Paper Overview

'Directors' Duties in the Anthropocene: Liability for Corporate Harm Due to Inaction on Climate Change'

Author details

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Short Biography

Sarah Barker (B.Comm, LLB (Hons), M.Env (Hons), MAICD) is a Special Counsel in the Corporate Group at international law firm **Minter Ellison**. She has nearly two decades' experience advising on corporate governance and commercial law issues, with particular expertise in fiduciary duties, misleading conduct and competition (antitrust) law. Her clients include companies listed on Australian and international stock exchanges, in the finance, insurance, logistics, software, publishing, construction materials, manufacturing and distribution, retail, aviation and automotive sectors.

A significant part of Sarah's practice involves conducting workshops on strategic governance issues for boards and senior management, and the facilitation of 'top-down' shifts in entrenched corporate cultures. She is the author of the 'Directors' Duties & Responsibilities' unit of the **Australian Institute of Company Directors**' Company Directors' Course, and lectures both that unit and 'The Board's Legal Environment'.

Sarah has a particular professional interest in sustainable investment and progress toward a 'closed-loop' economy. She is a Non-Executive Director of the **Natural Resources Conservation League Limited** and Chairs the Audit & Risk Committee of the **Commissioner for Environmental Sustainability Victoria**. She is on the foundation board of **Bioregional Australia Ltd**, the regional representative of the **Bioregional Development Group** (UK) in the promotion and certification of 'One Planet Living'. She has undertaken graduate studies in economics at the **London School of Economics & Politics**, and holds a Master of Environment degree (awarded with Dean's Honours) from the **University of Melbourne**.

She is widely published in the financial press, academic and industry literature on the themes of governance, compliance and sustainability.

Additional publication details and professional references available on request.

Abstract

The paper considers the economic risks presented by climate change, and presents an applied analysis of the *personal liability* consequences for corporate boards who fail to proactively govern for those risks (and opportunities). Australian fiduciary law, as codified under the *Corporations Act 2001* (Cth), is applied as the exemplar. The paper is unique in its examination of the common rationales for governance inaction on climate change, and their utility (or otherwise) as defences to a claim for breach of duty.

The paper concludes that passivity, reactivity or inactivity on climate change governance is increasingly likely to contravene the directors' primary duty of competence, that of duty of care and diligence. Even where directors' subjective bona fides are not in question, inaction on climate change risks (and opportunities) may contravene the duty of care where it stems from:

- climate change denial;
- ignorance or unreflective assumption;
- paralysis caused by the inherent uncertainty of the magnitude and timing of climate change impacts; or
- a default to a base set by regulators or industry peers.

In addition, even considered decisions to prevail with 'business as usual' are increasingly unlikely to satisfy the duty (or the business judgment rule defence) - particularly if they are the product of a conventional investment methodology that fails to recognise the unprecedented challenges presented by an erratically changing climate.

Accordingly, directors who do not proactively respond to the commercial risks and opportunities of climate change, now, may be held to account for a breach of their fiduciary duties if corporate value becomes impaired into the future.

This conclusion provides a key platform for escalated investor engagement with investee directors on climate change risks.

Proposed extension

The author is currently preparing an extended version of the paper for presentation at the 2014 United Nations Principles of Responsible Investment Conference (Montreal, September 2014) with an application of its analysis and conclusions to generalised fiduciary liability principles for investor trustees and investee corporations:

> ***'ESG and fiduciary duty: personal liability of trustees and directors for climate change damages'***
>
> *[aka: 'No more Mr Nice Owner: using fiduciary law to drive ESG action when polite engagement fails']*

Indeed, Australian law provides an important exemplar in the international application of fiduciary duties, for a number of reasons. First, the fiduciary principles underlying Australian duties law are consistent with those in other common law (and indeed many civil law) jurisdictions: those of **loyalty** (generally, to act in good faith in the best interests of the principal), and of **competence** (generally, to act with prudence and exercise due care and diligence in the discharge of their duties).[1] Secondly, the Australian duties regime is applied in a manner that is relatively rigorous by global standards. This includes the operation of the 'Business Judgment Rule' as a notoriously narrow defence, rather than as a rebuttable presumption of competence. Thirdly, Australia has emerged as an attractive jurisdiction for shareholder class actions, with low 'class' threshold requirements coupled with a rise in specialist plaintiff law firms and professional litigation funders. Fourth, the exposure of companies listed on the Australian Stock Exchange (**ASX**) to significant climate change risks is substantial, with more than two-thirds of capitalised value concentrated in the resource, energy and financial sectors. The asset portfolios of the Australian superannuation industry - the fourth largest in the world with a funds pool in excess of US$1.5 trillion – are heavily weighted into to such equities. Accordingly, Australia presents as a prime jurisdictional candidate to test the content of trustees' and directors' governance obligations - a test that may have global implications for the corporate and institutional investment approach to ESG in general, and an embedded approach to climate change risks in particular.

Contribution to academic theory

This paper and its extensions represent a significant progression of the academic literature, in two ways. First, it challenges the orthodox positioning of climate change as a 'non-financial' issue. Secondly, it advances a significant new body of law and practice in relation to legal liability for climate change damage. These progressions are explained below.

(a) Reframing the debate on ESG and fiduciary duties

A theory of 'enlightened self-interest' is now generally accepted to prevail under Anglo-American fiduciary law.[2] This theory holds that the duty to act 'in the best interests' of the company (or beneficiaries) permits consideration of ESG issues *to the extent* that those 'extraneous' interests are consistent with the wealth maximisation interests of shareholders (beneficiaries). However, even the more progressive literature on point remains constrained by the inherent framing of climate change as an 'external environmental stakeholder': one whose interests are subservient to, and often inconsistent with, the priority of wealth

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[1] Of course, whilst the particular content of the duties of the particular responsibilities of different fiduciaries – from investment advisors to superannuation trustees to corporate directors – will differ, and will be subject to statutory gloss in each jurisdiction (for example, under the UK *Companies Act 2006*, *Pensions Act 2004*, *Corporate Governance Code* and *Stewardship Code 2010* and, in the US, the *Delaware General Corporation Law* and the *Model Business Corporation Act*, the *Employment Retirement and Income Security Act 1974* and *Uniform Trust Code 2002*, they are all ultimately grounded in these core fiduciary principles.

[2] See for example Corporations and Markets Advisory Committee (**CAMAC**), Parliament of Australia, *The Social Responsibility of Corporations* (2006); Freshfields Bruckhaus Deringer, *A legal framework for the integration of environmental, social and governance issues into institutional investment*, report prepared for the UNEP Finance Initiative Asset Management Working Group (October 2005); Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013); Parliamentary Joint Committee on Corporate and Social Responsibility (**PJC**), Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006); UNEP Finance Initiative Asset Management Working Group, *Fiduciary Responsibility – Legal and Practical Aspects of integrating environmental, social and governance issues into institutional investment* (July 2009).

maximisation. Understandably, therefore, many proponents of corporate social responsibility have called for the reinterpretation or expansion of fiduciary duties to ensure that long-term ESG issues are given due priority alongside financial aims.[3]

In contrast, this paper does purport to engage in the 'CSR' debate, and in fact takes a somewhat antithetical perspective on the relationship between 'the environment' and wealth maximisation. It proposes that developments in climate change science and corporate governance law mean that climate change can no longer be treated as an 'environmental externality'. It is now a squarely *financial* concern: not only consistent with, but *prerequisite to*, the maximisation of wealth beyond the short-term, and therefore imperative to fiduciary oversight of risk and strategy. In short, proactive governance of climate change issues is necessary (albeit not sufficient) to discharge a fiduciary's duties – even if the beneficiary's interests are singularly financial.

As a result, the conclusions of this research suggest that the seminal literature on climate change and fiduciary duty – the Freshfields Report (2005) (updated by the UNEP Finance Initiative Asset Management Working Group (2009)) – may now *understate* the fiduciary obligations on trustees to embed climate change issues (as a particular sub-set of ESG) into investment strategy.

(b) Liability for climate change damages

Despite the significant industrial contribution to anthropogenic climate change, the law on liability for the damage caused by climate change impacts is at an embryonic stage of development. There is even less law and scholarship on the specific question of directors' and trustees' liability for failures in the governance of climate risks – to either the corporation, beneficiaries or third parties. Early tentative examinations on point focussed mainly on duties arising from failures to mitigate emissions, and have been surpassed by developments in both the climate change science and corporate governance law. More recently, commentators such as Baker & McKenzie (2012), Share Action (formerly Fair Pensions) (2011, 2012), Shearing (2012), Fischer Kuh (2012), Hecht (2012), Godden et al (2013), Johnston, Burton and Baker-Jones (2013), Norton Rose Fulbright (2014) and West and Brereton (2013)[4] have begun to

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[3] See for example Gordon L. Clark, 'Fiduciary Duty and the Search for a Shared Conception of Sustainable Investment', in James P Hawley, Andreas GF Hoepner, Keith L Johnson, Joakim Sandberg and Edward J Waitzer (eds), *Cambridge Handbook of Institutional Investment and Fiduciary Duty*, Chapter 20 (Cambridge University Press, 2014); Andrew Keay, 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71(5) *The Modern Law Review* 663; Andrew Keay, *The Corporate Objective* (Edward Elgar, 2011). Note that whilst Keay's variation on the 'enlightened shareholder value' theory, the 'entity maximisation and sustainability model' is acknowledged, he uses the term 'sustainability' as a reference to 'continuing financial solvency' rather than in the context of the natural environment; Michael E Porter and Mark R Kramer, 'Creating Shared Value: How to reinvent capitalism - and unleash a wave of innovation and growth', *Harvard Business Review*, January-February 2011, 62; Joakim Sandberg, '(Re)-Interpreting Fiduciary Duty to Justify Socially Responsible Investment for Pension Funds?' (2013) 21(5) *Corporate Governance: An International Review* 436.

[4] See for example Baker & McKenzie, *Pension and Superannuation Trustees and Climate Change Report* (Sydney 2012); Katrina Fischer Kuh, 'Impact Review, Disclosure and Planning', in Michael B Gerrard and Katrina Fischer Kuh (eds), *The Law of Adaptation to Climate Change – US and International Aspects* (American Bar Association, 2012) 543; Sean B Hecht, 'Insurance', in Michael B Gerrard and Katrina Fischer Kuh (eds), *The Law of Adaptation to Climate Change – US and International Aspects* (American Bar Association, 2012) 511; Godden, Lee, Francine Rochford, Jacqueline Peel, Lisa Caripis and Rachel Carter, 'Law, Governance and Risk: Deconstructing the Public-Private Divide in Climate Change Adaptation' (2013) 36(1) *UNSW Law Journal* 224, 225; Gareth Johnston, Donovan Burton and Mark Baker-Jones, *Climate Change Adaptation in the Boardroom*, final report for National Climate Change Adaptation Research

recognise the potential relevance of climate change mitigation and adaptation in the context of fiduciary obligations. However, all have merely raised the *potential* for fiduciary duty to be enlivened. None have gone further to apply the relevant laws in detail, nor to investigate the practical circumstances in which liability is likely to occur. The research addresses that significant gap in the literature: examining the practical circumstances in which trustees and directors may be exposed to primary or accessorial liability for damage to beneficiaries or their corporation (or a third party) due to the impacts of climate change.

Relevance to conference theme and practical context for institutional investors

This research presents a prime example of the potential for academic research to have practical application for institutional investors and their advisors. In particular:

- ***Relevance to central themes of the PRI:*** The scope and content of fiduciary duties is central to the PRI Principles themselves, which are expressed to apply only '*where consistent with our fiduciary responsibilities*'. In addition, the paper addresses specific Conference topics including ESG Integration, Shareholder Engagement and Short-Termism. It is also consistent with the PRI Academic Network's Research Priorities for 2013/14, including the Fundamental Drivers of Return and Risk, Engagement and Barriers to Collaboration.

- ***A practical tool for institutional investor engagement -*** Responsible investment practitioners often cite effective engagement with investor trustees and investee boards as a key issue in ESG integration.[5] Overcoming barriers to such engagement with asset rich, yet time poor, trustees and directors is a common challenge – particularly on issues conventionally viewed as 'environmental externalities' such as climate change. Few issues capture the attention of trustees and directors (and their D&O insurers) like the spectre of personal liability. Accordingly, the conclusions of this research suggest a new basis for escalated engagement with investee businesses (or disinterested trustees) where other strategies to communicate the importance of climate change have failed.

- ***Practical relevance for governance and insurance -*** With continuing political paralysis on an effective global emissions mitigation treaty, fiduciary duties law has significant potential as a remedial cause of action for climate change harms: circumventing political impediments to legislative reform, and overcoming the barriers of duty and causation faced by tortious claims to date. This paper therefore represents not only a timely and important extension of the emerging scholarship on the role of litigation as a tool of climate change regulation and governance, but will be of critical practical interest to all governance stakeholders – including directors and their insurers, financiers, investment advisers, fund managers and, particularly, institutional investors.

Facility, Gold Coast, 2013, v; Susan Shearing, 'Raising the boardroom temperature? Climate change and shareholder activism in Australia' (2012) 29(6) *Environmental and Planning Law Journal* 479; Jason West and David Brereton, D, *Climate Change Adaptation in Industry and Business: A Framework for Best Practice in Financial Risk Assessment, Governance and Disclosure*, report for National Climate Change Adaptation Research Facility, Gold Coast, 2013, 68.

[5] See for example Baker & McKenzie, above n 4; Sandberg, above n 3.

- ***Commercial context -*** this academic research paper was written by a corporate practitioner who understands, and speaks the language of, the business and investment worlds. In fact, the paper's findings have already attracted significant interest as 'the missing piece in the engagement puzzle' from senior ESG practitioners within a number of PRI-member organisations. Attestations can be provided upon request.

Please do not hesitate to contact me should you wish to discuss any aspect of the attached paper or its extensions.

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Melbourne, June 2014