THE MAINSTREAMING OF CLIMATE CHANGE AND THE IMPACT ON DIRECTORS' DUTIES

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ABSTRACT

The New Zealand government recently enacted legislation that will make climate risk disclosure mandatory for approximately 200 organisations, including listed companies and certain other large entities. This article outlines the main features of the new laws. It also reviews the current requirements on boards to consider climate-related matters in their deliberations and in corporate disclosures, and concludes that the new legislation will provide increased protections for directors. However, globally and within New Zealand, there are evolving pressures on directors to consider other non-financial matters and New Zealand corporate law needs to be reformed to accommodate such pressures.

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I INTRODUCTION

New Zealand enacted the *Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021* (NZ) ('the Act') on 27 October 2021.[1] However, only those parts of the Act that empower the External Reporting Board ('XRB')[2] to proceed with developing new climate standards are immediately in force. The passage of the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill ('the Bill')[3] through Parliament was relatively rapid as it was only introduced on 12 April 2021,[4] but there had been a significant degree of consultation on the legislation before its introduction.[5]

The Act is an omnibus bill as it amends the *Financial Markets Conduct Act 2013* (NZ) ('*FMC Act*'), the *Financial Reporting Act 2013* (NZ) ('*FR Act*') and the *Public Audit Act 2001* (NZ). The Act's principal objective is to broaden non-financial reporting by introducing a new requirement for certain *FMC Act* reporting entities ('FMC reporting entities') to make climate-related disclosures. The legislation reflects the New Zealand government's policy commitments to address the negative impacts of climate change. Other policy measures include the *Climate Change Response (Zero Carbon) Amendment Act 2019* (NZ) and the *Climate Change Response (Emissions Trading Reform) Amendment Act 2020* (NZ), which both substantially amended the *Climate Change Response Act 2002* (NZ). Together with the new Act, these measures will contribute to New Zealand achieving its 'nationally determined contribution under the Paris Agreement of 2015, which relates to climate change mitigation, adaption and finance'.[6] 'Nationally determined contributions' are public undertakings by each state party of the mitigation and adaption measures that each state agrees to work towards to achieve the Paris Agreement's temperature reduction goals.[7]

The enactment of this legislation also reflects the evolution of our understanding of climate change 'from a purely "ethical issue" or "environmental externality" to an issue that poses

[1] *Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021* (NZ) received Royal Assent on 27 October 2021 ('*Climate-related Disclosures Act*').
[2] The External Reporting Board ('XRB') is an independent Crown entity that is responsible for the accounting, auditing and assurance standards in New Zealand. It was originally established under the *Financial Reporting Act 1993* (NZ), with continued existence under the *Financial Reporting Act 2013* (NZ) s 12 ('*FR Act*').
[3] Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill 2021 (30-1) (NZ), which was introduced under Standing Order 267(1)(a) because the amendments deal with an interrelated topic that can be regarded as implementing a single broad policy ('Climate-related Disclosures Bill').
[4] The Climate-related Disclosures Bill (n 3) was referred to the Economic Development, Science and Innovation Committee after its first reading. This committee reported on 16 August 2021 and the Bill received its second reading on 28 September 2021, followed by the third reading on 21 October 2021.
[5] The Ministry of Business, Innovation and Employment ('MBIE') and the Ministry for the Environment issued a discussion document on 31 October 2019 outlining the proposals that underpin the policy of the Climate-related Disclosures Bill (n 3). Over 75 submissions were received. In MBIE, *Financial Sector (Climate-related Disclosures and other Matters) Amendment Bill* (Departmental Disclosure Statement, 30 March 2021) 10 ('Departmental Disclosure Statement') it is stated that this consultation process did not lead to any fundamental design changes for the proposed disclosure system, but minor modifications have been made to the Bill.
[6] Departmental Disclosure Statement (n 5) 7.
[7] *Paris Agreement to the United Nations Framework Convention on Climate Change*, adopted 12 December 2015, No 54113 (entered into force 4 November 2016) art 2(1) <https://unfccc.int/sites/default/files/english_paris_agreement.pdf>.

foreseeable financial risks and opportunities for companies across short, medium and long-term horizons'.[8] As the UK Financial Stability Board's Task Force on Climate-related Financial Disclosures ('TCFD') states in its 2017 final report, climate change is '[o]ne of the most significant, and perhaps most misunderstood, risks that organizations face today'.[9] Closer to home, the Governor of the Reserve Bank of New Zealand recently stated that climate change 'is a key risk to global financial stability' that has 'far-reaching implications for New Zealand's financial system'.[10]

This article outlines the structure of the rules for the new climate-related disclosures required to comply with new climate standards to be issued by the XRB. The article then overviews the main requirements of those climate standards. This is followed by an outline of the current regulations that apply to listed companies with respect to climate-related disclosures; this part of the article focuses only on listed companies and does not discuss other types of climate reporting entities. Finally, the article briefly discusses the obligations of New Zealand company directors to consider other non-financial factors — environmental, social and governance ('ESG') — in their decision-making.

II OVERVIEW OF THE NEW LEGISLATION

Part 1 of the Act inserts into the *FMC Act* a requirement for a climate reporting entity ('CRE') to make annual climate-related disclosures. It comes into force on the earlier of a date set by Order in Council or 27 October 2022, being the first anniversary of the Royal Assent with the effect that entities will need to comply from 2023 onwards.[11] CREs are a subset of FMC reporting entities,[12] which are already required by the *FMC Act* to keep accounting records and to annually prepare, have audited and disclose financial statements that comply with generally accepted accounting practice ('GAAP').[13] CREs are entities under s 461K of the *FMC Act* that are considered to have a higher level of public accountability and satisfy the requirements of the new s 461O. Section 461O encompasses large listed issuers (that are not otherwise excluded under s 461P), large registered banks, large credit unions and building societies, large insurers,

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[8] Climate Governance Initiative and Commonwealth Climate and Law Initiative, *Primer on Climate Change: Directors' Duties and Disclosure Obligations* (Legal Primer, June 2021) 12 <https://www.tcfdhub.org/wp-content/uploads/2021/06/Primer_on_Climate_Change_Directors_Duties_and_Disclosure_Obligations_CGI_CCLI.pdf> ('*Primer on Climate Change*').
[9] Task Force on Climate-related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures* (Final Report, June 2017) ii <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf> ('TCFD Report').
[10] Adrian Orr, 'Progressing Climate Action by Driving Transformational Change' (Speech, 2020 Pacific Ocean, Pacific Climate Change Conference, 28 October 2020) <https://www.rbnz.govt.nz/research-and-publications/speeches/2020/speech2020-10-28>.
[11] *Climate-related Disclosures Act* (n 1) ss 2(2)–(3)(a).
[12] See definition of 'FMC reporting entity' in the *Financial Markets Conduct Act 2013* (NZ) s 451 ('*FMC Act*').
[13] *FMC Act* (n 12) ss 455–61D. Also, any company that does not fall within the definition of an FMC reporting entity, but is large as defined by the *FR Act* (n 2) s 45, or has public accountability, is required to prepare financial statements that comply with generally accepted accounting practice under the *Companies Act 1993* (NZ) ss 201–2.

and the managers of large managed investment schemes.[14] Large issuers are listed on New Zealand's Exchange ('NZX') with a market capitalisation over NZD60 million and are not an 'excluded listed issuer'. Originally, all listed issuers were caught by the definition of 'climate reporting entity', but in its report on the Bill, the Select Committee (the Economic Development, Science and Innovation Committee) restricted the application of the new rules to large listed issuers and excluded any issuer of securities that is only listed on a growth market or does not have any quoted equity or debt securities.[15] This change was a consequence of submissions that smaller businesses may struggle to meet the costs involved with making climate-related disclosures, and that listed issuers with a market capitalisation under NZD60 million are a very small percentage of NZX's total market capitalisation.[16] 'Large', for the purposes of entities other than listed companies and licensed insurers, means that, as at the balance dates of each of the two preceding accounting periods, the combined assets of an entity and its subsidiaries are more than NZD1 billion.[17] Licensed insurers qualify if they have greater than NZD1 billion in total assets under management, or if the combined annual gross premium revenue of the insurer and its subsidiaries is more than NZD250 million.[18] In addition, overseas incorporated organisations will be required to comply with the disclosure rules if their New Zealand business or group's New Zealand business falls into any of these categories.[19] The government has estimated that these thresholds for entities with higher levels of public accountability will ensure that 90% of assets under management in New Zealand are included within the disclosure system.[20] Approximately 200 organisations will be required to disclose their exposure to climate risk, including large Crown financial institutions such as ACC and the NZ Super Fund.[21]

The pt 1 provisions are inserted into the *FMC Act* as a new pt 7A. Part 7A contains the new disclosure rules requiring CREs to prepare annual climate-related disclosures, known as climate statements.[22] The new provisions also include obligations on boards to keep climate-related document records in order for the end-of-financial-year climate statements to be prepared.[23] The new rules, when in force, will sit alongside the existing financial reporting requirements in pt 7 of the *FMC Act*, which apply to all FMC reporting entities and will have the same deadlines as to preparation and filing that apply to financial statements prepared in

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[14] *Climate-related Disclosures Act* (n 1) s 8 inserts a new *FMC Act* (n 12) pt 7A s 461S that sets out the meaning of large manager with respect to managed investment schemes. Section 461S is not yet in force.

[15] *Climate-related Disclosures Act* (n 1) s 8 inserts a new *FMC Act* (n 12) pt 7A ss 461P(2)–(5). These provisions are not yet in force.

[16] Economic Development, Science and Innovation Committee, *Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill* (Final Report, 16 August 2021) 3–4 ('Select Committee Report').

[17] *Climate-related Disclosures Act* (n 1) s 8 inserts a new *FMC Act* (n 12) pt 7A s 461Q(1), which is not yet in force.

[18] *FMC Act* (n 12) s 461Q(2) (not yet in force).

[19] Ibid s 461Q(3) (not yet in force).

[20] James Shaw, 'New Zealand First in the World to Require Climate Risk Reporting' (Press Release, New Zealand Government, 15 September 2020) <https://www.beehive.govt.nz/release/new-zealand-first-world-require-climate-risk-reporting>.

[21] Ibid.

[22] *Climate-related Disclosures Act* (n 1) s 8 inserts a new *FMC Act* (n 12) pt 7A s 461Z, which is not yet in force.

[23] *FMC Act* (n 12) ss 461V–Y (not yet in force).

accordance with pt 7. Accordingly, climate statements or group climate statements must be completed within four months after the entity's balance date.[24] In addition, they must comply with the applicable climate standards and be signed and dated by two directors of the entity.[25] In order to ensure that climate statements are accessible to stakeholders and regulators, a copy of an entity's climate statement must be lodged with the Registrar of Financial Service Providers within the four-month deadline. For a registered scheme, climate statements must be prepared for each separate fund of the scheme.[26]

In addition, any CRE that is required to prepare an annual report under the *Companies Act 1993* (NZ) or any other enactment must include in that report a statement that the entity is a CRE and provide the URL or a link to the website where copies of the statements and any assurance report can be found.[27]

The Bill proposed a 'comply or explain otherwise' disclosure regime. This means that a business that reasonably determines that it is not materially affected by climate change does not have to comply with the regime, provided it complies with specific requirements.[28] However, the majority of the Select Committee removed the 'comply or explain otherwise' option from the regime as they were concerned it would result in 'substantially different reports and quality of reporting', which would undermine the 'goal of providing consistent and comparable climate reporting'.[29] Accordingly, any entity that falls within the definition of a CRE will need to disclose in accordance with the Act. The proposed extension in the Bill of the Financial Markets Authority's ('FMA') power to exempt any person or entity from compliance with certain parts of the *FMC Act* to include exemptions from compliance with pt 7A has been retained in the regime as enacted.[30] The FMA has powers to make an exemption subject to any conditions it thinks fit.[31]

The XRB is responsible for issuing the new climate standards and eventually new auditing and assurance standards that will apply to any assurance report in relation to a CRE's climate statements after October 2023. Part 3 of the Act amends the *FR Act* to give the XRB the power to prepare and issue these standards. These amendments are now in force,[32] and the XRB has already started consulting on the content of new climate standards.[33] At the time of writing, the final form of the standards has not been published, although it has been signalled that they will

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[24] Ibid s 461ZA (not yet in force).
[25] Ibid.
[26] Ibid s 461ZC (not yet in force).
[27] Ibid s 461ZJ (not yet in force).
[28] Climate-related Disclosures Bill (n 3) cl 7 proposes a new *FMC Act* (n 12) s 461ZA.
[29] Select Committee Report (n 16) 6.
[30] *Climate-related Disclosure Act* (n 1) s 19, which is not yet in force, amends *FMC Act* (n 12) s 556.
[31] *FMC Act* (n 12) s 556(1).
[32] *Climate-related Disclosure Act* (n 1) s 2 provides that pt 2 of the Act (which authorises the XRB to issue climate standards) comes into force the day after the Royal Assent is granted, with the rest of the provisions (other than pt 2 and pt 4 sub-pt 1) commencing on a date or dates to be set by Order in Council, with a mandatory backstop of one year after the date of Royal Assent.
[33] XRB, 'First Ever Climate Change-related Disclosure Consultation Begins' (Press Release, XRB, 20 October 2021) <https://www.xrb.govt.nz/information-hub/news>.

align with the framework set out in the TCFD's final report, which is widely acknowledged as international best practice,[34] and is considered in more detail below. However, the new standards will include rules determining the extent to which entities will need to disclose greenhouse gas ('GHG') emissions. To protect against 'greenwashing', whenever an entity is required to report on GHG emissions, the entity's climate statements must be accompanied by a written assurance report by an assurance practitioner. As stated above, this requirement does not come into effect until three years from the date of Royal Assent.[35] An assurance practitioner who finds that a CRE is not complying with the climate standards relating to GHG emissions must report this to the XRB and the FMA within 20 working days of signing the report,[36] and it is an offence if an assurance practitioner fails to comply with this obligation.[37] The Act makes the FMA responsible for the independent monitoring and enforcement of the CRE's compliance with the new reporting standards.

Finally, the Act also allows the XRB to 'issue guidance on a wider range of environmental, social, governance (ESG) and other non-financial matters' that an entity may voluntarily apply. The purpose of any such publications by the XRB is to facilitate best practice reporting on such matters,[38] to improve 'the quality of disclosures on a range of issues beyond the types of information presented in financial statements'.[39]

III Content of the Climate Standards and TCFD's Report on Climate-related Financial Disclosures

A *Climate Standards*

As stated above, the XRB is responsible for the issuance of the new climate change standards. The Act provides little guidance on the content of the standards, so the following discussion outlines the identified purposes of climate standards and the new disclosure regime generally. It then provides an overview of the TCFD's final report.

The new s 19B of the *FR Act* sets out the purpose of climate standards and climate-related disclosures. However, it provides little guidance as to the content of such standards. The provision states that the purposes of climate standards are to: provide for, or promote, climate-related disclosures in order to encourage entities to routinely consider the short-, medium- and long-term risks and opportunities that climate change presents for the activities of the entity; enable entities to show how they are considering these risks and opportunities; and enable investors and other stakeholders to assess the merits of such considerations. This provision is

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[34] Departmental Disclosure Statement (n 5).
[35] *Climate-related Disclosures Act* (n 1) ss 2(3)(a)–(b).
[36] *Climate-related Disclosures Act* (n 1) s 8 inserts a new *FMC Act* (n 12) pt 7A s 461ZHB(2)(c), which provides that, in the case of a CRE that is an issuer of debt securities or a manager of a registered scheme, a copy of the report and the relevant climate statements must be sent to the manager. This provision is not yet in force.
[37] *FMC Act* (n 12) pt 7A s 461ZHB(5) (not yet in force).
[38] *Climate-related Disclosures Act* (n 1) s 40 inserts a new *FMC Act* (n 12) s 19A, which is not yet in force.
[39] Explanatory Note, Climate-related Disclosures Bill (n 3) 2.

effectively a restatement of the overall purposes of the new disclosure regime as discussed below.

More generally, the government policy behind the introduction of the Act is set out in the Explanatory Note to the Bill. This note expressly refers to the 'potentially disastrous effects of climate change for biodiversity and humanity', specifically citing the Intergovernmental Panel on Climate Change, which in 2018 'noted that human activities have already caused global warming of 1°C above pre-industrial conditions, and are on track to cause at least 1.5°C warming between 2030 and 2052'.[40] The note also identifies the impact of increased concentration of GHG as a factor 'resulting in further delay of temperature-reducing responses'.[41]

The Explanatory Note also identifies three specific purposes of the Bill, encompassing short-term to longer-term statutory objectives. Immediate and medium-term statutory purposes include: ensuring that the effects of climate change are routinely considered in business, investment, lending and insurance underwriting decisions; and helping entities demonstrate responsibility and foresight in their considerations of climate issues. With a longer time horizon, the third statutory purpose is moving to a smarter, more efficient allocation of capital and assisting in transitioning to a more sustainable, low-emissions economy.[42]

B *Recommendations of the TCFD*

As stated above, the XRB's climate standards will be aligned with the disclosure framework contained in the TCFD's 2017 final report.[43] The TCFD's framework structures its recommendations around four thematic areas that it considers represent the core elements of how organisations operate. These are governance, strategy, risk management, and metrics and targets. Governance refers to an entity's governance around climate-related risks and opportunities; strategy refers to the actual and the potential impacts of climate-related risks and opportunities on an organisation's business, strategy and financial planning; risk management includes the processes used by the entity to identify, assess and manage climate-related risks; and metrics and targets are used by the entity to evaluate and manage such risks and opportunities.[44]

The TCFD takes a broad view as to what are climate-related risks, and not only identifies and includes the physical impacts of climate change, but also classifies risks related to the transition to a lower-carbon economy as climate-related risks. Physical risks can be event-driven, resulting in direct damage to an entity and indirect disruption to its supply chain. They also may result from longer-term shifts in climate patterns, such as risks caused by sea-level rise

[40] Ibid 1.
[41] Ibid.
[42] Ibid 2.
[43] TCFD Report (n 9).
[44] Ibid 13.

disruption or chronic heat waves.[45] Risks from transitioning to a lower-carbon economy include varying levels of financial and reputational risks for entities. Such risks may result from policy changes that attempt to constrain existing activities that contribute to climate change, or policy actions that promote adaptations to climate change. Businesses may also face litigation or legal risk and, as the value of loss or damage arising from climate change grows, litigation risks are also likely to increase. Other 'transition risks' are those that arise from changes to technology, such as changes in the use of renewable energy, energy efficiency and carbon capture, and may inevitably mean that new technology will displace older systems and businesses.

Conversely, climate change will create opportunities for organisations through cost savings due to resource efficiency, development of new products, access to new markets and resilience building along the supply chain. Like risk, however, climate-related opportunities will vary depending on the region, market and industry in which an organisation operates.

The TCFD makes four high-level disclosure recommendations tied to each thematic area and 11 specific disclosure recommendations. An organisation should include disclosures on these matters in its financial statements to provide decision-useful information relating to climate-change risks and opportunities faced by that organisation.

IV CURRENT CORPORATE DISCLOSURE REQUIREMENTS

A *Current Reporting and Disclosure Requirements*

One of the advantages of mandating climate-related financial disclosures is that such disclosures become mainstream and routine in the same manner as FMC reporting entities' existing financial reporting obligations. Because financial climate-related disclosures will become compulsory once the relevant provisions of the Act are in force, this will remove any uncertainty for boards regarding whether and how climate-related factors should be disclosed.

Currently, climate-related risk disclosures may be included amongst other disclosures required to be made by listed companies. First, as stated above, New Zealand public issuers are required to prepare annual general purpose financial statements that comply with GAAP, which means the financial statements and accompanying information must comply with applicable financial reporting standards for that type of entity as issued by the XRB.[46] In order to comply with GAAP, general purpose financial statements must contain sufficient disclosures and information to make users understand the entity's financial position and performance. Currently, in meeting this requirement, boards need to consider whether climate change risks and opportunities should be disclosed in the same manner as any other information.

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[45] 'Acute physical risks' refer to those that are event-driven, including increased severity of extreme weather events, such as cyclones, hurricanes and floods. 'Chronic risk' is the term used to describe physical risks due to longer-term shifts in climate patterns.

[46] *FR Act* (n 2) s 8(a), although s 8(b) provides that if there is no provision in applicable financial reporting standards in relation to a particular matter, then the statements or information must comply with an authoritative notice.

Also, any company that is listed on NZX must comply with NZX's *Listing Rules*. These require a listed company to disclose in its annual report the extent to which the company has followed the recommendations in NZX's Corporate Governance Code,[47] or provide reasons why not. The Code recommends that listed companies have a risk management framework and report on the company's material risks and how they are being managed. Accordingly, any board of a listed company that faces material climate-related risks to its business should include in the company's annual report information about these risks, together with a plan to manage them. The Code also recommends the company provide annual non-financial disclosures on ESG and economic sustainability factors and practices or explain why it has decided not to do so. NZX amended its *ESG Guidance Note* in December 2017 to refer to the TCFD final report's recommendations.[48] In addition, the FMA's handbook, *Corporate Governance in New Zealand*, recommends entities determine the appropriate level of non-financial reporting, considering the interests of their stakeholders and material exposure to ESG factors.[49]

Furthermore, the board of a listed company must ensure that all material information related to that company is disclosed to NZX promptly and without delay under the *FMC Act* and NZX's continuous disclosure rules.[50] Information relating to the climate-related risks and opportunities faced by the company must be disclosed if the information meets the threshold of material information. Material information is information that a reasonable person would expect, if it were generally available to the market, to have a material effect on the price of the company's quoted financial products. The information must relate to the particular issuer or group of issuers or specific financial products, rather than to listed issuers or financial products generally.

Accordingly, corporate boards, especially boards of listed companies, are already required to report on and disclose climate-related risks to varying degrees. Also, reference needs to be made to the significant number of international and overseas bodies that recommend reporting of certain non-financial information or have published frameworks for entities when reporting on climate risks.[51] Despite these various recommendations and codes, or perhaps because of their number and variety, the government decided to implement mandatory climate-related financial disclosures. As the Explanatory Note to the Bill states, such disclosures will provide 'consistent, comparable, reliable and clear information about climate-related risks and opportunities that are, for the most part, not being made available to investors at present'.[52]

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[47] NZX, *Listing Rules* (at 10 December 2020) Appendix 1: NZX Corporate Governance Code.
[48] NZX, *ESG Guidance Note* (at 11 November 2017) 8 <https://s3-ap-southeast-2.amazonaws.com/nzx-prod-c84t3un4/comfy/cms/files/files/000/003/274/original/ESG_Guidance_-_6_March_2018.pdf>.
[49] Financial Markets Authority, *Corporate Governance in New Zealand: Principles and Guidelines — A Handbook for Directors, Executives and Advisers* (Financial Markets Authority, 2018) 16.
[50] *FMC Act* (n 12) pt 5 sub-pt 4 ss 270–2; NZX, *Listing Rules* (n 47) ss 3.1–3.4.
[51] Eg, the Global Reporting Initiative Sustainability Reporting Standards, available at <https://www.globalreporting.org/standards>; the Integrated Reporting Framework, available at <https://www.integratedreporting.org/resource/international-ir-framework>; the United Nations Global Compact, which requires companies to commit and report against 10 universal principles, available at <https://www.unglobalcompact.org/what-is-gc/mission/principles>.
[52] Explanatory Note, Climate-related Disclosures Bill (n 3) 1.

B *Corporate Law and Climate-related Risk Considerations*

The amendments to the *FMC Act* to make annual climate-related disclosures compulsory for CREs responds to increasing expectations on directors from investors, employees, consumers and other stakeholders. The changes will also remove a great deal of the heat from the debate as to whether the current law governing directors' duties requires (or allows) directors to consider climate-related factors when exercising their decision-making duties. Once all parts of the Act are fully in force, directors will be under an obligation to disclose climate-related risks. This will heighten the degree of attention that directors must pay to climate change in the future and the extent to which they must take it into account in their decision-making. As the Hon James Shaw, Minister for Climate Change, stated, '[w]hat gets measured, gets managed — and if businesses know how climate change will impact them in the future they can change and adopt low carbon strategies.'[53]

The directors' duties set out in ss 131 and 137 of the *Companies Act 1993* (NZ) encompass the fundamental duties that establish the standard of behaviour required of directors. Section 131 sets out the duty of loyalty and requires directors to act in good faith and in what the director believes to be the company's best interests. However, s 137 is the most relevant duty,[54] providing that a director, when exercising powers or performing duties as a director, must exercise the care, diligence and skill that a reasonable director would exercise in the circumstances. To satisfy this standard of care, directors must have a general understanding of a company's business and be in a position to identify and consider the risks facing that business.[55]

In 2019, the Aotearoa Circle published a legal opinion provided by Chapman Tripp for the Sustainable Finance Forum. This opinion concluded that, as risks to a company from climate change are increasingly foreseeable, the standard of care that a court would expect of a reasonable director would be to take into account the specific climate-related risks confronting the company. The opinion acknowledged that climate change is a foreseeable financial risk and must be considered by directors in the same way as any other financial risk. In particular, where companies are affected by climate-related financial risk, directors' duty of care requires that they, at a minimum: identify that risk; periodically assess the nature and extent of the risk to the company, including by seeking and critically evaluating advice as necessary; and decide whether and, if so, how to take action in response, taking into account the likelihood of the risk occurring and possible resulting harm to the company.[56] This is particularly the case when a

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[53] Shaw (n 20).
[54] Chapman Tripp, *Sustainable Finance Forum: Legal Opinion 2019* (Report, The Aotearoa Circle, 2019) 20 [89] <https://static1.squarespace.com/static/5bb6cb19c2ff61422a0d7b17/t/5f8e0158c25b93160fb19ae1/1603141987306/SFF_Climate%2BChange%2BRisk%2BLegal%2BOpinion_301019.pdf> ('Aotearoa Circle Legal Opinion').
[55] *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [404] *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [404]; *Davidson v Registrar of Companies* [2011] 1 NZLR 542 (HC) [83].
[56] Aotearoa Circle Legal Opinion (n 54) 16–19.

company already has public disclosure obligations, such as under the *FMC Act*, NZX's *Listing Rules* or other statutory provisions.[57]

V SANCTIONS FOR NON-COMPLIANCE WITH THE NEW DISCLOSURE REGIME

Once the new disclosure regime is fully in force, any director of a CRE will need to ensure that the entity complies with it. Otherwise, the directors may be in breach of their duties under the *Companies Act 1993* (NZ) and may expose the company and themselves to a range of new civil and criminal sanctions for non-compliance with the *FMC Act* that have been 'designed to incentivise compliance'.[58]

Similar to the FMA's responsibility for the oversight of GAAP-compliant financial statement disclosures pursuant to pt 7 of the *FMC Act*, the FMA will also be responsible for the oversight and enforcement of climate-related disclosures. The Act sets out a new *FMC Act* offence that applies to both companies and directors when the entity has failed to comply with an applicable climate standard and the entity or directors know of the non-compliance.[59] In addition, there are new infringement offences, including failing to lodge climate statements within four months of the CRE's balance date and failing to make information available about climate statements in the company's annual report.[60] Non-compliance with the obligations to keep climate-related document records and to prepare and lodge climate statements may also give rise to civil liability.[61] Overall, the new penalties arise for non-compliance in the same manner as non-compliance with other financial disclosure provisions in the *FMC Act*.

VI NON-CLIMATE-RELATED SUSTAINABILITY CONSIDERATIONS

As outlined above, the Act also provides for the XRB to issue non-binding guidance on disclosures relating to ESG and other non-financial matters. Currently, under the *FR Act*, the Minister responsible for the administration of the Act (currently the Minister for Economic and Regional Development) may authorise the board to issue financial reporting standards that relate to certain non-financial matters, including the 'social, environmental and economic context in which an entity operates'.[62] As to what matters fall within the ESG framework, NZX's *ESG Guidance Note*[63] provides some guidance, amongst other sources,[64] although no

[57] Ibid 21–3.
[58] Department Disclosure Statement (n 5) 12.
[59] *Climate-related Disclosures Act* (n 1) s 8 inserts a new *FMC Act* (n 12) pt 7A s 461ZG, which is not yet in force. Under this provision, conviction in the case of an individual can lead to imprisonment for a term not exceeding five years or a fine not exceeding NZD500,000, or both, and for any other case, a fine not exceeding NZD2.5 million.
[60] *FMC Act* (n 12) ss 461ZI(4), 461ZJ(4) (not yet in force).
[61] Ibid s 461ZK(2) (not yet in force).
[62] *FR Act* (n 2) s 17(2)(a)(iii).
[63] NZX, *ESG Guidance Note* (n 48) 5–6.
[64] See, eg, 'Home', *Principles for Responsible Investment* (Web Page) <https://www.unpri.org>; 'Welcome to FTSE Russell Sustainable Investment Data', *FTSE Russell* (Web Page, 2021) <https://si.ftserussell.com>; New Zealand Institute of Directors and MinterEllisonRuddWatts, 'Stakeholder Governance: A Call to Review Directors' Duties' (White Paper, July 2021) ('IoD White Paper').

definitive list of such matters exists.[65] Environmental considerations may include environmental protection, biodiversity, water use, waste management and sustainable procurement. Social matters may include labour standards, human rights and modern slavery, diversity and inclusion, and consumer responsibility. Governance factors may include board composition, remuneration, ethics, anti-bribery and whistleblowing.

The final part of this article briefly considers the extent to which directors must take account of such matters when making decisions on behalf of the company. In contrast to climate-related risks, where the 'links between climate change and financial risk are becoming increasingly evident and inextricable',[66] the issue for directors is that ESG matters may pose less foreseeable financial risks and may conflict with the interests of shareholders. In addition, society's expectations and developments in the knowledge of material risks, together with changes in regulations and market practices, mean that the expectations placed on directors for good governance and prudent risk management are constantly evolving.

Accordingly, the issue that directors increasingly face is whether the failure to consider ESG matters when making decisions for the company could result in a court later finding them in breach of the duty of care or the duty to act in the company's best interests. However, directors who have approached ESG risks in the same manner as any other risk, taking the materiality of the risk into account when making decisions, obtaining independent advice as appropriate and taking concrete steps to address the company's exposure to financial risk from the particular risk, will likely be found to have discharged their duty to the company.

In respect of the duty of good faith, courts have tended to presume directors have acted in good faith in the absence of any evidence of self-dealing.[67] Concerning the more subjective part of the section, namely that directors must act in what the director considers to be the company's best interests, this then raises the question of what the company is in the context of this duty in New Zealand law? This is an issue that has been the subject of academic debate in New Zealand.[68] Chapman Tripp, in their legal opinion for the Sustainable Finance Forum, observes that, although New Zealand company law is generally understood to reflect the theory of shareholder primacy,[69] this does not prevent directors from considering climate change risk in their company management. A company is a different entity than its group of current shareholders, and the company's best interests may necessitate a longer-term perspective than focusing on present shareholders. Also, the current law does not preclude directors from considering wider stakeholder interests, provided they do not pursue those interests without regard to the company's interests. However, as Chapman Tripp concludes, it is

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[65] NZX, *ESG Guidance Note* (n 48) 5.
[66] *Primer on Climate Change* (n 8) 12.
[67] *Holland Corporate Ltd v Holland* [2015] NZHC 1407, [39] (Duffy J); and see discussion in Aotearoa Circle Legal Opinion (n 54) 19–20.
[68] See, eg, in the New Zealand context: Peter Watts, *Directors' Powers and Duties* (LexisNexis, 2nd ed, 2015) ss 5.3–5.5; cf Susan Watson and Lynne Taylor (eds), *Corporate Law in New Zealand* (Thomson Reuters, online ed, 2018) ss 16.18.4.2–4.
[69] Aotearoa Circle Legal Opinion (n 54) 19–20.

> unclear whether and to what extent a New Zealand court could seek to interpret a director's duty to act in the best interests of the company as indirectly including a requirement to consider the interests of broader stakeholders. This is an issue for future discussion and beyond the scope of this legal opinion.[70]

There is growing pressure for law reform in this area.[71] For example, the Institute of Directors together with MinterEllisonRuddWatts published a White Paper calling for a review of the law regulating directors' duties in New Zealand.[72] The White Paper observes that, at a time when more and more is expected of directors, it is critical that directors have more clarity in relation to which stakeholders they can or should legitimately have regard to, to what extent, and whether they can or should give priority to others over the stated preferences of shareholders.[73] Also, in October 2021 a private member's Bill, the Companies (Directors Duties) Amendment Bill 2021 (NZ), was introduced into Parliament.[74] This Bill proposes amending s 131 of the *Companies Act 1993* (NZ) by making it clear that a company director can take into account broader matters other than the financial bottom line.[75] These include issues such as Te Tiriti (the Treaty of Waitangi), environmental impacts, corporate ethics, being a good employer, and the wider community's interests.[76] As of 1 November 2021, the Bill had yet to have its First Reading.

New Zealand organisations and politicians are not alone in calls for reform in this area of company law. For example, in 2020, the European Commission published a report titled *Study on Directors' Duties and Sustainable Corporate Governance*, prepared by Ernst & Young.[77] The starting point of this study is the view that publicly listed companies within the EU focus on the short-term benefits of shareholders, to the detriment of the long-term interests of the company.[78] Building from that starting point, the study sets out the authors' views on the root causes of short-termism, whether these root causes are due to current market practices or regulatory frameworks within the EU member states, and possible EU-level solutions.

Ernst & Young identifies seven key causes (referred to as problem drivers) that work together to promote a focus on short-term financial return within states in the EU. These include national corporate laws and judicial approaches that narrowly view director duties and company

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[70] Ibid 20.
[71] Sustainable Finance Forum, *Roadmap for Action* (Final Report, November 2020) 8; Jane Horan et al, *Structuring for Impact: Evolving Legal Structures for Business in New Zealand* (Report, The Impact Initiative, produced for the Social Enterprise Sector Development Programme, 2019); Jo Smith and Sally Garden, 'New Zealand Boards and Frontier Firms' (Working Paper No 2020/02, New Zealand Productivity Commission, August 2020).
[72] IoD White Paper (n 64).
[73] Ibid 17.
[74] Companies (Directors Duties) Amendment Bill 2021 (75-1) (NZ) was introduced by Member of Parliament Duncan Webb on 23 October 2021.
[75] Explanatory Note, Companies (Directors Duties) Amendment Bill 2021 (75-1) (NZ).
[76] Companies (Directors Duties) Amendment Bill 2021 (75-1) (NZ) cl 4.
[77] European Commission Directorate-General for Justice and Consumers and Ernst & Young, *Study on Directors' Duties and Sustainable Corporate Governance* (Final Report, July 2020) <https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en>.
[78] Note that this categorisation of short-termism as detrimental has been criticised by the European Corporate Governance Institute: see Mark Roe et al, 'The Sustainable Corporate Governance Initiative in Europe' (2021) 7 *Yale Journal on Regulation Online Bulletin* 133–53.

interests and favour the short-term maximisation of shareholder value. Other drivers include board remuneration structures that incentivise a focus on short-term shareholder value rather than long-term value creation for the company, and current board composition rules that do not fully support a shift towards sustainability.

The report concludes by recommending that any future EU statutory intervention in this area should pursue the following three specific objectives: first, to strengthen the role of directors in pursuing their company's long-term interests by dispelling current misconceptions and errors concerning the purpose of the company and the duties of directors; second, to improve the accountability of directors towards integrating sustainability into corporate decision-making by making directors more accountable for the sustainability of their business conduct; and, finally, to promote corporate governance practices that contribute to company sustainability in areas such as corporate reporting, board remuneration and board composition, while encouraging stakeholder involvement.

VII CONCLUSION

The new climate-related disclosure provisions will provide clarity for boards as to their responsibilities to consider and disclose climate-related matters. However, companies globally and in New Zealand face evolving pressures from investors and other stakeholders to consider ESG matters. While directors should report on any circumstances that exist or could arise to materially increase the risks to their strategies or future plans and any plans to manage such risks, the issue that directors face is how to take into account longer-term non-financial considerations within the current legal framework governing directors' duties. Law reform on this issue is needed.