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Author: Sarah Clarke, James Macdonald
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Leading organisations of the future – the rising importance of ESG factors

ESG factors are becoming increasingly important not only as an aspiration but also operationally. Boards genuinely implementing ESG founded strategy can derive long term sustainability, staff retention and social licence benefits. Boards must, however, ensure that ESG policies are appropriate and achievable. As ESG often involves long term strategic planning, it is critical for companies to ensure that any statements on ESG matters have a reasonable basis and are not misleading and deceptive. In this insight, we examine the important considerations for ESG policies and how to minimise risks associated with inaccurate ESG related statements.

ESG factors are those relating to environmental, social and governance. Environmental factors typically include the sustainability of operations, carbon footprint, handling of pollutants, water usage and recycling. Social factors can include diversity, human rights, health and safety, employment standards, native title and the impact on the supply chain and communities in which a company operates. Governance commonly covers the policies that a company has, its risk and compliance frameworks, executive remuneration, ethics and culture.

In recent times there has been a groundswell of change around both "social" and "environmental" expectations, such that ESG factors have taken much more prominence in Board and operational decisions. Actions that may be entirely legal may no longer be socially or ethically acceptable.

This was particularly evident with the destruction of the culturally significant Juukan Gorge rock shelters in 2020, where the action taken by Rio Tinto was technically legally authorised, but resulted in such public outcry that three senior executives of Rio Tinto (including the CEO) were forced to resign and the relevant legislation in Western Australia was rewritten. Rio Tinto has acknowledged that:

> *"In allowing the destruction of the Juukan Gorge rock shelters to occur, we fell far short of our values as a company and breached the trust placed in us by the Traditional Owners of the lands on which we operate. It is our collective responsibility to ensure that the destruction of a site of such exceptional cultural significance never happens again, to earn back the trust that has been lost, and to re-establish our leadership in communities and social performance."*

This focus on 'social licence' is also evident in the amendments to the ASX Corporate Governance Principles, which now include a principle that a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner.

Increasing activism from consumers and shareholders and media pressure both on government and companies to meet certain minimum expectations around ESG factors, particularly around carbon footprints and plans to achieve net zero emissions, raises potential risks for Boards.

Whilst it is now more important than ever for companies to ensure that they have authentic and appropriate ESG policies, attempts to greenwash customers or investors with bold claims about the future run the significant risk of misleading and deceptive conduct claims.

ESG policy making

For a company that wishes to review its own ESG policies, this should not be a tick box exercise. Once an ESG policy is adopted, it should be reviewed regularly and incorporated into the overall strategy of the company and not implemented in isolation. When devising or updating ESG policies a Board should:

- understand its current and likely future regulatory requirements;
- consider the company's values and goals to ensure that its ESG policies align with this;
- identify any strategic ESG concerns and what customers and investors want from the company from an ESG perspective;
- understand the cost, risk and opportunity of the current and proposed ESG positions;
- identify the people within the company that will be responsible for overseeing the policies' implementation; and
- as with any other forecast, critically examine any public statements made or to be made regarding the company's ESG policies or claims, what risks there are to achieving those claims and whether corrective statements are required.

Greenwashing risks

It is critical companies not to overstate their ESG credentials or goals. Such a practice is known as 'greenwashing' and may include:

- statements where there is an over representation of the extent to which a company has practices which are environmentally friendly, sustainable or ethical; or
- forecasts around expected environmental or sustainability goals- for example, a goal to be a net zero carbon emitter by a particular date.

If there is no reasonable basis for a statement being made, or a definitive forecast has not been achieved that statement is likely to be misleading and deceptive. This could place a company at risk of breaching the law and being subject to a shareholder class action. As a result, companies need to be particularly careful in making any statements about their ESG credentials, and should ensure they have records regarding the basis for such statements at the time they are made. If circumstances change, that information should be updated in a timely manner (and in accordance with the requirements of the ASX listing rules, if applicable).

Any due diligence (either as vendor or purchaser) should include ESG risk factors so that ESG risks are appropriately mitigated or priced accordingly.

If you need any assistance either reviewing your disclosures around ESG or your ESG policies, or conducting ESG based due diligence, please contact us.