DIRECTORS WALKING TIGHTROPE ON ESG DISCLOSURE

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Legal Briefings – By **Timothy Stutt**

In the context of BlackRock's climate 'epiphany' last month, as well as clear indications from significant fund managers such as Sir Christopher Hohn's TCI Funds Management that they will be taking more overtly activist steps to catalyse climate action in future, listed company boards have never been under greater pressure to fulsomely explain the environmental, social and governance (**ESG**) footprint of their business.

However, in their rush to meet shareholders' demands for greater information, directors are often unwittingly exposing themselves to additional litigious risks, particularly with respect to forward-looking statements on ESG risks and strategies. Common examples include statements regarding the impact of climate change on market demand for the company's products, the risks which will affect the company in the future and, depending on how they are framed, climate scenario plans.

Under the Corporations Act, when a person makes a representation to the market about a future matter and the person does not have reasonable grounds for it, the representation is automatically deemed to be misleading by law if it ultimately proves to be inaccurate. This is the case even where the person genuinely believed that the representation was true when it was made.

Where directors fail to correctly distinguish between expectation and fact, or fail to properly explain the assumptions underlying the company's analysis, they may be exposed to claims for misleading disclosure if events unfold differently to how they were anticipated. Similarly, aspirational statements, no matter how well intended, can be grounds for litigation if ultimately they are not achieved.

Increasingly, litigation for inaccurate or misleading disclosure is being used as a ‘hook’ by activists and consumers overseas when seeking to hold companies to account on ESG. Examples include the class actions filed against Mars, Nestlé and Hershey regarding their statements on sustainable sourcing and allegations of child labour in their cocoa supply chains, as well as litigation filed against Costco over statements regarding its anti-human trafficking disclosure.

The risk of misleading disclosure can be managed by having an effective disclosure process, sensible disclaimers, correct framing of information, and the robust ‘testing’ of information prior to disclosure.

However, in practice, companies typically develop their reporting on climate change, water usage, ethical sourcing, and other ESG topics in siloed specialist teams. It is fairly unusual for the information to be subject to the same level of rigour as other corporate reporting and it is too often hastily ‘blessed’ by the board on the way to investors’ inboxes.

While institutional investors will typically seek ESG data to gain better insights into the value and risk profile of their investments, in the context of Australia’s shareholder class action regime, the prospect of litigious action for inaccurate disclosure looms large for company boards where they fail to anticipate material risk exposures or incorrectly describe their impact.

Increasingly, we are also seeing activist complaints to regulators, requisitioned resolutions and social media campaigns challenging the level – or content – of ESG disclosure by listed companies. Although such demands are typically couched as being in furtherance of shareholder interests, activists are not bound to act in the bests interests of the company and will often have motivations divergent from their stated shareholder altruism.

Clearly, the answer is not less ESG disclosure. Demand for more fulsome information is reflective of both investor and broader community expectations regarding ESG and, relevantly, it now forms a baseline expectation of regulators such as ASIC. Instead, companies need to be cognisant of the myriad of users of their ESG disclosure, implement robust processes for objective review, and proactively ‘stress test’ the grounds on which statements are being made.

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