" commitments by companies are becoming common and appear to be regarded by many directors as an appropriate or necessary step in the discharge of their duties. Consideration of the impact of these commitments and related developments would also appear to be regarded by many directors as an appropriate or necessary step in the discharge of their duties, regardless of whether or not the corporation to which they owe a duty has made such a commitment.

7.3 Companies making net zero commitments require “reasonable grounds” to support the express and implied representations contained within such commitments at the time those commitments are made.

7.4 It is foreseeable that a company (and its directors) could be found to have engaged in misleading or deceptive conduct or other breaches of the law by not having had reasonable grounds to support the express and implied representations contained within its net zero commitment.

7.5 There are practical steps companies and directors can take to reduce the likelihood of liability arising from a net zero commitment and to increase the likelihood of available defences for their actions.

Recent developments affecting the standard of care

8. Since the finalisation of our 2019 opinion, there have been a number of significant developments which, in our opinion, are capable of bearing upon a director’s standard of care.

9. Some of the important matters include the following:

9.1 *Continued emphasis by Australia’s financial regulators.* Australia’s financial regulators appear to have a co-ordinated focus on climate risk and disclosure. APRA has recently released new draft guidance to banks, insurers and superannuation trustees on climate-related financial risk management, emphasising that it is prudent practice for boards to “seek to understand and regularly assess the financial risks arising from climate change".[2] APRA is also conducting a supervisory review of climate risk governance, as well as vulnerability assessments to stress test the resilience of Australia's banks, financial system, and economy against climate risks.[3] ASIC has recently reiterated that "disclosing and managing climate-related risk is a key director responsibility."[4] ASIC has also reiterated earlier climate risk guidance to directors, including its view that material climate risks must be discussed in operating and financial reviews, emphasising that it "may consider enforcement action should there be serious disclosure failures".[5]

9.2 *Clear guidance on assessing and reporting climate risk materiality.* In April 2019, the Australian Accounting Standards Board and Auditing and Assurance Standards Board issued an updated joint guidance on disclosure and materiality of climate change risks.[6] This guidance, echoed by the International Accounting Standards Board,[7] explains that climate risks may be material to financial statements, including insofar as they impact asset impairment, the useful lives of assets and fair valuation. ASIC has reiterated this view in its updated guidance on impairment of non-financial assets.[8] Similarly in November 2020, the International Financial Reporting Standards (IFRS) Foundation published a guide demonstrating that IFRS standards already require companies to consider climate risks which are material to financial statements.[9]

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2 Australian Prudential Regulation Authority (APRA), *Prudential practice guide: Draft CPG 229 Climate Change Financial Risks*, (April 2021), 13, available here.

3 APRA, *Information Paper: APRA's Supervision Priorities* (February 2021), available here.

4 ASIC Commissioner Cathie Armour, 'Managing climate risk for directors' (February 2021), available here.

5 Ibid.

6 Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB), 'Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2' (April 2019), available here.

7 International Accounting Standards Board (IASB), 'IFRS standards and climate-related disclosure' (November 2019), available here.

8 ASIC, 'Information Sheet - Impairment of non-financial assets: Materials for directors (INFO 203)' (August 2019), available here.

9 International Financial Reporting Standards Foundation, 'Effects of climate-related matters on financial statements' (November 2020), available here.

9.3 *The emergence of an industry-standard form of disclosure.* The Task Force on Climate-related Financial Disclosures (TCFD) recommendations appear to have transitioned from "best practice" to industry standard. They are endorsed by APRA, ASIC and the ASX Corporate Governance Council.[10] TCFD-aligned disclosures have been or will soon be made mandatory for some sectors in the United Kingdom, and other jurisdictions such as New Zealand.[11] Many of the jurisdictions taking such steps are countries where Australian firms have subsidiaries and are major two-way trade and investment partners.

9.4 *Measures to accelerate decarbonisation by global trading partners, firms and investors.* The world's largest economies, including the United States, the European Union and China, have committed to achieving net zero emissions by mid-century. In total, 14 of Australia's top 20 trading partners – including the United Kingdom, Japan and South Korea – have made similar commitments.[12] Increasingly, these long-term commitments are being underpinned by substantial interim emissions reductions targets and measures, such as the 2030 and 2035 targets announced by the United States, United Kingdom, European Union and other jurisdictions as part of the April 2021 Leaders Summit on Climate. Global investors, individually and through collaborations like the Net Zero Asset Owner Alliance and Climate Action 100+, are taking significant steps to decarbonise investment portfolios and drive more ambitious corporate responses to climate risk. Similarly, many of the world's (and Australia's) largest banks have committed to reducing their

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[10] For example, see ASIC (n 4); APRA, 'Understanding and managing the financial risks of climate change', Letter to APRA-regulated entities (24 February 2020), available here; ASX Corporate Governance Council, '4th Edition of the Corporate Governance Principles' (February 2019), available here.

[11] See HM Treasury, 'Interim Report of the UK's Joint Government-Regulator TCFD Taskforce' (November 2020), available here; Hong Kong Monetary Authority, 'Cross-Agency Steering Group Launches its Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future' (17 December 2020), available here; New Zealand Government Ministry for the Environment, 'Mandatory climate-related financial disclosures' (September 2020), available here.

[12] Centre for Policy Development, 'Chasing the Pack: Australia's prospects on green trade and climate diplomacy', Discussion Paper (February 2021), available here.

financed emissions to net zero by 2050.[13] A growing number of companies have now made net zero commitments globally and in Australia.[14]

9.5 *More ambitious and coordinated responses at the industry level.* There have been several Australian industry-based initiatives addressing climate risks, by establishing frameworks for disclosure, scenario analysis and risk management. These include the Climate Measurements Standards Initiative, the Australian Sustainable Finance Initiative, Climate League 2030, and the Australian Industry Energy Transitions Initiative.[15]

10. In our opinion, developments of this kind are pertinent to a director's standard of care: they serve to emphasise the foreseeability and materiality of climate risks, together with the accelerating impact of responses to climate change on the economy.

11. We would also observe that many countries have taken steps to align COVID-19 recovery and rebuilding packages with climate and decarbonisation priorities, including the United States which has incorporated far-reaching measures on climate and carbon transition at the heart of its plans for economic recovery.[16] The pandemic appears to have accelerated rather than diminished the momentum of the developments we have described. Indeed, the Network of Central Banks and Supervisors for Greening the Financial System, of which the Reserve Bank of Australia is a member, has said the "sweeping disruption to our daily lives and huge swathes of our economies from lockdown measures is a real-life stress test of what we could potentially experience in an increasingly unstable climate or disorderly transition shock".[17]

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[13] In April 2021, 43 global banks with US$28.5 trillion in assets became founding members of the UN-convened Net Zero Banking Alliance, committing to aligning lending and investment portfolios with net zero emissions by 2050 and setting science-based interim targets. See UN Environment Program, *Net Zero Banking Alliance*, (21 April 2021), available here.

[14] ClimateWorks Australia, 'Net Zero Momentum Tracker' (2021), available here.

[15] Climate League 2030 members include Cbus, Lendlease, UniSuper, AustralianSuper and IFM Investors, and Australian Industry Energy Transitions Initiative members include BHP, AustralianSuper, Orica, BP, NAB, Woodside, Bluescope, ClimateWorks, the CSIRO and the Australian Gas Infrastructure Group.

[16] White House, 'Fact sheet: The American Jobs Plan' (31 March 2021), available here.

[17] Network of Central Banks and Supervisors for Greening the Financial System, 'Statement on the need for a green recovery out of the Covid-19 crisis' (8 June 2020), available here.

12. Further, these considerations apply equally to other regulated decision-makers, including directors of superannuation funds and public sector authorities, to which the law applies an objective standard. Trustee directors under the *Superannuation Industry (Supervision) Act 1993* (Cth) are required to exercise the same "degree of care, skill and diligence" as a *prudent* superannuation entity director.[18] Likewise, directors of public sector authorities governed (for example) by the *Public Governance, Performance and Accountability Act 2013* (Cth) are required to perform their powers, functions and duties with "with the degree of care and diligence that a reasonable person would exercise" in that position.[19] In each case, relevant legislation, and the circumstances of the entity in question, will be determinative.[20]

13. Net zero emissions targets, commitments and strategies have become a critical focal point for assessing board-level climate governance. This is part of a shift towards *planning and action* to manage risks and opportunities in the transition to a zero-carbon economy – it no longer being sufficient merely to identify and disclose such risks. This presents an acute risk associated with greenwashing.

Aspects of the Legal Framework for Financial Disclosure

14. It now appears to be widely accepted that Australian law requires any material exposure to climate change risks to be incorporated into the various financial disclosures mandated by the *Corporations Act 2001* (Cth).

15. The Act stipulates requirements relating to the content of directors' reports (s 299 and s 299A(1)), annual financial reports (s 295) and continuous disclosure obligations (s 674). Relevantly for present purposes, directors' reports must include, for example, likely developments in the entity's operations in future financial years (s 299(1)(e)) and contain information reasonably required for members to make an informed assessment of the entity's business strategies and prospects for future financial years (s299(A)(1)(c)).

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18 *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A(2)(b).

19 *Public Governance, Performance and Accountability Act 2013* (Cth) s 25(1).

20 For a recent discussion, see Centre for Policy Development, 'Public authority directors' duties and climate change', Discussion Paper (January 2019), available here.

16. ASIC and APRA have continued to emphasise that climate change-related assumptions may be material to financial statements, and to encourage regulated entities to adopt a framework for disclosure that is aligned with that recommended by the TCFD.[21]

17. Disclosure consistent with the TCFD framework will require that companies make representations about the nature of their businesses. For example, recommended disclosures under the framework include describing "the resilience of the organization's strategy, taking into consideration different climate-related scenarios", describing "the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning", and describing "the targets used by the organization to manage climate-related risks and opportunities".[22] These representations will often be *forward looking*, placing greater emphasis on companies' long term climate risk strategies.

Pressure to Commit to Net Zero

18. There is increasing momentum towards net zero commitments. There is also an increasing sophistication in the understanding of the meaning of net zero, how companies are expected to achieve it, and processes to scrutinise progress towards these targets.

19. There are net zero targets in all Australian States and Territories.[23] Many of Australia's largest superannuation funds and banks have now publicised commitments to net zero emissions by 2050.[24] Investor groups are mobilising collectively to push for more effective net zero planning. For example, Climate Action 100+, an initiative involving over 500 global investors which is active in Australia, has

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[21] APRA (n 2); ASIC (n 4).

[22] FSB Task Force on Climate-related Financial Disclosures (TCFD), *Final Report* (June 2017), available here.

[23] *Climate Change Act 2017* (Vic); *Climate Change and Greenhouse Gas Reduction Act 2010* (ACT); New South Wales Government, 'NSW Climate Change Policy Framework' (2016), available here; South Australian Government, 'Climate Change Action Plan 2021-2025' (December 2020), available here; Queensland Government, 'Queensland Climate Transition Strategy' (2017), available here; Northern Territory Government, 'Northern Territory Climate Change Response: Towards 2050' (2020), available here; Western Australian Government, 'Western Australian Climate Policy' (2020), available here; Tasmanian Government, 'Climate Action 21' (2019), available here.

[24] ClimateWorks Australia, 'Net Zero Momentum Tracker' (2021), available here.

called upon the CEOs and chairs of 161 global companies (collectively responsible for over 80 per cent of global industrial emissions) to put in place net zero business strategies.[25]

20. In November 2019, the Australian Government published the *Climate Active Carbon Neutral Standard for Organisations*, which is a voluntary standard that provides best-practice guidance on how to measure, reduce, offset, validate, and report emissions that occur as a result of the operations of an organisation.[26] In February 2021, the Clean Energy Regulator announced a new Corporate Emissions Reduction Transparency report which will engender greater scrutiny of companies' progress towards their net zero commitments.[27]

21. In September 2020, the Science Based Targets initiative, a partnership between CDP and the UN Global Compact amongst others, published their report *Foundations for Science-Based Net-Zero Target Setting in the Corporate Sector*.[28] Similarly, in March 2021, the Institutional Investor Group on Climate Change launched their *Net Zero Investment Framework*.[29] Also in March, the Climate Action 100+ released its first set of assessments under its *Net-Zero Company Benchmark*.[30] The latter defines key benchmarks for assessing business alignment with a net zero emissions future, including net zero ambition by 2050 or sooner and clear short, medium and long term decarbonisation targets and strategies.

22. The increasing prevalence of net zero commitments amplifies the risk of greenwashing.

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25 Climate Action 100+, 'Climate Action 100+ Calls for Net-Zero Business Strategies and Sets Out Benchmark of Largest Corporate Emitters' (14 September 2020), available here.

26 Australian Government Department of Industry, Science, Energy and Resources, 'Climate Active Carbon Neutral Standard for Organisations' (November 2019), available here.

27 Australian Government Clean Energy Regulator, 'Consultation Paper – Corporate Emissions Reduction Transparency report' (February 2021), available here.

28 Science Based Targets, 'Foundations for Science-Based Net-Zero Target Setting in the Corporate Sector' (September 2020), available here.

29 Institutional Investors Group on Climate Change, 'Net Zero Investment Framework Implementation Guide' (March 2021), available here.

30 Climate Action 100+, 'Net-Zero Company Benchmark' (2021), available here.

Net Zero Commitments as "Future Matters"

23. In our opinion, depending upon the way in which they are expressed, net zero commitments (and other predictions about a company's ability to mitigate climate risks) are capable of constituting representations as to future matters.

24. Consider the following examples:

- "We support the Paris Agreement objectives and are committed to achieving net zero carbon emissions by 2050."
- "Our ambition is to reach net zero emissions by 2050 across our operations."
- "Our aspiration is to achieve net zero Scope 1 and 2 emissions by 2050."

25. The underlined words might be thought to express deliberately varying degrees of dedication. What would a user of financial statements understand by these words?

26. Section 1041H of the *Corporations Act 2001* (Cth) prohibits conduct which is misleading or deceptive, or likely to mislead or deceive. Section 12DA of the *ASIC Act 2001* (Cth), and s 18 of the *Australian Consumer Law*, contain similar prohibitions. It is very common in this country to have litigation about misleading or deceptive conduct comprising express or implied representations made in the financial statements of listed companies.[31]

27. For the most part, the legal principles in respect of these provisions have been well-established for some time. Conduct is misleading or deceptive, or likely to mislead or deceive, if it has a tendency to lead a consumer into error.[32] The word "likely" has been held to require a "real or not remote chance or possibility regardless of whether it is less or more than fifty per cent".[33] In the context of s 50 of the *Competition and Consumer Act*, "likely" means a "real commercial likelihood".[34] Determining whether conduct is misleading or deceptive is an objective enquiry, and there is no need to

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31 For example, see *TPT Patrol Pty Ltd v Myer Holdings Ltd* [2019] FCA 1747; *Fisher v Vocus Group Ltd* [2019] FCA 712; *Webster v Murray Goulburn Co-Operative Co Ltd (No 2)* [2017] FCA 1260; *Whittenbury v Vocation Ltd* [2017] FCA 1185.

32 *Australian Competition and Consumer Commission v TPG Internet Pty Ltd* (2013) 250 CLR 640, 655 [49].

33 *Global Sportsman Pty Ltd v Mirror Newspapers Pty Ltd* (1984) 2 FCR 82, 87.

34 *Australian Competition and Consumer Commission v Pacific National Pty Ltd* (2020) 277 FCR 49, 116 [246] (Middleton and O'Bryan JJ).

prove any person was actually misled or deceived.[35] It is also unnecessary to prove intention to mislead or deceive.[36]

28. Silence will constitute misleading or deceptive conduct if the circumstances are such as to give rise to a reasonable expectation that, if some relevant fact did exist, it would be disclosed.[37] The fact that a member of the public could have made inquiries and discovered the truth does not prevent such silence from being misleading.[38]

29. The conduct in question must also be assessed by reference to its audience.[39] Where conduct is directed to the public at large, or to a section of the public, the conduct is tested against an ordinary or reasonable member of that class.[40]

30. Where a representation is found to be a representation about a *future matter*, this will have particular consequences for the conduct of the litigation. Section 769C of the *Corporations Act 2001* (Cth) provides that, if a person makes a representation about a future matter, and the person "does not have reasonable grounds for making the representation", then the representation is "*taken to be misleading*". Section 12BB of the *ASIC Act 2001* (Cth) and s 4 of the *Australian Consumer Law* are similar. Section 769C(1) of the *Corporations Act 2001* (Cth) provides as follows:

> *For the purposes of this Chapter, or of a proceeding under this Chapter, if:*
>
> *(a) a person makes a representation with respect to any future matter (including the doing of, or refusing to do, any act); and*
>
> *(b) the person does not have reasonable grounds for making the representation;*
>
> *the representation is taken to be misleading.*

31. Section 12BB(1) of the *ASIC Act 2001* (Cth) provides that:

> *If:*

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35 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 198-199.

36 *Australian Competition and Consumer Commission v TPG Internet Pty Ltd* (2013) 250 CLR 640, 657 [56].

37 *Addenbrooke v Duncan (No 2)* (2017) 348 ALR 1, 119 [482] (Gilmour and White JJ; Dowsett J agreeing); *Rafferty v Madgwicks* (2012) 203 FCR 1, 68 [277]–[278].

38 *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (1988) 39 FCR 546, 558.

39 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 199.

40 *Campomar Sociedad Limitada v Nike International Limited* (2000) 202 CLR 45, 87 [105].

(a) a person makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act); and

(b) the person does not have reasonable grounds for making the representation;

the representation is taken, for the purposes of Subdivision D (sections 12DA to 12DN), to be misleading.

32. Similarly, s 4(1) of the *Australian Consumer Law* stipulates that:

If:

(a) a person makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act); and

(b) the person does not have reasonable grounds for making the representation;

the representation is taken, for the purposes of this Schedule, to be misleading.

33. Although these provisions do not shift the ultimate onus of proof,[41] a finding that a representation concerns a *future matter* places an evidential burden on the person who makes the representation, to adduce evidence that there were reasonable grounds for making it.[42]

34. Whether a statement relates to a future matter depends upon the words used and their context.[43]

35. An example of a net zero commitment contained in financial statements is as follows:

"2030 target: Reduce Scope 1 and 2 absolute emissions by 26–30% by 2030 from 2020 baseline.

2030 Scope 3 emissions target: [the company] will actively work with customers to reduce their Scope 1 and 2 emissions by >1 mtCO2e per year by 2030.

2040 target: Net zero Scope 1 and 2 absolute emissions by 2040."

36. Commitments of this kind are capable of conveying representations, including to the effect that:

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[41] *GlaxoSmithKline Australia Pty Ltd v Reckitt Benckiser (Australia) Pty Limited (No 2)* [2018] FCA 1, 38 [149].

[42] *Australian Competition and Consumer Commission v Woolworths Limited* [2019] FCA 1039, 37 [113] (this point was not disturbed on appeal).

[43] *Australian Competition and Consumer Commission v Woolworths Group Limited* [2020] FCAFC 162, 40 [125].

36.1 the company intends to achieve net zero emissions by the date stipulated;[44]

36.2 the company expects to achieve net zero emissions by the date stipulated;[45]

36.3 the company's expectation is based on reasonable grounds, and formed on the basis of reasonable enquiries.[46] In the present context, that might include that the company is engaged in planning to achieve that end; and

36.4 if new facts arose which would prevent the net zero commitment from being fulfilled, that those facts would be disclosed, and the commitment amended.[47]

37. In our opinion, a net zero commitment of this kind is inherently "in the nature of a promise, forecast, prediction or other like statement about something that will only transpire in the future".[48] It conveys "something about what may (or may not) happen"[49] and is consequently not "capable of being proven to be true or false when made".[50] Therefore, it is likely to be a representation as to a future matter, requiring the existence of "reasonable grounds". For there to have been "reasonable grounds", there must have existed "facts sufficient to induce that state of mind in a reasonable person".[51] A person's belief that they had reasonable grounds is not relevant,[52] and the fact that a representation is later proved correct does not mean that the grounds upon which it was based were reasonable.[53]

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44 For example, see *Awad v Twin Creek Properties Pty Ltd* [2011] NSWSC 923, 11 [29] (on intention to perform).

45 Ibid (on expected ability to perform).

46 For example, see *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304, 321 [33] (French CJ).

47 For example, see *Thong Guan Plastic and Paper Industries SDN BHD v Vicpac Industries Australia Pty Ltd* [2010] VSC 11, 34-35 [123]-[125] (on reasonable expectation of disclosure).

48 *Australian Competition and Consumer Commission v Woolworths Group Limited* [2020] FCAFC 162, 43-44 [132].

49 *Samsung Electronics Australia Pty Ltd v LG Electronics Australia Pty Ltd* [2015] FCA 227, 21 [84].

50 *Australian Competition and Consumer Commission v Woolworths Group Limited* [2020] FCAFC 162, 43-44 [132].

51 *Prior v Mole* (2017) 261 CLR 265, 298 [98] (Gordon J); *Australian Competition and Consumer Commission v Dateline Imports Pty Ltd* [2015] FCAFC 114, 23 [100]; *George v Rockett* (1990) 170 CLR 104, 112.

52 *Cummings v Lewis* (1993) 41 FCR 559, 565 (Sheppard and Neaves JJ).

53 *Australian Competition and Consumer Commission v Dateline Imports Pty Ltd* [2015] FCAFC 114, 23 [99].

38. It follows that companies making net zero commitments require “reasonable grounds” to support the express and implied representations contained within a net zero commitment. Moreover, reasonable grounds are required *at the time of making a net zero commitment*.[54] That is, companies wishing to commit to net zero must have a reasonable basis *now* for believing that they can achieve that commitment.

39. Consequently, it is foreseeable that a company (and its directors) could be found to have engaged in misleading or deceptive conduct by not having had reasonable grounds to support the express and implied representations contained within its net zero commitment. Directors may also face personal liability as a result of “stepping stone liability”,[55] where, by facilitating the making of the misleading representation, they will be found to have breached their own duties of care.

40. To be clear, in our view, risks relating to greenwashing do not mean it is safer for directors to avoid making net zero commitments. Directors will need to consider in a robust way whether such a commitment is in the best interests of the company. Indeed, given the developments cited above, the risks of inaction on this front appear to be profound. Nor do we think that companies can only set out such targets or commitments if they have a complete roadmap or plan for how they will be achieved. Rather, a company must have a *genuine intention*, on reasonable grounds, to follow through with reasonable strategic efforts and commitment of resources as may reasonably be expected to fulfil the intent implied by the announced target. A company must also take care to *convey accurately* the stage of its progress on the journey when such commitments are announced, updated or impacted.

54 *Sykes v Reserve Bank of Australia* (1998) 158 ALR 710, 712 (Heerey J).

55 *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52, 641-642 [462]-[466] (Greenwood and Thawley JJ; Rares J in dissent); *Australian Securities and Investments Commission v Vocation Limited (In Liquidation)* [2019] FCA 807, 226 [730]-[732]; see also Ian Ramsay and Miranda Webster, ‘An Analysis of the Use of Stepping Stones Liability Against Company Directors and Officers’ (2021) *Australian Bar Review* 168; Alice Zhou, ‘A Step Too Far? Rethinking the Stepping Stone Approach to Officers’ Liability’ (2019) 47(1) *Federal Law Review* 151.

Practical Steps

41. To reduce the likelihood of liability arising from a net zero commitment, and to reduce the difficulty in any future litigation of demonstrating the existence of "reasonable grounds" for a past decision, directors can take several practical steps.

42. *First*, directors should develop a net zero strategy which is integrated with their company's operational strategy. An internally integrated decarbonisation strategy is likely to provide a surer footing for directors than a decarbonisation strategy contingent on unknown contingencies: such as the emergence of new technologies, or different carbon offsets, or other businesses in the company's supply chain reducing *their* emissions.

43. The company's net zero strategy should document the drivers of the company's ability to decarbonise, and the assumptions underpinning that strategy. The assumptions should be tested, and relevant deliberations should also be documented. Where appropriate, qualified external advisors may assist in the formulation or review of a net zero strategy, though this will not absolve directors of the responsibility of supervising the strategy and the grounds upon which it is based.[56]

44. For example, one issue that warrants careful attention in this context is the availability of effective and affordable carbon offsets in the future. Studies investigating historical offset programs have shown that often these programs have extracted less carbon than promised.[57] A failure to provide *additionality* is a common problem, especially when the same offset projects receive funding from multiple sources.[58] Other important factors for assessing the quality of offsets include *permanence* of emissions reductions, the absence of *leakage* whereby emissions are merely relocated from one

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[56] *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291, 330 [166]–[168]; *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109, 161.

[57] Henry Lee and Abigail Mayer, 'The Future of Carbon Offset Markets' (October 2020), 8, available here; see also Martin Cames et al, 'How additional is the Clean Development Mechanism?' (2016) Report prepared for the European Commission 1, 11.

[58] Axel Michaelowa et al, 'Additionality revisited: guarding the integrity of market mechanisms under the Paris Agreement' (2019) 19(10) *Climate Policy* 1211, 1213-1214.

place or activity to another, and credible *verification* or certification of offsets by third parties.[59]

45. If a viable carbon offset market exists in the future, the cost of offsets may be substantially higher. Research conducted by the Taskforce on Scaling Voluntary Carbon Markets and McKinsey & Company has found that demand for carbon offsets could increase by a factor of up to 100 by 2050.[60] Moreover, by 2030, the price of Australian Carbon Credit Units (ACCUs) could "more than double",[61] and the overall market for carbon credits could be worth upward of $50 billion USD.[62] Depending on the price, availability and characteristics of such offsets, as well as the company's circumstances, it may therefore be imprudent to rely on carbon offsets as the key pillar of a company's net zero strategy.

46. *Second*, the net zero strategy should explain which emissions it encompasses and the relevant time-frame, for example:

    46.1 Scope 1 emissions are those released as a direct result of an activity at a facility level. These include emissions from manufacturing processes and the burning of diesel fuel in trucks.[63]

    46.2 Scope 2 emissions are those from the indirect consumption of an energy commodity. For example, if a company uses electricity which is produced from burning coal, the emissions from burning the coal form part of the company's scope 2 emissions.[64]

    46.3 Scope 3 emissions are indirect emissions, other than scope 2 emissions, which are generated by the wider economy. They occur as a consequence of the activities of a facility, but from sources not owned or controlled by that facility's business. Some examples are extraction and production of purchased

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59 Henry Lee and Abigail Mayer, 'The Future of Carbon Offset Markets' (October 2020), 8, available here.

60 Taskforce on Scaling Voluntary Carbon Markets, *Final Report* (January 2021), 55, available here.

61 RepuTex Energy, 'What impact will a net-zero emissions target have on forecast ACCU prices?' (7 April 2021), available here.

62 Taskforce on Scaling Voluntary Carbon Markets, *Final Report* (January 2021), 68, available here.

63 Australian Government Clean Energy Regulator, 'Greenhouse gases and energy' (2018), available here.

64 Ibid.

materials, transportation of purchased fuels and use of sold products and services.[65]

47. Commitments addressing Scope 1 and Scope 2 emissions are commonplace. However, companies are increasingly incorporating Scope 3 emissions into their commitments which, for many companies, will constitute the greatest proportion of emissions. Particular care should be taken in expressing the scope or timing of a commitment.

48. *Third*, if a company's net zero strategy is amended, not suitably fulfilled, affected by supervening circumstances, or otherwise untenable, this information should be disclosed promptly. Circumstances surrounding net zero commitments (including heightening concern about climate change amongst governments, regulators, and investors) are apt to give rise to an expectation that should some relevant facts change, they would be disclosed.[66] For example, if a company's net zero strategy is premised on significant advancements in carbon capture and storage technologies, but those advancements do not materialise and achieving the net zero commitment consequently becomes impossible, there is likely to be a reasonable expectation that such facts would be disclosed as they become known. Hence, a company's failure to disclose may readily constitute misleading or deceptive conduct through silence.

Conclusion

49. The pendulum has swung on directors' duties and climate change. In 2016, our focus was the existence of the duty; that is, what directors could and should be doing on climate change to discharge their duty of due care and diligence. That is now uncontroversial. In 2019, we observed that the risk of liability for directors on this front was rising exponentially. In 2021, it appears to us that the focus is increasingly on *how* the duty is discharged. One aspect of this is that a company (and its directors) could be found to have engaged in misleading or deceptive conduct or other breaches

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[65] Ibid.

[66] *Addenbrooke v Duncan (No 2)* (2017) 348 ALR 1, 119 [482] (Gilmour and White JJ; Dowsett J agreeing); *Rafferty v Madgwicks* (2012) 203 FCR 1, 68 [277]–[278].

of the law by not having had reasonable grounds to support the express and implied representations contained within climate change commitments.

50. There is reason to think that "greenwashing" claims of the kind outlined in this memorandum will become an acute source of risk. Cases of this kind have been emerging overseas.[67] Greenwashing could prove to be the focus of what has been called the "third wave" of climate change litigation.[68]

51. Duties, risks and opportunities relating to climate are increasingly well understood, and more sophisticated responses are taking shape. Accelerating impacts of climate change, and responses to climate change overseas and domestically, are profoundly influencing, positively and negatively, the interests of many Australian businesses. It is now perfectly clear that *reasonable* directors and firms should foresee these risks. We would caution against any misrepresentation about the steps such directors and firms may be taking in response.

23 April 2021

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[67] See for example: *State v BP America Inc*., No. N20C-09-097 (Del. Super. Ct., filed Sept. 10, 2020); 'Green groups file FTC complaint against Chevron over climate claims', *Reuters* (17 March 2021), available here; United Kingdom Competition and Markets Authority, 'Misleading environmental claims' (November 2020), available here.

[68] For example, see Brian Preston, 'Legal imagination and climate litigation' (2020) 35(1) *Australian Environment Review* 2, 3.