CLAYTON UTZ

Liability and Enforcement of Climate-related Financial Disclosure

Second Treasury Consultation on Climate-related financial disclosure

Submission by Clayton Utz

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Second Consultation Paper on Climate-related financial disclosure

Submission by Clayton Utz

Clayton Utz welcomes the opportunity to comment on the issues raised by the Treasury consultation paper published on 27 June 2023 on climate-related financial disclosures.

1. Climate-related Financial Reporting

Clayton Utz acknowledges the gravity of climate change and sustainability risks on the global financial system. We recognise and endorse the landmark Paris Agreement on climate change and the COP 15 Global Biodiversity Framework, which seeks to mitigate risks of climate change on nature and promote nature-based solutions to tackle climate change. Clayton Utz has advised on issues of environmental protection and climate change and adaptation risk management for decades.

The opinions by Noel Hutley SC and Sebastian Hartford-Davis in 2016, 2019, and 2020 on the management of climate risks said that directors could be held liable for breaking their legal duty of due care and diligence if climate risks are not properly managed. The latest opinion from Hartford-Davis in December 2022, further articulates general principles of governance practice for directors to follow in order to minimise liability concerns with forward-looking climate-related disclosures. We acknowledge the duty of directors to take active steps to identify and manage climate risks and make appropriate climate-related financial disclosures.

Clayton Utz understands the practical realities of business, having a long history working closely with Australian and international businesses. However, we consider the proposed climate-related financial disclosures tendered by the Treasury may be difficult to implement in practice. The Treasury's proposals will require granular reporting on climate-related risks and close consideration of climate-related performance metrics.

Clayton Utz is aware of the challenges businesses will face in compliance, particularly smaller-scale entities who still meet the size threshold. Further, assuring scope 1, 2 and 3 emissions disclosures will necessitate proper systems and controls to ensure long-term data quality. This is particularly challenging for scope 3 emissions.

It will be important to ensure that any proposed disclosure regime and accounting standards do not over emphasise a specific set of considerations when compared with the broad range of other matters to which attention must also be given. We urge the Treasury to consult deeply with stakeholders to find an appropriate balance for climate-related financial reporting requirements.

2. Liability Regime

2.1. Modified Liability

Treasury has proposed that a liability approach be adopted whereby new climate reporting requirements would be drafted as a civil penalty provision, attracting the protection of sections 1317S and 1318 of the *Corporations Act 2001* (Cth) ('Corporations Act') for entities and company officers respectively. Treasury purports that this approach seeks to balance the importance of disclosing decision-useful information with appropriate protections for reporting entities. Specifically, Treasury had stated that this approach will protect company officers and entities in civil proceedings where they have acted honestly and ought fairly to be excused for the breach whilst also not diminishing the impact of the mandatory climate disclosure regime. Furthermore, we note that infringement notices will be available for breaches to enable flexibility in regulator responses to non-compliance with the obligations.

We believe that the modified liability approach is not a regime which provides the level of protection that is envisaged. By limiting liability to a civil penalty, the modified liability approach does not provide for a large concession to relieve entities and their officers. In *Australian Securities and Investments Commission v Healey* (No 2) (2011) 196 FCR 430 ('Healy's case') at [86] the Court stated that "neither ss

1317S nor 1318 operates to remove the breach, rather they operate as a dispensing power to excuse the contravener". In Healy's case, the Court found the directors of the Centro Group personally liable for errors in the financial statements of the Group for failing to properly make accounting disclosures and in doing so failed to discharge their duties with the degree of care and diligence that a reasonable person would in the circumstances and failed to take all reasonable steps to comply with, or to secure compliance with, the financial reporting provisions in the *Corporations Act.* As a matter of the exercise of the court's discretion under ss 1317S and 1318, Justice Middleton concluded that the appropriate course to take is to decline to relieve the directors from liability.

This suggests that, although entities and their officers can invoke ss 1317S and 1318 to relieve them wholly or in part from liability where the Court is satisfied that the person has acted honestly and the person ought fairly to be excused from the contravention, relief from liability is ultimately at the discretion of the Court. By modelling the modified liability approach of ss 1317S and 1318, we submit that it is unduly harsh towards entities and their officers.

While the consultation process that Treasury is undertaking is part of a process to determine the extent to which IFRS S2, Climate-related Disclosures, should be applicable in Australia it is likely that the standard will require disclosure of information which is far more complex, inherently uncertain, forward-looking and new to the companies, directors and officers concerned.

Further, from commencement, the climate-related disclosures will only be the subject of "limited assurance". This means that the assurance would be in the form of a statement from the relevant professional to the effect that that "based on the procedures performed and evidence obtained, nothing has come to their attention that causes them to believe that the company has not complied, in all significant respects with the relevant law". In other words, it is a "negative assurance", not the type of positive assurance that company's receive on their audited financial reports.

We recommend that the Treasury should adopt a liability approach by replicating the continuous disclosure liability regime under s 647A of the *Corporations Act*. By implementing this approach, liability for entities and its officers will arise for failure to make requisite disclosure, where the entity knows or is reckless or negligent with respect to whether the information would have been disclosable. The disclosure obligations which will arise under the proposed regime under the climate change reporting standards will impose challenges that are similar to those arising under the continuous disclosure regime.
We are of the view that implementing this approach would afford entities and their officers with adequate protection from liability.

2.2. Forward Looking Statements

Under sections 670A(2), 728(2) and 769C of the *Corporations Act* and section 12BB(1) of the *Australian Securities and Investments Commission Act 2001* ('ASIC Act'), forward-looking statements must be based on reasonable grounds at the date the statement is made or it will be misleading. In order to disclose forward-looking statements, boards are required to make very full disclosure of the assumptions on which forward looking statements are made.

We note that ASIC Regulatory Guide 170.59 states that investors should be given enough information to enable them to assess whether the prospective financial information is relevant and reliable (i.e. to form their own view about how reasonable the grounds are for making the statement); and identify with certainty the facts and circumstances that support prospective financial information, as well as being able to demonstrate that the information is reasonable.

Furthermore, ASIC Regulatory Guide 170.60 expects to see full details of the assumptions used to prepare the prospective financial information, the time period covered by the prospective financial information, the risks that the predictions in the prospective financial information will not be achieved and an explanation of how the prospective financial information was calculated and the reasons for any departures from accounting standards or industry standards that investors would reasonably expect to be followed.

We believe that similar principles should apply in relation to forward looking statements included in the proposed climate change financial reporting standards. We are of the view that, provided entities and their officers are able to make full and frank disclosure along the lines outlined above, the legislation should provide entities and their officers with protection from liability for forward looking disclosures made in that way.