AUSTRALIAN COUNCIL OF SUPERANNUATION INVESTORS LIMITED

ADVICE REGARDING POTENTIAL LIABILITY OF DIRECTORS UNDER THE ISSB DRAFT STANDARDS FOR FORWARD LOOKING STATEMENTS

A. INTRODUCTION

1. Our instructing solicitors act for the Australian Council of Superannuation Investors Limited, the Investor Group on Climate Change and Responsible Investment Association Australasia.

2. In November 2021, the International Financial Reporting Standards (**IFRS**) Foundation announced the establishment of the International Sustainability Standards Board (**ISSB**), to address the growing global demand for more consistent and comparable disclosure of sustainability-related financial information. In March 2022, the ISSB published exposure drafts of the ISSB Draft Standards, which set out both *general* requirements for disclosing sustainability-related financial information (**General Requirements**) in Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (**General Requirements Exposure Draft**) and *specific* requirements for disclosure of climate-related risks and opportunities (**Climate Requirements**) in Exposure Draft IFRS S2 Climate-related Disclosures (**Climate-related Exposure Draft**). The ISSB aims to finalise the standards as early as possible in the 2023 calendar year.

3. The ISSB Draft Standards have prompted calls, in some quarters, for a "safe harbour" for forward-looking statements on the basis that compliance with the Draft Standards would create significant risk exposure for reporting entities and their directors. The concern, as we understand it, is that Australian company directors face comparatively higher exposure to liability risk compared to international peers, including because of the requirement in Australia to establish "reasonable grounds" for any forward-looking statements.

4. By written observations dated 11 November 2022, we are asked to advise on the following questions:

   (a) ***Question 1:*** Do the requirements in the Climate-related Exposure Draft in relation to forward-looking statements present *heightened* liability risks to company directors of publicly-listed corporations than those under prevailing disclosure laws?;

   (b) ***Question 2:*** To what extent is a "safe harbour" attaching to such forward-looking disclosures necessary or desirable in order to manage liability exposure risks for directors?; and

   (c) ***Question 3:*** What general principles of governance practice should be followed by directors in order to minimise liability concerns associated with forward-looking

statements made pursuant to the Climate-related Exposure Draft?

5. Before addressing these questions, it will be necessary first to outline some background detail about Australian financial reporting requirements: see **Section B** below.

6. In summary, in our opinion:

   (a) as set out in **Section C** below, the ISSB Draft Standards require disclosure of material information about sustainability risks in a manner which is *broadly* consistent with existing requirements that apply to listed companies in Australia, and requires disclosure of things which in our opinion company directors should *already* be considering in the proper discharge of their duties as directors. In this sense, although the ISSB Draft Standards increase the number and kinds of forward-facing matters that directors are *required* to disclose, for diligent company directors properly supported by competent management, the ISSB Draft Standards should not increase directors' exposure;

   (b) to the extent that the ISSB Draft Standards lead to the evolution of enhanced processes and disclosure standards within or across industries, this will impact on the expectations placed on directors in the general discharge of their duties, and the expectations placed upon them with regard to the provision of forward-looking information to the market. This may be characterised as a "heightened" level of risk, and may be expected to expose bad or substandard practices, but in practice simply reflects the need for directors to adapt and respond to climate risk issues facing their companies;

   (c) the legal requirement to have a "reasonable basis" for the making of forward-looking statements is capable of being sensitive to the inherent uncertainties in the scope, distribution, impacts and timing of the impacts of climate change. Directors must make a genuine assessment as to the appropriateness of the forward-looking disclosure at the time it is made, but they will not face liability merely because their assessment later turns out to be incorrect;

   (d) as set out in **Section D** below, from our perspective as *litigators*, a specific "safe harbour" aimed at climate and/or sustainability-related disclosures is not necessary or desirable. The ISSB Draft Standards will likely assist in *exposing* existing bad practice, in *improving* sub-standard practice (by providing a consistent framework against which sub-standard practice can be improved), and in *standardising* the reporting and disclosure which accompanies good practice. A safe harbour would only undermine those beneficial effects, by removing the effective incentive (liability risk) which will actuate them; and

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(e) as set out in **Section E** below, a number of practical steps may be taken to minimise liability concerns associated with forward-looking climate-related disclosures.

B. BACKGROUND

B.1 Existing Financial Reporting Requirements

7. Under the *Corporations Act 2001* (Cth) (the **Act**), listed reporting companies are required to prepare and lodge a financial report and a directors report each financial year (s 292), as well as comply with other periodic disclosure requirements and continuous disclosure obligations (s 674). Reporting entities are also subject to an overriding requirement under s 297 of the Act that financial statements present a "true and fair view" of financial performance and position.

8. Reporting entities are required to comply with Australian Accounting Standards promulgated by the Australian Accounting Standards Board (**AASB**) (s 296(1)). It is not possible here to be exhaustive about relevant AASB accounting standards, but we note that:

   (a) paragraph 125 of AASB 101 *Presentation of Financial Statements* requires a reporting entity to "disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year";

   (b) materiality is defined in AASB 101, in relation to omissions or misstatements, to be those which "could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements"; and

   (c) in their Joint Bulletin dated April 2019, AASB and the Auditing and Assurance Standards Board (**AUSB**) stated that "investors have specifically identified climate-related risks as being used in their decision making".

9. In our opinion, as a matter of law but subject always to the circumstances of the business in question, climate-related risks are therefore likely to be regarded by a Court as "material" within the meaning of AASB 101.

10. Further, the annual directors' report is required to give details of any matter or circumstance that has arisen since year-end that may significantly affect the entity's operations in future financial years (s 299(1)(d)(i)), and to refer to "likely developments in the entity's operations in future financial years and the expected results of those operations" (s 299(1)(e)). It is also required to contain information that members of the listed entity would reasonably require to make an informed assessment of the business strategies, and prospects for future financial years, of the entity reported on (s 299A(1)(c)). If a company's operations are subject to any particular and significant environmental regulation, the directors' report is required to give details of the

company's performance in relation to that regulation (s 299(1)(f)). These requirements are apt to include matters relating to climate risk.

11. There have been some key regulatory interventions relating to climate-risk reporting, including but not limited to the following:

    (a) the ASX Corporate Governance Council publication *Corporate Governance Principles and Recommendations (Fourth Edition)* (February 2019), Recommendation 7.4, which provides that companies are required to disclose whether they have any material exposure to environmental or social risks and if they do, how they manage or intend to manage those risks. The ASX listing rules also require companies to include within their annual report a "corporate governance statement" disclosing the extent to which the company has followed recommendations set by the ASX Corporate Government Council during the reporting period;[1]

    (b) the AASB/AUSB Joint Bulletin, which states (p.2) that "entities can no longer treat climate-related risks as merely a matter of corporate social responsibility and may need to consider them also in the context of their financial statements";

    (c) ASIC *Guidance 247, Effective Disclosure in an Operating and Financial Review* (August 2019), which provides at RG 247.66 that "[c]limate change is a systemic risk that could have a material impact on the future financial position, performance or prospects of entities", and states that directors may also consider whether it would be worthwhile to disclose additional information that would be relevant under the recommendations from the Task Force on Climate-related Financial Disclosures (**TCFD**) where that information is not already required for the OFR;

    (d) in February 2021, ASIC Commissioner Cathie Armour published an article, *Managing climate risk for directors*, which reiterated that listed companies should provide the market with reliable and useful information on their exposure to "material climate-related risks and opportunities", and that such disclosures are legally mandated where the material risk could affect the company's achievement of its financial performance;

    (e) ASIC's *Corporate Finance Update – Issue 4* (March 2021), in which ASIC reported on a surveillance exercise it had undertaken in relation to the climate change-related disclosure and governance practices of a cohort of large listed companies, focusing on the TCFD recommendations. In that update, ASIC addressed the need for all listed companies to comply with the law where it requires disclosure of material climate risk and, where climate risk is material, to consider the TCFD recommendations when

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[1] ASX Listing Rules, rule 4.10.3.

reporting;

(f) guidance from the NSW Treasury, *Guidance on how to reflect the effects of climate related matters in financial statements* (March 2021), in which the NSW Treasury states that "[i]n preparing financial statements, [public sector] agencies should consider climate related matters, if the effect of climate risk is material. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that primary users of financial statements make on the basis of those financial statements"; and

(g) in November 2021, APRA finalised the *Prudential Practice Guide CPG 229 Climate Change Financial Risks*, which draws on the structure of the TCFD recommendations. The guide states (at [50]) that "APRA considers it better practice for any disclosures to be in line with the framework established by the TCFD".

12. In our opinion, directors are already subject to a range of liability risks in connection with the discharge of their duties relating to climate-related issues, including for breach of the duty of care, skill and diligence and for misleading or deceptive conduct.

13. ***First***, under s 180(1) of the Act and at general law, directors are already exposed to claims that they have breached the duty of care and diligence to the company in relation to negligently prepared climate-related disclosures. It is now widely accepted that climate change risks (including physical, transition and litigation risks) represent foreseeable risks of harm to Australian businesses. This requires prudent directors to take positive steps to inform themselves and disclose the risks as part of financial reporting frameworks. Directors who fail to consider climate change risks could be found liable for breaching this duty. Honesty and conscientiousness is no excuse if reasonable steps have not been taken.[2] In complex situations which need specialist knowledge, directors may be required to seek and rely on expert or professional advice, which in turn will engage the protection under s 189 of the Act.[3]

14. Further, with reference to the reporting requirements outlined above, conduct that forms the basis for a company's breach of disclosure rules could potentially be the basis for an alleged contravention by the director of s 180(1) of the Act for failure to exercise due care and diligence through so-called "stepping stone" liability.[4]

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2 *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 at [8].

3 See also *AWA v Daniels* (1992) 7 ACSR 759, 865 (Rogers CJ).

4 *ASIC v Big Star Energy Ltd (No 3)* [2020] FCA 1442 at [512]: "Liability of a director may be triggered where a director's failure to exercise reasonable care and diligence has caused or allowed the company to contravene the Corporations Act, at least where it was foreseeable that such contravention might harm the company's interests", citing *ASIC v Mariner Corporation Ltd* (2015) 241 FCR 502 at [448]-[452] (Beach J); cited in *ASIC v Avestra Asset Management Ltd* (2017) 348 ALR 525 at [214]-[216]; cited by Nicholas J in *ASIC v Vocation* [2019] FCA 807 at [732].

15. It has been held that the business judgment rule, which absolves directors of liability under s 180(1) of the Act and the equivalent duties at common law and in equity, does not to apply to the disclosure of forward-looking information, on the basis that a decision as to what should be disclosed is not a "business judgment" relating to the "business operations" of the company under s 180(3).[5] On this analysis, if a director is liable for breaching the statutory duty of care and diligence in relation to a misleading forward-looking statement, no protection against liability is provided by the business judgment rule.

16. ***Second***, company directors are exposed to the risk of liability for misleading or deceptive conduct if forward-looking statements are made about climate risks and opportunities without a reasonable basis.

17. The Act prohibits misleading or deceptive conduct in relation to financial products (including shares) (s 1041H of the Act, and see comparable provisions in the ASIC Act and the ACL[6]). Conduct is misleading or deceptive if it has a tendency to lead people into error.[7] Determining whether conduct is misleading or deceptive is an objective enquiry, and there is no need to prove that any person was actually misled or deceived,[8] although this will be relevant to the award of damages or penalties. It is also unnecessary to prove *intention* to mislead or deceive.[9] The conduct must be assessed by reference to its audience,[10] which is likely to comprise investors, market analysts and other stakeholders.[11] The conduct will be assessed by reference to what message is conveyed to a reasonable member of the intended audience.[12]

18. Where a representation is made about a future matter, it will be "taken to be misleading" if the person making the representation "does not have reasonable grounds for making the representation" (s 769C of the Act).[13] Although this requirement does not shift the ultimate burden of proof, a finding that a director has made a representation concerning a future matter places an evidential burden on the director to adduce evidence that there were reasonable grounds for making that representation.[14] For there to have been "reasonable grounds", there

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5 See *ASIC v Fortescue Metals Group Ltd* (2011) 190 FCR 364 at [197]-[198] (Keane CJ); *ASIC v Vocation* [2019] FCA 807, cited in *ASIC v Big Star Energy Ltd (No 3)* [2020] FCA 1442 at [530]-[531].

6 Section 12DA of the ASIC Act and section 18 of the ACL.

7 *ACCC v TPG Internet Pty Ltd* (2013) 250 CLR 640 at [39].

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

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

10 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191, 199. See also *Fortescue Metals Group Ltd v Australian Securities and Investments Commission* (2012) 247 CLR 486.

11 *ASIC v Macdonald* (2009) 256 ALR 199 at [314].

12 *Fortescue Metals Group Ltd v Australian Securities and Investments Commission* (2012) 247 CLR 486 at [69].

13 See also s 12BB(1) of the ASIC Act and s 4(1) of the ACL.

14 *Australian Competition and Consumer Commission v Woolworths Limited* [2019] FCA 1039 at [113] (this finding was not disturbed on appeal).

must have existed "facts sufficient to induce that state of mind in a reasonable person"[15] at the time the representation was made.[16]

B.2 Existing Disclosure Guidance

19. Australian regulators (ASIC and APRA) and the ASX Corporate Governance Council have made clear that publicly listed companies should be making climate-related disclosures in line with the TCFD framework, on a "comply or explain" basis.[17]

20. A number of key statements and guidance materials have been published by Australian regulators in relation to the TCFD framework, including ASIC's *Corporate Finance Update – Issue 4* (March 2021) and APRA's *Prudential Practice Guide CPG 229 Climate Change Financial Risks* referenced at paragraph 11 above.

21. The TCFD framework consists of four major recommendations (governance, strategy, risk management, metrics/targets), 11 supporting recommended disclosures (together, the **TCFD Recommendations**), and sector-specific guidance (the **TCFD Guidance**). The TCFD Guidance informs implementation of the recommendations but is not part of the TCFD Recommendations. Of the 11 recommended disclosures, each of the recommended "strategy" disclosures and one of the "metrics and targets" disclosures contemplate the disclosure of the following forward-looking information:

    (a) Strategy Disclosure (a): disclosure of the climate-related risks and opportunities the organisation has identified over the short, medium and long term;

    (b) Strategy Disclosure (b): disclosure of the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning;

    (c) Strategy Disclosure (c): disclosure of the resilience of the organisation's strategy, taking into consideration different climate-related scenarios including a 2°C or lower scenario; and

    (d) Metrics & Targets Disclosure (c): the provision of a description of the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

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

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

17 See ASIC Commissioner Cathie Armour, *Managing climate risk for directors* (February 2021); APRA, *'Understanding and managing the financial risks of climate change', Letter to APRA-regulated entities* (24 February 2020); ASX Corporate Governance Council, *'4th Edition of the Corporate Governance Principles'* (February 2019).

B.3 The ISSB Draft Standards

22. Our instructing solicitors observe that, in recent years, there have been calls from accounting and auditing bodies to "connect the dots" between the risks to financial prospects associated with climate change and the financial statements governed by accounting standards. One of the issues is that many assumptions and variables relating to climate risk, which are material to the calculation of line items within the company's balance sheet, involve important assumptions relating to future matters (eg demand outlooks, discount rates and asset useful lives). These are matters which are impacted by climate-related financial risk.

23. The establishment of the ISSB under the IFRS Foundation's umbrella and the release of the ISSB Draft Standards is aimed at establishing a global baseline for sustainability reporting. ISSB is working with other international organisations and jurisdictions, including Australia, in relation to the ways in which this global baseline could be incorporated into domestic requirements. The exposure draft for the Climate Requirements states (p.5) that it was "developed in response to calls from users of general purpose financial reporting for more consistent, complete, comparable and verifiable information, including consistent metrics and standardized qualitative disclosures". The exposure draft therefore aims to "facilitate the provision of comparable information for global markets", by requiring an entity to provide information about its exposure to climate-related risks and opportunities (p.5).

24. In their current form, the provisions in the ISSB Draft Standards would require Australian companies to make a range of detailed forward-looking disclosures in relation to climate change, including, as set out in the Climate-related Exposure Draft:

    (a) significant climate-related risks and opportunities that could reasonably be expected to affect the entity's business model, strategy and cash flows, its access to finance and its cost of capital over the short, medium or long term (paragraph 9);

    (b) anticipated effects of significant climate-related risks and opportunities on its value chain (paragraph 12(b));

    (c) anticipated changes to its business model arising from significant climate-related risks and opportunities (paragraph 13);

    (d) the anticipated effects of significant climate-related risks and opportunities on its financial position, financial performance and cash flows over the short, medium and long term (paragraph 14);

    (e) the assessment of its climate resilience (i.e. the capacity of an organisation to adjust to uncertainty related to climate change), by using climate-related scenario analysis (the process of identifying and assessing a potential range of outcomes of future events

under conditions of uncertainty) unless the entity is unable to do so (paragraph 15); and

(f) targets set by the entity to mitigate or adapt to climate-related risks or maximise climate-related opportunities (paragraph 20(d)).

25. Disclosures would also be required in relation to gross greenhouse gas emissions generated by an entity in the reporting period, including Scope 1, Scope 2 and Scope 3 emissions (paragraph 21(a)(i)).

26. The ISSB has stated that, although some differences arise with respect to the implementation of the TCFD Guidance, the requirements proposed by the Climate Requirements are consistent with the TCFD Recommendations.[18] The ISSB has also confirmed that companies are required to use climate-related scenario analysis to report on climate resilience and to identify climate-related risks and opportunities to support their disclosures.[19]

27. The key difference for present purposes is the fact that the Climate-related Exposure Draft requires the provision of more detailed/granular forward-looking information than as is addressed under the TCFD framework. In relation to the matters set out at paragraph 21 above, the ISSB has stated that further disclosures will be required under the Climate Requirements in relation to:

(a) how an entity's strategy and plans will be resourced;[20]

(b) expected changes in financial position over time, including investment plans and sources of funding;[21]

(c) expected changes in financial performance over time (revenue and costs);[22]

(d) the disclosure of emission reduction targets; [23] and

(e) an entity's capacity to adjust and adapt its strategy over time. [24]

C. QUESTION 1: DO THE ISSB DRAFT STANDARDS PRESENT HEIGHTENED LIABILITY RISKS TO DIRECTORS?

28. We have summarised at **Section B.1** above certain aspects of Australian company directors' existing exposure to liability risk relating to reporting requirements.

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18 IFRS Sustainability, Comparison [Draft] IFRS S2 Climate-related Disclosures with the TCFD Recommendations, March 2022 (**Comparison Draft**).

19 https://www.ifrs.org/news-and-events/news/2022/11/issb-confirms-requirement-use-climate-related-scenario-analysis/

20 Comparison Draft, p 4.

21 Ibid.

22 Ibid.

23 Ibid.

24 Ibid, p 5.

29. Do the ISSB Draft Standards increase this exposure?

30. In our opinion, the ISSB Draft Standards require disclosure of material information about sustainability risks in a manner which is *broadly* consistent with existing requirements that apply to listed companies in Australia, and requires disclosure of things which company directors should *already* be considering in the proper discharge of their duties as directors. In this sense, for diligent company directors properly supported by competent management, the ISSB Draft Standards will not increase directors' exposure.

31. As discussed above, the current position under Australian law is that financial statements are *required* to disclose assumptions about the future, and sources of estimation uncertainty, including (where relevant to the business) in relation to climate-risk; and to refer to "likely developments in the entity's operations in future financial years" including in relation to climate-risk. Those disclosures are required by Australian law to be made on a reasonable basis in order for them not to be deemed to be misleading or deceptive. All of this already occurs under a threat of personal liability.

32. It is true that the ISSB Draft Standards increase the number and kinds of forward-facing things that directors are *required* to disclose. But, at a generalised level, the ISSB Draft Standards do not impose additional requirements upon company directors over and above what might already be considered to be required in the discharge of directors' duties of care, skill and diligence. When regard is had to the *nature* of the things that must be disclosed under the ISSB Draft Standards, it emerges that to a large degree they are things that company directors should (in discharge of their duties of care, skill and diligence) *already* be doing. Whilst comprehensive, the ISSB Draft Standards are directed only to that which is *material* for the entity in question, and thus to that which the directors should already be considering. In particular:

    (a) the company would be required by the Climate-related Exposure Draft to disclose significant climate-related risks and opportunities that could reasonably be expected to affect the entity's business model, strategy and cash flows, its access to finance and its cost of capital over the short, medium or long term (paragraph 9). Further, the anticipated effects of significant climate-related risks and opportunities on its financial position, financial performance and cash flows over the short, medium and long term (paragraph 14). These are things that directors should *already* be considering in the discharge of their duty to the company on the basis that the consideration of risks and opportunities is a core function of a company director, and is central to the duty of care;

    (b) the company would be required by the Climate-related Exposure Draft to disclose the anticipated effects of significant climate-related risks and opportunities on its value chain (paragraph 12(b)). This is something that directors likely should *already* be

considering in the discharge of their duty to the company, on the basis that the company's value chain is central to its financial health and stability.

(c) the company would be required by the Climate-related Exposure Draft to disclose anticipated changes to its business model arising from significant climate-related risks and opportunities (paragraph 13). This is something that Australian law already requires be done, and to be disclosed with a reasonable basis;

(d) the company would be required by the Climate-related Exposure Draft to disclose its assessment of its climate resilience (i.e. the capacity of an organisation to adjust to uncertainty related to climate change), by using climate-related scenario analysis (the process of identifying and assessing a potential range of outcomes of future events under conditions of uncertainty) unless the entity is unable to do so (paragraph 15). This is something that directors of companies in certain sectors likely should *already* be conducting in the discharge of their duty to the company, on the basis that it represents a proactive approach to climate risk assessment. We are aware that many companies are *already* conducting scenario analysis and *disclosing* the results of that analysis. In sectors where climate risk are most evident, there is already an expectation of rigorous financial analysis, targeted governance, comprehensive disclosures and, ultimately, sophisticated corporate responses at the individual firm and system level; and

(e) the company would be required by the Climate-related Exposure Draft to disclose the targets it sets to mitigate or adapt to climate-related risks or maximise climate-related opportunities (paragraph 20(d)). There is presently no legal requirement to formulate or disclose targets. But there is substantially increased social and investor pressure on directors to demonstrate that their companies are moving towards greener operating models by adopting "net zero" and other forward-looking commitments directed at combatting climate change. These market forces likely mean that directors of companies in certain sectors are *already* considering such targets in the discharge of their duties to the company, and in our experience are already required by market forces to do.

33. To this extent, the ISSB Draft Standards have a significant capacity to *assist* company directors by identifying with clarity and particularity the things that s 180(1) probably already requires them to be doing and Part 2M.3 requires the company to disclose, where those things are otherwise perhaps currently not very well appreciated. Further, the ISSB Draft Standards will *assist* company directors to make sure that management is already carrying out the kinds of

functions which will minimise liability risk to the greatest extent possible.

34. Relatedly, to the extent that the ISSB Draft Standards leads to the evolution of enhanced processes and disclosure standards within or across industries, this will impact on the expectations placed on directors in the general discharge of their duties, and the expectations placed upon them with regard to the provision of forward-looking information to the market. This may be characterised as a "heightened" level of risk, but in practice simply reflects the need for directors to adapt and respond to issues facing their companies. Directors of companies in impacted sectors must be able to demonstrate genuine engagement with climate change issues. To consider climate risks actively, and disclose them properly, will reduce exposure to liability. The ISSB Draft Standards can be expected to assist with that process.

35. In our opinion, the legal requirement to have a "reasonable basis" for the making of a forward-looking statement is not so blunt as to ignore that some matters which are required by the ISSB Draft Standards to be the subject of forward-looking statements are inherently uncertain. To the extent that there is inherent uncertainty in the scope, distribution, impacts and timing of the impacts of climate change, and to the extent that matters of that kind are required by the ISSB Draft Standards to be considered and disclosed, the "reasonableness" standard is capable of being sensitive to those difficulties. In other words, the legal requirement to have a "reasonable basis" does not require the introduction of certainty where the subject-matter makes that impossible. Each representation will be judged in its context, which will include any assumptions or other qualifications made at the same time. Reasonableness will then fall to be assessed in that context. So, where disclosures are made with appropriate disclosure of assumptions, methodologies and uncertainties, the assessment of reasonableness will take into account those assumptions and disclosed uncertainties.[25]

36. As an example of this, in *Bell Resources Ltd & Anor v BHP Co Ltd & Ors* (1996) ATPR 40-702, the court considered forecasts of the company's profitability communicated to shareholders. The court held in this case that the profit forecasts were balanced and, under the circumstances of the case, supported a conclusion that the shareholders would understand them in the context of assumptions to which management had applied reasonable professional judgment. The shareholders could therefore be assumed to understand the disclosures to be the opinion of the company, not incontrovertible truths about the future.

37. In *TPT Patrol Pty Ltd v Myer Holdings Ltd* [2019] FCA 1747, Beach J stated at [1320]-[1322]

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25 See, eg, *ASIC v Macdonald (No 11)* (2009) 256 ALR 199 at [373]-[374] (the actuarial reports relied upon were "inherently uncertain"). See also [79]-[83] of the General Requirements Exposure Draft, including the statement at [79]: "The use of reasonable estimates is an essential part of preparing sustainability-related metrics and does not undermine the usefulness of the information if the estimates are accurately described and explained".

that:

> "In determining whether a person held reasonable grounds for a representation of opinion, the relevant inquiry is into whether the facts possessed by him were capable of supporting the opinion that he held.
>
> A person will have had reasonable grounds for making a representation with respect to a future matter if there are facts which are sufficient to induce that state of mind in a reasonable person.
>
> The question whether there were reasonable grounds for the making of a profit forecast is to be resolved by looking at whether the relevant director had made a genuine assessment as to the appropriateness of the forecast. If such a genuine assessment had been made, there would be reasonable grounds to support the making of the forecast."

38. In its *Guidance 247, Effective Disclosure in an Operating and Financial Review*, ASIC states that: "In our view, the risk of being found liable for a misleading or deceptive forward-looking statement is minimal, provided:

    (a) the statements are properly framed in the operating and financial review as, for example, being based on the information available at this time;

    (b) the statements have a reasonable basis, which involves good governance at board level for signing off on the statements; and

    (c) there is ongoing compliance with continuous disclosure obligations when events or results overtake forward looking statements in the OFR."

39. Finally, in our opinion, at a practical level, the ISSB Draft Standards (if implemented) are likely to expose existing *bad* practice to a greater degree than is presently visible. To the extent that the ISSB Draft Standards increase the number and kinds of things required to be disclosed, there is probably a statistical increase in the probability of companies being found to have made misleading statements. In that sense, there may be a numerical increase in claims / investigations, and a corresponding increase in the exposure of directors. But that is not to say there will be an increase in the scope or magnitude of risk for directors acting with due diligence and properly supported by competent management.

D. QUESTION 2: TO WHAT EXTENT IS A 'SAFE HARBOUR' ATTACHING TO FORWARD-LOOKING DISCLOSURES NECESSARY OR DESIRABLE IN ORDER TO MANAGE LIABILITY EXPOSURE RISKS FOR DIRECTORS?

40. Before commenting on whether a "safe harbour" is necessary or desirable, it is necessary to identify two anterior questions: (1) how would the "safe harbour" work?; and (2) from which perspective is "necessity" or "desirability" to be measured?

D.1 Examples of "safe harbours"

United States

41. In the US, directors will be immune from liability in private actions for certain forward-looking statements[26] that turn out to be untrue if a "meaningful cautionary statement" is provided that identifies important factors that could cause actual results to differ materially from those in the forward-looking statement, and/or the forward-looking statements were immaterial, and/or the regulator cannot prove that the forward-looking statements were made with actual knowledge that the statements were false or misleading.[27]

42. In other words, there are *three* separate tests or means for securing a statutory safe harbour against potential liability for forward-looking statements.[28] In relation to the operation of these tests:

    (a) whether a statement is "forward-looking" will depend on the facts and circumstances of the language of the particular report but it does *not* need to be contained in a separate section or specifically labeled as such;[29]

    (b) cautionary language that is misleading in light of historical fact cannot be "meaningful" and therefore falls outside the test.[30] Nor can the cautionary language be boilerplate or vague – it must convey substantive information (tailored to the specific future projections) in order to be "meaningful";[31]

    (c) a statement is "immaterial" if a "reasonable investor could not have been swayed" by the statement. Vague, optimistic rhetoric or corporate "puffery" fall into this category;[32]

    (d) "actual knowledge" is a higher standard than recklessness;[33] and

    (e) to prove actual knowledge of false or misleading statements, courts consider whether an inference of scienter is at least as compelling as any opposing inference of nonfraudulent intent.[34]

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26 s 27A(i)(1) of the *Securities Act 1933* (US) defines what is a "forward-looking statement". The safe harbour is subject to a number of exclusions, including financial statements and statements made in connection with a tender offer or an IPO (s 27A(b) of the *Securities Act 1933* (US)).

27 s 27A(c) of the *Securities Act 1933* (US).

28 *Slayton v American Express Co,* 604 F3d 758, 766 (2d Cir, 2010).

29 *Slayton v American Express Co,* 604 F3d 758, 769 (2d Cir, 2010).

30 *Slayton v American Express Co,* 604 F3d 758, 770 (2d Cir, 2010), citing *Rombach v Chang,* 355 F.3d 164, 173 (2d Cir, 2004) ("Cautionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired").

31 *Slayton v American Express Co,* 604 F3d 758, 772 (2d Cir, 2010).

32 *City of Plantation Police Officers Pension Fund v Meredith Corp*, 16 F4th 553, 556 (8th Cir, 2021).

33 *Slayton v American Express Co,* 604 F3d 758, 776 (2d Cir, 2010).

34 *Slayton v American Express Co,* 604 F3d 758, 775 (2d Cir, 2010).

Canada

43. Canada has adopted a similar safe harbour regime to the US. In Ontario, a director will not be liable for a misrepresentation in certain forward-looking information[35] if the person or the company proves: (a) the document containing the forward-looking information contained, proximate to that information, (i) "reasonable cautionary language" and identified material factors that could cause actual results to differ materially from the forward-looking information *and* (ii) a statement of the material factors or assumptions underlying the forward-looking information; *and* (b) there was a reasonable basis for drawing the conclusions or making the projections set out in the forward-looking information.[36] Key differences when compared to the US include:

(a) the test is cumulative, not disjunctive (that is, all three requirements must be met);

(b) the test adopts the language of "reasonable cautionary" (cf "meaningful cautionary");[37] and

(c) there is no limb requiring "actual knowledge" – instead, it only requires the director to have a "reasonable" basis for the forward-looking information.

44. In the only Canadian judgment that has rendered a final decision on forward-looking information in primary markets, the Supreme Court of Canada has held that:

(a) the Ontario Act "supplants the 'buyer beware' mindset of the common law with compelled disclosure of relevant information";[38] and

(b) "while forecasting is a matter of business judgment, disclosure is a matter of legal obligation" and "the disclosure requirements under the Act are not to be subordinated to the exercise of business judgment".[39]

United Kingdom

45. In the UK, a safe harbour exists under s 463 of the *Companies Act 2006* (UK), which provides that a director will not be liable to a person other than the company arising from reliance by that person or another, on statements in the strategic report, the director's report, the director's

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35 As defined in s 1 of the *Securities Act, RSO 1990* (Ontario). The safe harbour excludes forward-looking information in a financial statement or forward-looking information in a document released in connection with an initial public offering (s 132.1(2) of the *Securities Act, RSO 1990* (Ontario)).

36 s 132.1(1) of the *Securities Act, RSO 1990* (Ontario); see also s 138.4(9)-(10).

37 Iacobucci, "On Lemons and Leather: Liability for Misrepresentations of Forward-Looking Information in *Danier Leather*" (2009) 48 *Canadian Business Law Journal* 3, 33 (the safe harbour emphasises "disclaimers").

38 *Kerr v Danier Leather Inc* [2007] 3 SCR 331 at [32].

39 *Kerr v Danier Leather Inc* [2007] 3 SCR 331 at [54]-[55].

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remuneration report and any separate corporate governance statement.[40]

46. The safe harbour further provides that a director will only be liable to the company if the director "knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading; or knew the omission to be dishonest concealment of a material fact".[41]

47. The provision ensures that directors cannot be sued by their company for negligence by making forward-looking (or other) statements in the prescribed documents except in cases of dishonesty or recklessness.[42]

D.2 Necessity or desirability of safe harbours generally

48. The next question is from which perspective is "necessity" or "desirability" to be measured? How are competing interests to be balanced? There are at least the following competing considerations.

49. Obviously, from the perspective of company directors, a safe harbour is highly desirable.

50. In the US, the safe harbour was enacted partly with the aim of protecting directors against private securities litigation and, in turn, to encourage more directors to make projections about the future potential of their companies without fearing liability.[43]

51. In Australia, commentators have observed that an increase in shareholder class actions supported by litigation funding may serve as a possible reason for including a safe harbour in the Act.[44]

52. Specifically, the Australian Institute of Company Directors has recommended introducing an "honest and reasonable director defence", designed to overcome the limits of the statutory business judgment rule, and applying to all acts and omissions by a director so long as the director acted with honesty (without moral turpitude), for a proper purpose and with the degree of care and diligence that the director rationally believes to be reasonable in all the circumstances.[45]

53. From the perspective of the companies themselves, a safe harbour may also be highly desirable,

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[40] s 463(4) of the *Companies Act 2006* (UK). In March 2022, NGO ClientEarth announced its intention to commence a derivative action against 13 of Shell's directors alleging breaches of directors' duties for failure to prepare sufficiently for the transition risk for Shell to net zero. If the case proceeds, it will be the first UK case seeking to hold directors personally liable for failing to properly manage climate risk.

[41] s 463(3) of the *Companies Act 2006* (UK).

[42] Third parties (such as auditors) remain liable to the company for negligence in preparing their own report.

[43] Olazabal, "False Forward-Looking Statements and the PSLR's Safe Harbour" (2011) 86 *Indiana Law Journal* 595, 595; Ripken, "Predictions, Protections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements" (2005) 4 *University of Illinois Law Review* 929, 944.

[44] Huggins, Simnett and Hargovan, "Integrated Reporting and Directors' Concerns About Personal Liability Exposure: Law Reform Options" (2015) 33 *Company and Securities Law Journal* 1176, 1178.

[45] AICD, *A Proposal for Law Reform: The Honest and Reasonable Director Defence* (AICD, August 2014).

and may reduce concerns of able individuals who would otherwise be be deterred from accepting appointments to act as directors in and for companies in hard-to-abate sectors. Companies could advocate for a safe harbour by reference to efficient capital market theory: even if unsophisticated investors suffer from cognitive errors in decision making, the presence of sophisticated investors and market intermediaries will move the market price of securities to their fair, intrinsic value.[46]

54. From the perspective of investors, and the broader economy, a safe harbour appears (at least ostensibly) undesirable:

(a) as our instructing solicitors have observed, an important function of financial reporting is to create efficiency in investment decisions by ensuring that members of the community make resource allocation decisions on a properly informed basis. On that view, the community interest is best served through *effective* provision of financial reporting information, which (experience suggests) is best procured under obligation backed by sanctions (rather than imperfect obligation); and

(b) as noted above, there is a competing view that safe harbours serve to increase the flow of useful information into capital markets and prompt corporate disclosure of forward-looking information by reducing the real threat of expensive litigation.[47]

55. From the perspective of regulators and those concerned with enforcement, safe harbours are also (largely) undesirable:

(a) in the US, there was (and remains) serious concern that the safe harbour has created a "licence to defraud" (ie an opening for deceitful predictions and projections).[48] Some members of Congress described it as an open invitation to "crooked corporations … to promise the Sun, Moon and stars in their forward-looking statements" knowing they will never deliver on what they have promised (provided they attach cautionary language to their projections).[49] Others have described it as "unseemly", "remarkable"

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46 Ripken, "Predictions, Protections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements" (2005) 4 *University of Illinois Law Review* 929, 936-7.

47 Olazabal, "False Forward-Looking Statements and the PSLR's Safe Harbour" (2011) 86 *Indiana Law Journal* 595, 595, 627. The author argues that Congress was seeking (through the "meaningful cautionary statement" prong) to eliminate type I errors that were muzzling corporate directors (but was willing to tolerate type II errors).

48 Ripken, "Predictions, Protections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements" (2005) 4 *University of Illinois Law Review* 929, 933 ("corporate executives can knowingly lie to the market by making a forward-looking statement they are fully aware will never materialize, so long as they attach meaningful cautionary language to warn the market of the potential risks of the investment").

49 Ripken, "Predictions, Protections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements" (2005) 4 *University of Illinois Law Review* 929, 933.

and "unique in the history of the federal securities laws";[50]

(b) the UK government has also expressed concern that overly cautious directors might place inappropriately large volumes of information, including that not required to meet a specific legal requirement, in protected reports in order to benefit from the safe harbour provision.[51]

56. Ultimately, the assessment of these competing perspectives is a matter for the community through its democratically elected representatives. We can only offer a *litigator's* perspective; i.e., the perspective of persons familiar with the operation of the legal system upon plaintiffs and defendants in court cases.

D.3 The necessity of a safe harbour in this context

57. Judged from that perspective, and as a consequence of the matters discussed under **Section C** above, in our opinion, a "safe harbour" does not appear to be necessary or desirable. We do not perceive (from advice work) that directors have found it impossible to procure a reasonable basis for forward-looking statements relating to climate-risks. If a concern about legal liability sometimes means that a desired forward-looking statement cannot be made (i.e. because it lacks reasonable assumptions and therefore reasonable grounds), we do not perceive that to be a bad thing. In our experience, an important and valid concern of directors is that they lack precisely the *guidance* about processes and disclosures which it is the purpose of the ISSB Draft Standards to assist in providing. The ISSB Draft Standards appear likely to assist in *exposing* existing bad practice, in *improving* sub-standard practice (by providing a consistent framework against which sub-standard practice can be improved), and in *standardising* the reporting and disclosure which accompanies good practice. A safe harbour would only undermine those beneficial effects, by removing the effective incentive (liability risk) which will actuate them.

58. In our experience, the "reasonable basis" requirement does not operate unfairly or inefficiently. It is appropriate and efficient that directors be required by law to consider whether a forward-looking statement has a reasonable basis. It is not beyond the experience of company directors to decide for themselves whether management has sufficiently identified a reasonable basis – indeed, that is a core competency for which they are appointed and remunerated.

59. A justification which has been proffered for a "safe harbour" is that scientific understanding, and methodologies for the measurement and quantification of risk, are constantly evolving. In our opinion, this is not a secure policy basis to create such a defence. That is because, under existing law, a forward-looking statement is not misleading merely because it later turns out to

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50 Olazabal, "False Forward-Looking Statements and the PSLR's Safe Harbour" (2011) 86 *Indiana Law Journal* 595, 596.

51 UK Government, *FRC Guidance on Narrative Reporting* (30 April 2014).

be wrong[52] or based on science or methods that were later overtaken. A forward-looking statement which later turns out to be wrong might be found to have been made on a reasonable basis at the time, if for example it was consistent with the best available science at the time. Investors and courts do not expect companies to predict the unpredictable, but instead to make sensible disclosures on a reasonable basis, and to update earlier disclosures if they become misleading by reason of later events.[53]

60. There have been specific calls for a "safe harbour" in relation to Scope 3 emissions disclosures. We share the concern which underlies those calls. The challenge with Scope 3 is that a company does not know all the emissions implicated in its value chain: it relies on its up-stream suppliers, and its down-stream consumers, to accurately report their emissions. But we doubt whether a "safe harbour" is truly required. Generally speaking, the company is permitted to rely on disclosures by others, and on the best available information. To use a supplier's reported Scope 1 and 2 emissions as a basis for reporting a company's own Scope 3 emissions *likely would* furnish a reasonable basis, provided that there was not some reason to mistrust the reporting of emissions by others, and provided that it is accompanied by adequate disclosures regarding the reliability of the data or necessary proxies on which that information has been based.

E. QUESTION 3: WHAT GENERAL PRINCIPLES OF GOVERNANCE PRACTICE SHOULD BE FOLLOWED BY DIRECTORS IN ORDER TO MINIMISE LIABILITY CONCERNS ASSOCIATED WITH FORWARD-LOOKING STATEMENTS?

61. In our view, the following key principles of governance practice should be followed by directors in order to minimise liability concerns associated with forward-looking statements:

    (a) individuals and committees within the organisation and at board-level should be specifically tasked with governance responsibilities, and with assembling information to provide directors with assurance that there is a reasonable basis for forward-looking statements;

    (b) processes should be put in place to assess, measure and report on climate-related risks and opportunities on a continuous basis;

    (c) relatedly, ongoing monitoring systems should be put in place to identify if updates are required to climate-related disclosures over time (e.g., see *TPT Patrol Pty Ltd v Myer Holdings Ltd* [2019] FCA 1747 at [1463]-[1488]);

    (d) expert input should be obtained and expressly referenced in disclosures;

    (e) forward-looking disclosures may be the subject of specialist independent assurance;

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52 *Bonham atf Aucham Super Fund v Iluka Resources Ltd* (2022) 404 ALR 15 at [698].

53 See *Ambergate Ltd v CMA Corporation Ltd* (2016) 110 ACSR 642 at [36]-[37].

(f) disclosures of forward-looking climate-related information and scenario analysis of physical and transitional risks should be accompanied by a description of the assumptions and methodologies used to develop the information, as well as the time periods covered and the risks that the predictions will not materialise (see *Wesfi Ltd v. Blend Investments Pty Ltd* (1999) 31 ACSR 69 and *Cultus Petroleum NL v. OMV Australia Pty Ltd* (1999) 32 ACSR 1, which held that information can be misleading if assumptions and methodologies are not provided). Assumptions should be as specific as possible;[54]

(g) warnings and cautionary language should also be used (note, however, that warnings and other cautionary language will not always be sufficient to prevent particular information being misleading and will not, of itself, affect the requirement for there to be reasonable grounds to state the information (see ASIC RG 170.94)); and

(h) consideration should be given to the requirements of ASIC guidance in relation to forward-looking financial information. For example, adopting the approach set out in ASIC RG 170.59, investors should be given enough information to enable them to:

  (i) assess whether the forward-looking climate-related disclosure is relevant and reliable (i.e. to form their own view about how reasonable the grounds are for making the statement); and

  (ii) identify with certainty the facts and circumstances that support prospective climate-related information, as well as being able to demonstrate that the information is reasonable.

16 December 2022

S.H. Hartford-Davis

K. Dyon

Banco Chambers, Sydney

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54 Note ASIC RG 170.68: Disclosure of the basis for prospective financial information may reduce the capacity of the information to mislead because such disclosure assists the assessment/decision of an investor or retail client.