

Company directors can be held legally liable for ignoring the risks from climate change

Written by Travers McLeod, Honorary Fellow in the School of Social and Political Sciences, University of Melbourne

Company directors who don't properly consider climate related risks could be liable for breaching their duty of due care and diligence, a [new legal opinion](#) has found.

Although the alarm for business leaders has [been sounding for some time](#), the release of [the opinion](#) by senior barristers and leading solicitors confirms the potential liability for Australian company directors.

Australian companies are particularly [exposed](#) to the physical, transition and liability risks posed by climate change. The [Paris Climate Agreement](#), which comes into force today, [brings the transition risks \(and opportunities\) forward](#), given the policy and business changes necessitated by the agreement's commitment to a sustainable economy.

Directors' liability hinges on the foreseeability of risks or opportunities material to the best interests of the company. Courts have long experience of finding fault for inadequate responses to foreseeable risks, even where there is supposed uncertainty. Examples of this are when health risks associated with HIV and asbestos were improperly understood or managed. A defendant can be liable even though they are ignorant, if a reasonable person would have known about them.

Some corporate leaders might want to hit the snooze button again, but today's challenges to business as usual are acute. The long foreseen economic and environmental impacts of a changing climate are intensifying. Legally, any excuse that prior uncertainty about the science or impacts of climate change may have previously afforded directors has expired.

Corporate leadership ignoring interdependent economic, social and environmental risks and drivers of value has never been a sustainable long term strategy. Here are four reasons why there is only upside for business leaders to change course:

1. Markets are supporting the transition

Investors are demanding [better information](#) about companies' carbon emissions and risk management strategies so they can properly understand the near and long term prospects of the companies they are investing in. Increasingly, they are getting it. Large [institutional investors like BlackRock have led the charge on board-level](#) management of climate and other sustainability risks.

Underpinned by better information, new opportunities are being supported by [financial instruments such as green bonds](#)

or [government backed financing](#) for clean technology or renewable energy projects. Such instruments help capital flow towards investments that are consistent with decarbonisation of the economy in the longer term.

These initiatives are being reinforced by economy-wide measures like carbon pricing schemes to ensure that market prices reflect true costs of emissions-intensive activities. The latest example is Canada's decision to impose a [benchmark price](#) on carbon pollution.

Under this plan, Canadian provinces can decide how the revenue raised is spent, but are required to have an effective price of C\$10 per tonne of carbon pollution in 2018, rising by C\$10 each year to C\$50 per tonne in 2022.

2. Risk disclosure will improve and converge

[Michael Bloomberg's Taskforce on Climate-related Financial Disclosures](#) will update its (voluntary, business-led) framework for climate risk disclosure in December 2016. This is the next step in accelerated global efforts to increase transparency of physical, liability and transition risks.

In Australia, [enhanced ASX guidelines](#), which commenced in July 2014, require listed entities to disclose any exposure to economic, environmental and social sustainability risks, and how

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such risks will be managed.

[Calls to renew](#) the lapsed Senate Economics Committee inquiry into carbon risk disclosure have been answered; the committee will report in early 2017.

However, significant issues remain around consistency and comparability of disclosures. The [level of variation](#) of disclosure of carbon-related and other sustainability risks by entities in the same sector, including Australia's [banks](#), is concerning.

3. Regulators are focusing more on climate risk

Global regulators are stepping up supervision of firms exposed to disruptive climate related changes in asset prices, technology, and policy. [Bank of England Governor Mark Carney, said](#) that regulators and investors expect much more than “static” disclosure of risks.

Australian regulators are [sending similar signals](#) that more sophisticated stress testing and scenario-based analysis of climate related risks will be par for the course.

4. Better political dynamics

With the [Paris targets locked in](#), more ambitious national policy settings needed to deliver them will not be far away. Years of policy reversals and missteps domestically and globally have been replaced by the policy certainty business craves.

Pressure from Australian businesses for the government to take ambitious commitments to Paris in 2015, including through the [Australian Climate Roundtable](#), is a sign the game has shifted, albeit after years of diversion and delay for which business leaders share some

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responsibility.

This trend was reinforced when [NSW became the latest state government](#) to commit to a net zero emissions target by 2050. Policy changes inevitably create transition risks. But by supporting the implementation of effective, proactive policy, business can reduce the risks of sharper and unpredictable responses later.

Corporate governance will be tested against this backdrop. The implications are clear: at a minimum, where they are not already, climate and other sustainability issues must be elevated to the board level. Boards must establish the information channels, governance processes and technical capabilities. They must also be able to cultivate shareholder support for effective long-term strategies, rather than short-term sugar hits.

The coming into force of the Paris Climate Agreement promises to be a historic global tipping point in accelerating the transition to a net zero carbon economy. The release of this legal research on directors' duties is a timely and powerful reminder of the risks, opportunities – and responsibilities – which Australian company directors face in addressing this challenge.

This piece was written with Sam Hurley, Policy Director of the Centre for Policy Development's Sustainable Economy Program.

Travers McLeod is CEO of the Centre of Policy Development (CPD), which is funded by philanthropic foundations and donations from community and business organisations. CPD partnered with the Future Business Council (FBC) to commission the legal opinion on directors' duties and climate risks from Noel Hutley SC and Sebastian Hartford-Davis, instructed by Sarah Barker and Maged Girgis of Minter Ellison Lawyers. CPD and FBC also jointly convened the business roundtable to discuss the legal opinion hosted by Minter Ellison Lawyers in October.

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