ESG

A guide for General Counsel

November 2021

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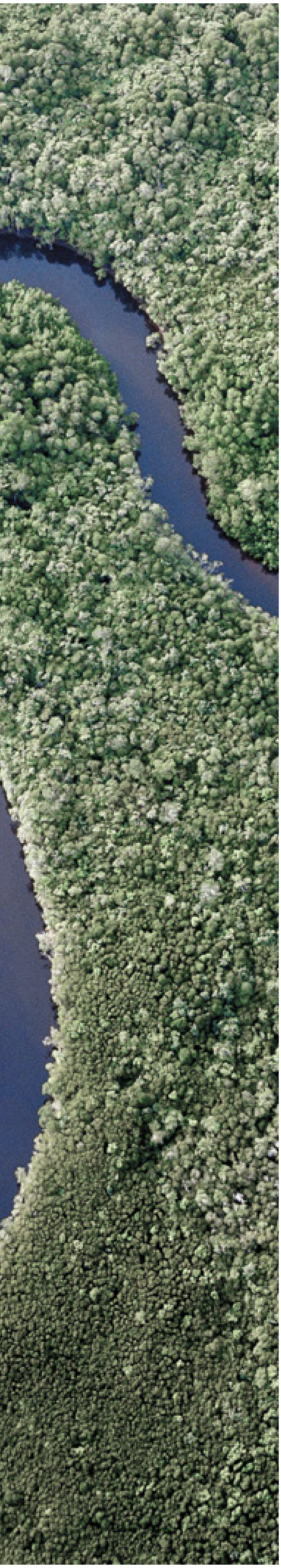

Foreword

A new world of ESG risk and opportunity

Historically, environmental, social and governance (**ESG**) matters were considered to be distinct from, and subsidiary to, the core business of companies. Consigned to corporate social responsibility (**CSR**) departments, ESG matters figured as opportunities for reputational enhancement, separate from commercial activity.

This is no longer the case.

Regulators, investors and lenders are increasingly insisting on greater transparency and demonstrated leadership on ESG issues. Activist shareholders are rallying for net zero policies and more robust management of climate-related financial risks across short, medium and long-term horizons. Socially conscious consumers are more inclined to vote with their wallets, forcing businesses to re-think their mission, products and workforce practices.

ESG issues present significant risks and opportunities for organisations. With widespread acknowledgement that holding global warming to 1.5 degrees or less is imperative, now more than ever, companies' financial performance and reputation depends upon their upholding every aspect of their social licence to operate.

Organisations with a well-developed approach to responsible business issues have embraced this new reality. These organisations accept that commercial strategy must properly incorporate ESG risks and opportunities. They see the environment, people and community trust as valuable assets that need to be protected. They identify (and seek to mitigate) risks to their operations posed by ESG factors, and consider how people and the environment are impacted by their operations. Importantly, they also understand that through robust engagement with ESG factors, they may be able to derive benefits not just for themselves, but for the environment and their broader communities.

Against this backdrop, we have developed this guide to assist General Counsel (**GCs**) identify, assess and capitalise on ESG opportunities and to develop a leading ESG risk and compliance culture across their organisation.

I hope you find it useful.

Gavin MacLaren

Senior Partner and CEO

Corrs Chambers Westgarth

Contents

01

Understanding ESG

ESG is an umbrella term used to describe the environmental, social and governance factors that may impact on or present opportunity to an organisation.

Until recently, ESG issues have been viewed as non-financial risks that have been addressed by undertaking CSR measures in order to mitigate any ethical, sustainability and environmental impacts of the organisation. There is a growing body of stakeholders, including investors and regulators, who evaluate ESG issues as material financial, commercial, legal and reputational risks and assets. This shift drives responsibility for ESG into the boardroom and requires directors to be building ESG considerations into their organisation's strategy and risk framework. This shift is explored more in Chapter 2.

Increasingly, we are seeing organisations considering the impact their business is having on the environment and on the community, and proactively taking steps to ensure they are maintaining trust, brand and reputation (i.e. social capital) through sound governance – recognising that making decisions with regard to ESG issues makes good business sense.

Environmental capital, also known as 'natural capital', refers to renewable or non-renewable environmental resources and assets including plants, animals, water, soil, minerals and air. For more information, see the Convention on Biological Diversity definition.

Human capital consists of the knowledge, skills, competencies and attributes that people have, enabling them to realise their potential as productive members of an organisation or society. For more information, see the World Bank definition.

Social capital refers to the value of an organisation's internal and external social connections and the trustworthiness that these connections engender. It is often reflected in the concept of a 'social licence to operate'. For more information, see the OECD definition.

53%

of Australians say they would be motivated to invest and save more money if they knew their savings or investments made a positive difference in the world

67%

of Australians believe ethical or responsible banks perform better in the long term and 62% believe ethical or responsible super funds perform better in the long term (up from 29% in 2017)

87%

of Australians think Australia's financial services sector has a role to play in generating positive social, environmental and economic outcomes for the country

Source: Responsible Investment Association Australia, *From Values to Riches 2020 - Charting consumer expectations and demand for responsible investing in Australia*, March 2020.

Environment

Environmental issues arise from consideration of whether an organisation helps or harms the environment.

Organisations must consider how they utilise their environmental capital and how changes in the environment affect them.

In the context of climate change, organisations must consider both the risks that climate change may pose to the organisation and how its activities contribute to the causes of climate change. This includes through customers using the products or services it supplies, or through its own procurement practices and operations.

Key issues

Carbon emissions, climate change and net zero commitments

Sustainable water use

Air and water pollution

Deforestation and land use

Biodiversity protection

Hazardous waste prevention and management

Contamination and land rehabilitation

Supply chain environmental due diligence

Waste and resource management (removal of single-use plastics, recycling, move to circular economy etc.)

Decreasing energy consumption

Reducing embedded carbon in materials and products

Implementation of technologies (electric cars, renewables etc.)

Social

The social aspects of ESG include a range of human rights issues within the organisation, its operations and supply chains, and in the broader community in which the entity operates. Human rights issues require organisations to undertake due diligence to evaluate how their operations may impact people (including those within the entity and those external to it, such as local communities).

This could include how the organisation deals with its own workforce – workplace health and safety, diversity and inclusion, labour relations and employment rights, education and training for employees. It also includes how the entity interacts with suppliers, stakeholders and other third parties – considering any human rights impacts, issues of modern slavery, supply chain due diligence and supplier relationships, as well as engagement with First Nations people and respect for their human and cultural rights and community engagement.

Organisations that are investing in human capital (by providing development opportunities and dealing with responsible suppliers) and maximising social capital (by contributing to and engaging constructively with their community) are observing that their social licence to operate is more readily maintained and, in some cases, enhanced.

Key issues

- First Nations rights
- Child labour
- Health and safety (workplace and product)
- Diversity
- Human rights
- Labour relations and employment rights
- Modern slavery
- Supply chain exposure and supplier relationships
- Data protection and privacy
- Investment into stakeholder and community relationships
- Inequality (including gender inequality, sexual harassment in the workplace, economic inequality and wages)
- Education and training for employees

Governance

Governance issues are those most familiar to management and directors (and traditionally trained lawyers). They are increasingly being acknowledged as having the potential to significiantly impact on social capital. The Australian Institute of Company Directors (**AICD**) defines corporate governance by reference to the framework of rules, systems and processes put in place to control and monitor an organisation, as well as how authority within organisations is exercised and maintained.[1]

Traditionally, the idea of corporate governance is a sytem of checks and balances designed to identify and manage risk (internal controls and procedures, clear and accurate reporting and accounting), as well as compliance with directors' and officers' statutory duties. Modern corporate governance incorporates consideration of ESG risks.

These systems and processes now extend beyond bare compliance with laws to acting reasonably in the context of an organisation's risk profile.

Key issues

- Director and officer fiduciary duties and ethics
- Executive compensation
- Risk management and oversight
- Diversity and inclusion in governance structures
- ESG-conscious investment
- Anti-bribery and corruption
- Anti-money laundering and counter terrorism financing
- Whistleblower protections and reporting mechanisms
- Governance structure management (including stakeholder and employee participation in management and investment practices)

1 AICD, *Guiding Principles of good governance*, 2017.

02

Navigating the shifting ESG landscape

Capital and business opportunities are increasingly flowing to responsible businesses that are seen to hold themselves accountable by considering their environmental and social impacts, and by governing with integrity and transparency.

In 2021 social, environmental, regulatory and market forces have coalesced to produce a seismic shift in the allocation of capital and what is considered corporate best practice.

Propelled in part by unprecedented natural disasters, the first pandemic in 100 years and significant global social movements regarding gender and racial equity, this shift is manifesting itself from boardroom to courtroom.

Heightened investor awareness and sensitivity to the longitudinal risks of climate change, biodiversity loss, labour exploitation and human rights violations in supply chains is creating rapid and ongoing change in all sectors. Investors and consumers reallocated capital and made purchasing decisions that favoured responsible and sustainable funds and businesses in an unprecedented manner throughout the first two quarters of 2021, and shareholder and employee activism has increasingly driven organisations to take action to enhance their ESG credentials.

The global state of play regarding key issues like climate change is continually evolving, highlighted by the release of the Intergovernmental Panel on Climate Change (IPCC) 6th Assessment Report in August 2021 and the expected outcomes of COP 26.

Clients and customers are demanding greater ESG performance as a threshold requirement for continued participation in their supply chains, due to pressures to improve their own ESG standing.

The message from corporate stakeholders is clear: companies must rise to meet demands for ESG accountability and transparency with proper risk management, due diligence and reporting, or risk shareholder and employee activism, investor divestment and exclusion.

As ESG risk becomes integrated with investment and supply chain risk, the legal, financial and reputational consequences associated with failing to robustly engage are likewise becoming increasingly serious.[2]

While the pace of change is challenging, there is a market advantage to be had in aligning with evolving best practices in ESG risk assessment and disclosure. Regulators, investors, employees, customer, consumers and interest groups including NGOs are actively seeking ethical goods and services with low environmental impact. The shifting public sentiment presents opportunity for those willing to adapt. The Edelman Trust Barometer 2021 indicates that public trust in companies is presently higher than trust in the government, with 66% of respondents voting that 'CEOs should take the lead on change rather than waiting for the government to impose change', and 68% endorsing the notion that 'CEOs should step in when the government does not fix societal problems'. Investor pressure is driving a global reallocation of capital, with market advantages to be had for those companies who proactively manage ESG risks alongside financial and commercial risks.

Edelman Trust Barometer 2021

66% of respondents believe CEOs should take the lead on change rather than waiting for the government to impose change.

68% of respondents endorse the notion that CEOs should step in when the government does not fix societal problems.

2 Boston Consulting Group, Interview with BlackRock CEO Larry Fink, June 2021.

Five key drivers of change

There are five key drivers of change in relation to ESG risks with legal, financial and strategic consequences for organisations.

Organisations that proactively monitor these drivers, and integrate their response to them into strategic and operational decision-making, will be best placed to respond and benefit from the evolving ESG landscape.

01

Accelerating capital flows to ESG funds and businesses

The allocation of capital to ESG funds is increasing at a rate that demands attention. Between 1 January and 30 September 2020, BlackRock observed a $230 billion inflow into ESG funds[3] and more than half the ESG-linked funds outperformed the S&P500 in the first several months of 2021.[4] Momentum is projected to continue, with investors anticipated to, on average, double their allocation to sustainable assets under management in the next five years.[5]

This effect is likely to intensify as ESG-related financial risk disclosure and reporting becomes more and more rigorous and standardised, indicating that access to capital will be increasingly contingent on robust engagement with ESG.

Corrs insight	[Responsible investment: key approaches for long-term value]()

02

Global drive towards net zero (by 2050)

Every individual, company, supply chain, stakeholder and investment is, and will increasingly be, impacted by climate risks. The urgency and necessity of climate action, emphasised by the work of the IPCC, Taskforce for Climate-related Financial Disclosures (**TCFD**) and Taskforce for Nature-related Financial Disclosures (**TNFD**), has propelled movement towards decarbonisation at a faster pace. GlobalData's most recent thematic report on climate change reveals the emergence of a 'race to net zero', with market competition regarding climate performance metrics increasingly occurring.

Key market players and global standard-setting bodies like the TCFD are repositioning climate considerations as mainstream material financial considerations. Australian regulators and industry bodies have followed suit, with a suite of guidance materials from organisations including the Australian Prudential Regulation Authority (**APRA**), the Australian Securities and Investments Commission (**ASIC**), ASX Corporate Governance Council and the Governance Institute of Australia emphasising the need for companies to monitor, report and manage climate risks in a transparent and verifiable manner.[6]

Corrs insight	[Over the climate change horizon: corporations must prepare now for biodiversity loss risk disclosures]()

3 BlackRock, *Sustainability goes mainstream: 2020 Global Sustainable Investing Survey*, 2020.

4 S&P Global Market Intelligence, *Most ESG funds outperformed S&P 500 in early 2021 as studies debate why*, 16 June 2021.

5 Ibid.

6 See e.g. Australian Securities and Investments Commission, *Report 593: Climate risk disclosure by Australia's listed companies*, September 2018.

03

Movement from voluntary to mandatory regulation

The TCFD framework has paved the way for the introduction of a growing suite of ESG law and policy, such as the European Commission's EU Sustainable Finance Disclosure Regulation. In Australia, voluntary guidelines include APRA's draft Prudential Practice Guide on Climate Change Financial Risks and the Governance Institute of Australia's Climate Change Risk Disclosure Guide.[7] Such guidelines are useful for organisations seeking to remain up-to-date with industry standards and the developing attitudes of regulators in respect of ESG issues and how they may be expected to consider, manage and report ESG related risks.

The UN Biodiversity Conference (**COP15**) and Climate Change Conference (**COP26**) are anticipated to place renewed pressure on legislatures and regulators to enhance legal requirements and enforce mandatory disclosure obligations for ESG-related environmental risks. The transition to a business model that systematises the response to ESG risks may be difficult, but those organisations that are early adopters and equip themselves to implement risk mitigation strategies and appropriate controls, including robust due diligence processes, will be best positioned to attract capital and customers.

As global capital flows and supply chains are redirected in favour of 'ESG positive' ventures, regulators are likewise taking action around the communication of inaccurate climate-related targets and the misleading ESG credentials of products to investors, shareholders, customers and consumers, warning in particular against greenwashing.[8]

Corrs insight

Passing of Customs Amendments Bill by Senate highlights the need for business ESG integration

04

Shifting investor expectations and increasing shareholder activism

Corporate investors and shareholders are increasingly demanding responsible business conduct and utilising a range of levers to do so. Investors and shareholders are leveraging capital, actively voting in AGMs against directors who fail to engage on key issues, commencing litigation to demand robust financial disclosures of material ESG-related risks and, where necessary, divesting. This is apparent in the Australian corporate environment with 12 Australian-based companies being publicly subjected to activist demands in the opening quarter of 2021, and many others admitting to having pressure applied to them regularly behind closed doors.

ESG reporting and assessment is being utilised as a proxy to evaluate management, identify the risk and value of actual and prospective investments, and make decisions regarding the allocation of capital.[9]

Corrs insight

From the courtroom to the boardroom: climate change risks and remedies

7 See APRA, *Draft Prudential Practice Guide CPG 229 Climate Change Financial Risks* (CPG 229), April 2021; Governance Institute of Australia, *Climate Change Risk Disclosure Guide: A practical guide to reporting against ASX Corporate Governance Council's Corporate Governance Principles and Recommendations*, February 2020.

8 See e.g. ASIC's Corporate Plan 2021-2025.

9 Money Management, *'S' in ESG becoming more important, Ausbil says*, November 2018.

05

Heightened customer and employee sensitivity to ESG

Customers, consumers and employees are more equipped with knowledge on the operations and actions of companies than ever before. They compare company statements and marketing to social media, media reports, investigative journalism and other information now readily available to carefully scrutinise commercial conduct. Recent studies show that these stakeholders are increasingly sensitive to, and engaged with, ESG issues.

Potential employees are also actively seeking out workplaces, products and services which align with their values, with 64% of American millennials reporting that they would not accept a job unless their prospective employer had a strong CSR policy and 83% stating they would feel more loyal to a company which helped them to contribute to social and environmental causes.[10]

This heightened sensitivity is reflected in direct action by consumers and employees. They are demanding change, withholding labour, boycotting products, initiating action for greenwashing and misleading or deceptive conduct, launching social media campaigns and leveraging reputational damage to create change. This in turn is having a profound impact on investors and shareholders.

Customers are increasingly re-orientating their procurement strategies to demand improved ESG performance from their suppliers as their stakeholders expect them to look beyond their own activities to those of their business partners. Focus, flexibility and responsiveness on all ESG matters will be necessary to develop and maintain long term relationships and be embedded in medium and long term supply arrangements which cover this period of rapid change.

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Maintaining an ESG focus in times of crisis

These drivers emphasise that ESG risk and investment, financial and commercial risks are increasingly interrelated.

Remaining alive and responsive to emerging social and environmental issues, and maintaining a clear dialogue with stakeholders regarding their interests and expectations, is essential to achieving sustainable market performance and attracting capital flows. To ensure this occurs, GCs can exercise significant influence and oversight over their organisation's ESG risk assessment, due diligence, financial and non-financial disclosures and reporting mechanisms, and help the board navigate the shifting state of play.

10 Forbes, *The Power of Purpose*, March 2020.

03

Leading from the front on ESG matters

In recent years, the recalibration of ESG away from corporate social responsibility to addressing what are often material and foreseeable risks places ESG strategy directly into the boardroom. The board has a critical role to play in incorporating ESG issues into the organisation's strategy and risk framework. Organisations should develop a coherent narrative in relation to ESG issues. This should be in a form that is easily communicated to both internal and external stakeholders in order to manage expectations and ensure communication is consistent in the face of constant and changing demands.

With expectations of business shifting, so too is the role of today's GC. More and more, organisations are looking to their GC to lead from the front on a variety of regulatory, reputational and cultural ESG matters, and support the board in their ESG related decision-making.

We see the GC's role in leading on ESG matters as having two key components:

ESG awareness

Ensuring their organisations are aware and continuously informed of ESG-related developments, both in terms of compliance and the more general issues associated with preservation of organisational reputation.

1. Regulatory trends
2. Linking ESG with directors' duties
3. Shareholder activism and litigation

ESG management

Shaping the future by assisting with the development and management of their organisation's ESG strategy and framework to ensure effective achievement of ESG goals.

1. ESG strategy
2. ESG framework

ESG awareness

Keeping up to speed with ESG issues, requirements and expectations is challenging given the rapidly evolving landscape. Trends draw attention and focus to certain concerns at different times, but it is important for GCs to be across the range of ESG risks – including regulatory trends, ESG and directors' duties and shareholder activism and litigation – that may impact their organisation and the consequences of failing to properly engage with these matters.

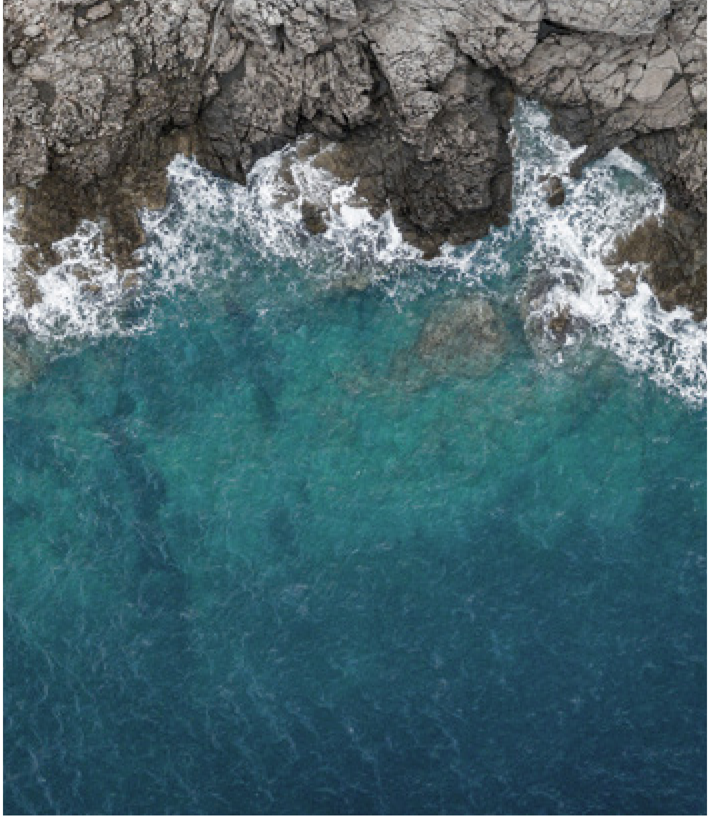
01

Regulatory trends

GCs have a critical role to play when it comes to advising on compliance with current and emerging requirements and expectations and guiding an organisation's engagement with them. Robust engagement is not only imperative at an organisational level, but also for the board in respect of the fulfilment of individual directors' duties.

The evolving regulatory environment and the trajectory of domestic and international jurisprudence suggest that if companies fall short, a range of stakeholders might look to bring actions against corporate entities, executive management and the board.

Regulatory requirements and guidance in relation to ESG issues, their assessment, management and disclosure are constantly evolving. While it is not possible to address all the ESG issues that affect all organisations in a single guide, there are four particular areas which organisations and their directors should be aware of.



Environmental impacts

Compliance with environmental laws is no longer enough. Increasingly, organisations are being asked to demonstrate that relevant operations are conducted sustainably in respect of land and water use, biodiversity, climate change, waste management and energy use. These practices need to be supported by policies, evidence of action and verifiable reporting that demonstrates the accuracy of any statements that are made about the organisation's approach and progress.

Climate change

National and international best practice regarding the identification, assessment and financial reporting of climate-related impacts and dependencies has evolved significantly in recent years. Organisations need to be able to identify climate-related risks and opportunities, both in their primary operations and across the supply chain.

Currently, there is minimal direct regulation of climate risk disclosure in Australia. Instead, regulator guidance materials, accounting standards guidance and industry best practice dictate how organisations should disclose and report on climate risk, for the purpose of complying with their broader disclosure and financial reporting obligations.

ASIC has confirmed that climate-related disclosures in a company's operating and financial review are required wherever climate risk is a material issue that could affect the company's achievement of its financial performance.

ASIC and other regulators are also largely aligned in recommending that companies adopt the TCFD framework as the basis of climate risk assessments and disclosures, and many companies have been or are beginning to do so. At a minimum such an assessment should include consideration of both physical and transition risks and ideally scenario testing. A failure to assess and disclose material climate related risks may expose both the company and individual directors to liability under the *Corporations Act 2001* (Cth).

While there are few direct regulations, organisations are pursuing low carbon objectives by including qualitative requirements in their procurement policies, tender evaluation and contracts, for example, the procurement of renewable energy or low embodied carbon materials.

Even if an organisation forms the view that climate risk is unlikely to have a material impact, the business may need to be able to justify that risk assessment to regulators, investors, shareholders and the wider community. It will also need to reassess that position as the climate and its operating context alter over time.

In focus

BHP climate change analyses

BHP has been publishing scenario analyses used to assess how climate change may affect its businesses since 2015, and in 2020 it published the BHP Climate Change Report 2020 that describes their latest portfolio analysis.

Corrs insight

Infrastructure contracts playing catch up to low embodied carbon construction materials

Greenwashing

'Greenwashing' encompasses a wide range of actions that are designed to exaggerate the 'green' credentials of companies and financial service providers. At its most innocent, greenwashing is marketing spin designed to create a favourable impression about a company or its products. At its worst, it is conduct designed to mislead and deceive investors and customers.

The *Corporations Act 2001* (Cth) outlaws misleading or deceptive conduct and false or misleading statements, as does the *Competition and Consumer Act 2010* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth). Overstatement of a company's climate-friendly credentials to investors, suppliers or customers, including unrealistic representations about net zero goals or emission reduction targets, exposes a company to breaches of these prohibitions and to action by regulators, activists and competitors.

As of August 2021, the first proceedings in Australia against a corporate for climate-related greenwashing in breach of these provisions has been filed. Across the globe, similar challenges have already been occurring.

There are several key factors which heighten the risk of companies engaging in greenwashing. One factor is the pace at which many companies are attempting to make climate-related disclosures and statements, set business targets and make product claims. Another is the immaturity of climate-related risk evaluation, valuation and disclosure practises. Each creates a risk of error and miscommunication.

Therefore, it is critical that companies ensure all information provided to the market reflects current operations and situational realities. This includes in respect of ESG.

In focus

Australia's first greenwashing proceedings

An oil and gas giant became the first corporate to be hit with Australian proceedings for alleged climate-related 'greenwashing'.

The types of statements that may be tested in this litigation, and subsequent litigation, include:

- claims about future emission reductions (including targets) which are made without a short or medium term strategy to achieve progress towards the goals, or which are only based on technological advancements that have not yet occurred; and
- claims about business strategies being 'Paris-aligned', or just consistent with local or national climate policies, when on closer inspection there is not genuinely an alignment, or it only exists in some limited scenarios.

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[Corporate 'greenwashing' the latest target for climate change litigation]

In focus

Chevron greenwashing accusations

Chevron currently faces accusations of greenwashing in a false advertising complaint jointly filed by Global Witness, Greenpeace and Earthworks with the US Federal Trade Commission earlier this year. The trio complain that Chevron's promotions:

- imply that its business operations do not harm (and even help) the environment, despite environmental disasters;
- state that it produces 'ever-cleaner' or 'clean' energy, while spending less than 0.2% of its capital expenditures on renewable energy sources;
- misrepresent the benefits of 'renewable natural gas'; and
- mislead consumers with confusing phrases as 'reducing emissions intensity' while continuing to increase overall oil and gas extraction and production.

Anti-bribery and corruption

Australia became a signatory to the Organisation for Economic Co-operation and Development (**OECD**) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (**Convention**) in 1999 and implemented the Convention via Division 70 of the *Criminal Code Act* (**Code**) the same year. There are significant penalties for bribing a foreign public official. Individuals may face a lengthy prison sentence and / or a fine, while corporate offenders are exposed to very significant fines and a requirement to forfeit any benefits obtained.

In its periodic assessments of Australia's implementation of the Convention, the OECD Working Group on Bribery in International Transactions (**Working Group**) has typically found enforcement of foreign bribery offences to be lacking. In its most recent follow up report in 2019, the Working Group remained deeply concerned about the lack of 'meaningful progress' in Australia's foreign bribery enforcement, with only two companies and six individuals being convicted of foreign bribery, across two matters, in 20 years.

Various amendments have been made to the foreign bribery offences in the Code in response to recommendations of the Working Group. For example, in 2016, false accounting offences were inserted. However, there have been no successful prosecutions under the false accounting offences and various deficiencies in the foreign bribery offences remain, which may explain Australia's relatively low enforcement record.

In December 2017, the Australian Government introduced a bill to amend the foreign bribery offences in order to remove unnecessary impediments to prosecution, introduce a new corporate offence for failing to prevent foreign bribery, and implement a deferred prosecution agreement scheme for foreign bribery offences, similar to the scheme successfully implemented in the *Bribery Act* 2010 (UK) (**CLACCC Bill**). As at the time of writing, the CLACCC Bill has not been passed.

Australia's approach to future enforcement of foreign bribery offences largely depends on the passing of the Bill, which, if enacted, is expected to result in an increase of successful foreign bribery prosecutions in the coming years. The requirement for companies to have an effective anti-bribery and corruption compliance program to avoid prosecution under the new 'failure to prevent foreign bribery' offence is likely to see increased focus on the adequacy of such measures once the Bill passes.

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Why aligning anti-corruption and human rights approaches makes good business sense

Anti-money laundering and counter terrorism financing

The aftermath of the Financial Services Royal Commission has seen increased investigatory and enforcement action by Australia's financial intelligence agency, AUSTRAC, against three of Australia's largest banks for non-compliance with anti-money laundering (**AML**) and counter terrorism financing (**CTF**) laws.

AML / CTF program failures have resulted in penalties amounting to hundreds of millions of dollars, including for failing to report threshold transactions and make timely suspicious matter reports, as well as failing to conduct customer due diligence. AUSTRAC investigations into alleged 'serious concerns' are ongoing.

In the gambling sector, in 2017, the Federal Court of Australia issued a listed wagering company with an A$45 million penalty for AML / CTF compliance program failures and for failing to provide suspicious matter reports to AUSTRAC in relation to suspected match-fixing, credit betting and credit card fraud. AUSTRAC is currently investigating potential, serious non-compliance with the AML / CTF regime at casinos in major Australian cities.

As a consequence of these large penalties, AML enforcement risks continue to be a significant focus for regulated entities in Australia and this trend is unlikely to abate.

AUSTRAC's regulation of digital currencies

Since 3 April 2018, digital currency exchange (**DCE**) services have been regulated by AUSTRAC and subject to Australia's AML / CTF regime. DCE service providers are subject to registration requirements, which provides AUSTRAC with the power to suspend, cancel or refuse to issue or renew a registration. However, the AML / CTF regime only applies to DCE services that involve an exchange between digital currencies and money (or gaming chips and tokens or betting instruments) – it does not focus on the digital currencies themselves.

The Australian regulatory landscape is continuing to evolve in this area, with AUSTRAC and ASIC publishing various guidance materials for entities involved in digital currency.

Human rights and modern slavery

Organisations and the wider community have become highly sensitive to business impact on their employees, workers along the value chain, and the communities in which they are situated.

The unanimous endorsement of the United Nations Guiding Principles on Business and Human Rights (**UNGPs**) at the Human Rights Council in 2011 has created the expectation that organisations consider and act on their human rights impacts. While the UNGPs are voluntary guidance for organisations, they are being increasingly applied in the application of mandatory rules such as *Australia's Modern Slavery Act 2018* (Cth) (the **Modern Slavery Act**).

The Modern Slavery Act requires many entities to report on the risks of modern slavery in their supply chains and operations. Many are doing so voluntarily. For those organisations that are not required to report, there is increasing pressure to demonstrate a capacity to undertake a certain level of modern slavery risk due diligence to provide reporting entities with confidence in their supply chains. GCs should understand how human rights impacts can manifest in relation to their organisation's operations, particularly in respect of modern slavery, and be able to monitor and evaluate compliance programmes to ensure these risks are adequately addressed.

The COVID-19 pandemic has highlighted a range of risks and disruption to business and particularly to the realisation of human rights. It is estimated that the equivalent of 255 million full time jobs were lost in 2020, and women have been disproportionately affected. Automation has been accelerated by the pandemic, usually affecting low skilled workers. Throughout 2020-2021 the pandemic caused some industries to close while others ramped up production with little regulation and short delivery times, often increasing the risk of labour exploitation and occupational health and safety risks as dispatch of goods continued around the clock.

Environment: a new human right

On Friday 8 October 2021, the United Nations Human Rights Council recognised for the first time that having a clean, healthy and sustainable environment is indeed a human right.

Resolution 48/13

Business' role in addressing systemic inequality has also been a focus as the #blacklivesmatter and #metoo movements gained traction and demanded more diversity, more inclusion and greater equality in the community and in the workplace. Employees demand more action from their employers, and diversity and inclusion has taken on an urgency and focus for organisations.

This has been reflected in AICD Guidance to boards of directors on their responsibilities for preventing sexual harassment and builds upon the ASX Corporate Governance Council's Principles and Recommendations. These include requirements for listed entities to have and disclose a gender diversity and to set measurable objectives for achieving gender diversity in the composition of their boards, senior executives and workforce generally (which are likely to be updated in response to the recent National Sex Discrimination Commissioner's report *Respect@Work*).

Importantly, business engagement with Australia's First Nations people has grown. Where possible, organisations are committing to Reconciliation Action Plans and making commitments to address the systemic inequality experienced by Aboriginal and Torres Strait Islander people. Where appropriate, working with First Nations people to protect country, culture and advance reconciliation is an important component of good ESG governance.

02

Linking ESG with directors' duties

The GC has a role to play in advising the board to ensure it receives relevant information at an appropriate level of detail in relation to issues that are subject to board oversight and decision-making. There are a number of factors to consider.

Given the ESG emerging trends and the activism and litigation threats, for many directors ESG matters are fast becoming a significant part of their oversight of the organisation.[11]

Failures in respect of ESG matters can have devastating reputational impacts and limit market opportunities. Directors have a duty to preserve the reputation and standing of the organisation. This may mean that directors need to weigh up long-term sustainability and reputation of the organisation against short-term impact in order to discharge their directors' duties.

The increased risk of adverse action from shareholders, investors, regulators, consumers and interest groups necessitates that directors take a broader view of the steps needed to preserve and protect the organisation's social licence.

> **Investors increasingly view corporate attention to ESG criteria as closely linked with business resilience, competitive strength and financial performance.**
>
> Harvard Law School Forum on Corporate Governance[12]

Boards are expected to drive corporate culture. The tone from the top is critically important to building a culture of integrity. It follows that the question GCs should encourage directors to ask themselves is no longer simply 'is this lawful?' but 'is this lawful and the right thing to do?'.

This concept was forcefully articulated in the Final Report of the Financial Services Royal Commission as:

> *"[It] is the board and senior management of financial services entities who are responsible for, and have the greatest degree of control over, the way that risks – including compliance risk, conduct risk and regulatory risk – are managed within those entities.*
>
> *To put that in more concrete terms, it is the board and senior management of financial services entities who are responsible for, and have the greatest degree of control over whether the entity has a culture that encourages good customer outcomes and the sound management of risk – a culture in which employees ask,* 'what should I do?' instead of 'what can I do?*"*[13]

Another area for GC's to watch is the application of ESG related issues to 'stepping stone' liability. While there are limits to the application of the doctrine, it is possible that directors may breach their duties if they allow the company to breach the law, for example by allowing the company to engage in misleading or inadequate reporting of stakeholder issues.[14]

Corrs insight	Climate-related risk: a rising bar for directors' responsibilities

11 See e.g. Noel Hutley SC and Sebastien Hartford-Davis, *Centre for Policy Development and Future Business Council Climate Change and Directors' Duties*, Memorandum of Opinion, 7 October 2016.

12 Kai H.E. Liekefett, Holly J. Gregory and Leonard Wood, Sidley Austin LLP, *Shareholder Activism and ESG: What Comes Next, and How to Prepare*, Harvard Law School Forum on Corporate Governance blog, 29 May 2021.

13 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report Vol. 1, 2019, p 347.

14 See for example *ASIC v Cassimatis (No8)* (2016) 336 ALR 209.

03

Shareholder activism and litigation

The demand for responsible business conduct in the context of ESG has led to a surge in ESG-related litigation and shareholder activism.

Shareholder activism

Regulators, investors, shareholders, consumers, employees and interest groups are demanding business operate in way that is cognisant of the growing ESG agenda. Investors and shareholders are leveraging capital, actively voting against directors who fail to engage on key issues, commencing litigation to demand robust financial disclosures of material ESG-related risks, and where necessary, divesting.

At a more general level, shareholder activism is on the rise in Australia, and is projected to take two forms into the future:

1. **Economic activism**. Shareholders seek to change the corporate strategy of a firm or influence specific business decisions to increase the value.
2. **Social activism**. Shareholders seek to influence a company's operations and strategy on ESG matters.

Shareholder activism can cause significant business disruption and reputational risk to organisations who fail to proactively engage with the activists. Australia's regulatory regime is generally conducive to shareholder activism in that clear statutory rights are afforded to shareholders with a relatively small shareholding, such as calling shareholder meetings, nominating and removing directors, mandated votes on remuneration and requisitioning resolutions.

While it is difficult for activists to definitively dictate the direction of a company, there have been several attempts to use shareholder power to achieve ESG objectives and we do not expect that trend to change. GCs need to be aware of the activist 'toolkit' and the how they may help to put the company into the best possible position to avoid or resolve these issues – for example, by understanding the limits of the ability of the general meeting to set the direction of a company.

In focus

BlackRock support for shareholder activism

The world's largest asset manager BlackRock has been making waves over the past few years through its support of shareholder activism.

Continuing a trend of climate action sentiment, CEO Larry Fink's 2021 Letter to CEOs spoke to climate risk being investment risk, and the opportunity of the net zero transition.

Increasingly, BlackRock has supported shareholder proposals relating to governance and climate issues, supporting 35% in the 2020-21 proxy voting year. Most recently that included a vote against the election of a long-serving director of Woodside Petroleum, as a result of concerns about climate risk disclosure.

BlackRock has positioned itself as a keen supporter and powerful ally of climate activists who seek to engage in transition discussions with company directors and propel the uptake of TCFD recommendations.

Litigation

The growth in stakeholder awareness of climate issues has been accompanied by a significant global increase in climate litigation. The number of climate change-related cases more than doubled between 2015 and 2021.

Four key categories of claims are emerging, being:

1. Rights and duty-based claims against governments for a lack of action on climate issues.
2. Actions against major greenhouse gas emitters.
3. Challenges to project approvals associated with a significant increase in greenhouse gas emissions.
4. Actions against companies, directors and advisers regarding fulfilment of fiduciary duties, financial disclosures, climate-related risk assessment and greenwashing.

The Federal Court's recent finding in *Sharma*[15] that the Commonwealth Minister for the Environment owes Australian children a duty of care to protect them from the health impacts of climate change which may be incurred by the grant of approvals for projects that will release a significant volume of carbon dioxide, is significant. While an appeal has been filed on behalf of the Minister, the question now arises as to whether consent authorities and other decision-makers are subject to a similar duty of care. If so, it is conceivable that litigants may argue that Australian courts should likewise find that corporations have a similar duty of care regarding climate change.

We have also seen recent examples of shareholders taking action directly against companies in relation to climate disclosures, highlighting the need for robust verification processes for those disclosures. If these claims succeed, or gain traction, regulatory attention is sure to follow.

This elevated litigation risk emphasises the necessity of being alive to ESG issues. Considering ESG impacts in the context of strategic decision making such as evaluation a new project or product or expanding operations will help an organisation to be seen as proactive in this space, and may make it less likely that it will be the target of potential action. Monitoring and engaging with community expectations and public sentiment regarding ESG issues may provide a good way for organisations to manage the legal, commercial and reputational risks.

In focus

Big emitters not held liable to pay the costs of harm caused by global warming

One of the most significant international actions against major emitters came in New York City's 2018 suit under state nuisance law against BP Plc, Chevron Corp, ConocoPhillips, Exxon Mobil Corp and Royal Dutch Shell Plc for damages caused by the companies' production and sale of fossil fuels.

The suit was ultimately rejected (and the rejection upheld), with US District Court Judge John F. Keenan ruling that problems associated with climate change should be tackled by Congress and the executive branch. Despite the failure in this instance, increasing acceptance by other courts of scientific evidence may eventually see like proceedings lead to success.

Corrs insight

A new era of climate change litigation in Australia?

15 *Sharma by her litigation representative Sister Marie Brigid Arthur v Minister for the Environment* [2021] FCA 560

Major Australian and international climate cases

8 February 2019

Rocky Hill Coal Project decision (Australia)

In February 2019, the NSW Land and Environment Court upheld the refusal of development consent for the Rocky Hill Coal Project in the *Gloucester Valley (Gloucester Resources Limited v Minister for Planning* [2019] NSWLEC 7), a project that would see the erection of a new open cut coal mine with allowance for the extraction of 2Mtpa of coal for a period of 21 years.

In upholding the refusal of the project, Chief Justice Preston cited among other adverse impacts, the result of the emission of greenhouse gases that would contribute to climate change and not assist in the achievement of agreed emissions targets.

20 December 2019

Urgenda decision (the Netherlands)

The claim made out in *Urgenda* alleged that the Dutch Government was in breach of its duty of care to the Dutch people, in failing to take sufficient steps to set and meet greenhouse gas emissions reduction targets. This duty of care was cited as being enshrined in Article 21 of the *Dutch Constitution*, and Articles 2 and 8 of the *European Convention on Human Rights* (being the right to life and right to respect of private and family life). The applicants sought declaratory and injunctive relief, including orders compelling the Dutch Government to implement an action plan for limiting greenhouse gas emissions.

The Supreme Court and Hague Court of Appeal applied the precautionary principle, determining that the Dutch State has a duty of care to protect the human rights of its citizens, by taking appropriate action to mitigate the existential threat of climate change. In making this determination, particular regard was had to the unique vulnerability of the Netherlands to the physical effects of climate change, including rising sea levels and flooding. The final orders made required the Dutch Government to implement an action plan to reduce greenhouse gas emissions by 25% by the end of 2020, comparative to 1990 levels.

2 November 2020

McVeigh settlement (Australia)

McVeigh v Retail Employees Superannuation Pty Ltd (**REST**) [2019] FCA 14 was one of the first instances in Australian climate litigation where a superannuation fund has been held to account in respect of its disclosure of climate-related risks and dependencies. This action preceded but mirrors much of the substantive thinking embodied in the TCFD framework, which is now increasingly being endorsed and adopted globally. The claim was made out on the basis of section 1017C of the *Corporations Act 2001* (Cth) and section 52 of the *Superannuation Industry (Supervision) Act* 1993 (Cth). These provisions require superannuation funds to act in the best interests of their members, exercise due care, diligence and skill, and provide members with adequate information to make an informed judgment on the financial position of the fund.

It was alleged that REST's failure to disclose material information regarding the fund's climate-related risk exposures prevented the applicant from being able to make an informed judgment in this respect, amounting to a breach of the fund's statutory duties. The matter was settled privately. In its public statement, REST committed to nine climate initiatives focused on the introduction of climate reporting and disclosure against the TCFD framework and the alignment of the fund's portfolio with the goals of the Paris Agreement. Notably, the initiatives include the integration of scenario analysis as a component of the fund's investment strategy and strategic asset allocation decisions, the alignment of REST's portfolio with the target of achieving net zero by 2050, the disclosure of the fund's portfolio holdings and associated risks to stakeholders in accordance with the TCFD framework, and a commitment to engaging in increased advocacy with investee companies to encourage compliance with the Paris Agreement.

26 May 2021

Royal Dutch Shell decision (the Netherlands)

Milieudefensie et al. v Royal Dutch Shell plc (*Shell*) in the Netherlands demonstrated the willingness of courts to impose positive obligations born out of human rights obligations on major corporations to develop corporate policies that align with adopted international climate change agreements, such as the Paris Agreement.

In *Shell*, the applicants argued that the company had a positive obligation to significantly reduce its aggregate greenhouse gas emissions generated by the company's business and the use by customers of its products (i.e. scope one, two and three emissions) as not doing so would breach the standard of care owed to persons and corporations to protect the human rights of others, specifically the right to life, as set out in the Dutch Civil Code. Relying upon the Netherlands' commitment to the Paris Agreement targets and the existing body of evidence surrounding the impacts of climate change, the applicants successfully argued that Shell has a human rights obligation to reduce its greenhouse gas emissions in alignment with the goals of the Agreement.

Shell has announced that it will appeal the court's decision.

27 May 2021

Sharma v Minister for the Environment (Australia)

The applicants in the *Sharma* class action, a group of eight Australian children, advanced similar rights-based arguments to those made in *Urgenda* and *Shell*. It was submitted that the Commonwealth Minister for the Environment owes a duty of care to Australian children, to protect them from the reasonably foreseeable harms resulting from anthropocentric climate change. It was further argued that such harms may be incurred via the production of increased greenhouse gas emissions resulting from approvals granted by the Minister under the *Environmental Protection and Biodiversity Conservation Act 1999* (Cth) (**EPBC Act**). The applicants proposed that Minister's prospective approval of an application for the extension and expansion of a coal mine near Gunnedah, pursuant to sections 130(1) and 133 of the EPBC Act, would be in breach of this purported climate change duty of care.

In making its determination, the Federal Court of Australia gave weight to the common law tort of negligence, and the emerging body of international rights-based climate change judgments. It held that there is a duty of care owed by the Minister to Australian children, characterising this as a specific duty to avoid personal injury or death arising from the emission of carbon dioxide from the burning of coal. The final orders granted declaratory relief, however confined this relief to the specific approval in question. An appeal on behalf of the Minister is presently on foot, and is set down for hearing in mid-October 2021.

Despite the judgment being subject to appeal, the Minister has determined the approval under the EPBC Act and in the reasons given has had regard to the climate change duty of care owed to Australian children.

26 August 2021

Bushfire Survivors v Environment Protection Authority (Australia)

Most recently, the judgment in *Bushfire Survivors for Climate Action Incorporated v Environment Protection Authority* [2021] NSWLEC 92 (*Bushfire Survivors*), handed down on 26 August 2021, found that the NSW Environment Protection Authority has a duty to take serious action on greenhouse gas emissions and climate change.

It is the first time that an Australian Court has ordered a government to take meaningful action on climate change.In this case, the plaintiffs sought and obtained an order of mandamus compelling the NSW Environment Protection Authority (**EPA**) to "develop environmental quality objectives, guidelines and policies to ensure environment protection from climate change".

It was argued that the statutory duty under section 9(1) of the *Protection of the Environment Administration Act 1991* (**POEA Act**) evidently requires the EPA to develop policies that protect the environment from the most 'grave' threat of all, climate change. The Land and Environment Court agreed that the EPA had such a statutory duty and had failed to fulfil that duty.

ESG management

Organisations should formulate an ESG strategy as the basis for the ESG framework through which to establish, implement and maintain a program of actions and activities to manage ESG issues.

The strategy should define the organisation's ESG principles and performance goals and the company's risk appetite statement should include consideration of ESG risks.

There is no 'off the shelf template' for an ESG framework, however there are likely to be some common elements – it may include components that organisations are familiar with as they are often part of a company's framework for compliance risks. For example, the ESG framework is likely to include policies, systems and procedures to ensure appropriate measures are in place to identify, prevent and mitigate present and future ESG-related risks.

All ESG frameworks should be fit for purpose, having particular regard to the nature of the organisation, where it has operations and the risks that are relevant to the organisation's business and sector.

As senior members of the organisation, GCs have a critical role to play in advising in relation to the ESG strategy and ESG framework. They are well placed to take an active role in developing the ESG framework to ensure that it reflects current best practice and takes into account emerging trends, including adopting clear and measureable targets for the organisation (with a reasonable basis).

There are often multiple internal stakeholders and groups grappling with ESG and its various components. GCs are likely to be well positioned to advise internal stakeholders on problems that arise in the development, implementation and management of ESG strategies so that decisive action can be taken early on.

GCs also have an important role to play in embedding ESG off-the-shelf principles into the culture of the organisation and decision-making processes to ensure that the organisation achieves its ESG objectives in a meaningful way. This includes ongoing monitoring and continuous improvement.

In addition, there are key functions specific to the role of a GC in which ESG considerations need to be factored into, including advising the board and senior management, and reviewing annual reports, public or ASX statements.

"

We continue to see both internationally and in our own market an increasing focus on company matters that sit outside of traditional evaluative metrics and in particular, those matters concerning the environment, sustainability and / or governance…

A salient question for boards and directors to ask now is therefore: 'how do we identify the risks and opportunities presented by this new environment and respond in a manner that is both consistent with the social contract under which we operate and nurturing of long-term business success?

ASIC Commissioner John Price
Keynote at the Centre for Policy Development:
Financing a Sustainable Economy, 18 June 2018

01

ESG strategy

An effective ESG strategy will be founded on a set of core principles which embody an organisation's position in relation to ESG issues and how it will conduct itself in managing social, human and environmental capital.

These principles should be supported by a cascading ESG framework of policies and guidance which inform risk assessment, due diligence, systems and processes, disclosure and reporting by the organisation.

What is the role of the GC?

GCs have a unique perspective taking into account knowledge of the external environment and the various pressure points, risks and potential conflicts within an organisation, so can be an effective guide or adviser in the development of the organisation's ESG principles. In doing so, a GC may encourage appropriate stakeholders across the organisation to consider ESG in the context of:

- the long term strategy of the organisation and its values and mission;
- the current climate and likely direction of community and stakeholder expectations for the key facets of the ESG landscape outlined in Chapter 2; and
- whether the ESG commitments are capable of being satisfactorily embedded in the operations of the organisation.

The establishment of ESG principles and commitments is not the end of the exercise. A GC should remain attuned to their continuing relevance and effectiveness, and may do so by regularly asking themselves the following questions:

- Are the organisation's principles and commitments still aligned to the long term strategy of the organisation and are they continuously reflected in the day-to-day operations and decision making of the organisation?
- Do the organisation's principles and commitments reflect current best practice and the expectations of government, investors, shareholders, the community and other stakeholders?

GCs are also well positioned to recognise where external expertise may be useful or required to answer these questions given any in house limitations.

Target setting and reporting requirements for outcomes across the full ESG spectrum are anticipated to proliferate in the next three to five years. The organisation's ESG strategy will set principles and commitments in respect of their environmental and social impacts and governance practices. Thoughtful targets can help determine the direction and workplan for the organisation and will help with the integration of ESG risks into the organisation's risk management system.

02

ESG framework

With high level commitments and established targets to guide the organisation it can still be difficult to manage and report on ESG programs, and mitigate ESG risks when functional responsibilities are dispersed across the organisation. For example, environmental considerations are often the responsibility of a sustainability team, modern slavery risk may be managed by procurement and human rights may sit with compliance or with community or human resources professionals while governance rests with the legal department or company secretary.

In some instances, this can result in a siloed approach to risk and reporting, potentially causing issues to fall through the cracks or duplication of effort, and sometimes, there can be unintended consequences. The intersectionality of climate change and human rights, for example, needs a cohesive and integrated response by the organisation.

To address this issue, there is a movement towards integrated risk management for ESG risks. An integrated approach is one that considers the intersectionality of environmental, social and governance risks and brings together cross-functional expertise in risk assessment processes, integrates the design and evaluation of controls across a range of different risks, and considers ESG assessment in new business activities and projects. Those organisations that transition early to an integrated ESG framework that brings together diverse perspectives will be best placed to readily and seamlessly adapt to new laws and policies when they are implemented.

ESG integration: a modern slavery dilemma for renewable energy

As businesses move to net zero carbon emissions and transition to renewable energy sources, in particular solar energy, they are likely to significantly increase their exposure to modern slavery in the supply chain.

In Australia, 85% of solar panels and many of their components come from jurisdictions and regions that are widely recognised as having an extremely high risk of forced labour.

What is the role of the GC?

Understanding risks

The ongoing risk management aspects of an organisation's ESG framework may ultimately sit outside of the GC's responsibilities. However, GCs that are equipped with a comprehensive awareness of ESG regulatory requirements and trends relating to the organisation, and are attuned to the risks of activist interference and litigation when things go wrong, can play an important role in:

- advising and ensuring the right functions are involved in the development of the ESG risk management processes; and
- ensuring a rigorous risk assessment has been undertaken which brings together appropriate cross-functional expertise. This assessment should consider:
  - regulatory and compliance ESG risks;
  - the organisation's impact on the environment and on society across the length of the value chain; and
  - how environmental, social or governance issues may impact on the performance and long term viability of the organisation.

Risk assessment and subsequent due diligence are likely to be appropriate on a portfolio or at transactional level so that prospective investments, M&A transactions, major procurement decisions and other business dealings are routinely evaluated for ESG risks.

The GC has an important role to play in ensuring ESG matters have been incorporated into advice to the board and senior officers on legal, social, commercial or reputational risks that accompany any major investment decision or action.

ESG risk management questions

While the GC may not be ultimately responsible for developing the body of an organisation's ESG risk management framework, they may play a useful role in ensuring that it is fit for purpose and in commissioning arms of their organisation to undertake aspects of its development. In this respect, the following questions are useful to keep in mind:

Q Where will the responsibility for different aspects of ESG lie across the organisation and how will a coordinated and integrated approach be achieved?

Q How will the ESG targets that are set as part of the development of the ESG framework be integrated into the organisation's overarching risk management framework?

Q Have the ESG risks been appropriately identified and assessed?

Q Should stress testing and scenario analysis to determine how the organisation's policies and operations would withstand relevant national and global scenarios be used?

Q What are the processes for managing and mitigating ESG risks?

Q What internal risk reporting mechanisms are to be followed?

Q What are the protocols for creating and maintaining accurate records of ESG related activity?

Q What metrics will be used to measure the achievement of the ESG targets?

Q How often and by what method will the ESG targets and functions be reviewed (internal and external audits)?

Q How will the performance of the organisation be assessed against the ESG framework? Will there be a certification required from an external body each year against particular targets? Or is it an internal process?

Q How often will ESG disclosures be made, both publicly and reporting to the board?

Embedding the organisation's response

An ESG framework provides only limited defence from adverse events if it is not integrated into an organisation's business and processes, and if it is not designed in a way that supports achievement of the organisation's objectives and is well communicated to internal and external stakeholders. Testing and assurance is an important part of the ESG framework and valuable opportunity for continuous improvement.

Governance and management frameworks for ESG risks can benefit if the GC:

- ensures appropriate and up-to-date policies and procedures are in place to manage identified risks;
- considers seeking perspectives from relevant external stakeholders and interest groups as a valuable step to ensure the suitability of the organisation's policies;
- takes steps to engage specialist advice for:
  - periodic internal and external audits which will be important to reporting integrity and give confidence regarding ESG disclosures to the market, investors and shareholders; and
  - upskilling and horizon scanning on ESG developments; and
- commits to the implementation of voluntary principles and guidelines before they become mandatory.

So long as it is matched by implementation, taking these steps will help the organisation stay ahead of the curve and meet regulatory requirements as they develop. An example of this is the early adoption of the environmental due diligence aspects of Mandatory Human Rights and Environmental Due Diligence (**mHREDD**).

Continuous improvement

In the rapidly evolving ESG landscape, GCs have a crucial role to play in horizon scanning and in relation to assurance processes for the ESG framework. Once trends are identified, a GC can assist their organisation to remain ahead of the curve by raising developments with the board and senior management and implementing strategies for mitigating emerging compliance or regulatory risks.

GCs should:

- ensure the commitments remain fit for purpose and that there are systems and processes in place to measure their relevance and appropriateness;
- develop clear processes through which the board and senior management will remain informed as to the organisation's ESG obligations and their responsibility in relation to them, as well as legal and policy development and results of monitoring / measuring of the organisation's ESG performance;
- create an internal ESG interest group comprised of members from all teams and levels of the organisation, to provide a forum for improving ESG awareness and to capture employee perspectives throughout the organisation;
- ensure appropriate education and training is available to upskill board members, senior management and relevant employees and that there is responsibility for ensuring attendance at senior management levels (which may be a metric reported to the board – in some areas, this may include the delivery of professional development programs by the legal team or the engagement of external specialists to facilitate delivery);
- ensure the organisation schedules regular mandatory reviews and updates of ESG policies and guidance and that there is a mechanism to trigger a review (and update) in the event of material developments, such as new regulatory requirements (this will ensure these processes remain fit for purpose and effective); and
- engage with periodic external specialist legal and financial audits of the ESG framework and financial disclosures, to ensure maintenance of current best practice, including around reporting.

Early adoption and implementation of innovative practices for identification, monitoring, reporting and mitigation of ESG risk exposures will ensure that an organisation is able to adapt to new ESG developments promptly and efficiently. It may also present opportunities and result in the organisation becoming a 'leader' in the ESG space.

In focus

Biodiversity loss and supply chain risk frameworks

An evolving area of ESG which may soon filter down to create new law and policy requirements is the scope of due diligence and financial disclosure surrounding biodiversity-related risks.

The TNFD initial scoping report dated June 2021 sets out a full value chain approach, where companies will be required to assess the bidirectional biodiversity impacts and dependencies throughout their immediate operations, supply chain and business relationships.

This has been emphasised by Executive Secretary of the UN Convention on Biological Diversity and Co-Chair of the TNFD Elizabeth Maruma Mrema in her open editorial of 14 July 2021:

"We have to treat business and financial sectors as key drivers of solutions… Financial institutions and corporates have the necessary resources, autonomy, technology and ability to innovate… Global businesses [are] realising the extensive financial risks posed by biodiversity loss…

The loss of biodiversity can have a direct impact upon business operations, where raw materials are no longer available at the quality and quantity needed. Increasing costs in commodity supply chains, as a result of decreasing biodiversity, can have consequences on a company's bottom line."

ESG management

ESG awareness

Understand the ESG context

- environmental and social impacts relevant to what you do, how and where you do it
- regulatory and compliance requirements
- relevant stakeholders and their expectations

Stay aware of emerging risks / trends

Strategy*

Establish board approved enterprise wide ESG principles and commitments*

Board considers ESG issues in the context of the organisation's strategy and risk oversight*

- what is the impact on environment and community of your strategy (what you plan to do)
- understand how stakeholder expectations may impact strategy and operations

Framework

Understanding risks

- integrate consideration of ESG issues, including environment and social impact of operations and strategy, in risk framework*

Embedding action across the organisation

- develop policies and procedures to mitigate risks (consulting with external experts to inform approach and verify effectiveness)
- establish ESG governance (board oversight, management accountabilities and metrics)*
- incorporate specialist advice and assistance into decision making

Continuous improvement

- regularly measure for effectiveness
- engage with external interest groups
- enterprise-wide education and training (including board)
- incorporate regular internal audits and periodic external reviews into your audit and compliance program
- report to the board on performance in relation to ESG commitments*

* Specifically relating to boards

Strategic guidance

Keeping abreast of the wide array of emerging and established ESG issues is a challenge for any GC.

We have identified a number of important questions that GCs can ask to identify, assess, and be confident that the organisation is mitigating and addressing, ESG risks and opportunities.

Environment

Considerations

- How does your organisation's operations, its supply chain and downstream activities (for example, scope 3 greenhouse gas emissions) impact on the environment?
- What does your organisation have in place to assess, monitor and mitigate any environmental impacts and dependencies it may have, including for example in relation to water sources, biodiversity loss and climate change? How are those impacts and dependencies identified, measured and reported?
- Does the organisation understand its exposure to both physical and transition risks in relation to climate change? How are those risks assessed, measured and reported?
- Are there any governance or human rights risks associated with environmental compliance?

Guidance tools

- Global Reporting Initiative Standards
- Organisation for Economic Cooperation and Development, Guidelines for Multinational Enterprises
- Governance Institute of Australia, Climate change risk disclosure: A practical guide to reporting against ASX Corporate Governance Principles and Recommendations

Social

Considerations

- Who may be affected by the organisation's activities along its value chain, and are those people and / or communities positively or negatively impacted? How is the organisation assessing, addressing and mitigating those impacts?
- Is there an effective grievance mechanism to hear concerns or complaints from employees, contractors, suppliers and customers? Is the mechanism accessible and has the organisation responded with appropriate remedies where raised concerns are validated?
- How does the organisation interact with the wider community, including relationships with First Nations people?
- How does the organisation manage and report on the risks of modern slavery and other human rights concerns in the supply chain?

Guidance tools

- United Nations Guiding Principles on Business and Human Rights
- The Australian Business Guide to Implementing the UN Declaration on the Rights of Indigenous Peoples
- Blueprint for Finance against slavery and trafficking

Governance

Considerations

- How does the board make decisions, how are directors appointed, remunerated and how does it provide risk management and strategic oversight? Are ESG considerations incorporated into those decision making processes?
- Does the organisation have robust internal controls in place to mitigate the potential for harmful conduct by those involved in (or with) the business, or who may pose an external threat to the business, and otherwise to identify and manage the risks of the business?
- Do climate-related and sustainability disclosures and commitments reflect the processes in place, and include measurable and verifiable actions and targets thereby ensuring statements are not open to misrepresentation?
- Does the board have a good understanding of the types of issues which could drive shareholder activism for their organisation?
- Is there a clear view of community expectations and emerging issues in your sector, and is there a clear strategy in place to ensure the organisation addresses/meets those expectations?

Guidance tools

- Australian Institute of Company Directors, Guiding principles of good governance
- ASX Corporate Governance Council, Corporate Governance Principles and Recommendations (4th Edition)
- Australian Competition and Consumer Commission, Green marketing and the Australian Consumer Law

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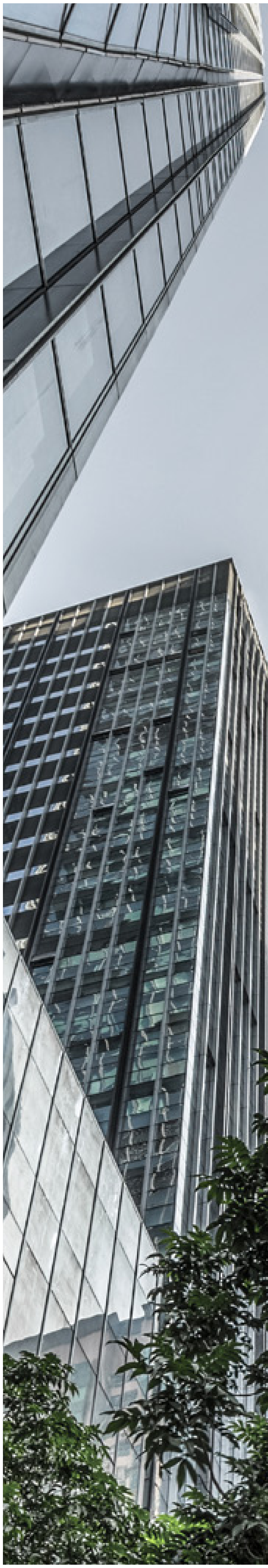

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