Advice

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Directors' exposure to liability associated with disclosure under the ISSB Standards

1. About this advice

We have been engaged by the Australian Institute of Company Directors (**AICD**) to provide advice on the liability impact on Australian directors resulting from disclosures under IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (**IFRS S1**) and IFRS S2 *Climate-related Disclosures* (**IFRS S2**) (together, **ISSB Standards**), as well as other legal implications arising from the interaction between the ISSB Standards and the current Australian legal framework.

This advice considers:

(a) current requirements and practices for the disclosure of climate and sustainability information (section 3);

(b) how the requirements to make disclosures under the ISSB Standards differ from current reporting requirements and practices (section 4);

(c) current liability settings for forward-looking misleading disclosure (section 5);

(d) the interaction between the current liability settings and the ISSB Standards (section 6);

(e) the liability impact on reporting entities and their directors under the ISSB Standards (section 7);

(f) liability settings for disclosure in comparable jurisdictions (section 8); and

(g) other legal implications arising from the interaction between the ISSB Standards and the Australian legal regime (section 9), including:

  (i) the interaction between the ISSB Standards and the Australian continuous disclosure regime; and

  (ii) the interaction between the 'reasonable grounds' test in Australian law and the principle that certain ISSB-aligned disclosure need only be made on the basis of 'reasonable and supportable information that is available at the reporting date without undue cost or effort'.

This advice builds on our previous advice for AICD on liability risks associated with the ISSB Standards, dated 13 July 2022 (**July Advice**), and supplements that advice to reflect material developments since that time and to provide additional detail on key parts. The two advices should be read together.

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2. Executive summary

(a) **The ISSB Standards will require more granular disclosure of climate and sustainability information than is currently the case**. Australian companies and their directors are currently subject to very limited specific requirements to disclose climate and sustainability matters. Beyond this, some Australian companies voluntarily disclose additional information, but the quality and completeness of these disclosures vary considerably, indicating that climate and sustainability reporting in Australia is nascent and still evolving. The ISSB Standards will require more granular disclosure of climate and sustainability information than is currently the case, even when considering voluntary disclosure practices.

(b) **There are challenges in demonstrating reasonable grounds for ISSB-aligned forward-looking disclosure**. Forward-looking disclosure must be made on 'reasonable grounds' to not be misleading under Australian law. This presents challenges in respect of the granular forward-looking information required to be disclosed by the ISSB Standards because such information requires reliance on inherently uncertain matters, there are differing views on what is objectively 'reasonable', and the 'reasonable grounds' test lacks clarity in this context. Further, with the benefit of hindsight, forward-looking statements which are ultimately wrong can always initially be perceived as having lacked a reasonable basis, therefore increasing the test's susceptibility to challenge. As a result, many Australian directors will likely find it difficult to be comfortable that 'reasonable grounds' for forward-looking ISSB-aligned disclosure can be demonstrated. Similar concerns have been raised by the Law Council of Australia in its submission[1] to Treasury's recent climate reporting consultation.

(c) **Unlike their counterparts in comparable jurisdictions, Australian directors would have very limited recourse to defences – and no recourse to safe harbours – under existing law**. While section 189 of the *Corporations Act 2001* (Cth) (***Corporations Act***) provides some scope for directors to rely on information or advice provided by others, this applies narrowly and only in relation to whether a director has breached his or her duty of care and diligence.[2] It does *not* apply to circumstances where proceedings are brought against directors alleging they are persons 'involved in' misleading or deceptive conduct.[3] Even where the section 189 defence is available, there are limitations in its application and effectiveness. This is relevant to not only forward-looking disclosure, but also other disclosure required by

[1] Law Council of Australia, 'Climate-related financial disclosure – Consultation Paper' (2 March 2023), available at <https://www.lawcouncil.asn.au/publicassets/0f063284-c3bb-ed11-947a-005056be13b5/2023%2003%2002%20-%20S%20-%20Climate-related%20financial%20disclosure.pdf>.

[2] As set out in our July Advice, directors can be liable for failing to discharge their duty of care and diligence in relation to their adoption and approval of financial statements and other types of reporting, or be liable, via 'stepping stone' liability, for failing to discharge their duty of care and diligence by failing to prevent the company's breach of misleading and deceptive conduct provisions.

[3] As set out in our July Advice, directors could become personally liable to pay compensation for representations that are found to be misleading or deceptive, as section 1041I(1) of the Corporations Act provides that a person who suffers loss or damage by a contravention of section 1041H (that a person must not engage in conduct in relation to a financial product or financial service that is misleading or deceptive or likely to mislead or deceive) may recover against any person who is 'involved in' the contravention.

the ISSB Standards that relies on information or advice from others, such as in relation to scope 3 emissions.

(d) **The litigation and enforcement landscape, enhanced expectations regarding the discharge of directors' duties, and lack of applicable defences increase liability risks**. There are various factors that, in our view, are likely to increase the amount of private litigation and enforcement action taken in respect of climate and sustainability disclosure of the type required by the ISSB Standards. An increase in claims and investigations would come with a corresponding increase in liability exposure, which is more acute when considering the lack of available defences or a safe harbour mechanism. Further, in our view, the ISSB Standards will likely influence the standard of care expected of a reasonable director in managing climate and sustainability risks, which would, in practice, also increase liability exposure.

(e) **The disproportionate risk of litigation (with or without merit) and liability may discourage comprehensive and candid ISSB-aligned disclosure**. The enhanced liability risks associated with ISSB-aligned disclosure may lead to many companies and their directors endeavouring to limit climate and sustainability disclosure to the minimum mandated level, or making more general or generic disclosure. Research suggests this is already playing out in the Australian market in respect of voluntary climate-related disclosure. This outcome would undermine the aim of the ISSB Standards and suggests that the current liability landscape would not strike a balance between incentivising complete and candid ISSB-aligned disclosure and penalising inadequate disclosure. Safe harbour-type mechanisms in other comparable jurisdictions might be considered as examples of how liability can be adjusted to promote disclosure on matters subject to uncertainty.

(f) **There are other complexities and uncertainties in the interaction between the ISSB Standards and existing Australian law**. For example:

(i) There are complexities around the interaction of the ISSB Standards' concept of materiality and the Australian continuous disclosure regime, meaning that the ISSB Standards may trigger continuous disclosure obligations in a way that would be onerous for companies and directors.

(ii) The interaction between 'reasonable grounds' and the ISSB Standards' principle that certain disclosure need only be made on the basis of 'reasonable and supportable information that is available at the reporting date without undue cost or effort' is not clear.

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3. Current reporting requirements and practices

Currently, there are very limited mandatory periodic reporting requirements to specifically disclose on climate and other sustainability matters in Australia, and current practice in terms of voluntary disclosure varies considerably.

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Current periodic reporting requirements

In terms of mandatory requirements, some limited requirements exist for listed companies in respect of the Corporate Governance Statement, which identifies the extent to which the entity has followed the recommendations set out in the ASX Corporate Governance Council Principles (4th ed.) (**Corporate Governance Principles**). Recommendation 7.4 of the Corporate Governance Principles states that an ASX-listed company should disclose whether it has any material exposure to environmental and social risks and, if so, how it manages or intends to manage those. However, it should be noted that a company is not strictly *required* to disclose those risks – rather, if it does not do so, it must instead explain why not.

Further, whilst not explicitly required by the legislation, ASIC also considers that the operating and financial review (**OFR**)[4] must include a discussion of environmental, social and governance risks where those risks could affect the entity's achievement of its financial performance or outcomes disclosed, taking into account the nature and business of the entity and its business strategy.[5]

Whilst listed companies currently make some forward-looking statements on climate and broader sustainability matters under the Corporate Governance Principles or in the OFR, we note that presently there is neither a legal requirement nor regulator expectation for granular disclosures in relation to inherently uncertain future matters. Further, in practice, many ASX listed companies rightly or wrongly do not consider that they have material environmental or social risks requiring disclosure.[6]

Outside of the specific legal requirements, climate and other sustainability-related matters are nonetheless required to be disclosed in corporate reporting when the relevant materiality threshold is met, for example the materiality threshold in AASB 101, which applies to financial statements.[7]

However, that is a different proposition to requiring companies to disclose a significant volume of highly granular climate and sustainability information, including inherently uncertain and/or forward-looking information. That the ISSB Standards will increase the number and kinds of forward-looking

[4] Boards of listed companies are required to provide information in an OFR that shareholders would reasonably require to make an informed assessment of the entity's operations, financial position, business strategies and prospects for future financial years. See section 299A of the Corporations Act.

[5] See ASIC, 'RG 247 Effective disclosure in an operating and financial review' (12 August 2019) at 19. See also ASIC Commissioner Cathie Armour's statements in February 2021 that "ASIC considers that the law requires an operating and financial review to include a discussion of climate risk when it is a material risk that could affect the company's achievement of its financial performance", available at <https://asic.gov.au/about-asic/news-centre/articles/managing-climate-risk-for-directors/>.

[6] An analysis conducted by KPMG on disclosures made by listed Australian entities between 1 January 2021 and 31 December 2021 found that around a quarter of entities reported that they do not have material exposure to environmental and/or social risks: KPMG, 'ASX Corporate Governance Council: Adoption of Recommendation 7.4 – Reporting on Environmental and Social Exposures' (June 2022) at 29.

[7] AASB 101 states that information is 'material' if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. AASB 101 further states that "materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole": see Australian Accounting Standards Board, 'AASB 101: Presentation of Financial Statements' at 7.

things that are *required* to be disclosed does not seem to be in dispute in publicly available legal commentary in Australia.

Current voluntary periodic reporting practices

Beyond mandatory reporting requirements, some Australian companies choose to voluntarily disclose additional information on climate and broader sustainability-related matters. The Task Force on Climate-related Financial Disclosures (**TCFD**) framework is most commonly applied in this regard, with Australian Council for Superannuation Investors (**ACSI**) research in July 2022 indicating that 103 companies on the ASX 200 either reported fully *or partially* against the TCFD framework.[8]

However, whilst there has been reasonably strong uptake of the TCFD framework in Australia, the comprehensiveness and completeness of TCFD disclosure varies considerably, with most companies applying the TCFD framework not disclosing under all 11 recommended disclosures. This aligns with international analysis conducted by the TCFD which, in its 2022 Status Report, found that only 4% of the companies reviewed[9] disclosed in line with all 11 recommended disclosures and only around 40% disclosed in line with at least five.[10]

The quality of disclosure also varies considerably, with some companies providing more detailed and specific and, where relevant, quantitative disclosure than others. For instance, in July 2022 ACSI noted that:[11]

- few companies provide disclosure on physical risk analysis (that is, the mapping of assets against physical risk and assessing the severity, likelihood and financial impact of such events); and
- the quality of disclosure on climate scenario analysis is variable, as some companies do not provide both qualitative detail and quantitative outcomes and investors are often faced with inconsistent, incomplete, incomparable and unverifiable scenario analysis-related information.

The above indicates that climate reporting is still relatively nascent and in a state of flux, and that good practice on climate disclosure continues to evolve. This is unsurprising given that climate impacts and opportunities over different time horizons, which are forward-looking in nature, are speculative and depend on a variety of uncertain policy, regulatory, technological and market factors that are difficult – if not impossible – to predict.

In our experience, these challenges can drive limited disclosure, as companies and their directors seek to manage litigation and liability risk in terms of misleading disclosure, as further discussed below.

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[8] See ACSI, 'Climate change disclosure in the ASX200' (July 2022) at 6 <https://acsi.org.au/wp-content/uploads/2022/08/WEBSITE-VERSION-ACSI-Climate-Change-Disclosure-in-ASX200-designed-1.pdf>.

[9] The TCFD reviewed publicly available reports for over 1,400 large companies in specific sectors around the world.

[10] See Task Force on Climate-related Financial Disclosures, '2022 Status Report' (October 2022) at 5 <https://assets.bbhub.io/company/sites/60/2022/10/2022-TCFD-Status-Report.pdf>.

[11] See ACSI, 'Climate change disclosure in the ASX200' (July 2022) at 6 <https://acsi.org.au/wp-content/uploads/2022/08/WEBSITE-VERSION-ACSI-Climate-Change-Disclosure-in-ASX200-designed-1.pdf>.

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4. Disclosure under the ISSB Standards

It is accepted in the publicly available Australian legal opinions we have reviewed that mandated disclosure under the ISSB Standards would result in more disclosure on forward-looking climate and sustainability matters than is currently the case.[12] This is even so when considering voluntary reporting practices against the TCFD framework. **Schedule 1** contains a high-level and thematic comparison of forward-looking disclosure under the ISSB Standards and the TCFD framework.

For example, in addition to requiring further and granular detail on TCFD-related matters,[13] the ISSB Standards would mandate *new* disclosure on the following forward-looking matters:

- the current and anticipated effects of climate-or sustainability-related risks and opportunities on the reporting entity's value chain;[14]
- how the reporting entity plans to achieve any climate-related targets and how those plans will be resourced;[15]
- the intended use of carbon credits[16] to achieve climate targets, including the extent to which credits are relied upon, whether they are subject to third party verification/certification, the type of credits used (for example, carbon removal or avoidance), and other information related to offset credibility and integrity;[17] and
- how the reporting entity expects its financial position and financial performance to change over the short, medium and long term,[18] given its strategy to address risks and opportunities, reflecting investment plans and planned sources of funding to implement its strategy.[19]

This is supported by research conducted by PwC, which compares the disclosures of the ASX200 against the disclosure requirements in the ISSB Standards, and which found that ASX200 disclosure levels will need to be significantly enhanced to meet the ISSB Standards.[20] For example, the research found that, in respect of forward-looking information:[21]

- of the 49% of companies which disclosed a net zero target, only 55% also disclosed a discussion of their transition plan; and

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[12] Our July Advice sets out a full list of the forward-looking information which would be required to be disclosed under the ISSB Standards. This should be read in light of the tentative decisions made at ISSB meetings to amend certain elements of IFRS S1 and IFRS S2.

[13] For example, in relation to scenario analysis. See IFRS S2 at [15].

[14] IFRS S1 at [15(b) and 20]; IFRS S2 at [8(b) and 12].

[15] IFRS S2 at [13].

[16] The ISSB tentatively agreed to use the term "carbon credit" rather than "carbon offset" in the context of offsetting emissions in the transition plan (October 2022 meeting).

[17] IFRS S2 at [13(b)].

[18] The ISSB tentatively agreed to consistently use the phrase "short, medium and long term" instead of "over time" (January 2023 meeting).

[19] IFRS S1 at [22(c) (d)]; IFRS S2 at [14(c) and (d)].

[20] PwC, 'ESG Reporting in Australia: Change afoot, but are companies ready?' (December 2022) at 2 <https://www.pwc.com.au/assurance/environmental-social-and-governance-reporting.html>.

[21] Ibid at 5.

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- only 18% of companies disclosed how their financial position may change over time because of climate change-related risks and opportunities.

We also note that the TCFD framework relates only to climate – and not broader sustainability – matters and so all requirements of IFRS S1 will require *new* disclosure across the board when compared to the TCFD framework (which is the most commonly applied framework in Australia for voluntary disclosure).[22]

Therefore, the additional disclosure required under the ISSB Standards – particularly in respect of forward-looking matters – would represent a significant step-change to current Australian periodic reporting requirements and practices.

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5. Australia's current liability settings for forward-looking disclosure

Disclosure on climate and broader sustainability matters is subject to the general prohibitions on misleading disclosure under the Corporations Act.[23] That is, a person must not engage in conduct in relation to a financial product or a financial service (including the making of public statements) that is misleading or deceptive or is likely to mislead or deceive.

Our July Advice sets out the ways in which directors may become liable in respect of misleading disclosure.

'Reasonable grounds' test

The regulatory framework

Where a person makes a representation with respect to any future matter, the representation will automatically be taken to be misleading if the person does not have 'reasonable grounds' for making the representation.[24] A representor as to a future matter bears an evidentiary onus with respect to the reasonable grounds for that representation – they must adduce evidence as to those grounds.[25]

Regulatory guidance on prospective financial information[26] indicates (amongst other things) that it is ASIC's interpretation of the law that:

- 'reasonable grounds' means that there must be sufficient objective foundation for the statement. To demonstrate reasonable grounds, an issuer must be able to point to facts or circumstances supporting the information that existed at the time of publication, on which the issuer relied, and which are *objectively* reasonable;
- what constitutes 'reasonable grounds' must be judged according to the facts and circumstances of each case;

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[22] Voluntary sustainability disclosure is much more nascent in Australia than climate disclosure, with research from PwC indicating that most companies on the ASX200 have yet to consider broader sustainability-related risks and opportunities, such as natural capital. Ibid at 7. See also footnote 6.

[23] Section 1041H(1). Similar prohibitions are contained in section 12DA of the *Australian Securities and Investment Commission Act 2001* (Cth) (**ASIC Act**) and section 18 of the Australian Consumer Law (**ACL**).

[24] Section 769C Corporations Act; section 12BB ASIC Act; section 4 ACL.

[25] *Bonham v Iluka Resources Ltd* [2022] FCA 71 (***Iluka***) at [668].

[26] See ASIC, 'RG 170 Prospective financial information' (1 April 2011) (**RG 170**). Regulatory Guides like RG 170 are not authoritative statements of the law, but they are based on precedent and explain how ASIC interprets the law, and therefore give a strong indication of how ASIC would argue particular matters were they to come to Court.

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- prospective financial information supported only by hypothetical assumptions does not, by itself, indicate reasonable grounds and, rather, is likely to be misleading; and
- issuers of prospective financial information need to ensure that all material assumptions are reasonable.

Case law principles

To date, there has been no case law on the meaning of the term 'reasonable grounds' in the context of forward-looking climate or sustainability disclosure. However, there is a substantial body of Australian case law already built up in relation to 'reasonable grounds' more broadly, which would likely form the starting foundation for a hypothetical future Court's assessment.

The relevant question under the 'reasonable grounds' test is whether the company who made the forward-looking statement had "facts sufficient to induce in the mind of a reasonable person a basis for making the [statement]".[27] This means that the Court is testing whether the hypothetical reasonable person would be able to discern a logical basis for a particular statement from the facts on which that statement was based.

Whether or not a company has reasonable grounds for a forward-looking statement is assessed objectively – that is, according to the facts that were available to the maker of the statement at the time that the statement was made.[28] However, the Court is not precluded from "examining evidence of later events which may throw light upon the overall probabilities".[29] In *North East Equity Pty Ltd v Proud Nominees Pty Ltd,*[30] the Full Court of the Federal Court considered a situation where there was "reliance upon representations as to future matters which are found to have come to pass (and thus found not to be false)", and expressed the view that "such findings concerning the later events might give rise to an inference… that the representor had reasonable grounds at the time of making the representations, for making them."[31]

It is important to bear in mind that the question of reasonable grounds is limited to an assessment of the facts actually within the knowledge of the company making the statement. This extends to the company's knowledge of information that falsifies the statement, but does not extend to what the company could or should have known.[32] The Court in *Jazabas* described the relevant process as the representor "identify[ing] the facts or circumstances (if any) actually relied upon before turning it over to the trier

[27] *ACCC v ACM Group (No 2)* [2018] FCA 1115 at [173].

[28] *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 (***Bathurst***) at [2827(a)].

[29] *City of Botany Bay Council v Jazabas Pty Ltd* [2001] NSWCA 94 (***Jazabas***) at [83]. In an interlocutory decision in the *Iluka* proceeding, this principle was glossed further by the Court saying that a future event ("the trigger for Iluka revising its outlook") "did not matter unless it suggested that the bases for [a particular forward-looking statement] were not reasonable": *Bonham v Iluka Resources Ltd* [2017] FCAFC 95 at [80].

[30] [2012] FCAFC 1 (***North East Equity***).

[31] *North East Equity* at [34].

[32] *Bathurst* at [2827(c) and (e)].

of fact to decide whether they were objectively reasonable and whether they support the representation made".[33]

In the case of large companies, it is also important to bear in mind that the facts known to the company may be broader than the facts known to the board of directors when signing off on proposed public disclosures. The knowledge of the company's employees or agents may be properly attributable to the company through the laws of agency, including if those employees or agents had knowledge that they did not share with (or which they deliberately or innocently mischaracterised to) the board.[34] This could place directors in a difficult position if, for example, they are not provided with information that falsifies a proposed statement or renders it misleading.

Also relevant for large companies is that the presence of a reasonable process that led to a particular statement will assist in establishing that the statement had reasonable grounds but will not be determinative of the issue.[35]

Information provided to the company making the statement by a reliable adviser or third party may form the basis for reasonable grounds.[36] However, this principle has not been tested in a climate or sustainability context in relation to (inherently uncertain) forward-looking matters.

In cases where a representor has particular expertise or skill, then it will be necessary to take account of professional and industry standards in assessing whether reasonable grounds for a representation exist.[37]

Several principles stated in *ACCC v GlaxoSmithKline Consumer Healthcare Australia Pty Ltd* (2019) 371 ALR 396 at [33] make clear that the situations in which a disclaimer will overcome otherwise misleading information will be rare (additional citations omitted):

> *(1) There may be occasions upon which the effect of otherwise misleading or deceptive conduct may be neutralised by an appropriate disclaimer…*
>
> *(2) A person engaging in misleading or deceptive conduct cannot readily or easily use the device of a disclaimer to evade responsibility, unless that disclaimer erases the proscribed effect…*
>
> *(3) A disclaimer having the effect of dispelling otherwise misleading or deceptive effects of conduct may be a rare occurrence given the onus that is ordinarily on the person making the otherwise contravening representation to establish that the disclaimer it relies upon creates an overall effect that is benign…*
>
> *(4) Disclaimers or qualifications must be taken into account in evaluating the conduct as a whole…*

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[33] *Jazabas* at [85].

[34] *Crowley v Worley Limited* [2022] FCAFC 33 at [117].

[35] *Iluka* at [670].

[36] *Bathurst* at [2827(f)].

[37] *Bathurst* at [2827(g)].

ASIC has provided regulatory guidance to the same effect in relation to forward-looking financial information, where it said that the use of warnings, disclaimers and other cautionary language will not "affect the requirement for there to be reasonable grounds to state the information".[38]

6. The interaction between the ISSB Standards and current liability settings

The 'reasonable grounds' test is intended to be adaptable to the circumstances in which it arises for determination. However, in practice, the application of the 'reasonable grounds' test is particularly challenging in relation to forward-looking climate and sustainability information. This is because:

- *Reliance on matters subject to uncertainty*

  Extensive prediction or estimation of the impacts of risks and opportunities over different time horizons will be required, despite those impacts being speculative and, in some cases, unknowable. For example, the International Energy Agency (**IEA**) has stated that "in 2050, almost half the reductions come from technologies that are currently at the demonstration or prototype phase. In heavy industry and long-distance transport, the share of emissions reductions from technologies that are still under development today is even higher".[39]

  The pace with which market dynamics are changing and the breadth of uncertainties with respect to the energy transition, technological development, policy and regulatory levers[40] and geopolitical pressures[41] complicate assessments underpinning such forward-looking statements. These uncertain inputs significantly influence estimations of the future impacts of climate opportunities and risks, for instance in relation to demand for a company's products or services, market share and industry competition, carbon pricing (and the cost of compliance), and delays in or rejections of project approvals. This must be considered in light of current regulatory guidance that prospective financial information based on hypothetical assumptions is likely to be misleading.[42]

- *Diverging views on reasonableness*

  There are differing views on 'reasonableness', including whether reliance on emerging technologies, offsetting and/or particular strategies can form the basis of *objectively* reasonable grounds underpinning a climate or sustainability-related forward-looking statement, including targets. Further, although whether there were

[38] RG 170 at [94].

[39] See IEA, 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (October 2021) (**IEA Net Zero Roadmap**) at 15. The IEA similarly stated in a 2023 report that "(m)any of the clean energy technologies required to get to net zero by mid-century are not available at scale today": see IEA, 'Energy Technology Perspectives' (January 2023) (**IEA Energy Technology Perspectives**) at 50.

[40] For an example of policy and regulatory levers in play, consider how "(a) drop in [energy] prices usually results in some rebound in demand". The IEA has emphasised that "policies and regulations would be essential to avoid this leading to any increase in the unabated use of fossil fuels, which would undermine wider emissions reduction efforts": see IEA Net Zero Roadmap at 52.

[41] An example of geopolitical pressure is "the geopolitical repercussions of the war in Ukraine, including economic sanctions on Russia and lower gas exports to Europe, [which] have further disrupted supply chains and driven up the prices of a wide range of commodities": see IEA Energy Technology Perspectives Report at 119.

[42] See RG 170 at [170.18].

reasonable grounds for a forward-looking statement is assessed according to the facts at the time that the statement was made, the Court is able to examine evidence of later events which may throw light upon the overall probabilities.[43]

- *Lack of clarity*

  At present, the 'reasonable grounds' test in respect of forward-looking climate (and broader sustainability) information lacks clarity. The legislation does not provide additional colour and, even though there has been some case law on the meaning of 'reasonable grounds' in other contexts (see above), the meaning of this phrase has yet to be considered by a Court in the context of forward-looking climate and broader sustainability-related information, which come with their own particular challenges.

These challenges, coupled with the fact that full assurance is not available on these sorts of disclosures, make it difficult for Australian directors in terms of achieving the requisite level of comfort that disclosure on climate and sustainability-related forward-looking matters is supported by reasonable grounds.

In our experience working with boards, Australian directors show a strong desire to make comprehensive forward-looking information to meet the informational needs of stakeholders. They are, however, aware of litigation and liability risk and take a generally cautious approach to climate and sustainability disclosure knowing that it will be heavily scrutinised. Where the amount of litigation increases (as would be anticipated where additional forward-looking information is disclosed, as set out below), the balance between providing comprehensive disclosure and managing litigation and liability risk becomes even more challenging.

This difficulty may lead to some companies and their directors *not* making disclosure in relation to certain forward-looking matters. In this respect we note the research undertaken by consultancy South Pole, which surveyed 1200 companies and found that up to a quarter of respondents with science-based targets were not planning on publishing them (known as 'green-hushing').[44] Even in heavy emitting industries (which arguably face the most acute pressure for disclosure to stakeholders), equivalent trends were observed by South Pole regarding non-disclosure of forward targets. Even if there were to be mandatory requirements to disclose on forward-looking information like targets, these challenges may lead to some companies making more general or generic disclosure, especially without the benefit of external assurance (as is currently the case), in an attempt to manage litigation and liability risk.

This view is shared by prominent legal bodies. For example, the view of the Law Society of New South Wales was referenced in the Law Council of Australia's response to the Australian Government's consultation on climate-related financial disclosure: "*…the unique settings of the Australian jurisdiction need to be considered in assessing the liability risk for directors. It suggests that the liability settings for the types of forward-looking*

[43] *Jazabas* at [83]. However, it is not possible at present to know how a Court would balance the need to avoid 'hindsight illusion' with the possibility of it assessing limited evidence of future events shaped by rapidly changing technologies and market dynamics.

[44] South Pole, 2022 Net Zero Report, accessible at 'Going Green, then Going Dark' (18 October 2022) <https://www.southpole.com/news/going-green-then-going-dark>.

statements contemplated by the ISSB standards will need careful calibration to avoid the risk of unhelpful and generalised disclosure that will not meet the expectations of investors".[45]

7. Enhanced risks for reporting entities and their directors under the ISSB Standards

Enhanced litigation and enforcement risk

In our view, there are a myriad of factors which, in combination, make it likely that increased litigation and enforcement will be brought against companies and their directors in respect of disclosure required under the ISSB Standards:

- *First*, the comprehensive adoption of the ISSB Standards would mandate the disclosure of more climate and sustainability information than is currently disclosed in Australia. This does not seem to be the subject of debate.
- *Second*, given the importance placed on climate (and broader sustainability) matters by stakeholders, and that greenwashing is an enforcement priority for regulators, further disclosures on these topics are likely to be susceptible to heightened scrutiny.
- *Third*, the 'reasonable grounds' test in respect of forward-looking climate (and broader sustainability) information is susceptible to challenge, for the reasons outlined in section 6 above.
- *Fourth,* there is a recent and growing trend towards private litigants seeking to bring strategic proceedings against companies alleging misleading disclosure on forward-looking climate matters, and we expect this trend to continue with claimants applying hindsight when considering whether to target a company and its directors. This is on top of Australia already having the highest volume of climate-related litigation outside the United States.[46]
- *Fifth,* Australian regulators are active in bringing enforcement action – including litigation – in respect of alleged greenwashing[47] and breaches of directors' duties,[48] compared to some other comparable jurisdictions.
- *Sixth*, Australia has a uniquely facilitative securities class action regime, as detailed in our July Advice.

That there will, statistically, probably be an increase in claims and investigations, and a corresponding increase in the liability exposure of directors, in respect of additional information required to be disclosed under the ISSB Standards does not appear to be in dispute in publicly

[45] Law Council of Australia, 'Climate-related financial disclosure – Consultation Paper' (2 March 2023), available at <https://www.lawcouncil.asn.au/publicassets/0f063284-c3bb-ed11-947a-005056be13b5/2023%2003%2002%20-%20S%20-%20Climate-related%20financial%20disclosure.pdf>.

[46] See J Setzer and C Higham, 'Global trends in climate change litigation: 2022 snapshot' (June 2022) at 9, <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/08/Global-trends-in-climate-change-litigation-2022-snapshot.pdf>.

[47] In addition to issuing infringement notices against four companies, ASIC has launched Court proceedings against a fifth company alleging greenwashing.

[48] In some cases, directors can be found liable for misleading disclosure when they have failed to discharge their duty of care and diligence in relation to their adoption and approval of financial statements and other types of reporting, or via 'stepping stone' liability. See further our July Advice and footnote 2. We note that in the last six months or so there have been three section 180(1) cases brought by ASIC against directors, reflecting that this is a high regulatory focus.

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available legal opinions in Australia.[49] The liability exposure for Australian directors is however more acute when compared to their counterparts in other jurisdictions, given the challenges associated with demonstrating 'reasonable grounds' and the limited application of available defences.

Whilst increasing legal action can help to clarify the 'reasonable grounds' test and the availability of the section 189 defence (discussed further below) over time in relation to climate and sustainability disclosure, in our view the aims of introducing reporting against the ISSB Standards in Australia would be better achieved by adjusting the current liability provisions. This is because the current liability framework in many cases is likely to disincentivise full, frank and comprehensive disclosure under the ISSB Standards, on the basis that, in practice, companies and their directors may not feel they have the requisite level of comfort to make such disclosures given the litigation and liability risks.

In this regard, in our experience working with directors, the mere fact of a claim being made against them and the protracted litigation then ensuing is damaging, both in terms of reputation, legal costs and management time. The fact that ultimately, they may be exonerated where they can demonstrate reasonable grounds for making the statements is of little comfort in practice.

We note that this already appears to be borne out in the market (see South Pole's analysis above that some companies do not make disclosure of their science-based targets due to perceived greenwashing risks). It follows that an increase in liability risk will further disincentivise comprehensive disclosure, a principle that has also been recognised by global institutional investors, such as Blackrock.[50]

Discouraging, rather than encouraging, comprehensive disclosure in this way would be at odds with the aim of the ISSB Standards, which seek to incentivise complete and comprehensive disclosure to ensure comparability and decision-usefulness

Implications for the discharge of directors' duties

The ISSB Standards are likely to result in an evolution towards higher disclosure standards in relation to climate and sustainability-related matters. With it, regulatory and market expectations for directors are likely to continue to shift.

Australian directors have an existing duty to exercise their powers and discharge their duties with care and diligence. The standard of care expected of a reasonable director in relation to the management of climate and sustainability risk is an area that is already in a state of flux. For example, in recent years, the expectation placed on directors around the

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[49] See also the Law Society of New South Wales' views, referenced in the Law Council of Australia's response to the Australian Government's consultation on climate-related financial disclosure: "*…moving from a general and amorphous obligation to very specific and detailed disclosure obligations would necessarily appear to change the risk profile and prospect of increased litigation exposure*". See Law Council of Australia, 'Climate-related financial disclosure – Consultation Paper' (2 March 2023), available at <https://www.lawcouncil.asn.au/publicassets/0f063284-c3bb-ed11-947a-005056be13b5/2023%2003%2002%20-%20S%20-%20Climate-related%20financial%20disclosure.pdf>.

[50] Blackrock's submission to the proposed SEC rule, Enhancement and Standardization of Climate-Related Disclosures for Investors (17 June 2022), states that a proportionate liability regime and meaningful protection from legal liability encourages, rather than discourages, higher quality disclosure. See<https://www.blackrock.com/corporate/literature/publication/sec-enhancement-and-standardization-of-climate-related-disclosures-for-investors-061722.pdf>.

consideration of climate risks has expanded, due to regulatory, investor and community pressure.[51]

While, in our experience, most Australian directors generally now accept that their duty of care and diligence includes the identification and management of material climate risks, it does not necessarily follow that this duty requires them to proactively make forward-looking granular climate and sustainability-related disclosures of the type covered by the proposed ISSB Standards.

Rather, in our view, the ISSB Standards would likely lead to higher regulatory and market expectations than exist presently, which could in turn influence the standard of care expected of a reasonable director in relation to the management of climate and sustainability risk in discharging their duty of care and diligence.[52] In practice, higher standards associated with the discharge of directors' duties comes with heighted litigation and liability risks.

Further, as discussed in section 4, the ISSB Standards would introduce a step-change in the level of climate and sustainability information that Australian companies will need to disclose. That this would result in an increased quantum of disclosures that Australian companies will be required to make does not appear to be in contention. It follows that this would result in an increase in the quantum of disclosures that Australian directors could ultimately be held liable for, which, for the reasons set out above, would in turn increase the legal risks to which they may be exposed. While the duties of Australian directors already encompass approving public disclosures about material risks, such disclosures are not presently as extensive, granular or subject to as much uncertainty as what the ISSB Standards would require.

The exposures mentioned above, combined with the current liability framework for misleading disclosure, may result in more limited or general or generic disclosure being made, in an attempt to manage liability exposure. This suggests that the current liability landscape for forward-looking disclosure does not achieve its aims, in that it would not strike a good balance between incentivising complete and candid ISSB-aligned disclosure and penalising misconduct. Shifting from the current reporting requirements and practices in Australia to mandated granular ISSB-aligned disclosure therefore warrants a review of the current liability provisions.

Limitations in the application of section 189 of the Corporations Act

Currently, were litigation to be brought, there are limited specific defences to directors' liability for misleading representations under the Corporations Act.

Section 189 of the Corporations Act sets out the specific circumstances where a director's reliance on the information or advice provided by others will be taken to be reasonable, where the reasonableness of the director's reliance on the information or advice arises in proceedings brought to determine whether the director has performed his or her duties under Part

[51] See, for example, the evolution of the views expressed in a series of legal opinions issued in 2016, 2019 and 2021 by Noel Hutley SC and Sebastian Hartford-Davis.

[52] For example, in their 2019 opinion, Noel Hutley SC and Sebastian Hartford-Davis stated that recent developments, including significant changes in financial reporting frameworks, elevated the standard of care that will be expected of a reasonable director.

2D.1 of the Corporations Act and equivalent common law duties.[53] Section 189 sets out a rebuttable presumption, meaning that, if all the elements of section 189 are satisfied, the protection will apply – and the director's reliance on the information or advice is taken to be reasonable – unless the contrary is proven.

Despite section 189 applying to duties under Part 2D.1 of the Corporations Act (and equivalent common law duties), legal commentary suggests that, in practice, section 189 is only relevant to the duty to exercise care and diligence under section 180(1) of the Corporations Act and at general law.[54] This is on the basis that the other duties do not call up the notion of 'reasonableness' and that, therefore, whether the director's reliance on information and advice is reasonable will not be relevant.[55,56] If this is correct, then it will *not* apply where a private litigant[57] seeks to recover compensation from a director 'involved in' misleading and deceptive conduct under section 1041I(1) of the Corporations Act.[58,59] In such a case, section 189 would not limit the liability of directors for misleading disclosure under the ISSB Standards, even if their reliance on information or advice was reasonable.

As set out in our July Advice, directors may separately become liable for misleading and deceptive conduct of the company where they fail to discharge their duty of care and diligence under section 180(1) of the Corporations Act (and the equivalent general law duty).[60] Section 189 would apply in those cases. However, even so, there are limitations to the protection offered by section 189. It was pointed out by Ward J in *Re Idylic*

[53] The other circumstances are that: (a) the director relies on information, or professional or expert advice, given or prepared by certain persons; and (b) the reliance was made in good faith and after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation.

[54] See Austin & Black's Annotations to the Corporations Act, '[2D.189] Reliance on information or advice provided by others – Annotations to section 189' (July 2020); Australian Corporate Practice Manual (CCH IntelliConnect), '[41-110] Board of directors: delegating powers to others and reliance on advice' (May 2019).

[55] See Austin & Black's Annotations to the Corporations Act, '[2D.189] Reliance on information or advice provided by others – Annotations to section 189' (July 2020).

[56] Another defence, the 'business judgment rule' in section 180(2) of the Corporations Act, similarly only applies to the duty of care and diligence. However, it has been said to *not* apply to matters of legal compliance. See *Australian Securities and Investments Commission v Fortescue Metals Group* (2011) 190 FCR 364 at [197] and [198]; *Asden Developments Pty Ltd (in liq) v Dinoris (No 3)* (2016) 114 ACSR 347 at [87]; and *Australian Securities and Investments Commission v Vocation Ltd (in liq)* (2019) 371 ALR 155 at [739]. By extension, there is an argument that the business judgment rule would not provide protection to directors in respect of legally required disclosures. See also Jean Du Plessis and Andreas Rühmkorf, 'New Trends Regarding Sustainability and Integrated Reporting for Companies: What Protection do Directors Have?' (2015) The Company Lawyer, 56. This advice does not consider the business judgment rule further.

[57] Accessorial liability attaches to section 1041H of the Corporations Act – via section 1041I – only for the purposes of a private right of damages: *Re Vault Market Pty Ltd* [2014] NSWSC 1641 at [64] and [87].

[58] Directors could become personally liable to pay compensation for statements that are found to be misleading or deceptive under section 1041I(1) of the Corporations Act, which provides that a person who suffers loss or damage by a contravention of section 1041H may recover against any person who is 'involved in' the contravention.

[59] Proceedings can be brought regarding alleged contraventions of section 1041H and liability under section 1041I without allegations also being made about that director's failure to discharge his or her duty of care and diligence. See for example *Re Mediation & Online Dispute Resolution Network Pty Ltd* [2022] NSWSC 5, where it was found that a director breached section 1041H and that the director's company was involved in that contravention under section 1041I. Damages were awarded to the plaintiffs against the director and the company under section 1041I. The Court did not discuss the director's duty under section 180(1) of the Corporations Act.

[60] Directors can be liable for failing to discharge their duty of care and diligence in relation to their adoption and approval of reporting, or be liable via 'stepping stone' liability.

Solutions Pty Ltd; ASIC v Hobbs[61] that there has "been little judicial discussion as to the operation of section 189",[62] a point that has been picked up in subsequent academic literature.[63]

This lack of judicial consideration is a sign that "the section does not serve its purpose" of relieving directors from having to adopt "an overly cautious approach when relying on information or advice provided by others".[64] On the rare occasions that defendants have claimed section 189 by way of defence, they have often failed to establish the requisite facts to access the presumption.[65] On other occasions, defendants have raised section 189, but have not been required to rely on it because it was determined they had not breached section 180(1), even before a consideration of whether section 189 applied.[66] These cases, taken together, suggest that the section has a very limited field of operation and is therefore ill-adapted to its purpose.

The narrowness of section 189 is particularly significant given both the developing and growing importance of climate and sustainability-related matters, and also because it seems inevitable that compliance with requirements to report against the ISSB Standards will require Australian directors to rely upon significantly more information and advice from others than is currently the case (given the specialist knowledge and expertise required to assess and report on climate and sustainability matters, including forward-looking matters and scope 3 emissions).

There are also additional challenges in applying section 189 in the climate and sustainability reporting context, including, for example:

- *Reasonable belief as to competence*

  In the case of advice or information from professional advisers or experts, section 189 requires directors to believe on 'reasonable grounds' that the matters are within their competence. Whilst this principle is readily applicable in the context of certain specialists like auditors, its application to climate and sustainability specialists is likely to be more complex. That is because climate matters – including, for example, methodologies for calculating scope 3 greenhouse gas emissions, conducting scenario analysis, assessing future financial impacts of climate risks and opportunities, and the viability of new and emerging technologies – are a relatively new and developing field of expertise in Australia. Expertise in broader sustainability matters is at an even earlier stage of development. This raises the question of how a director may be satisfied on 'reasonable grounds' of an employee's or

[61] [2012] NSWSC 1276 (***Re Idylic***).

[62] *Re Idylic* at [1524].

[63] Jean J du Plessis and Jim A Mathiopoulos, "Defences and relief from liability for company directors: Widening protection to stimulate innovation", (2016) 31 Aust Jnl of Corp Law 287.

[64] Ibid at 309.

[65] See, for example, *Fitz Jersey Pty Ltd v Atlas Construction Group Pty Ltd (in liq)* [2021] NSWSC 1692 at [1123] to [1129], where the defendants failed to establish that they had been given advice on the relevant question; *ASIC v Macdonald (No 11)* (2009) 71 ACSR 368 at [546] and [547], where the Court found that there was "no evidence" of reliance; *Pages Property Investments Pty Ltd v Boros* [2020] NSWSC 1270 at [92], where it was found that the defendant did not bring an independent mind to the advice given, as section 189 requires; *Re Idylic* at [2482], where it was found not to be reasonable to rely on advice predicated on a factual scenario known not to be accurate.

[66] See, for example, *ASIC v Mariner Corporation (ACN 002 989 782)* (2015) 106 ACSR 343 at [551].

professional adviser's or expert's 'competence' and the extent to which a director is required to interrogate the adviser's or expert's qualifications and experience in connection with the advice or information in question.

- *Independent assessment*

  To rely on section 189, a director's reliance on information or advice must come "after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation".[67] Case law establishes that directors must not blindly follow advice and must bring their own mind to bear on the issue using such skill and judgment as they may possess.[68] However, in the context of emerging and evolving climate and sustainability matters, as opposed to well understood current financial reporting obligations, the standards or thresholds applying to such 'independent assessment' – and the minimum level of climate and sustainability-related 'literacy' required of directors in conducting such assessment[69] – is not clearly established.

  It is also uncertain the extent to which factors such as industry affiliations should be considered in determining whether a director failed to conduct an independent assessment of the information or advice. For example, there is commentary that "it is conceivable that directors may not discharge their duty of care where they obtain advice only from advisors who, by their mission or articulated policies, may have interests skewed towards a particular outcome".[70] Climate issues in particular have historically been heavily politicised in Australia, with many advisers or preparers of information who have developed expertise on climate issues also advocating for policy outcomes. This adds another layer of complexity in terms of the thresholds of duties of directors in carrying out an independent assessment of information or advice.

- *Reliance not covered by section 189*

  Section 189 is *not* generally applicable to every occasion in which directors rely on others; the information or advice covered by section 189 must have been prepared by one of the categories of people listed in section 189 (a)(i) to (iv). Broadly, those categories of people are: (i) an employee *of the corporation*; (ii) a professional adviser or expert; (iii) another director or officer; or (iv) a committee of directors on which the director did not serve.

  In a corporate group context, climate and sustainability human resources may be employed by subsidiaries rather than the parent

[67] Section 189(b)(ii) of the Corporations Act.

[68] *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 56 SASR 455 at 474–5.

[69] Case law provides that it is part of the director's duty to acquire a degree of financial literacy required to be able to review financial statements, given that the Corporations Act expressly tasks them with the approval of financial statements: *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 at [124-5]; *Australian Securities and Investments Commission v Godfrey* (2017) 354 ALR 536 at 549. Further, in *Daniels & Ors v Anderson & Ors* (1995) 37 NSWLR 438 at 502 Clarke and Sheller JJA found that directors are under a continuing obligation to keep informed about the activities of the corporation.

[70] Sarah Barker, 'Directors' Liability and Climate Risk: Australia – Country Paper' *Commonwealth Climate and Law Initiative* (April 2018).

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> company. In some circumstances, this may result in directors of the parent company needing to rely on the information and advice of persons who are not employees of the same corporation of which they are directors. Unless the relevant employees are "professional advisers or experts", the directors of the parent company may not have the benefit of section 189 in those circumstances. Commentary indicates that the same point probably applies to information or advice supplied by an officer or a director or committee of directors, although section 189(a)(iii) merely uses the words "director", "officer" and "committee of directors", without adding the words "of the corporation".[71]

Therefore, directors will *not* be able to rely on section 189 in respect of misleading and deceptive conduct claims against them under section 1041I(1) of the Corporations Act and, in respect of directors' duties cases, the extent of the protection offered by section 189 is uncertain – particularly in the rapidly expanding climate and sustainability reporting context. This may indicate that it does not provide a degree of protection that is, in practice, felt by directors. In our view, this, coupled with the fact that section 189 seems to be the only applicable specific defence-type mechanism for directors in relation to such reporting,[72] warrants the review of the current directors' liability framework in Australia to best ensure that comprehensive and quality disclosure on climate and sustainability matters are made (and 'green-hushing' is avoided).

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8. Liability settings in other jurisdictions

In terms of reviewing the current liability framework, a 'safe harbour' or similar mechanism for directors might be considered to respond to the inherent uncertainty associated with climate and sustainability disclosure, including forward-looking disclosure.

Liability settings in other jurisdictions

A number of key comparable jurisdictions allow for a safe harbour or similar mechanism for directors in respect of certain information. Some of those are described in our July Advice and are set out in further detail below. The liability settings in these jurisdictions generally require a degree of intention or recklessness to ground liability for directors, rather than mere negligence.

United States

The US Congress passed the Private Securities Litigation Reform Act of 1995, to encourage public companies to make 'forward-looking statements' by creating a safe harbour to protect companies from frivolous private securities law liability in connection with such statements.

Companies and their directors are immune from liability in respect of forward-looking information where:

- a 'meaningful cautionary statement' is used which identifies important factors that could cause the actual results to differ materially from those in the forward-looking statement; or

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[71] Austin & Black's Annotations to the Corporations Act, '[2D.189] Reliance on information or advice provided by others – Annotations to section 189' (July 2020).

[72] Given the limitations of the business judgment rule in section 180(2) of the Corporations Act (see footnote 56) and the absence of a safe harbour mechanism of the type described in this Advice.

- the forward-looking statement is immaterial; or
- the plaintiff fails to prove that the forward-looking statement:
  - if made by an individual, was made with actual knowledge that the statement was false or misleading; or
  - if made by an entity, the statement was made by or with approval of an executive officer of that entity and that executive officer made or approved the statement with actual knowledge that it was false or misleading.

Thus, the maker of a forward-looking statement can be shielded from liability for that statement by satisfying any one of these three prongs above.

These provisions only apply to private actions and do not apply to civil and criminal enforcement actions brought by the Securities and Exchange Commission (**SEC**) or other regulatory agencies, among other specific exceptions that apply.[73]

If the provisions are unavailable for any reason, the judicially created 'bespeaks caution' doctrine can serve as an alternative defence. The doctrine holds that forward-looking statements are not misleading if they are accompanied by adequate risk disclosure to caution readers about specific risks that may materially impact the forecasts.

United Kingdom

In the United Kingdom, a director is only liable to compensate the company for any loss suffered by it as a result of any untrue or misleading statement in the narrative section of the annual report and accounts[74] where the director knew, or was reckless as to whether, the statement was untrue or misleading. The effect of this provision is to exclude any liability of the directors to the company for negligence, with fraud or deceit required in order for a director to be liable. The safe harbour does not affect liability for a civil penalty (for example, action by a regulator) or a criminal offence (for example, fraud-related offences).[75] Whilst directors are only liable to the company in these circumstances, shareholders may seek to bring a derivative action against directors on behalf of the company, but rarely do so in practice.

Further, shareholders of listed companies suffering a loss as a result of a misleading statement in certain published information (including the annual report and accounts) are also able to bring actions against the company (but not directors) in the circumstances set out in section 90A and Schedule 10A of the *Financial Services and Markets Act 2000* (UK). A company is liable in respect of a misleading statement *only if* a person discharging managerial responsibilities within the issuer knew, or was reckless as to whether, it was misleading. This is subject to exemptions and, again, does not affect liability to certain civil liability (for example,

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[73] Section 27A of the *Securities Act of 1933* (US) and Section 21E of the *Securities Exchange Act of 1934* (US). For example, the safe harbour does not apply in respect of forward-looking information in financial statements and IPO documents, amongst others.

[74] The strategic report, directors' report and directors' remuneration report, and any separate corporate governance statement.

[75] Section 463 of the *Companies Act 2006* (UK).

under the law of misrepresentation), to a civil penalty (for example, action by a regulator) or criminal liability (for example, fraud-related offences).

The liability settings in these examples are not *full* exemptions:

- In the United States, the regulator may still take action against directors notwithstanding the safe harbour provisions. Specifically, the SEC can take enforcement action in the form of administrative and civil proceedings against directors of public companies in connection with misleading and deceptive disclosure prohibitions under the Securities Act of 1933 and Securities Exchange Act of 1934. The SEC most frequently brings enforcement actions when there is a showing of wilful misconduct or recklessness.

  Notably, the safe harbour also does not explicitly limit liability for claims under state laws. Further, the safe harbour does not apply where a private litigant can establish that the forward-looking statement was made with actual knowledge that it was misleading or untrue (assuming that the other safe harbour tests are not met, i.e., assuming that the statement was *not* immaterial and that it was *not* accompanied by a meaningful cautionary statement).

- Similarly, in the United Kingdom, civil or criminal enforcement action (which generally require more than negligence) may still be taken, notwithstanding the safe harbours. While the UK Financial Conduct Authority (**FCA**) does not have powers to enforce the statutory directors' duties in the *Companies Act 2006* (UK) – which is a significant difference to Australia – it can nonetheless take enforcement action against companies and directors in connection with breaches of the UK listing regime. As such, the FCA can take enforcement action where reasonable care has not been taken to ensure that any TCFD-aligned disclosures (as required by the Listing Rules) are not misleading, false or deceptive. Although typically the FCA will take enforcement action in this regard against the listed company itself in relation to disclosure failings, it is increasingly taking action against individual directors on the basis that they are 'knowingly concerned' in the listed company's non-compliance.

  Further, as mentioned above, shareholders can seek to bring a derivative action against directors under the *Companies Act 2006* (UK) (subject to the derivative claims provisions in that Act, including that permission be granted by the Court), or bring an action against the company under the *Financial Services and Markets Act 2000* (UK), in each case where a director knew, or was reckless as to whether, the statement was untrue or misleading.

Application in the Australian context

As described above, we consider that the introduction of mandatory disclosure under the ISSB Standards warrants a review of the current liability framework, particularly in respect of forward-looking disclosure. That is on the basis that, in our view, the current framework would not be proportionate and would not strike a balance so as to encourage comprehensive and decision-useful disclosure and also discourage misconduct and poor reporting practices.

Other comparable jurisdictions have sought to strike this balance through the application of a safe harbour or similar mechanism which provides protection from liability in certain circumstances, whilst still allowing

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regulators to bring enforcement action and allowing litigants to bring private claims when certain, higher, thresholds are met. In this way, there remains a 'liability incentive' for good disclosure practice, without imposing disproportionate liability risk.

If there were to remain a lack of a comparable safe harbour in Australia, Australian companies and directors would have significantly more litigation and liability exposure compared to comparable jurisdictions. As set out above, this may lead to a more cautious approach and could disincentivise full and transparent disclosure which, in turn, could impact the international comparability and decision-usefulness of Australian disclosures under the ISSB Standards. This has the potential to impact Australia's efficient integration into international markets and the attractiveness of Australian companies for 'green capital'.[76]

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9. Further areas of complexity associated with the ISSB Standards

In addition to the matters raised in our July Advice, we raise below a number of other areas of complexity for Australian directors with respect to the ISSB Standards.

Continuous disclosure

There are complexities in the interaction between the ISSB Standards and the Australian continuous disclosure regime. Some of these complexities were canvassed in our July Advice. In addition to those, we note that the lack of a carve out in the ISSB Standards for disclosure of confidential information impacts the availability of the existing exceptions for continuous disclosure in Australia.

The objective of the ISSB Standards is to require an entity to disclose information about its material climate- and sustainability-related risks and opportunities.[77] All of the requirements under the ISSB Standards are underpinned by a materiality threshold, as "an entity need not provide a specific disclosure that would otherwise be required by an IFRS Sustainability Disclosure Standard if the information resulting from that disclosure is not material".[78] For the purposes of the ISSB Standards, information is material if omitting, misstating or obscuring that information "could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting, which provides information about a specific reporting entity".[79]

As set out in our July Advice, this test seems to be more similar to the Australian test for continuous disclosure (as opposed to the materiality tests applying to the disclosure of forward-looking sustainability-related information in the OFR and under the Corporate Governance Principles). The continuous disclosure test asks whether "the information would, or would be likely to, influence persons who commonly invest in securities in

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[76] That reliable and transparent sustainability disclosure can attract 'green capital' was discussed in the speech by ASIC Chair Joe Longo at the AICD Australian Governance Summit on 2 March 2023, available at <https://asic.gov.au/about-asic/news-centre/speeches/chair-s-remarks-at-the-aicd-australian-governance-summit-2023/>.

[77] IFRS S1 at [1] and IFRS S2 at [1]. See also the ISSB's tentative decision to remove reference to 'enterprise value' from the objective of IFRS S1 and remove the word 'significant' from the proposed requirements.

[78] IFRS S1 at [60]. This also applies to IFRS S2, as it is an "IFRS Sustainability Disclosure Standard".

[79] IFRS S1 at [56].

deciding whether to acquire or dispose of the … securities”.[80] This is taken to be information that a reasonable person would expect to have a material effect on the price or value of securities (and hence needs to be immediately disclosed).

However, the ISSB Standards do not have similar exceptions to the Australian continuous disclosure rules, which provide that material price-sensitive information does *not* need to be continuously disclosed if the information is (amongst other things) insufficiently definite, a matter of supposition, or internal management information — and, importantly, the information has remained confidential in each case.[81] If, though, the relevant entity has to subsequently disclose the information in their next periodic report in order to meet the ISSB Standards’ requirements for material information to be disclosed, this could mean that the benefit of the exception would be lost prematurely.

This is an issue that arises less frequently under Australia’s existing periodic reporting regime, which:

- does not require the same level of granular disclosure as the ISSB Standards;
- relates to less suppositious, uncertain and/or internal information spanning across multiple reporting periods that would otherwise have the benefit of the continuous disclosure exception;[82] and
- which provides for an exemption whereby future matters do not need to be disclosed if disclosure is likely to result in unreasonable prejudice to the entity.[83]

A related complexity (which we referred to in our July Advice) for Australian companies and their directors is the requirement under the ASX Listing Rules for disclosing entities to immediately announce materially price-sensitive changes to already-disclosed information to prevent securities from trading on a false market. By requiring a greater volume of granular forward-looking and inherently uncertain climate- and sustainability-related matters to be periodically disclosed, the ISSB Standards would increase the volume of information that reporting entities may need to update constantly without the ability to wait until the next periodic report. This is particularly so given the pace with which market, technological, policy and other developments may impact already disclosed climate and sustainability information. This, in turn, could have the (perhaps unintended) effect of turning periodic disclosure documents into sources of ongoing continuous disclosure obligations.

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[80] Section 677(1) of the Corporations Act.

[81] ASX Listing Rule 3.1A.

[82] For example, while AASB 101 uses substantively the same test for materiality as the proposed ISSB Standards (see footnote 7), it does not undercut the continuous disclosure rule exception under ASX Listing Rule 3.1A. This is because, by its very nature, financial information ‘crystallises’ every six months, and must hence be disclosed accordingly in any event. This contrasts with some of the disclosures that would be required to be periodically made under the ISSB Standards (for example, long-term climate-related forecasts) that would otherwise have the benefit of the Australian continuous disclosure exception for as long as confidentiality is maintained.

[83] Section 299A(3) of the Corporations Act.

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Interaction between Australian 'reasonable grounds' and ISSB disclosure on 'reasonable and supportable information that is available at the reporting date without undue cost or effort'

At its January 2023 meeting, the ISSB tentatively agreed that certain disclosures need only be based on 'reasonable and supportable information that is available at the reporting date without undue cost or effort', to ease the implementation of the ISSB Standards for those preparers that are less able to comply (i.e., to respond to concerns about proportionality and scalability). The information to which this principle would apply is that which is subject to a high level of measurement or outcome uncertainty, including certain forward-looking information like the determination of anticipated impacts on an entity's financial performance, financial position and cash flows under both IFRS S1[84] and IFRS S2.[85]

In Australia, this concept is currently included in AASB 9 *Financial Instruments and* AASB 17 *Insurance Contracts* (which are based on IFRS 9 and IFRS 17 respectively) in respect of limited uncertain future matters (e.g., expected credit losses and estimates of future cash flows) but is not used as a broad principle in the AASB Accounting Standards (or IFRS Accounting Standards).

The 'reasonable grounds' test has therefore existed alongside the 'reasonable and supportable information' principle in AASB 9 and AASB 17 for some time. We think that they are capable of continuing to exist in parallel in respect of a broader range of forward-looking information required to be disclosed under the ISSB Standards because they are used for different purposes: one determines the *parameters* of information to be considered to support forward-looking disclosure for individual companies, whereas the other applies to whether facts or circumstances relied upon to support forward-looking disclosure are objectively reasonable.

However, applying the 'reasonable and supportable information' principle more broadly to forward-looking disclosures required under the ISSB Standards raises some challenges for Australian companies and their directors:

- The principle would be applied to highly complex, granular and company-specific assessments underpinning much of the uncertain forward-looking matters required to be disclosed under the ISSB Standards, which is a departure from its application in limited and well-understood circumstances under AASB 9 and AASB 17.
- Such disclosures under the ISSB Standards would not have the benefit of full external assurance, unlike for disclosures associated with AASB 9 and 17.[86]
- Given the scrutiny on climate and sustainability disclosure and its susceptibility to challenge, there is a risk that the 'reasonable and supportable information' principle introduces another avenue of litigation risk (e.g., allegations that a company has not had regard to *all*

[84] IFRS S1 at [22].

[85] IFRS S2 at [12(a) 13(a)(i)].

[86] In our experience, only limited external assurance is provided in relation to climate and sustainability information, and only generally in respect of Scope 1 and 2 emissions and other technical data. Whilst we appreciate that assurance standards are expected to be developed in the near-term for this sort of disclosure, there will be a time lag before these are understood, and auditor expertise is developed, in the Australian market.

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reasonable and supportable information available at the reporting date without undue cost or effort). Given Australia's current liability regime (outlined above), this may neutralise the objective of the principle, which is to provide companies with comfort on the extent of information they should rely upon to support disclosure.

- The extent of the interaction between 'reasonable grounds' and 'reasonable and supportable information' has not been established and is subject to some ambiguity, given their overlapping concepts. For example, the staff paper for the ISSB's January 2023 meeting stated that, when considering the concept of 'reasonable and supportable information that is available at the reporting date without undue cost or effort', an entity must have a *reasonable basis* for using the information to support disclosure. Further, as noted above, Australian case law establishes that the question of reasonable grounds is limited to an assessment of the facts *actually* within the knowledge of the company but does not extend to information which the company could or should have known. If, however, the company is required to consider *all* reasonable and supportable information that is available at the reporting date without undue cost of effort, this could in effect nullify the protection offered by this case law principle. These ambiguities become particularly challenging in light of the scrutiny on the 'reasonable grounds' test and its susceptibility to challenge in the context of climate and sustainability disclosure, as outlined above.

Therefore, whilst the underlying objective of the 'reasonable and supportable information' concept is helpful in the context of ensuring quick and flexible adaptation of disclosure under the ISSB Standards, the application of this principle to such disclosure and its interaction with the 'reasonable grounds' test would benefit from clarification in Australia.

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Schedule 1

High-level and thematic comparison of forward-looking disclosures required under the ISSB Standards and TCFD framework[87]

ISSB Standards	TCFD framework
Significant sustainability- and climate-related risks and opportunities. The overarching purpose of the ISSB Standards is to require the disclosure of information about material sustainability- or climate-related risks and opportunities to enable users of general purpose financial reporting to assess the effects of such risks and opportunities on the reporting entity's enterprise value.[88] This would require a description of any significant sustainability- and climate-related risks and opportunities that could reasonably be expected to affect the reporting entity's business model, strategy, cash flows, access to finance and cost of capital over the short-, medium- and long-term.[89]	**2. Strategy** a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.
Effect of those risks and opportunities on business model and value chain. A reporting entity would be required to disclose information about its assessment of the current and anticipated effects of significant sustainability- or climate-related risks and opportunities on its business model. This would include a description of the current and anticipated effects of such risks and opportunities on its value chain, and a description of where in its value chain such risks and opportunities are concentrated.[90] **Effect of those risks and opportunities on strategy and decision-making**. The ISSB Standards require a reporting entity to disclose information about the effects of significant sustainability- and climate-related risks and opportunities on its strategy and decision-making.[91] Compared to IFRS S1,	**2. Strategy** b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.

[87] The contents of this Schedule considers the tentative decisions of the ISSB at meetings in 2022 and 2023 in respect of IFRS S2.

[88] IFRS S1 [1], IFRS S2 [1].

[89] IFRS S1 [16], IFRS S2 [9].

[90] IFRS S1 [20], IFRS S2 [12].

[91] IFRS S1 [21], IFRS S2 [13].

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IFRS S2 calls for more extensive forward-looking disclosures, including information about a reporting entity's transition plans, current and anticipated changes to its business model (e.g. changes in strategy and resource allocation, direct and indirect adaptation and mitigation efforts), and how these plans will be resourced.[92]

Effect of those risks and opportunities on financial position, financial performance and cash flows.

The ISSB Standards require a reporting entity to disclose information that enables users to understand the current effects of significant sustainability or climate-related risks on its financial position, financial performance and cash flows, and the anticipated effects over the short-, medium- and long-term, including how such risks and opportunities are included in its financial planning.[93] This would include, among other things, information about risks and opportunities for which there is a significant risk that there will be a material adjustment to the carrying amounts of assets and liabilities, and how the reporting entity expects its financial position and financial performance to change over the short-, medium- and long-term.[94]

Resilience.

IFRS S1 requires a reporting entity to disclose information that enables users to understand its capacity to adjust to the uncertainties arising from significant sustainability-related risks.[95] IFRS S2 sets out more extensive forward-looking disclosure requirements. Among other things, it requires a reporting entity to disclose information about the resilience of its strategy (including its business model) to climate-related changes, developments or uncertainties. Further, a reporting entity would be expected to use climate-related scenario analysis commensurate with the entity's circumstances, and would be required to disclose the results of its climate resilience analysis to enable users to understand the implications of its findings for its strategy, and its capacity to adjust or adapt its strategy and

2. Strategy

c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

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[92] IFRS S2 [13].

[93] IFRS S1 [22], IFRS S2 [14].

[94] IFRS S1 [22], IFRS S2 [14].

[95] IFRS S1 [23].

business model over the short-, medium- and long-term.[96]

Targets.

IFRS S1 would require the disclosure of targets (which are, by definition, forward-looking) that a reporting entity has set to assess its progress towards achieving its strategic goals (including milestones or interim targets).[97] IFRS S2 would require a reporting entity to disclose its targets to mitigate or adapt to climate-related risks or maximise climate-related opportunities.[98] Compared to IFRS S1, IFRS S2 requires the disclosure of a broader range of details for each target.[99]

Further, a reporting entity would need to disclose information regarding targets for its transition plan, including the amount of its emissions target to be achieved through emission reductions within its value chain, and a separate disclosure on the intended use of carbon credits in achieving those targets (e.g., the extent of their use, whether they are subject to third party verification/certification, their type, and any other significant factors related to credibility and integrity).[100]

4. Metrics and Targets

c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

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[96] IFRS S2 [15].

[97] IFRS S1 [32].

[98] IFRS S2 [20(d)].

[99] IFRS S2 [23].

[100] IFRS S2 [13(b)].