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The Social Role of Corporations in Asia-Pacific

Australia: Fast-Growing Awareness and Activism

By Jennifer G. Hill and Tim Bowley
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Australia is at an important inflection point in the area of sustainable corporate governance. Numerous corporate governance pressure points, which encourage corporate managers and directors to take ESG climate change seriously, have recently developed.

Before examining these pressure points, it is useful to provide a brief overview of corporate law and governance in Australia. Australia's system of corporate law, like many other jurisdictions in the Asia-Pacific region, originates from UK law. It principally comprises common law and a federal statute, the Corporations Act, which contains both mandatory and optional provisions. Listed public companies are also subject to the Australian Securities Exchange (ASX) Listing Rules, which include additional mandatory rules, and to the *ASX Corporate Governance Principles and Recommendations* (4th ed., 2019) (corporate governance code), which operate on a non-prescriptive "comply or explain"/"if not, why not" basis.

Australia's capital market structure is distinctive. In contrast to many Asian jurisdictions, where concentrated ownership remains the norm, Australia has, on one measure, the second-lowest level of share ownership concentration in the OCED (after the US) according to the

OECD's 2021 *Corporate Governance Factbook*. This still leaves Australia occupying an intermediate position on the spectrum of ownership concentration. Its capital markets exhibit significant levels of shareholding by both non-institutional blockholders and institutional investors, though there has been a dramatic rise in the level of institutional ownership in the largest listed companies over the last two decades.

Finally, Australia operates under a "twin peaks" model of financial regulation, whereby the Australian Prudential Regulation Authority (APRA) is responsible for regulation of financial institutions and the Australian Securities and Investments Commission (ASIC) has responsibility for business conduct and consumer protection.

ESG and climate change issues have recently come to the forefront in Australia via a range of corporate governance pressure points. These include banking scandals, corporate codes, shareholder activism and stewardship, directors' duties, and regulators.

Banking Scandals and Stakeholder Interests

Scandals at several leading financial institutions led to the establishment of a landmark Banking Royal Commission in 2017.[1] The commission identified misconduct and compliance failures that delivered huge profits to the relevant entities and their shareholders, while simultaneously harming customers.

The Royal Commission heightened attention in Australia to stakeholder interests and the responsibility of boards for both financial and non-financial risks, as well as community expectations concerning public corporations.

Corporate Codes

The approach taken by the Royal Commission informed revisions in 2019 to Australia's corporate governance code. The revisions placed greater emphasis on organizational integrity and corporate responsibilities to the public. Indeed, a 2018 consultation draft had referred to a listed entity's "social license to operate." This phrase attracted considerable backlash from the business community and was omitted from the final version of the code, though the final version used analogous phrases such as "reputation" and "standing in the community" to underscore societal expectations for listed companies.

The final version of the corporate governance code also placed greater emphasis on ESG risks, stating that a listed entity should disclose whether it has "any material exposure to environmental or social risks" (Recommendation 7.4). The provision specifically refers to climate change and encourages companies exposed to such risk to consider making the disclosures recommended by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). TCFD disclosure, although not mandatory under the code, has, according to a leading national law firm, shifted from being the gold standard to a basic expectation for Australian listed companies.

Shareholder stewardship codes are also relevant in this area. Early UK stewardship codes contained scant reference to ESG or sustainability considerations. This has changed in recent years as stewardship codes spread around the world, yet there is considerable variability in the detail and emphasis given to ESG matters in different codes. Australia demonstrates that such variation can occur within a single country. Unlike many other jurisdictions in Asia, Australia has not adopted a national stewardship code. Instead, two industry bodies representing different participants in the investment sector have published their own influential codes. Whereas ESG matters are treated as fundamental in one of these codes, they are barely mentioned in the other.

Shareholder Activism/Stewardship and ESG

There is an increasing level of shareholder activism and stewardship in Australia, with institutional investors showing greater willingness to use their voting power to put pressure on companies to address ESG concerns, particularly climate change.

ESG-related shareholder proposals have become an established practice in Australia and company directors at recent annual shareholder meetings have faced a barrage of questions relating to carbon emissions reduction, which is a major political issue in Australia. There is also growing support for ESG-related shareholder proposals. In April 2020, for example, shareholders in the Australian public listed company Woodside Petroleum Ltd. defied the board of directors by casting a majority of proxy votes in favor of establishing hard targets to align the company's emissions with the Paris Agreement. Support for ESG proposals has come not only from global institutions, such as BlackRock, but from Australian pension funds, which constitute the fifth-largest pension fund pool in the world.

In 2020, a group of 16 institutional investors in the superannuation industry announced that they had created a private initiative called Climate League 2030 in order to seek deeper carbon emission cuts for Australia. Mark Carney, former governor of the Bank of England and current United Nations special envoy on climate action and finance, has highlighted the potential power of Australia's pension industry to influence companies to adopt Paris-aligned, economy-wide emissions reductions.[2]

The Say on Climate initiative, which was launched in 2020 by Sir Chris Hohn's UK activist hedge fund, The Children's Investment Fund Management (TCI) and its charitable arm, The Children's Investment Fund Foundation (CIFF), has also made its way to Australian shores. This initiative is designed to provide shareholders a periodic vote at annual shareholder meetings and to inform shareholders about how their company plans to reduce emissions and manage its climate risks in alignment with the Paris Agreement.

In 2021, the Australasian Centre for Corporate Responsibility (ACCR) joined with CIFF to file Say on Climate resolutions at several Australian resource companies. These resolutions sought an annual vote on the adoption of a climate report, consistent with recommendations of the TCFD and the Climate Action 100+ Net-Zero Company Benchmark. Rio Tinto became the first Australian-listed company to commit to a Say on Climate vote in February 2021, with several other resource companies following suit shortly afterwards.

Directors' Duties, Securities Laws, and Climate Change

Almost 20 years ago, the James Hardie scandal in Australia raised the issue of shareholder versus stakeholder interests in an acute way—namely, whether directors could act to benefit employees, who had contracted mesothelioma, or whether this would conflict with their primary duty to maximize shareholder profits.[3] Following this scandal, two government reports considered whether Australia should adopt a new statutory duty based on the UK's "enlightened shareholder value" approach in Section 172 of the Companies Act 2006, which specifically refers to stakeholder interests. Both reports rejected the need for such a provision in the Australian context. They also rejected James Hardie's argument that Australian law requires directors to protect and preserve shareholder interests at all costs, with one committee stating that "rampant corporate irresponsibility certainly decreases shareholder value."[4]

Fast-forward two decades and today the critical issue is whether directors who fail adequately to address climate change risks could be liable for breach of their duties. The ACCR has released a series of landmark legal opinions on directors' duties with respect to climate change by two leading barristers. The authors argue that climate risks are now foreseeable risks, and that ignoring those risks can expose public company directors to liability for breach of the duty of care under Australian law. The opinions state that the litigation risk will be particularly acute in situations where directors engage in greenwashing by declaring a net zero emissions commitment without reasonable grounds to support that representation.

The ACCR legal opinions carry regulatory heft because they have been supported and affirmed by Australia's key financial market regulators, the Reserve Bank, APRA, and ASIC. ASIC's approval is particularly notable, since ASIC can bring actions for breach of directors' duties, including the duty of care, under Australia's public enforcement regime.

There are emerging signs that shareholder activists are prepared to litigate such matters. In a notable example from 2021, shareholders in a major Australian bank successfully sought access to its non-public records pursuant to shareholders' books and records inspection right under the Corporations Act. The shareholders sought access to the records to determine whether the bank's decisions to finance significant oil and gas projects were consistent with its sustainable lending policies. This may be the beginning of a trend involving activists litigating directors' duties or securities law claims in order to expose corporate greenwashing and hold corporate managers accountable for their ESG decision-making. This is potentially an area of vulnerability for corporations that are grappling with evolving ESG disclosure standards and the challenge of explaining how they are adapting their business models to a low carbon economy.

Regulators and Climate Change

Australian regulators are keenly aware of the financial risks posed by climate change. The deputy governor of the

Reserve Bank of Australia recently said that climate change is a "first-order risk for the financial system ... [with] a broad-ranging impact on Australia, both in terms of geography and in terms of Australian businesses and households."[5]

Both ASIC and APRA have shown a willingness to engage actively in the area of climate change. ASIC, which is a member of IOSCO's sustainable finance taskforce, is involved in a wide range of international initiatives.[6] In mid-2021, ASIC wrote to five fossil fuel firms to inform them that they were potentially in breach of their disclosure obligations for failure to declare climate change risks. In November 2021, APRA released its final prudential practice guide, CPG 229, which is designed to assist APRA-regulated companies in managing climate-related risks and opportunities.

Conclusion

There has been a dramatic shift in public opinion concerning climate change, with the Federal Court of Australia recently describing it as the "greatest inter-generational injustice ever inflicted by one generation of humans upon the next." [7] This shift in public sentiment is matched by the pace of developments in Australia corporate law and practice concerning ESG and climate change.

Notes

[1] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report, Vol. 1* (Commonwealth of Australia, 2019).

[2] Climate League 2030, "New Private Sector-Focused Initiative Launched to Back Deeper Australian Emission Cuts," Oct. 6, 2020.

[3] The scandal arose from a corporate restructuring undertaken by James Hardie. It subsequently became apparent that the restructuring had the effect of ring-fencing asbestos-related liabilities in underfunded legal entities and that public disclosures by James Hardie regarding how such entities were sufficiently funded were misleading.

[4] Parliament of Australia, Parliamentary Joint Committee on Corporations and Financial Services (PJC), Corporate Responsibility: Managing Risk and Creating Value (2006), 59.

[5] Guy Debelle, Deputy Governor, Reserve Bank of Australia, *Climate Risks and the Australian Financial System*, Speech, CFA Australia Investment Conference, Oct. 14, 2021.

[6] Sean Hughes, ASIC Commissioner, *Corporate Governance Update: Climate Change Risk and Disclosure*, Speech, Governance Institute of Australia Fellows Roundtable, Oct. 14, 2021.

[7] *Sharma v Minister for the Environment [2021] FCA 560.*

Jennifer G. Hill is the Bob Baxt AO Chair in Corporate and Commercial Law and the director of the Centre for Commercial Law and Regulatory Studies at Monash University.

Tim Bowley is a member of the Centre for Commercial Law and Regulatory Studies at Monash University and teaches in Monash Law's Corporations Law program

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