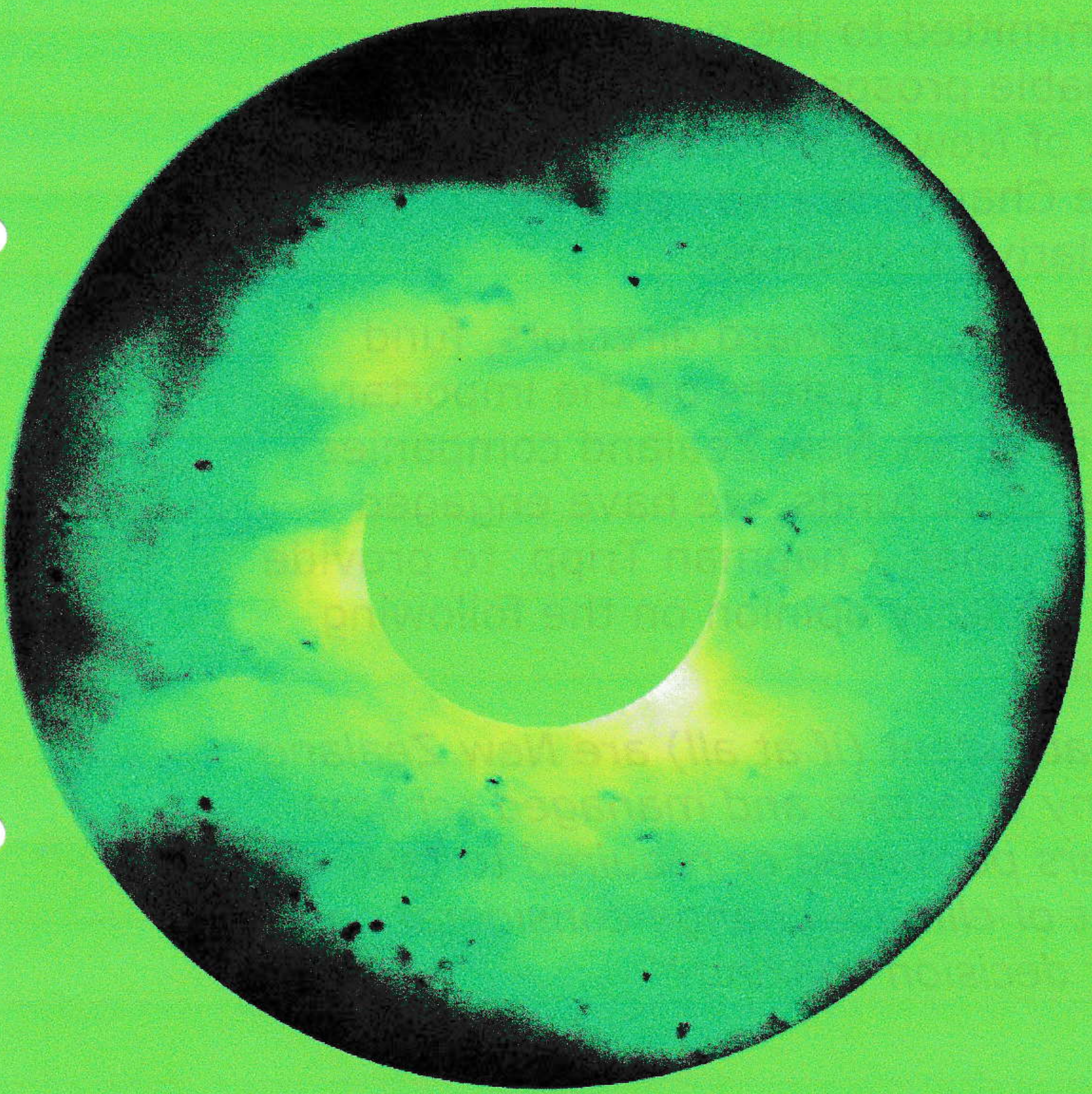
Chapman Tripp, 2019

The Aotearoa Circle

Mā te Kaitiakitanga ko te Tōnuitanga
Prosperity through Guardianship



Sustainable Finance Forum Legal Opinion 2019

CHAPMAN TRIPP

The Aotearoa Circle is a unique partnership of public and private sector leaders, unified and committed to the pursuit of sustainable prosperity and reversing the decline of New Zealand's natural resources. Climate Change is a key priority, particularly for business.

In order to focus board directors, fund managers and trustees on the importance of this issue for New Zealand companies and managed funds, we have engaged Circle member, Chapman Tripp, to provide a legal advisory opinion on the following question:

"To what extent (if at all) are New Zealand company directors and managed scheme providers permitted or required to take account of climate change considerations in their decision-making?"

1 Introduction and executive summary*

1 We are witnessing a step-change in climate-related business risk. Climate change is no longer a mere environmental concern: for many, it presents a material financial risk. New Zealand's business community is taking notice. Climate change issues facing businesses today include uncertainty over stranded or compromised assets, threatened natural resources, regulatory changes, insurance concerns, interruptions to supply chains, coastal property devaluation and rapidly evolving consumer demands.

2 The increasing recognition of such risks is driving boards of directors and investment professionals in New Zealand to question what they can and should be doing to address them.

3 In this opinion, we seek to clarify the present legal obligations on New Zealand company directors, and on the managers of retail managed investment schemes (*scheme managers*),[1] in respect of climate risk. The question we have been asked is set out above.

4 As with all legal opinions, what matters is what we consider the law is, not what it should or could be. But the exercise is not a recitation of how historic cases on different facts have been decided. Rather, we address and describe what we consider a New Zealand court *would do* if presented with a claim that a director or a scheme manager's decision-making failed to take due account of climate risk.

5 In determining a court's contemporary expectations for directors and scheme managers, the international and domestic scientific, political and regulatory context is important. Relevant context includes the growing scientific consensus on climate impacts, near-global adoption of the Paris Agreement, the Task Force on Climate Related Financial Disclosures' (*TCFD*) influential climate risk disclosure recommendations, and, in New Zealand, the Zero Carbon Bill and Emissions Trading Reform Bill. We elaborate on each of these in Part 2 below.

6 We conclude that directors and scheme managers must assess and manage climate risk as they would any other financial risk. This conclusion is not controversial, but reflects the application of settled principles to a rapidly-developing area. Nonetheless, our opinion is important in grounding the analysis within New Zealand's legal and regulatory environment.

7 The premise of this opinion, as explained in Part 2 below, is that climate change presents a foreseeable risk of financial harm to many businesses. We see particular risk arising directly or indirectly out of the impacts of transitioning to a lower-carbon economy. The legal impact of this for directors and scheme managers is as follows.

7.1 First, as explained in Part 3 below, directors of New Zealand companies are generally permitted, and will in many contexts be required, to take climate change into account when making business decisions. The requirement stems principally from the directors' duty to act with reasonable care.

* This opinion has been considerably assisted by the work of many within Chapman Tripp, especially Chris Gillies, Olivia Morgan and Scarlet Roberts. The authors, who alone are responsible for the content and conclusions of this document, gratefully acknowledge their input as well as expert contributions from Kara Daly, Alana Lampitt, Penny Sheerin, Geof Shirtcliffe, Roger Wallis, Tim Williams and Mike Woodbury.

7.2 Although directors are protected by the business judgement rule, this does not excuse a failure to make proper enquiries. Directors of companies affected by climate-related financial risk must, at a minimum: identify that risk; periodically assess the nature and extent of the risk to the company, including by seeking and critically evaluating advice as necessary; and decide whether, and if so, how to take action in response, taking into account the likelihood of the risk occurring and possible resulting harm. Directors can do so using conventional risk management strategies. The more material the risk, the more it would be reasonably expected to be considered.

7.3 Where the company has public disclosure obligations, directors also need to ensure they are disclosing material financial risk due to climate change as they would disclose other material business risks.

7.4 Second, as explained in Part 4 below, scheme managers in New Zealand, when making investment decisions and/or designing investment policies, are:

(a) permitted to take account of climate risk where to do otherwise could pose a financial risk to the investment portfolio; and

(b) required to take account of climate risk where to do otherwise could pose a material financial risk to the investment portfolio.

7.5 This is because, to demonstrate that they are acting in the best interests of investors, in furtherance of the proper purpose of the scheme or relevant fund and with due diligence, a scheme manager should consider all material financial risks. Scheme managers accordingly need to take reasonable steps to inform themselves about and identify such risks.

7.6 Where the scheme manager identifies a material climate-related financial risk, the manager would be expected to take action – namely by designing an investment policy which appropriately accounts for that risk. This means that there are some circumstances where, due to the scheme manager's investment risk assessment, an investment bias in favour of climate change adaptive stocks (a *climate change investment strategy*, or *CCIS*) will be required. While investment approaches will differ, the key is that scheme managers turn their mind to the overall objectives of the scheme or the relevant fund, what investment strategy they consider is best suited to the scheme or fund, and how climate-related financial risk is likely to play into future returns over the relevant investment period.

2 Background: climate change science and regulatory response

Climate change science

8 To assess directors' and scheme managers' duties arising from climate-related risk, it is necessary to have at least a basic understanding of climate change issues. For business, the key data points are the likely impacts of climate change and when we can expect them to occur.

9 The Intergovernmental Panel on Climate Change (*IPCC*) – an international and non-partisan scientific assessment body – has, since its inception in 1988, regularly produced reports on the state of knowledge about the science of climate change and its potential impacts.[2] The latest IPCC Special Report (*SR15*), released in October 2018, "*Global Warming of 1.5°C*",[3] outlines the expected impacts of global warming of 1.5° above pre-industrial temperatures as compared to those for a 2.0°C warming scenario.[4]

10 The IPCC's key findings in SR15 are:

10.1 global warming is likely to reach 1.5°C above pre-industrial temperatures at some point between the years 2030 and 2052;

10.2 the impacts of a 1.5°C global warming scenario, while great, are significantly less than a 2.0°C global warming scenario;

10.3 in order to limit global warming to 1.5°C, greenhouse emissions must decline to 45% below 2010 levels by 2030, and must reach net zero by 2050;

10.4 such reductions are physically possible, but will require unprecedented transitions in all aspects of society; and

10.5 even if global warming is limited to 1.5°C, we can expect consequences such as extreme temperatures; massive increases in frequency and intensity of precipitation, floods, droughts and other extreme weather events; sea-level rise; loss of coastal land; loss of species; an increase in ocean acidity; issues with food and fresh water availability; and all of the associated impacts that these will have on economic growth and human health and wellbeing.

Regulatory response to climate change

11 As the science has developed, the international and domestic regulatory and policy response to climate change has solidified. We set out below the key developments at the international level, followed by the position of the current New Zealand Government.

REGULATORY RESPONSE: INTERNATIONAL

UNFCCC

12 The founding international treaty relating to climate change is the UNFCCC, which entered into force on 21 March 1994,[5] having been adopted by the United Nations at the Rio Earth Summit in 1992.[6] The UNFCCC has near global acceptance, with 196 state parties. The ultimate objective of the UNFCCC is to stabilise greenhouse gas concentrations "*at a level that would prevent dangerous anthropogenic (human induced) interference with the climate system*".[7] While the UNFCCC requires reporting of emissions, it does not contain country specific targets.[8]

13 On 11 December 1997, UNFCCC state parties adopted the Kyoto Protocol,[9] pursuant to which certain states committed to binding emissions reduction targets. During the first commitment period (2008–2012), 37 industrialised states and the European Community committed to reducing their emissions by an average of 5% below 1990 levels.[10] Although a second commitment period was agreed for 2013–2020, it is not yet binding at international law.[11]

THE PARIS AGREEMENT AND NATIONALLY DETERMINED CONTRIBUTIONS

14 In December 2015, 196 state parties to the UNFCCC adopted the Paris Agreement, an international agreement recognised as a critical component of the global climate change movement. Under the Paris Agreement, the parties commit to limiting global temperature increase to "*well below 2°C above pre-industrial levels, and to pursue efforts to limit the global temperature increase to 1.5° above pre-industrial levels*".[12] The Paris Agreement entered into force on 4 November 2016.

15 One of the key features of the Paris Agreement is that each state party must undertake and communicate a "*Nationally Determined Contribution*" (*NDC*).[13] NDCs are effectively publicly-available state reports on the mitigation and adaptation measures that states are taking to help reach the Paris Agreement's temperature reduction goals. Every 5 years, states must submit successive – and more ambitious – NDCs, with the next round due in 2020.[14] The intention is that by combining the commitments made across all NDCs, global progress towards limiting temperature rise can be measured. NDCs from 184 states are now available on a public register, giving some insight into expected regulatory developments across all participating countries.[15]

16 New Zealand ratified the Paris Agreement and submitted its first NDC in October 2016. New Zealand's NDC commits New Zealand to reducing its greenhouse gas emissions to 30% below 2005 levels by 2030. New Zealand's NDC applies across all sectors and all gases (including biogenic methane), and confirms that New Zealand intends to use carbon markets to help meet its target.[16]

REGULATORY RESPONSE: NEW ZEALAND

17 New Zealand's primary industries are heavily dependent on the environment, which means that New Zealand's economy is particularly exposed to climate change. This was recognised by the Ministry for the Environment's (*MfE*) Climate Change Adaptation Technical Working Group in a report released in December 2017, which noted that:[17]

> *[A]griculture, fisheries, aquaculture, forestry and tourism are all significant contributors to New Zealand's economy, and all dependent on natural resources and the ability to function within the current climate range. They are therefore*

exposed to the direct impacts of climate change that are outside their ability to adapt, and to those that compound and cascade through the economy from other sectors.

18 In April 2019, MfE reported on the state of New Zealand's environment, detailing significant expected impacts from climate change.[18] In brief, the Ministry's key findings include the following:[19]

18.1 almost two thirds of New Zealanders live in areas prone to flooding and rising sea levels, which will worsen erosion and impact drainage for low-lying land and coastal farms. More than $2.7bn of local government infrastructure is at risk from 0.5m sea level rise (within 40-90 years);

18.2 agriculture, forestry and other primary industries are likely to be "*strongly affected*" by climate change through an increase in climate variability, changed average rainfall and temperature, erosion, droughts and more extreme weather events. For example, marine ecosystems, especially shellfish, face risks from ocean acidification and increased ocean temperature;

18.3 in urban areas, heat waves and sea level rise will cause increases in repair and upgrade costs for infrastructure such as transport, communications, water supply and waste systems. The supply of and demand for electricity will be affected by warmer temperatures and changes in rainfall; and

18.4 many historical and cultural areas of significance are located in areas vulnerable to sea-level rise and erosion.

19 The New Zealand Government has made a number of policy commitments to address climate change. Its signature policy – the Zero Carbon Bill[20] – is currently awaiting its second reading before Parliament. The Bill, in whatever form it is enacted, has the potential to transform all sectors of New Zealand's economy and require major changes to 'business as usual'.

20 In its current form, the Bill:

20.1 sets emissions reduction targets for:

(a) all greenhouse gases except biogenic methane to net zero by 2050; and

(b) biogenic methane to 10% below 2017 levels by 2030 and to 24-47% below 2017 levels by 2050;[21]

20.2 provides for a series of emissions budgets as "stepping stones" towards the 2030 and 2050 targets; and

20.3 establishes a standing Climate Change Commission to provide successive governments with expert advice and to monitor progress towards emissions targets.[22]

21 The Zero Carbon Bill had its First Reading on 21 May 2019. The Bill was reported back to the House by the Environment Committee on 21 October 2019 with a majority recommendation that it be passed with certain proposed amendments. The Committee received over 10,000 submissions on the Bill, and 11,500 requests to appear before the Committee in person.

22 Alongside the Zero Carbon Bill, the Government has announced major reform of the New Zealand Emissions Trading Scheme (*NZ ETS*).[23] This is aimed at strengthening and improving the operation of the NZ ETS under the Climate Change Response Act 2002 (*CCRA*) and aligning it with the Paris Agreement and the Zero Carbon Bill.

23 The NZ ETS amendments involve a range of measures designed to more effectively manage emissions, including introducing a cap on emissions covered by the NZ ETS (to align with emissions budgets in the Zero Carbon Bill), removing a fixed price option for surrender obligations (which effectively acted as price ceiling) and phasing down existing industrial allocations to incentivise reduced industrial emissions.

24 In October 2019 the Government also announced its intention that agricultural emissions will be regulated, with a price placed on greenhouse gas emissions, by 2025. The Government intends to regulate agricultural emissions through an alternative pricing mechanism outside the NZ ETS, although at this stage, the backstop position is inclusion in the NZ ETS.[24]

25 Other policy actions that are impacting industry in New Zealand include the Government's phasing out off-shore oil and gas exploration; promotion of electric vehicles; improvements to public transport, walking and cycling infrastructure; and investments in forestry.[25] The Government has also established a $100m green investment fund, New Zealand Green Investment Finance, to promote commercial co-investment in companies, projects and technologies that facilitate or provide lower emissions benefits.[26]

26 Overall, there is a clear international and domestic regulatory response to climate change, which we expect to strengthen. The immediate risks to New Zealand business stem both from the physical impacts of climate change and the impact of transitioning to a low carbon economy. We now turn to discuss these risks in detail.

Disclosure of climate-related financial risk

27 Against the above policy backdrop, a significant international trend is the increasing recognition of the importance of disclosure of *financial* risk from climate change. This reflects market concern that the financial implications to business from climate change are not being adequately disclosed to the market – specifically, to shareholders and other investors.

28 Financial risk to business from climate change stems from *physical* risks and *transition* risks:

28.1 *Physical* risks are risks related to the physical impacts of climate change, including damage to infrastructure from sea level rise and supply chain disruption due to increased severe storm events or chronic changes in weather conditions (eg, changing rainfall patterns); and

28.2 *Transition* risks are risks which might arise during the transition to a low-carbon economy, including policy risks (eg, higher prices on carbon); legal risks (eg, having to comply with new regulations, facing climate-related litigation); technology risks (new competition resulting from the transition to a low carbon economy); market risks (eg, changing supply/demand trends due to climate change); and reputational risks (eg, investor demand for divestment from fossil fuel investment).

28.3 These risks will affect different sectors of the economy to varying degrees and over uncertain timeframes. For example, it is expected that the sharper the temperature rise and the manifestation of physical risk, the more severe the regulatory response will be.

29 In June 2017, the TCFD, an international taskforce established by the G20, released its influential climate-related financial disclosure recommendations.[27]

30 The TCFD's main recommendation was that organisations should disclose material risks from climate change alongside their standard annual filings. More specifically, the TCFD recommended that organisations disclose:

30.1 the organisation's governance around climate-related risks and opportunities, and how it manages climate-related risks, in each case regardless of the materiality of that information; and

30.2 the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning strategy and the metrics and targets used to assess and manage such risks and opportunities, in each case to the extent such information is material.

31 The TCFD's recommendations represent a watershed for climate-related financial disclosure. They have been broadly endorsed internationally, with 80% of the top 1100 global companies now disclosing climate-related financial risks in line with some of the TCFD recommendations.[28] Regulators in Australia, the United Kingdom and the European Union have already taken action to support the TCFD recommendations. For example:

31.1 the Reserve Bank of Australia[29] and the Australian Prudential Regulation Authority (*APRA*)[30] have endorsed the need for businesses to comply with the recommendations of the TCFD. APRA Executive Board Member Geoff Summerhayes, in his recent speech to the International Insurance Society Global Insurance Forum, described the risk of climate change to the Australian financial system as "*foreseeable, material and actionable now*";[31]

31.2 the Australian Securities and Investments Commission (*ASIC*) published a detailed analysis of climate risk disclosure by Australia's listed companies in September 2018, updated several of its guidelines in August 2019 to more fully incorporate TCFD guidance[32] and released comprehensive guidance on director and officer oversight of non-financial risk in October 2019;[33]

31.3 the Australian Securities Exchange (*ASX*) and the Australian Accounting Standards Board (*AASB*) have each released guidelines endorsing and/or building upon the TCFD recommendations;[34]

31.4 the United Kingdom Government expects all listed companies and large asset owners to be disclosing in line with the TCFD recommendations by 2022[35] and is considering making such reporting mandatory;[36]

31.5 the Bank of England has been active on a number of TCFD-related initiatives, including publishing a Supervisory Statement to enhance banks' and insurers' approaches to managing financial risks from climate change,[37] and its Governor has warned of the criticality of assessing and disclosing climate-related financial risk;[38]

31.6 the United Kingdom Financial Reporting Council (which sets the UK's Corporate Governance Code) has published guidance on companies' 'Strategic Reports' (required alongside annual filings) including reporting on climate risk where material;[39]

31.7 the UK Department for Work and Pensions has introduced extensive new disclosure requirements to further integrate financially material environmental, social and governance (*ESG*) factors, including climate change, in pension scheme reporting;[40] and

31.8 the European Commission has required reporting of certain non-financial information, including environmental risks, by certain large listed companies, banks and insurers since 2018.[41] In addition, the Commission released formal guidelines for reporting of climate-related information in June 2019, drawing heavily on the TCFD recommendations.[42]

32 A major impact of the TCFD recommendations is that climate-related risk is increasingly viewed as a clear financial risk that should be included in organisations' risk management and reporting frameworks.[43]

33 Similar developments are now firmly on the horizon in New Zealand. For example:

33.1 the TCFD recommendations have been referenced by the NZX (New Zealand's principal securities markets operator) in its ESG Guidance Note (which accompanies the NZX Corporate Governance Code) since December 2017;[44]

33.2 the NZX's Corporate Governance Code and the Financial Markets Authority (*FMA*)'s Corporate Governance Handbook each recommend non-financial disclosure, including in relation to environmental factors;[45] and

33.3 in August 2019, the Government released its response to the Productivity Commission's 2018 Low Emissions Economy Report,[46] which includes:

(a) an endorsement of the TCFD's recommendations as one avenue for the disclosure of climate risk; and

(b) the Government's view that, subject to consultation, listed issuers, registered banks and licensed insurers (and potentially other entities) should be required to make climate-related disclosures.

34 The Government[47] is now considering what the specific disclosure requirements should be and whether the disclosures should be different for different classes of entity.[48] The present recommendation is to implement mandatory, climate-related financial disclosures by way of a standard under section 17(2)(a)(iii) of the Financial Reporting Act 2013.[49]

35 Of further relevance to banks and insurers, the Reserve Bank of New Zealand (*RBNZ*) published a report in November 2018 on the impact of climate change on New Zealand's financial system.[50] The report cited particular risk for the agricultural and insurance sectors, and concluded that the RBNZ had an important role in "*driving*

appropriate disclosure to help market participants assess climate-related exposures".[51] In June 2019, RBNZ indicated it would be working to develop an appropriate climate risk disclosure framework for New Zealand.[52]

36 These trends are also supported by relevant professional bodies. The Institute of Directors in New Zealand (*IoD*) recommends that directors focus on meaningful disclosures on climate change risk for the benefit of stakeholders such as investors, consumers and regulators.[53] Chartered Accountants ANZ has stated that it advocates for appropriate disclosures of climate risk, including the disclosure of material climate change risks in financial reports.[54]

Corporate response to climate change

37 There is an increasing corporate response to climate change, which reflects a sliding scale of sophistication and engagement. This is driven by factors such as increasing pressure from consumers, investors and other stakeholders for businesses to take action and the potential threat of climate-related litigation.

INVESTOR PRESSURE

38 Globally, there is a large, well-organised investor movement focusing on the corporate community's response to climate change. Institutional investors such as major pension fund trustees have singled out climate change as a key risk to their investments. Major financial backers such as the World Bank are actively divesting from carbon intensive assets and funds. Investment managers such as Mercer and BlackRock have specific climate change investment strategies.[55] Principles for Responsible Investment (*PRI*)[56], whose over 2,300 signatories together have USD 85trn in assets under management, has stated that climate change is the highest priority ESG issue facing investors. Net-Zero Asset Owner Alliance members, who together have more than USD 2trn of assets under management, have committed to transition their investment portfolios to net-zero by 2050.[57] The Institutional Investors Group on Climate Change, whose over 160 members together have over EUR 21trn assets under management, has published a guide for pension fund trustees and directors on climate risk.[58]

39 In New Zealand, the same trends are at play:

39.1 the Investor Group on Climate Change, a body representing Australian and New Zealand institutional investors, has released a 2019-2022 strategic plan promoting investment for a climate resilient net zero emissions economy by 2050;[59]

39.2 the New Zealand Super Fund (*NZSF*) released its "*climate change investment strategy*" White Paper in March 2019. The White Paper identifies climate change as a new return variable and concludes that ignoring climate change would be an "*undue risk*". NZSF's climate strategy includes divesting from assets exposed to climate policy through their emissions or fossil fuel reserves, implementing climate change considerations into its asset valuations and identifying climate friendly investments.[60] NZSF completed the process of divesting from its most carbon intensive equity holdings in July 2017, selling investments worth $950m (representing 2.7% of its $35bn portfolio); and

39.3 the Accident Compensation Corporation (*ACC*), which manages $44bn of assets, has disclosed that it holds $1bn of carbon intensive assets. ACC's Chair recently told Parliament's Education and Workforce Committee that ACC factors climate change risks into its investment decision-making and recognises climate change as a serious risk to its investment portfolio.[61]

SHAREHOLDER ACTION

40 Investors are increasingly pursuing shareholder resolutions requesting corporate action or disclosure on climate change risk, forcing engagement at board level. Demands include disclosure of climate change strategy, governance and risk management, compliance with the goals of the Paris Agreement, and linking director remuneration to the entity's climate change performance.

41 In Australia, several companies responded to challenges in 2018 in relation to their membership of industry associations with contested positions on climate change. Others were targeted ahead of the 2019 AGM season, with demands for disclosure of their strategies to decarbonise in line with the Paris Agreement.[62]

42 Formal shareholder actions have been taken in New Zealand, including unsuccessful shareholder proposals at Auckland International Airport (*AIA*) and Meridian Energy's respective 2017 AGMs that those companies "*investigate other areas of business that reduce CO_2 emissions that [the companies] can be involved in due to forecast climate change*".[63]

43 In general, shareholders of New Zealand companies are able to make such requests on a pre-notified basis[64] (as was the case for the AIA and Meridian examples) or during the meeting itself.[65]

CLIMATE LITIGATION

44 Climate change-related litigation is growing in frequency, scope, scale and impact.[66] The vast majority of such cases – over 1,000 to date – have been brought in the United States. There are around 100 such cases in Australia and several have also been filed in New Zealand.[67]

45 Businesses are typically affected by such litigation in one of two ways: they are either directly named as defendants or they are involved in projects which become the subject of climate litigation.

46 In the United States, a number of unsuccessful claims have been brought against corporates for climate change harm on negligence and nuisance grounds.[68] Recently, various US cities and local governments in coastal states have filed common law claims against major fossil fuel companies on nuisance, negligence, trespass and failure to warn grounds.[69] For example, in June 2018, a federal judge, in rejecting claims brought by the Cities of San Francisco and Oakland, acknowledged the science of global warming but stating that the courts were not the proper place to deal with such issues.[70] Nevertheless, cases continue to be filed.[71]

47 In Germany in November 2017, an appellate court ruled admissible a case filed against German utility company, RWE, seeking compensation for costs of preventing flood damage from glacial melt in the town of Huaraz, Peru caused by climate change.[72]

48 In the UK, trustees of 14 pension schemes have been threatened with legal action for failing to consider climate related financial risk.[73]

49 In Poland, the courts recently upheld a challenge by legal environmental NGO ClientEarth to the construction of a major coal-fired power plant, after argument that the resolution was legally invalid, and that the plant would become a stranded asset in light of rising EU carbon prices and increased competition from renewables.[74] The Court focussed on the management responsibilities of the Board in undertaking future investment, including environmental impact.

50 In Australia, many actions have been filed seeking judicial review of projects with climate change impacts as well as claims directly against corporates.[75] A claim filed against Commonwealth Bank of Australia for its allegedly deficient disclosure of climate change-related financial risk was withdrawn following increased disclosures by the Bank as to its exposure to climate risk.[76] Litigation is ongoing against the Australian Retail Employees Superannuation Trust for failure to sufficiently disclose its investment strategy relating to climate change risk.[77] In February 2019, the NSW Land and Environment Court rejected an application for a new open cut coal mine in part because of its expected greenhouse gas emissions.[78]

51 In New Zealand, legal experts have warned of the likely resort to the courts for climate change harms.[79] Chief Justice Winkelmann and Justices Glazebrook and Ellen France of the Supreme Court of New Zealand in May 2019 jointly issued a 70-page paper on climate change canvassing the increasing use of the courts and the likely challenges such recourse will bring.[80]

52 The first climate change case against New Zealand businesses was filed in August 2019. Climate Change Iwi Leaders Group spokesperson Mike Smith (Ngāpuhi and Ngāti Kahu) filed proceedings against 7 companies seeking injunctions to secure emissions reductions.[81] Mr Smith has also filed a parallel claim against the New Zealand Government.[82]

NEW ZEALAND BUSINESS COMMUNITY RESPONSE

53 Against the above backdrop of increasing interest from shareholders, investors and litigants, the New Zealand business community is increasingly active and vocal on climate change. Unsurprisingly, the IoD has identified climate change as one of its top five issues for directors for 2019.[83]

54 In July 2018, key New Zealand business leaders created the Climate Leaders Coalition to promote leadership and collective action on climate change. The Coalition now has 122 signatory organisations, between them covering 60% of New Zealand's carbon emissions, making up nearly one third of New Zealand's private sector GDP and employing 170,000 people. The Coalition requires a number of substantive commitments from its members, including to measure and report on emissions.[84]

3 Directors and climate change

55 In this section we consider the extent to which company directors[85] are permitted or required to take account of climate change considerations in their decision-making.

56 As further discussed at paragraph 86 below, directors are generally *permitted* to take account of climate change considerations in their decision-making (provided that climate change considerations potentially intersect with the interests of the company as the director perceives them). Accordingly, our principal focus is on the extent to which directors are *required* to take such considerations into account.

57 As discussed from paragraph 60 below, the directors' duties to:

57.1 act in good faith and in what the director believes to be in the best interests of the company (see s 131 of the Companies Act 1993 (the *CA 1993*)); and

57.2 exercise reasonable care, diligence and skill (per s 137 of the CA 1993),

are particularly relevant to this question because they provide the general standards against which courts assess director decision-making.

58 Also of particular relevance are situations where a company is legally required to disclose material risks. As further discussed from paragraph 92 below, in such cases, the company may be required to disclose climate-related risks, which may in turn require directors to take climate change into account in decision-making.

Summary

59 In summary:

59.1 climate change presents a foreseeable risk of financial harm to many companies, particularly with respect to the impacts of transitioning to a low-carbon economy as discussed from paragraph 27 above;

59.2 accordingly, directors of such companies must, at a minimum:

(a) identify that risk to the company;

(b) periodically assess the nature and extent of the risk, including by seeking and critically evaluating advice as necessary; and

(c) decide whether to take action in response, taking into account the likelihood of the risk occurring and possible resulting harm; and

59.3 directors can address climate change risk using conventional risk management strategies, such as adopting an organisation-wide risk management framework which includes climate change as appropriate.

Directors' duties and climate change risk

60 As noted above, the directors' duties of loyalty and care are relevant to determining the extent to which directors must take account of climate change considerations in their decision-making.

61 Sections 131 and 137 of the CA 1993 are the respective statutory formulations of these duties, which generally restate the pre-existing common law.[86] For practical reasons, we refer to the CA 1993 formulations in our analysis below. We also address briefly, as we consider it less relevant, the s 133 duty to act for proper purposes.

SECTION 137 — DUTY OF CARE, DILIGENCE AND SKILL

62 Section 137 of the CA 1993 requires a director, when exercising powers or performing duties as a director, to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances.[87] In applying this standard, a court must take into account context-specific features, including the nature of the company, the nature of the decision, the director's position and the nature of the director's responsibilities.[88]

63 The following principles expressed in the Australian decision of *Daniels v Anderson*[89] are particularly relevant in assessing the standard of care required of directors:

63.1 a director is obliged to obtain at least a general understanding of the business of the company and the effect that a changing economy may have on the business. Directors should bring an informed and independent judgement to bear on the various matters that come to the board for decision;[90] and

63.2 if directors know, or by the exercise of ordinary care should have known, any facts which would awaken suspicion and put a prudent director on guard, then a degree of care commensurate with the evil to be avoided is required, and a want of that care makes them responsible.[91]

64 Similarly, as the courts have stated in the New Zealand context: "*[a] director must understand the fundamentals of the business, monitor performance and review financial statements regularly…*"[92] and a director should bring "*an inquiring mind, in relation to both company strategy and general administration*".[93]

65 As further discussed from paragraph 79 below, directors may seek and rely on advice in discharging their duty of care. In doing so, however, directors must continue to make their own assessment of the matter in question.[94] As the Court of Appeal has observed, "*the days of the sleeping directors…are long gone*".[95]

66 While not determinative, Cooke J's remarks in the recent *Mainzeal* case indicate that a board which is too operationally focused and fails to properly address systemic risks may fail in its essential duty to govern a company.[96] This dicta is consistent with FMA and NZX guidance that directors should have a sound understanding of key risks (including environmental risks) and ensure appropriate frameworks exist to identify and manage them.[97]

67 It follows that:

67.1 s 137 requires a director to identify, consider and act on climate change risk if that is what a reasonable director would do in the same circumstances;

67.2 the foreseeability of climate change risk is a key determining factor in relation to what a director is expected to know and do about it; and

67.3 the degree of care expected of a director increases with the likelihood of the risk occurring and of its potential harm to the company.

68 The standard for reasonable foreseeability in New Zealand is not hard to meet: a risk will be reasonably foreseeable if it is 'real' - ie, something that a reasonable person would not brush aside as far-fetched or fanciful.[98]

69 However, in responding to foreseeable risk, directors are not measured against an impossible or impractical standard. The courts are generally unwilling to second guess the good faith commercial decisions of directors.[99] They are likely to focus instead on the level of care, diligence and skill used in directors' decision-making processes.[100] Accordingly, directors who balance foreseeable risk of harm against the cost of mitigation, and who act (or decline to act) based upon a rational and informed assessment, are unlikely to be found in breach.

Content of the duty to exercise reasonable care regarding climate change

70 In our assessment, the s 137 standard of care, properly applied, would require many directors of New Zealand companies to have identified some form of climate-related risk to their companies; considered the potential impact of that risk; and taken appropriate action in response.

71 The factors relevant to this assessment are broadly as follows:

71.1 first, for the reasons outlined in Part 2 above, our assessment is that a director would not be able to avoid liability for breach of s 137 by arguing that climate change does not exist. The only debate will be on whether the director's actions (or inactions) were justified against the specific climate-related risks faced by the company;

71.2 second, a number of businesses in New Zealand could suffer financial harm from the physical and/or transition impacts of climate change, as outlined in Part 2 above;

71.3 third, in terms of transition risks to business, the international and domestic regulatory response to climate change is increasingly robust. The Paris Agreement signaled a step-change in global commitment to addressing climate change. In the New Zealand context, the Zero Carbon Bill, in whatever detail it is finally enacted, has the potential to drive major transformation throughout the economy;

71.4 fourth, we expect stakeholder-led trends (in particular with respect to investors, customers and employees) will elevate climate risk for businesses in certain sectors. While New Zealand has not yet experienced the same actions taken by investors and activist shareholders overseas,[101] public awareness of and sensitivity to climate change as a policy issue seems to resonate particularly strongly in New Zealand. For example, the formation of the Climate Leaders Coalition last year takes New Zealand ahead of other countries given the scale and breadth of New Zealand companies that have committed to the Coalition and its specific goals;[102]

71.5 fifth, international and domestic trends towards mandatory disclosure of climate-related financial risk by listed and other publicly-accountable companies further elevates the degree of attention that directors of such companies must pay to the issue. Mandatory disclosure of material climate-related financial risks is well underway in Australia and may become mandatory in New Zealand;[103]

71.6 sixth, reasonably informed directors (at least of the type of companies referred to at paragraph 74 below) should now be aware of the litigation risk to their own decisions and to the company for failing to consider risk from climate change.[104]

72 In discussing the climate risks faced by companies, it is useful to conceptualise each as falling into one of three categories based on the financial risk categories discussed at paragraph 28 above:

72.1 those currently facing foreseeable physical risk due to climate change (and likely also transition risk);

72.2 those currently facing foreseeable transition, but not physical, risk due to climate change; and

72.3 those which currently do not face foreseeable financial (ie, physical and/or transition) risk due to climate change.

73 In our view, the number of companies currently in the first category is likely to be relatively small. By comparison, however, we consider that there are likely to be a significant number of companies currently in the second category, for example those impacted by the Zero Carbon Bill. Further, directors of companies in the second category may be less aware of their companies' exposure to climate risk compared to first category directors given the 'second order' nature of transition risks. It is therefore advisable for any director to obtain a basic understanding of climate change issues.

74 We expect that category one and two directors will predominantly be those on the boards of companies which are involved in carbon-intensive industry sectors; have assets, or are involved in activities, which are particularly exposed to future regulation of carbon emissions; and/or are required to make climate-related disclosures. We also expect the number and diversity of companies in categories one and two to grow.

75 It is outside the scope of this opinion to advise directors how to discharge their duties once they have identified their companies' climate risk. That is a process to be undertaken in context (rather than in the abstract) and by reference to the relevant evidence. In principle, however, directors should approach climate risk in the same way as any other risk. In the context of climate change, risk management steps could include:[105]

75.1 adopting an organisation-wide risk management framework, with climate change included within that framework as appropriate;

75.2 keeping the board and senior management up to date on climate change risks, for example through periodic briefings;

75.3 ensuring there is a sufficiently diverse range of knowledge, skills and experience on the board and within management to identify and effectively address climate risk;

75.4 seeking independent expert advice on the climate risk faced by the company and options for addressing that risk; and

75.5 taking concrete steps to address the company's exposure to financial risk from climate change.

76 Of particular note, our assessment above is broadly consistent with:

76.1 the following views recently expressed extra-judicially by three Supreme Court justices:[106]

> *...academics have argued that, taken together, annual reporting obligations and the directors' duties of care may mean that directors [of New Zealand companies] could breach their duty of care by failing to consider and respond to environmental risks that later harm the company...* ***Climate change is no longer simply an ethical issue. As a material financial risk, directors are accountable under care and diligence duties to take account of the financial consequences of climate change and this applies whatever model of corporate governance is subscribed to.***
>
> [Emphasis added]

76.2 the following conclusions of Noel Hutley SC and Sebastian Hartford Davis in the well-known "Hutley Opinion", published in 2016 and updated in March 2019, which assessed this question under Australian law:[107]

(a) Australian company directors *can* consider, and in some cases *should* be considering, the impact on their business of climate change risks, to the extent they intersect with the interests of the firm;[108]

(b) climate-related risks (including physical, transition and litigation risks) represent foreseeable risks of harm to Australian businesses;[109]

(c) Australian company directors who fail to consider climate change risks now could be found liable for breaching their duty of care and diligence in the future;[110] and

(d) Australian company directors who consider climate change risks actively, disclose them properly, and respond appropriately will reduce exposure to liability; but, as time passes, the benchmark is rising.[111]

RELIANCE ON OTHERS

77 Under the s 137 standard of care, a court will assess a director's response to climate risk against what it would expect a reasonable director to know about that risk in the same circumstances.

78 The more material the risk, the more reasonable it is to expect it to be taken into account. Directors are generally protected by the business judgement rule. We agree, however, that "*the 'business judgement rule' [will] not protect directors where the legal risk stems from inadequate information or lack of enquiry*".[112]

79 In discharging their duty of care in relation to climate change, s 138 of the CA 1993 expressly permits directors to rely on information supplied by other directors, employees, professional advisers and experts.[113] Directors may need to, and if so, should, seek relevant advice. This might address, as appropriate, risks to strategic assets from increased storm events or projected sea level rise; investment portfolios exposed to climate change; or risks arising from expected regulatory developments affecting the business.

80 Section 138, as interpreted in a succession of recent New Zealand cases,[114] makes it clear, however, that directors may not blindly rely on such advice.

80.1 if relying on an employee, professional adviser or expert, the director must believe on reasonable grounds that (as applicable) the employee is reliable and competent in relation to the matters concerned and that the matter is within the competence of the professional adviser or expert.[115] If relying on another director or committee of directors, the matter must be within their designated authority;[116] and

80.2 the director so relying must do so in good faith, make proper inquiry where the need to do so is indicated by the circumstances, and have no knowledge that such reliance is unwarranted.[117]

81 Accordingly, while directors may be well advised to take advice on climate change risk, they retain ultimate responsibility for making their own informed decisions on that risk.

SECTION 131 – DUTY TO ACT IN GOOD FAITH AND BEST INTERESTS OF THE COMPANY

82 Section 131 of the CA 1993 requires a director to act in good faith and in what the director believes to be the best interests of the company. The duty *"focuses directors on their fiduciary mandate of loyalty"*.[118] It contains both an objective requirement of acting in good faith, and a subjective measure of acting in what the director believes to be the best interests of the company.

83 The courts' tendency to presume directors have acted in good faith[119] and the subjective formulation of the best interests test (which responds to mismotivation, particularly self-dealing)[120] means that it would likely be difficult to show a breach in the climate change context except in the clearest of cases.

84 That said, at a practical level, the courts have shown a willingness to engage in some degree of objective assessment in ascertaining 'best interests'.[121] For instance, the High Court has held that directors needed to have identified the options available to the company and assessed each of them before being able to form a view about what was in the company's best interests.[122] While some commentators have challenged this view,[123] it seems logical that a director of a company potentially affected by climate change should consider that risk before forming a view as to the company's best interests.

85 This then invites the question as to how to assess a company's best interests. Directors generally owe their duties to the company, and only in certain circumstances to individual shareholders.[124] But a company is a legal construct. The question of who *"the company"* is for the purposes of these duties remains a matter of academic debate,[125] largely between proponents of the 'shareholder primacy' and 'stakeholder' theories of corporate governance.

86 While not uncontested, New Zealand company law is still generally understood to reflect the theory of shareholder primacy.[126] Recently, there has been prominent debate concerning the alleged incompatibility of shareholder primacy theory with efforts to address issues such as climate change.[127] But even shareholder primacy does not *prevent* directors from considering climate change risk in their management of the company:

86.1 the s 131 duty is to act in relation to the company itself, which is a different (and enduring) entity, as opposed to the group of particular shareholders at any one time (ie, promoting the best interests of the company may justify a longer-term perspective than the present shareholders might support);

86.2 directors may take into account the long-term interests of the company, or the interests of employees, suppliers, customers, the community and the environment, provided that they do not pursue those interests without any regard to the company's interests;[128] and

86.3 generally, directors' duties do not require maximisation of shareholder returns.[129]

87 This is not to say that company law *requires* directors to take a long term and expansive view of the company's interests. Indeed, directors may be able to pursue short term profit maximisation and/or act to the detriment of stakeholders without breaching their directors' duties. It is in this context that the emerging relevance of stakeholder theory is notable. For present purposes, it is sufficient to note that:

87.1 there is a clear drift in New Zealand towards appreciating the impact of company actions on other stakeholders that seems unlikely to be reversed;[130]

87.2 to date, New Zealand has not followed the lead of jurisdictions such as the United Kingdom by legislating a version of stakeholder theory into statutory directors' duties;[131] and

87.3 it is unclear whether and to what extent a New Zealand court could seek to interpret a director's duty to act in the best interests of the company as indirectly including a requirement to consider the interests of broader stakeholders.[132] That is an issue for future discussion and beyond the scope of this legal opinion.

88 Overall, s 131 is likely to come into play only where a director either:

88.1 takes climate change into account where there is demonstrably no possible relevance of climate change or resulting financial risk for the company; or

88.2 fails to take climate change into account when it demonstrably presents a material financial risk to the company.

89 Both scenarios would only arise for decision on very clear facts, which underscores that the most pertinent risk for directors is the s 137 duty discussed above.

SECTION 133 – DUTY TO EXERCISE A POWER FOR A PROPER PURPOSE

90 Section 133 of CA 1993 focuses on whether directors have acted within their assessment of the best interests of the company but nonetheless used specific powers for an improper purpose.[133] Increasingly, breaches of s 133 have been found by the courts where a director has exercised a power in circumstances where – for varying reasons – they did not have a legitimate reason for doing so.[134] This ties in with a wider legal principle that powers in most contexts should be exercised only for proper purposes.[135]

91 While this is an important and powerful principle, we do not presently see that it is especially apposite to the question of proper treatment of climate risk. That is because s 131 is the provision that asks, generally, whether a particular course of action is within the scope of a directors' responsibilities (by reference to that director's assessment of the company's best interests). By contrast, s 133 is more precisely concerned with whether a particular corporate power (such as the right to issue shares) is being exercised for its proper purposes. It is difficult to conceive of a case where the limits of a particular power could be said to be misused simply due to a failure to take proper account of climate change considerations. Such claims are, in our view, more appropriately fashioned as claims under s 137 (and, potentially, in a very clear case, s 131).

Disclosure of climate change risk

92 Directors of many companies must ensure their companies disclose material climate change risk. In addition, key regulators and industry organisations now generally recommend that boards consider broader disclosure of ESG factors on a voluntary basis.[136]

ENTITIES REQUIRED TO PREPARE GENERAL PURPOSE FINANCIAL STATEMENTS

93 In general, a company that is large and/or has public accountability must annually prepare and file general purpose financial reports (*GPFRs*) that comply with generally accepted accounting practice (*GAAP*).[137] Directors of such companies that fail to do so face potential personal liability.[138]

94 GAAP requires that such companies make sufficient disclosure in their GPFRs to enable users to understand the impact of relevant events and conditions on the companies' financial position and performance.[139] Directors of such companies should accordingly ensure that their companies disclose in their GPFRs any climate change-related events and conditions that meet this threshold.

95 If the company fails to do so, directors who can show they took all reasonable steps to ensure the company complied with its reporting obligations would have a defence to personal liability.[140] Such steps may include ensuring a proper assessment of climate-related risk had been undertaken by the board and/or management, and seeking expert advice where necessary.

96 The requirement to disclose climate-related risk in financial reports could come into sharper focus in the near future. As mentioned at paragraph 34 above, the Government is currently considering mandatory reporting of climate-related financial risk in accordance with the recommendations of the TCFD.

ANNUAL REPORTING BY LISTED COMPANIES

97 The NZX Listing Rules require each company with shares listed on the NZX Main Board (*listed company*) to disclose in its annual report:[141]

97.1 the extent to which it has followed the recommendations in the NZX Corporate Governance Code (*Code*); and

97.2 where the company has not followed a recommendation, the reasons why.

98 Of relevance to climate change risk, the Code recommends that listed companies:

98.1 have a risk management framework, report material risks facing the business and report how these risks are being managed; [142] and

98.2 provide non-financial disclosures at least annually, including considering environmental, economic and social sustainability factors and practices.[143]

99 Accordingly, a listed company facing material climate change risk must report how it is managing this risk or explain why it has decided not to do so. The company must also provide annual disclosure on environmental, economic and social sustainability factors and practices or explain why it has decided not to do so. A director of a listed company which fails to do will potentially be in breach of duty.[144]

100 NZX also suggests that listed companies consider disclosing the relevance of environmental factors to their business models and strategy, explaining how ESG issues may affect their business, and providing data that is based on consistent global standards to facilitate comparability.[145] One way companies can achieve this is by following the TCFD recommendations discussed from paragraph 29 above.

CONTINUOUS DISCLOSURE BY LISTED COMPANIES

101 Unless an exception applies, a listed company must promptly and without delay disclose to the market any material information it is aware of relating to the company.[146]

102 Climate change-related information will be material to the company if:[147]

102.1 a reasonable person would expect the information, if it were generally available to the market, to have a material effect on the price of quoted financial products of the company; and

102.2 the information relates to particular financial products, a particular listed issuer, or particular listed issuers, rather than to financial products generally or listed issuers generally.

103 A listed company is "*aware*" of information where a director or senior manager has, or ought reasonably to have, come into possession of the information in the performance of their duties.[148] This emphasises the need for directors of listed companies to actively monitor risks such as those presented by climate change.

COMPANIES MAKING REGULATED OFFERS OF FINANCIAL PRODUCTS

104 Directors of a company making a regulated offer of financial products under the Financial Markets Conduct Act 2013 (*FMCA*) need to satisfy themselves that the relevant offer documents contain all material information.[149] A director of a company that fails to do so faces potential personal liability.[150]

105 Climate change-related information will be material in the context of the offer if:[151]

105.1 a reasonable person would expect the information to, or to be likely to, influence persons who commonly invest in financial products in deciding whether to acquire the financial products on offer; and

105.2 the information relates to the particular financial products on offer or the particular issuer, rather than to financial products generally or issuers generally.

106 The above requirements as to disclosure of climate-related financial risk reflect the current legal position. Disclosure obligations are likely to be increased if the Government imposes regulation to reflect the recommendations of the TCFD.

4 Managed investment schemes and climate change

107 In this section we consider the extent to which the managers of retail managed investment schemes (*scheme managers*)[152] are permitted or required to take account of climate change in managing investment portfolios. We also consider this question briefly in relation to the licensed supervisors of retail schemes.

Summary

108 Scheme managers in New Zealand are subject to professional duties arising from several overlapping sources:

108.1 mandatory duties set out in Part 4 of the FMCA, codifying the core duties of the managers and supervisors of registered managed investment schemes (*schemes*);

108.2 until 30 January 2021 when the new Trusts Act 2019 (*2019 Act*) comes into effect, mandatory duties (and default duties to the extent not contracted out of) as set out in the Trustee Act 1956 (*1956 Act*);

108.3 from 30 January 2021, the mandatory and default duties set out in the 2019 Act that are not otherwise dis-applied by section 155A of the FMCA;[153]

108.4 contractual commitments made in the "*governing document*" for the scheme (which, for a managed investment scheme, will almost invariably be a trust deed)[154] and the scheme's Statement of Investment Policy and Objectives (*SIPO*), and any other issuer obligation[155] which is not inconsistent with any of the applicable mandatory duties; and

108.5 further explications of scheme managers' fiduciary duties contained in and developed by case law.

109 For the purposes of considering climate change, scheme managers owe two key duties under the FMCA and trust law:

109.1 to act in the *best interests of the scheme participants* (investors) and in furtherance of the *proper purpose* of the scheme; and

109.2 to act with the *care, diligence and skill that would be expected of a prudent investment professional*.[156]

110 In order to discharge these obligations, our view is that scheme managers, when making investment decisions and/or designing investment policies, are:

110.1 *permitted* to take climate change risk into account where to do otherwise could pose a *financial risk* to the investment portfolio; and

110.2 *required* to take climate change risk into account where to do otherwise could pose a *material financial risk* to the investment portfolio.

111 In short, a scheme manager needs to identify and consider all material financial risks in order to be acting in the best interests of the investors and in furtherance of the proper purpose of the scheme or the relevant fund and to properly discharge its duty to act with due care, diligence and skill. Because of the increasing evidence of climate change as a financial risk, it would be unwise and potentially unlawful for any scheme manager to proceed without at least considering the possible impact of climate change.

112 Where the identified financial risk is significant, the best interests and diligence rules mean that scheme managers would be expected to design an investment policy which appropriately accounts for the climate change financial risk identified. This means that there are some circumstances where, due to the scheme manager's investment risk assessment, an investment bias in favour of climate change adaptive stocks (a *climate change investment strategy*, or *CCIS*) will likely be required.

113 It is, of course, for individual scheme managers to assess the relevant risk. Even when adopting a CCIS, different approaches may be taken.[157] What matters is that scheme managers turn their mind to the overall objectives of the scheme or the relevant fund, what investment strategy is best suited to those objectives and how climate change financial risk is likely to play into future returns over the relevant investment period.

Professional duties of scheme managers

RELEVANT FMCA DUTIES

114 The FMCA regulates the licensing, governance and disclosure requirements for retail schemes as well some aspects of offers to investors in wholesale funds (although we focus in this opinion only on retail (registered) schemes).[158]

115 The FMCA requires that registered schemes have a licensed manager[159] and a licensed supervisor.[160] The function of the manager is to offer and issue managed investment products (ie, interests in the scheme) and (subject to permitted delegations) to manage and administer the scheme,[161] while the supervisor holds the scheme property[162] and supervises the manager in the performance of its obligations.[163] The supervisor's role is non-managerial. The supervisor is, however, obliged to refuse to act on a direction from the manager to acquire or dispose of scheme assets if the supervisor considers that the proposed acquisition or disposal would be in breach of the scheme's governing document, any rule of law, any enactment or (notably) manifestly not in the interests of the scheme participants.[164]

116 The scheme manager prepares, maintains and must act upon the SIPO, which sets out the framework for the scheme's investment policies and objectives. The supervisor monitors compliance by the manager with the scheme's governing document and the SIPO.

117 Of increasing relevance for investments that may be exposed to climate-related financial risk, a SIPO must state:[165]

117.1 the nature or type of investments that may be made, and any limits on those;

117.2 any limits on the proportion of each type of asset invested in; and

117.3 the methodology used for developing and amending the investment strategy and for measuring performance against the scheme's objectives.[166]

118 The core duties of scheme managers are set out at ss 143 and 144 of the FMCA. Managers must carry out their functions in accordance with the governing document, the SIPO, and all other issuer obligations.[167] In the context of this opinion, the most relevant duties of a scheme manager are to:

118.1 act *honestly*[168] (and, when the 2019 Act comes into force on 30 January 2021, "*in good faith*");[169]

118.2 act in the *best interests* of scheme participants[170] and treat the scheme participants *equitably*;[171] and

118.3 exercise the *care, diligence, and skill* that a prudent person engaged in that profession (i.e., acting as the professional manager of a registered scheme) would exercise in the same circumstances.[172]

119 There is also an expectation that scheme managers will only act in the *proper performance* of their duties. Scheme managers will be indemnified in relation to the performance of their obligations only where their rights of indemnity are set out in the scheme's governing document and only in relation to the "*proper performance*" of their duties under s 143(1) and s 144.[173]

120 A scheme manager who fails to comply with those statutory duties may incur civil liability, including a pecuniary penalty not exceeding $200,000 for an individual and $600,000 in any other case.[174] While only the FMA may apply for a pecuniary penalty,[175] investors may apply for declarations, compensatory orders or other civil liability orders.[176]

RELEVANT DUTIES UNDER TRUSTEE ACT 1956 AND TRUSTS ACT 2019

121 Schemes in New Zealand which are managed funds are typically established by trust deed. Trust deeds provide a useful structure for the managed funds model by which investors pool their contributions with others in exchange for a right to receive financial benefits, but without having day-to-day control over the scheme's operations. The FMCA confirms that, if a registered scheme is established under a trust deed, the scheme manager has the same duties and liability in the performance of its functions as scheme manager as it would if it performed those functions as a trustee (except to the extent that those duties are altered by or are inconsistent with the FMCA).[177]

122 Prior to the 2019 Act, there has been no definitive statement of all of a trustee's duties.[178] Many of the core trustee duties set out the 2019 Act are dis-applied to managers (and supervisors) of registered schemes by section 155A of the FMCA, in which case the core duties are as set out in ss 143 and 144 (and for supervisors, ss 153 and 154) of the FMCA.

123 The key duty imposed on professional trustees in the 1956 Act was that of reasonable care when exercising any power of investment: ie, to "*exercise the care, diligence, and skill that a prudent person engaged in that profession, employment, or business would exercise in managing the affairs of others*".[179] Other common law duties, such as to act in the best interests of all present and future beneficiaries, were preserved, but not created, by the 1956 Act.[180]

124 The 2019 Act clarifies the duties on trustees, as do the corresponding provisions of the FMCA as they apply to managers and supervisors. For the purposes of this opinion, the key duties imposed on scheme managers acting under schemes established by trust deed are:

124.1 to act *honestly* and in *good faith*[181] (this duty is codified in the FMCA, as it applies to scheme managers and supervisors);[182]

124.2 to act for the *benefit* of the beneficiaries *in accordance with the terms of the trust*, and in the case of a trust for a permitted purpose, to *further the permitted purpose* of the trust;[183]

124.3 to exercise trustee powers for a *proper purpose*;[184] and

124.4 to exercise the *care and skill that is reasonable in the circumstances* (including any special knowledge or experience that it is reasonable to expect a person acting in the course of a business or profession to have).[185] This duty is codified in the FMCA, as it applies to professional and non-professional managers and supervisors.[186]

125 The separate duty to *invest trust property with the care and skill that a prudent person of business would exercise in managing the affairs of others* (which may be modified or excluded by trust deed) is dis-applied to the managers of registered schemes under the FMCA and has no specific counterpart in the FMCA.[187] This means that the relevant diligence standard under the FMCA with regard to investing is the generic professional standard of care and not a specific prudent investment standard. We do not see this difference as being significant for the purposes of this opinion, as we consider the requirement to invest prudently would naturally form part of the wider professional standard of care imposed by the FMCA.

SUMMARY: DUTIES OF SCHEME MANAGERS

126 The statutory regime introduced by Part 4 of the FMCA, regulating the governance of registered schemes, is still relatively new and the duties imposed on managers (and supervisors) under that regime have not yet been fully tested in the courts. It is possible that subtle differences between obligations under the 2019 Act and under the FMCA will emerge through subsequent court decisions. We do not, however, see the difference in language between the 2019 Act and FMCA as material to the analysis we are undertaking.[188] The growing body of case law and legal analysis of trusts and trustee duties, including as regards the need to consider climate change when making investment decisions,[189] should therefore provide useful guidance for scheme managers seeking to ensure they properly discharge their statutory and fiduciary duties when formulating and monitoring investment policies.

127 Accordingly, for the purposes of this opinion, the relevant duties owed by scheme managers under both the FMCA and trust law can be condensed into two key duties which we discuss below. These are:

127.1 to act in the *best interests of the beneficiaries* and in furtherance of the *proper purpose* of the scheme; and

127.2 when exercising powers (including the power of investment) or performing duties, to act with the requisite standard of *care, diligence and skill* (in the case of the FMCA, that standard being what would be *expected of a prudent investment professional*).

DUTY TO ACT IN THE BEST INTERESTS OF BENEFICIARIES AND FOR PROPER PURPOSES

128 Whereas the key duty in this context for directors is the duty to act with reasonable care, the key duty for scheme managers is the duty to act in the best interests of beneficiaries and for proper purposes. This is because the latitude extended to directors to subjectively apprehend the best interests of the company (itself a flexible legal construct) does not extend to scheme managers. The best interests of beneficiaries and the proper purpose of the relevant scheme or fund are really two sides of the same coin.[190] They are collectively judged by an objective standard[191] which is not malleable. Usually, the best interests are financial interests. Thus, our analysis includes an extended discussion of these fiduciary duties and (because it adds little) a rather shorter discussion of the reasonable care and prudent investment obligations.

129 We note, however, that some managed investment funds now contain in their mandate a focus on ESG or climate change impacts that does not depend on demonstrable financial risk. Scheme managers must act in accordance with instructions, and so it is legitimate that these scheme managers consider these principles when investing if they are required by their mandate to do so (eg, by adopting investment screens, which can take various forms).

130 Central to the analysis we develop below, with respect to funds with no special mandate, is the distinction between a scheme manager that is considering climate change:

130.1 as a *material financial risk* to an investment (for example due to physical assets at risk or the financial impact of future carbon-related regulation on the investee entity, as explained at Part 2 above); and

130.2 more generally as an ethical matter that engages stakeholder concern but which does not have identifiable financial implications for the investment.

131 In this opinion, we focus on the first situation.

THE MEANING OF THE DUTY TO ACT IN BEST INTERESTS OF BENEFICIARIES

132 The leading case on a scheme manager's duties in this context is the 1985 decision of *Cowan v Scargill*[192], which remains important across the common law world. The case involved a mineworkers' pension scheme managed by a committee of 10 trustees; 5 appointed by the national coal board and 5 by the union. A dispute requiring court intervention arose when the union trustees refused to agree to the adoption of an investment plan unless it was amended to take account of their objections to proposals to invest in overseas assets and in oil. Such investments were argued to be *"to the detriment of coal"* and investment opportunities in Britain and therefore ultimately *"against the interests of the scheme's beneficiaries"*.

133 Vice-Chancellor Sir Robert Megarry considered that the trustees' "*paramount*" duty was to act in the best interests of the present and future beneficiaries.[193] The case accordingly and conventionally confirms that trustees must exercise their investment powers in accordance with the purpose of the trust. Where the purpose of the trust is the provision of financial benefits, "*the best interests of the beneficiaries are normally their best financial interests*".[194]

134 The case confirms that fiduciaries who manage other people's money are not at liberty to indulge their own moral scruples in doing so. But it is sometimes relied on for the rather more blunt proposition that professional investment managers are required to take a 'profit maximisation' approach in order to maximise financial returns on an investment-by-investment basis. Read carefully, however, *Cowan* merely confirms that fiduciary powers must be exercised "*carefully and fairly for the purposes for which they are given and not so as to accomplish any ulterior purpose*".[195] Indeed, the judgment observed that what is considered the best return for beneficiaries must be "*judged in relation to the risks of the investment in question*".[196] The Judge himself explained some years later that *Cowan* should not be taken as saying profit must be maximised at all costs.[197]

135 Case law following *Cowan v Scargill* has not adopted a crude profit maximisation approach. For example, take the case of *Martin v City of Edinburgh District Council*, where the District Council was alleged to have breached its fiduciary duties by withdrawing trustee investments in South Africa as an anti-apartheid protest,[198] In that case, Lord Murray rejected an argument that, based on *Cowan*, trustees had an unqualified duty simply to invest trust funds in the most profitable investment available. Lord Murray placed emphasis on the importance of trustees maintaining their discretion, rather than simply rubber stamping the professional advice of financial advisors.[199]

136 Ultimately, what matters is the *best interests of the beneficiaries*. This is not necessarily the same thing as 'profit maximisation' and certainly not the same thing as profit maximisation on an investment-by-investment basis. In modern portfolio theory, what matters is the balance of value, risk, risk-adjusted return over the relevant investment period and diversification. All of these factors play into the overall analysis.

137 Justice Glazebrook (then sitting on the Court of Appeal, now a member of the Supreme Court) carefully explained this point in *Kain v Hutton*,[200] a case concerning a family dispute over the administration of a number of trusts. One issue that arose was a decision by the trustees to lease trust land for development and viticulture purposes. Her Honour noted that the contentions of the aggrieved trust beneficiaries reflected a suggestion that the trustees had acted improperly because a different course of action (subdivision of the land for residential purposes) would have been more lucrative.[201] After addressing evidence that leasing the land for viticulture *was* currently the best use of the land, Her Honour continued:[202]

> *Even had there been evidence that subdivision of the Montana land was possible, the focus of trustees must be on prudently managing and investing the trust's assets.* ***The duty to act in the best interests of the beneficiaries is a holistic one which involves considerations of the trust's purpose, diversity of investment, risk management and a balance between capital growth and income yield*** *– see Trustee Act 1956 s 13E, Heydon and Lemming Jacobs' Law of Trusts in Australia (7ed 2006) at [1817], Hanbury and Martin Modern Equity (17ed 2005) at [18-015] and Cowan v Scargill [1985] Ch 270 at 287 (Ch).* ***These considerations may well conflict with profit maximisation.*** *Subdivisions are generally risky, subject to long delays, require substantial investment of capital and are of uncertain outcome. The*

trustees could not be criticised for rejecting such an undertaking in favour of a more stable long-term return with minimal risk, such as the Montana lease offered.

[Emphasis added]

138 A similar approach can be seen in recent United Kingdom and Australian cases. In 2015, the English High Court examined and explained the meaning of the best interests obligation by focussing on the link between the best interests of the beneficiaries and the proper purposes of the trust. Justice Asplin concluded:[203]

> *In my judgment, it is clear from Cowan v Scargill that the purpose of the trust defines what the best interests are and that they are opposite sides of the same coin [...].*

139 His Honour also cited with approval earlier observations of Sir Richard Scott VC in the Chancery Division in *Edge v Pensions Ombudsman*.[204] In that case, dealing with the proper treatment of a pension fund surplus, the Court had accepted that the trustees were justified in taking into account broader interests – specifically those of employers under a pension scheme – as opposed to solely considering the beneficiaries' financial interests.[205] Using similar reasoning, Asplin J was willing to recognise that acting in the best interests of the beneficiaries does not necessarily equate to taking the course of highest profits. Instead, trustees must take into account all relevant, and ignore all irrelevant, considerations. Assuming there are no ulterior motives at play, the overall test is really one of reasonableness and fidelity to the underlying purpose of the scheme or fund.

140 In 2018, the High Court of Australia also recognised the link between the purpose of a scheme and the best interests of the investors.[206] There, the issue concerned the approval, by the directors of a company which was the responsible entity of a managed investment scheme, of amendments that would have introduced substantial new fees. In finding that the directors had breached numerous duties, including the duty to act in the best interests of members of the scheme, the High Court held:[207]

> *Although the duty is not satisfied merely by honesty,* ***it is a duty to act in the best interests of the members rather than a duty to secure the best outcome for members.*** *Key factors in ascertaining the best interests of the members are the purpose and terms of the scheme, rather than 'the success or otherwise of a transaction or other course of action'.*

[Emphasis added]

ANALYSIS: DUTY TO ACT IN BEST INTERESTS OF BENEFICIARIES AND CLIMATE-RELATED FINANCIAL RISK

141 Perhaps the key point is that identifying the best interests of the beneficiaries depends on identifying the purpose of the trust. As Lord Nicholls, writing extra-judicially, said: *"to define the trustee's obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate, in different words, a trustee's obligation to promote the purpose for which the trust was created"*.[208]

142 The so-called profit maximisation rule is best understood as shorthand for this fundamental duty. There must of course be a single-minded focus on best interests and proper purposes. This reflects that funds are invested on behalf of others. But the law does not test compliance with the best interests rule by retrospectively comparing outcomes. It does not apply an investment-by-investment comparison, to the exclusion of modern portfolio theory. And it does not require focus on short-term non-risk-adjusted gain at the expense of longer-term financial considerations.

143 The essence of the duty relates to conduct and approach. It is for the scheme manager, and not the courts, to formulate an appropriate investment strategy. In practice, any question of whether the investment strategies employed comport with the scheme or fund's purposes will be measured against the SIPO and will include an expected balancing of diversification, value and risk objectives over the relevant investment period. The overall approach will ordinarily be to seek to secure the best realistic long-term return.

144 It is important for scheme managers to document decision-making, so as to make clear only relevant considerations are taken into account and considered. The courts will, if necessary, prevent deviation from the proper path. But the way to get there will inevitably involve judgement calls.

145 Climate risk is a potentially relevant consideration for future value, risk and diversification. As a financial risk factor, it can properly be considered in designing investment policies. Where it is a material financial risk factor, it will need to be considered. There are live arguments[209] relating to whether climate risk is presently sufficiently priced into stocks, so that an investor cannot expect a higher return than the market aggregate by selecting some stocks only. This is for scheme managers to judge, based on their experience and the available evidence. No legal issue ought to arise where scheme managers take genuine and reasonable efforts to judge financial risk on an informed basis.

146 The starting point for that assessment must be the purpose of the scheme or the relevant fund. Where that is to provide financial return to investors over the longer term, the scheme manager is required to take into account all material financial risks over that investment period, including material climate-related financial risk. In our view, if this means weighting a portfolio against (or even, if the data justifies this conclusion, avoiding) certain immediately attractive (but carbon intensive) investments to promote the longer-term stability and performance of the scheme or fund, then this approach will satisfy the 'best interests' duty.

147 The same conclusion has been reached in England and Wales. In 2014, the Law Commission (England and Wales) released a major report entitled "Fiduciary Duties of Investment Intermediaries". The report was in response to concerns from the industry including whether fiduciary duties restricted pension scheme trustees from taking ESG factors into account in investment decisions.[210] The Commission did not consider that ESG factors were of themselves illegitimate considerations. Where they had financial relevance, they should be treated like other financial considerations. Importantly, the Commission explained that the purpose of pension investment is not simply to maximise returns, but to provide for reliable retirement income – and that conflating these two different concepts may not serve beneficiaries' best interests.[211]

148 The Commission concluded that:

148.1 trustees *may,* and in fact *should,* take into account any matter which is, or may be, *financially material* to the performance of an investment, including ESG factors;[212]

148.2 it is for trustees' discretion, acting on proper advice, to evaluate the risks, including assessing which factors are financially material and the weight they should be given;[213] and

148.3 trustees should only take into account *"non-financial factors"* (factors that might influence investment decisions such as excluding or negatively weighting certain industries) if:

(a) trustees have good reason to think scheme members share the concern; and

(b) the decision should not involve a risk of significant financial detriment to the scheme.[214]

149 Keith Bryant QC and James Rickards expressed a similar view in a 2017 opinion prepared for environmental law firm/NGO, ClientEarth, on the duties of United Kingdom pension fund trustees regarding climate change. Bryant and Rickards concluded that:

149.1 pension fund trustees are *permitted* and *required* to take into account any climate change-related risks that are *"financially material"*;[215] and

149.2 pension fund trustees that considered they could *not* take climate change into account simply because it was an ESG factor – and so had not even considered that it could be financially material – would face the risk of legal challenge.[216]

150 We agree that trustees should take into account climate change considerations when they are, or may be, *financially material* to the performance of the investment. There should no longer be any uncertainty as to whether trustees should take climate change considerations into account. If they are or could be financially material, they should do so.

151 In a New Zealand context, we make the following observations:

151.1 consistent with the England and Wales Law Commission's view, we would expect a New Zealand court to proceed on the basis that it is inherent in the notion of investment (especially in equities) that assets are purchased not for short-term gain motives but to achieve medium to long-term objectives;[217]

151.2 writing in 2009, Butler suggested that there was an *"evolving"* view that applying *"ethical"* investment policies – including avoiding carbon intensive investments – could be properly justified as being within *"best interests"* where to do otherwise would mean that the long term value of the trust fund would suffer financially. We agree. Specific judgement calls will of course be for the scheme manager, but material financial risks should be considered, whether or not those risks arise from ESG or other factors;[218]

151.3 in its review of trust law in 2011, New Zealand's Law Commission considered that, in determining the 'best interests' duty, although financial interests will generally equate with beneficiaries' best interests, *"non-financial interests will be important factors for the trustees to consider"*. The Commission found that such considerations may justify a trustee avoiding an investment even where it would otherwise be a sensible financial decision.[219] We address this wider question briefly below, but as already noted, it is not the focus of this opinion given the potential for climate change to be a material financial risk; and

151.4 in New Zealand, s 59 of the 2019 Act, which sets out an (open) list of factors to which a trustee may have regard when making investments, confirms that profit maximisation is not a sole focus. Instead, s 59 promotes a broad assessment of various factors, including the objectives or permitted purpose of the trust, the desirability of diversification, the nature of trust investments, the risk of capital loss, the probable duration of the trust and the trustee's overall investment strategy. Although this provision is strictly dis-applied to registered schemes by section 155A of the FMCA, we consider that a New Zealand court will likely be influenced by s 59. We consider that a court would likely see s 59 as encapsulating a modern expression of relevant investment considerations that would also be expected to apply to scheme managers exercising powers under Part 4 of the FMCA.[220]

152 All of this means that scheme managers must now treat climate change in the same way as they would any other financial risk factor. At a minimum, scheme managers would be expected to:

152.1 assess the extent of any fund's overall exposure to climate-related financial risk;

152.2 assess whether the investment policy for a fund gives rise to investment decisions that are potentially affected by a climate-related risk that is or might be financially material to the investment;

152.3 consider the nature, scope and potential future impact of the identified risk;

152.4 seek appropriate advice on the projected impacts of climate change on that fund's investment policy, including, for example, the possibility of stranded assets and future changes to regulations and consumer preferences;

152.5 consider whether the degree of climate-related financial risk is adequately reflected in the SIPO and in any marketing material or other information provided to investors; and

152.6 where the risk is material, take appropriate action, for example to reduce any undue exposure to climate-related financial risk in the fund.

153 The difficulty obviously arises where an investment is potentially affected by climate change risk, but such risk is difficult to predict with certainty and/or quantify. Examples include expected disruption to supply chains from changing weather patterns that might make certain product lines unsustainable or a potential future carbon tax that will hit profits if imposed. We suggest that scheme managers should not shy away from thinking through indirect downstream financial consequences of investment decisions for fear that they are prohibited from considering ESG factors. There is no legal prohibition on responsible and thoughtful investment. But taking an evidence-based approach is best. Scheme managers should, where appropriate, seek expert advice and be guided by the paramount duty to act in the best interests of the beneficiaries.

154 The best expression of what this means is, in our view, that given by the England and Wales Law Commission: seeking to secure ***"the best realistic return over the long-term****, given the need to control for risks*" (emphasis added). Determining the "*best realistic return*" is a question of broad judgement, rather than mathematical formulae. It should not be judged with the benefit of hindsight.[221]

155 Courts will, in our view, respect scheme managers' discretion so long as the exercise of that discretion includes making appropriate enquiries and factoring the findings into decision-making.[222] This may lead to different acceptable outcomes depending on the judgement of the scheme manager. As stated in the Bryant Opinion:[223]

> *...it is important to recognise that when making decisions concerning investment the trustees of a pension scheme are exercising a discretion; faced with the same information different trustees may reach different decisions but as long as they have acted reasonably and taken account of all relevant and no irrelevant matters then their decisions are unlikely to be susceptible to challenge.*

156 In the New Zealand market, there is evidence that scheme managers are already taking climate change financial risk into account in their investment planning. For example, and as referred to at paragraph 39 above:

156.1 New Zealand's largest sovereign wealth fund, the New Zealand Superannuation Fund (*NZSF*), published its climate change investment strategy in March 2019. The NZSF concluded that climate risk was a financially material factor in its investment portfolio, particularly because of the extended (pension based) investment period for which the NZSF's assets were being managed.[224] Accordingly, as discussed at paragraph 39.2 above, the NZSF has reduced its exposures to carbon intensive investments and is actively seeking low-carbon investment opportunities;[225] and

156.2 ACC's Board Chair stated in August 2019 that ACC expects its investment managers to take account of the challenges, risks and opportunities that climate change – and the shift away from carbon fuels – may have on each individual investment and the reputation of ACC.[226]

CLIMATE CHANGE AS A NON-FINANCIAL FACTOR

157 A related issue is whether scheme managers are permitted to take climate change into account in a more generic sense where climate change is *not* likely to financially impact the investment - for example, where there is a moral or ethical preference to avoid carbon intensive industry in investments (ie, where climate change is a non-financial factor).

158 We do not definitively opine on this point. That is because the premise of this opinion is that climate change can properly be regarded as a potentially material financial risk and should be treated accordingly. But we do outline below some key principles:

158.1 it is important to distinguish ESG investing (which increasingly recognises the financial impact of ESG considerations) from purely ethical investing (based purely on moral or ethical principles), sometimes known as socially responsible investing (or *SRI*). Climate-related risk that is potentially material to a fund can and must be taken into account by scheme managers today. This is precisely the focus of the TCFD's work discussed from paragraph 29 above, which stresses that climate-related financial risk is a legitimate and serious financial risk;

158.2 the *Fiduciary Duty in the 21st Century* report,[227] an important piece of thought leadership, spans a number of jurisdictions and makes recommendations to regulators to clarify this issue. This report concludes that "*failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty*".[228]

This conclusion was based on the recognition of ESG factors as long-term investment value drivers – ie, financial factors;

158.3 there is some judicial support for the view that, with the appropriate (express or implied) consent of beneficiaries, scheme managers can make investment decisions by reference to ethical considerations.[229] In *Harries v Church Commissioners for England*,[230] declarations were sought that the Commissioners were obliged to have regard to the object of promoting the Christian faith and not to act in a manner which would be incompatible with that object when managing their assets. While the Court ultimately refused to grant the declarations, this was on the basis that it was clear the Commissioners did have an ethical investment policy and did already seek to have regard to the object of promoting the Christian faith;[231]

158.4 as discussed from paragraph 147 above, the England and Wales Law Commission's 2014 report found that trustees should only take 'non-financial factors' into account if (i) they have good reason to think that the members share the concern and (ii) there is no risk of significant financial detriment to the relevant fund.[232] In other words, where promoting a carbon efficient investment strategy would likely produce a similar return to the standard investment strategy, trustees could take such an approach if they believed their members would concur. This might be called a 'tie-break' approach. The Commission's report recognised that the delicate matter of determining members' preferences would be much more difficult for a larger fund, so the workability of this two-step test is not guaranteed; and

158.5 some have taken the view that a 'tie break' approach is not permissible.[233] A defence of this narrower view is provided by Sitkoff and Schanzenbach, who argue that (what they describe as) "*ESG investing*"[234] is *only* permissible for a fiduciary if (i) the fiduciary believes the ESG investment will benefit the beneficiary directly (ie, by improving risk adjusted return); and (ii) the fiduciary's exclusive motive is to obtain this direct benefit. If these criteria are not met, then the fiduciary must not take ESG factors into account.[235] Similarly, Baulaufh and Garz[236] argue that the only permissible purpose of employing ESG factor integration is improving financial performance or mitigating risk; if ESG considerations have no financial relevance, then they should not be considered,[237] and to do so would be a probable departure from "*proper fiduciary duty*".[238]

159 The two key issues for non-financial considerations are:

159.1 what form of approval, short of express written consent, is sufficient to enable scheme managers to take account of non-financial considerations; and

159.2 is the 'tie-break approach' permissible in New Zealand?

160 Given the focus of this opinion, and our starting point that climate change considerations pose potentially material financial risks, we do not express a definitive view on either issue. The core principle is that scheme managers cannot indulge their own moral or ethical preferences at the expense of doing their duty to act in the best interests of scheme or fund beneficiaries. It seems doubtful that a modern New Zealand court would apply this principle so as to preclude a tie-break approach where a sustainable investment was favoured in circumstances that did not present a financial

risk to beneficiaries. In any event, we consider that tie-break questions are more theoretical than real. No two investments have precisely the same profile over a fund's time horizon. The duty of scheme managers to act in accordance with proper purposes in the interest of beneficiaries is, as addressed above, to be considered with regard to the overall portfolio and not on an investment-by-investment basis.

DUTY TO TAKE REASONABLE CARE / INVEST PRUDENTLY

161 As set out above, the duty to take reasonable care[239] is reflected in both the FMCA and the trust legislation. In essence, this legislation requires professional managers and trustees, when managing investments, to exercise the *care, diligence and skill of a prudent professional manager*.[240] We address this duty briefly because it adds little to the foregoing analysis.

162 When assessing whether a scheme manager has exercised sufficient care, diligence and skill to meet this standard, the courts will focus on the process by which the manager adopted, implemented and monitored investment strategies, and not on the outcomes of those strategies.[241] In other words, the standard remains one of conduct, not outcome.[242] Similarly, investment decisions are judged at the time of the investment, not with hindsight.[243] A scheme manager is accountable for the way they have used their powers, not for legitimate risks, market forces and other uncontrollable aspects of trust funds.[244]

163 As set out above, New Zealand trustees are, from 2021, expressly permitted by statute to consider a broad range of factors when investing.[245] Even before then, we doubt that a New Zealand court would consider the potential list of factors to be circumscribed, at least where there is a factor with potentially material financial impact. Accordingly, to demonstrate due care and diligence, it will be important to create and retain a written record documenting the decision, the informed deliberation surrounding the decision-making, the investment strategy and how the decision fits into it.

164 This specific duty of prudent investment, with its associated detailed list of permissive factors, will not apply to a managed investment scheme regulated under Part 4 of the FMCA.[246] We consider it unlikely, however, that a court would find that the professional standard of care under s 144 of the FMCA does not include within it a requirement for prudent investment.[247] Thus, in our view, both professional trustees and scheme managers are required to act with reasonable care and diligence in making investment decisions.

165 The duty of professional care and/or prudent investment is particularly relevant when considering climate change. While the courts generally focus on process rather than investment outcomes, a court would need to undertake some objective assessment of whether an investment strategy had been careful or prudent. Sitkoff and Schanzenbach describe the duty as follows:[248]

> *Under the prudent investor rule, a fiduciary must (i) "invest and manage the funds of the trust as a prudent investor would" toward "an overall investment strategy" with "risk and return objectives reasonably suited to the trust," and (ii) "diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.*

166 In general terms, the due diligence standard for investments has been described as *"flexible and fact sensitive"*, with the purpose of the trust paramount.[249] It will also *"change with economic conditions and in the light of contemporary thinking and understanding"*.[250] The duty includes the need to seek advice on matters which an investor does not understand and to consider advice prudently upon receiving it.[251]

167 While a degree of caution and care is required,[252] scheme managers are not lawfully required to be unduly conservative. As Butler has explained, "*condoning a failure to advance capital growth would encourage minimal attention to fund management, which hardly amounts to prudent management of the capital assets of other people*".[253]

168 It has been suggested that the duty to invest prudently is really just one manifestation of the overarching duty to act in the best interests of the beneficiaries.[254] At a high level that makes sense. For this reason, our discussion of this duty is short as it would otherwise be repetitive. If suffices to say that, if the best interests of the beneficiaries is *the best realistic return over the long-term*, this will require the scheme manager to carefully administer the trust with due consideration of all potentially material financial factors over that investment period. That is because the reasonable and prudent course – and the one likely to secure the best realistic return over the long term – requires assessment of any financial risk that is material. In many cases, depending on the reasonable judgement of the scheme manager, this will require assessment of, and an appropriate response to, material climate-related financial risk.

5 Conclusion

169 We have sought to clarify current legal obligations on directors and scheme managers as to whether, and if so, how they must take climate change into account in their decision-making. In essence, our findings, which reflect commercial common sense, are that:

169.1 directors must act reasonably to inform themselves about, consider and decide how to respond to climate change risk, as they would any other financial risk; and

169.2 scheme managers must take climate change into account when making investment decisions and/or designing investment policies, where to do otherwise could pose a material financial risk to the investment portfolio.

170 Although our analysis has been restricted to climate change only, these conclusions are generally consistent with the broader proposition from the work done by the UNEP and PRI that "*failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty*".[255] New Zealand was not covered by the report, and New Zealand courts have not yet had to grapple with the intersection of ESG factors generally and the outer limits of fiduciary duty. Nor do we do so here. Our opinion is that our propositions stated at paragraph 169 above represent current New Zealand law.

171 Looking to the future, community expectations are likely to continue to evolve. In particular, neither New Zealand's Parliament nor its courts have yet mandated clear obligations in a non-financial context. But market expectations are moving quickly and the law is often not far behind.

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24 October 2019, with its first reading expected in early November. The Bill will then be referred to the Environment Select Committee.

[24] New Zealand Government "World-first plan for farmers to reduce emissions" (press release, 24 October 2019), <https://www.beehive.govt.nz/release/world-first-plan-farmers-reduce-emissions>.

[25] Ministry for the Environment, above n 19.

[26] The Government provided a $100 million capital injection, $1 million for the establishment in 2017/2018 and $4 million in 2018/2019, as well as $30 million over six years for its operational costs. Cabinet Paper *Establishing New Zealand Green Investment Finance* (December 2018).

[27] Task Force on Climate Related Financial Disclosure "Final Report: Recommendations of the TCFD" (June 2017), available at <https://www.fsb-tcfd.org/publications/final-recommendations-report>.

[28] Mark Carney, Governor of the Bank of England "TCFD: Strengthening the Foundations of Sustainable Finance" (TCFD Summit, Tokyo, 8 October 2019) at 3, available at <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/tcfd-strengthening-the-foundations-of-sustainable-finance-speech-by-mark-carney.pdf?la=en&hash=D28F6D67BC4B97DDCCDE91AF8111283A39950563>.

[29] Guy Debelle, Deputy Governor of the Reserve Bank of Australia "Climate Change and the Economy" (Public Forum hosted by the Centre for Policy Development, Sydney, 12 March 2019), available at <www.rba.gov.au/speeches/2019/sp-dg-2019-03-12.html>.

[30] Geoff Summerhayes, Executive Board Member of APRA "The weight of money: A business case for climate risk resilience" (speech to Centre for Policy Development, Sydney, 14 December 2017), available at <www.apra.gov.au/news-and-publications/weight-of-money-a-business-case-for-climate-risk-resilience>.

[31] Summerhayes, above n 30.

[32] ASIC "19-208MR ASIC updates guidance on climate change related disclosure" (12 August 2019), available at <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-208mr-asic-updates-guidance-on-climate-change-related-disclosure/>.

[33] ASIC "Corporate Governance Task Force: Director and officer oversight of non-financial risk report" (October 2019), available at <https://download.asic.gov.au/media/5290879/rep631-published-2-10-2019.pdf>.

[34] ASX Corporate Governance Council "Corporate Governance Principles and Recommendations" (4th Edition, February 2019), available at <https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf>; Australian Accounting Standards Board And Auditing and Assurance Standards Board "Climate –related and other emerging risk disclosures: assessing financial statement materiality using AASB Practice Statement 2" (December 2018), available at <https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASB_Joint_Bulletin_13122018_final.pdf>

[35] UK Government "Green Finance Strategy: Transforming Finance for a Greener Future" (July 2019) at 23, available at <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf>.

[36] UK Government "Green Finance Strategy", above n 35, at 24.

[37] Bank of England Prudential Regulation Authority "Enhancing banks' and insurers' approaches to managing the financial risks from climate change" (Supervisory Statement 3/19, April 2019).

[38] See for example Phillip Inman "Corporations told to draw up climate rules or have them imposed" *The Guardian* (online ed, 8 October 2019) <https://www.theguardian.com/business/2019/oct/08/corporations-told-to-draw-up-climate-rules-or-have-them-imposed>.

[39] Financial Reporting Council *Guidance on the Strategic Report* (July 2018).

[40] Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018; Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019.

[41] See *Directive 2014/95/EU of the European Parliament and of the Council* (22 October 2014) which required companies to include non-financial statements in their annual reports from 2018 onwards.

[42] European Commission *Guidelines on non-financial reporting: Supplement on reporting climate-related information* (2019/C 209/01), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019XC0620(01)&from=EN>.

[43] PwC *TCFD Final Report, a Summary for Business Leaders* (August 2017), available at <www.pwc.de/de/nachhaltigkeit/pwc-tcfd-final-report-summary-for-business-leaders-august-2017.pdf>.

[44] *Environmental, Social and Governance: NZX Guidance Note* (11 December 2017), available at <http://s3-ap-southeast-2.amazonaws.com/nzx-prod-c84t3un4/comfy/cms/files/files/000/002/940/original/Amended_NZX_ESG_Guidance_Note_-_11_December_2017_%28final_for_publication%29.pdf>.

45 NZX Ltd *NZX Corporate Governance Code* (1 January 2019), recommendation 4.3; Financial Markets Authority *Corporate Governance Handbook* (2018), principle 4.3.

46 New Zealand Government *Transitioning to a low-emissions future - the Government response to the Productivity Commission's Low Emissions Economy report* (Ministry for the Environment, INFO 908, August 2019), available at <https://www.productivity.govt.nz/inquiries/lowemissions>. The report itself was published by the New Zealand Productivity Commission *Low-emissions economy: Final report* (August 2018), also available at <https://www.productivity.govt.nz/inquiries/lowemissions>.

47 The Ministry of Business, Innovation and Employment and the Ministry for the Environment.

48 *Government response* at 5-6.

49 *Government response* at 4. Section 17(2)(a)(iii) of the Financial Reporting Act 2013 permits the Governor-General to authorise the XRB to issue financial reporting standards that relate to the social, environmental, and economic context in which an entity operates.

50 Reserve Bank of New Zealand *Financial Stability Report* (November 2018), available at <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Financial%20stability%20reports/2018/fsr-nov-2018.pdf>. RBNZ is a member of the international body 'Central Banks and Supervisors for Greening the Financial System'.

51 *Financial Stability Report*, above n 50, at 15.

52 Toby Fiennes, Head of Financial System Policy and Analysis at RBNZ, said at a meeting of the Sustainable Insurance Forum (which represents 25 national insurance supervisors): "*The New Zealand insurance sector has acknowledged that it is exposed to climate change risks ... The Reserve Bank will be working with industry and wider stakeholders to develop an appropriate climate risk disclosure framework for New Zealand...*", see <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Financial%20stability/climate-change/Press-Release-Sustainable-Insurance-Forum-Climate-Change-Risk-June-2019.pdf?la=en&revision=41079214-0887-40d7-bf2d-fafa68a00d75>.

53 Felicity Caird "Top five issues for directors in 2019" (17 December 2018) The Institute of Directors in New Zealand (Incorporated) <https://www.iod.org.nz/About-us/News-and-articles/boardroom-articles/Post/20117/Top-five-issues-for-directors-in-2019>.

54 See "Climate change risk" (2019) Chartered Accountants Australia and New Zealand <https://www.charteredaccountantsanz.com/member-services/technical/business-issues/climate-change-risk>.

55 Mercer published its latest climate scenario research and modelling information in a report assessing climate impact and investment returns on portfolio decisions: *Investing in a Time of Climate Change – The Sequel 2019*. BlackRock has developed specific tools for assessing climate-related risks to investment portfolios: <www.blackrock.com/americas-offshore/insights/blackrock-investment-institute/physical-climate-risks>.

56 Principles for Responsible Investment is a global organisation with over 2,300 signatories (including, in New Zealand, ACC and the New Zealand Super Fund) representing USD 85trn in total assets under management.

57 Principles for Responsible Investment, UNEP Finance Initiative "United Nations-convened Net-Zero Asset Owner Alliance", available at <https://www.unepfi.org/net-zero-alliance/>.

58 Institutional Investors Group on Climate Change *Addressing climate risks and opportunities in the investment process: a practical guide for trustees and boards of asset owner organisations* (2018), available at <https://www.iigcc.org/resource/addressing-climate-risks-and-opportunities-in-the-investment-process/>.

59 Investor Group on Climate Change *IGCC in 2022: Investing for a Climate Resilient Net Zero Emission Economy* (June 2019), available at <https://igcc.org.au/wp-content/uploads/2016/04/IGCC-in-2022-investing-for-climate-resilient-net-zero-emissions-economy.pdf>.

60 Matt Whineray and Anne-Maree O'Connor *'How We Invest' White Paper: Climate Change Investment Strategy* (NZSF, March 2019).

61 Paula Rebstock "Statement from ACC Board Chair, Dame Paula Rebstock, to the Parliamentary Education and Workforce Committee" (7 August 2019) ACC <www.acc.co.nz/newsroom/stories/how-we-invest-ethically/>.

62 See Martin Farrer "Activists to ramp up pressure on companies over climate during AGM season" *The Guardian* (online ed, 13 June 2019) <https://www.theguardian.com/australia-news/2019/jun/14/activists-to-ramp-up-pressure-on-companies-over-climate-during-agm-season>.

63 The resolution was unanimously rejected by the Board of Auckland International Airport and received 0.92% support from shareholders. The resolution was also rejected at Meridian's AGM, with around 1.5% support from shareholders. Note that Meridian has since released one of New Zealand's first corporate reports disclosing risks to its business resulting from climate change (including physical risks such as change in rainfall and increased storm events and also transition risks such as increased costs from

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I have been asked to independently review the legal content and conclusions of the accompanying paper. I am satisfied that it provides a comprehensive and accurate assessment of the legal framework within which professional decision makers with fiduciary and statutory obligations may or must take into account climate change considerations.

Yours faithfully

Alan Galbraith

1 The term "*scheme manager*" in this opinion includes the managers of KiwiSaver schemes, workplace savings schemes, and superannuation schemes, as well as all other managed investment schemes registered under the Financial Markets Conduct Act 2013.

2 The IPCC's First Assessment Report released in 1990, and an updated report released in 1992, warned that anthropogenic (man-made) emissions were causing a global temperature rise of about 0.3°C per decade (a more rapid increase than seen over the past 10,000 years), which would result in a global mean temperature of about 2°C above the pre-industrial global mean temperature by 2025. IPCC 1990 and 1992: *First Assessment Report Overview and Policy Maker Summaries and 1992 IPPC Supplement* at 52.

3 IPCC 2018: *Global Warming of 1.5°C: An IPCC Special Report on the impacts of global warming of 1.5° above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty* at [1.2.2].

4 SR15 was prepared by the combined efforts of 541 leading experts in the field of climate change (nominated by governments and IPCC observers), 133 contributing authors, and was subject to multiple rounds of review and revision by 796 individual expert reviewers and 65 governments.

5 United Nations Framework Convention of Climate Change 1771 UNTS 107 opened for signature on 4 June 1992, and entered into force on 21 March 1994.

6 The UNFCCC was adopted at the Rio Earth Summit alongside the Convention on Biodiversity and the Convention to Combat Desertification.

7 UNFCCC, Art 2.

8 UNFCCC, Art 4 sets out state party commitments, including to publish national inventories of emissions and removals of greenhouse gases.

9 Kyoto Protocol to the United Nations Framework Convention on Climate Change 2303 UNTS 162 opened for signature on 16 March 1998, and entered into force of February 2005.

10 Kyoto Protocol, Art 3.

11 The second commitment period (adopted in Doha in December 2012), requires parties to reduce greenhouse gas emissions by at least 18 percent below 1990 levels in the eight-year period from 2013 to 2020. The Doha Amendment only enters into force following acceptance of at least three fourths of the Parties to the Kyoto Protocol (144 countries). As of 18 October 2019, 134 Parties have deposited their instrument of acceptance, and accordingly, none of the committed Parties are yet bound by the Doha Amendment.

12 Paris Agreement, Art 2(1).

13 Art 4(2).

14 Arts 4(9), (12).

15 The public register is accessible online: <https://www4.unfccc.int/sites/ndcstaging/Pages/Home.aspx>.

16 "Nationally Determined Contribution for New Zealand" (5 October 2016), available at <https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/New%20Zealand%20First/New%20Zealand%20first%20NDC.pdf>.

17 Ministry for the Environment, Climate Change Adaption Technical Working Group *Interim Report: Adapting to Climate Change in New Zealand* (December 2017) at 33 and 34.

18 Ministry for the Environment and Statistics New Zealand *Environment Aotearoa 2019* (New Zealand's Environmental Reporting Series, April 2019), available at <www.mfe.govt.nz/sites/default/files/media/Environmental%20reporting/environment-aotearoa-2019.pdf>.

19 Ministry for the Environment, above n 17 and 18.

20 Properly titled the Response to Climate Change (Zero Carbon) Amendment Bill, which would amend the Climate Change Response Act 2002.

21 Climate Change (Zero Carbon) Amendment Bill, cl 5O.

22 An Interim Climate Change Commission was established in April 2018.

23 Ministry for the Environment "Proposed improvements to the NZ ETS" (31 July 2019), available at <www.mfe.govt.nz/climate-change/proposed-improvements-nz-ets>. The reform, in the form of the Climate Change Response (Emissions Trading Reform) Amendment Bill, was introduced in Parliament on

transition to lower emissions technology), which it prepared in accordance with TCFD guidelines: *Climate Risk Disclosures Meridian Energy Limited FY19* (July 2019).

[64] CA 1993, cl 9 sch 1.

[65] CA 1993, s 109.

[66] See for example Sandra Laville "Governments and firms in 28 countries sued over climate crisis – report" *The Guardian* (online ed, 4 July 2019) <https://www.theguardian.com/environment/2019/jul/04/governments-and-firms-28-countries-sued-climate-crisis-report>.

[67] See for example Joana Setzer and Rebecca Byrnes "Global Trends in Climate Change Legislation and Litigation: 2019 Snapshot" (Grantham Research Institute on Climate Change and the Environment, July 2019), available at < http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2019/07/GRI_Global-trends-in-climate-change-litigation-2019-snapshot-2.pdf>.

[68] For example, in *Comer v Murphy Oil* 585 F 3d 855 (5th Cir 2009), Mississippi residents unsuccessfully sued 34 energy companies operating in the Gulf Coast for damage sustained to their property during Hurricane Katrina, arguing that the intensity and magnitude of the hurricane was caused by the defendants' greenhouse gas emissions and contribution to global warming. The District Court dismissed the case on grounds that the plaintiffs had no standing and the claims were non-justiciable political questions. In *American Electric Power Co v Connecticut* 206 F Supp 2d 265 (SDNY 2005), several States unsuccessfully sued a group of companies in nuisance in relation to their combined greenhouse gas emissions. The Supreme Court ruled against the plaintiffs and held that companies cannot be sued for greenhouse gas emissions under federal common law because the Environmental Protection Agency's implementation of the Clean Air Act displaces any federal common-law right to do so. In *Kivalina v ExxonMobil* 663 F Supp 2d 863 (ND Cal 2009) and *Kivalina v ExxonMobil Corp* 696 F 3d 849, 854 (9th Cir 2012), residents of an Alaskan village due to be relocated due to melting ice brought an unsuccessful damages claim for public nuisance against energy producers. The District Court dismissed the case also on grounds that the plaintiffs had no standing and the issues raised were to be considered by the Environmental Protection Agency per the Clean Air Act.

[69] See for example *County of San Mateo v Chevron Corp and others* (No 17CIV03222, Cal, filed 17 July 2017).

[70] *City of Oakland v BP PLC and others* (Case Nos 3:17-cv-06011-WHA, 3:17-cv-06012-WHA, ND Cal San Francisco Division, Judgment filed 25 June 2018).

[71] See for example *Rhode Island v Chevron Corp and others* (No PC-2018-4716 RI Super Ct, filed 2 July 2018). On 22 July 2019, the Federal Court granted the State of Rhode Island's motion to remand the case to State Court. On 1 September 2019, the Federal Court denied the defendants' motion to stay the remand decision pending appeal, but most recently agreed to stay the remand order pending resolution of a stay application to the Supreme Court.

[72] *Lliuya v RWE AG* (2015) Case No 2 O 285/15 Essen Regional Court. The case is currently on appeal. See <http://climatecasechart.com/non-us-case/lliuya-v-rwe-ag/>.

[73] See <www.documents.clientearth.org/library/download-category/climate/>.

[74] *ClientEarth v Enea SA* (District Court in Poznan, IX Commercial Division, 31 July 2019).

[75] See for example *Macquarie Generation v Hodgson* [2011] NSWCA 424, (2011) 186 LGERA 311.

[76] See Gareth Hutchens "Commonwealth Bank shareholders drop suit over nondisclosure of climate risks" (21 September 2017) The Guardian (online ed) <www.theguardian.com/australia-news/2017/sep/21/commonwealth-bank-shareholders-drop-suit-over-non-disclosure-of-climate-risks>.

[77] *McVeigh v Retail Employees Superannuation Pty Ltd* [2019] FCA 14.

[78] *Gloucester Resources Ltd v Minister for Planning* [2019] NSWLEC 7.

[79] See for example Jack Hodder QC "Climate Change Litigation: Who's Afraid of Creative Judges?" (paper presented to the 'Climate Change Adaptation' session of the Local Government New Zealand Rural and Provincial Sector Meeting, Wellington, 7 March 2019), available at <https://www.lgnz.co.nz/assets/Uploads/f488365773/Climate-change-litigation-Whos-afraid-of-creative-judges.pdf> and Sir Geoffrey Palmer QC "Can Judges Make a Difference? The Scope for Judicial Decisions on Climate Change in New Zealand Domestic Law" (2018) 49 VUWLR 191.

[80] Helen Winkelmann, Susan Glazebrook and Ellen France "Climate Change and the Law" (paper prepared for Asia Pacific Judicial Colloquium, Singapore, May 2019).

[81] *Smith v Fonterra Cooperative Group and others* HC Wellington CIV-2019-404-1730, 27 August 2019. By way of disclosure, Chapman Tripp is acting for three of the defendants in these proceedings.

[82] See "Iwi leader to sue government for 'failing to protect Māori' from effects of climate change" *stuff.co.nz* (16 July 2019) <www.stuff.co.nz/environment/climate-news/114278978/iwi-leader-to-sue-government-for-failing-to-protect-maori-from-effects-of-climate-change>.

[83] "Top five issues for directors in 2019" (21 January 2019) Institute of Directors in New Zealand <https://www.iod.org.nz/About-us/IoD-news-and-articles/Post/20146/Top-five-issues-for-directors-in-2019>.

[84] Companies that are members of the Coalition have committed to: (a) measuring their greenhouse gas footprint; (b) having the data independently verified by a third party and making the information publicly available; (c) adopting science-based emissions reductions targets in order to contribute to New Zealand being carbon neutral by 2050; (d) assessing their climate change risks and publicly disclosing them; and (e) proactively supporting their people and suppliers to reduce their emissions.

[85] Unless specified otherwise, a reference to a 'company' is to a New Zealand company, and to a 'director' is to a director of a New Zealand company.

[86] See for example Heath J in *Benton v Priore* [2003] 1 NZLR 564 at [46] and in *EBR Holdings Ltd (in liq) v van Duyn* [2017] NZHC 1698 at [133]–[135]; *Ng v Harkness Law Ltd (No 2)* [2014] NZHC 1667 at [7]–[10]; Susan Watson and Lynne Taylor (eds) *Corporate Law in New Zealand* (online ed, Thomson Reuters) at [16.18.2]; and Peter Watts, Neil Campbell and Chris Hare *Company law in New Zealand* (2nd edition, LexisNexis, Wellington, 2016) at 373.

[87] CA 1993, s 137.

[88] *Daniels v Anderson* (1995) 37 NSWLR 438 (CA) is an Australian case in which the Supreme Court of New South Wales considered the standard of care required of directors at common law (see in particular at 501–505). *Daniels* has been favorably cited by courts and academics in New Zealand (for example, see *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [87] and Watson and Taylor, above n 86, at [16.23.2.1]).

[89] *Daniels v Anderson*, above n 88.

[90] *Daniels v Anderson*, above n 88, at 500, citing *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 (VSC) at 117.

[91] *Daniels v Anderson*, above n 88, at 503 at 502–503, quoting from *Rankin v Cooper* 149 F 1010 (1909) (Fed Ct) at 1013.

[92] *Davidson v Registrar of Companies* [2011] 1 NZLR 542 (HC) at [121].

[93] *R v Moses*, above n 88, at [404] per Heath J.

[94] For example, see *R v Moses*, above n 88, from [419] and *Jefferies v R* [2013] NZCA 188 from [194].

[95] *Mason v Lewis* [2006] 3 NZLR 225 at [83].

[96] *Mainzeal Property and Construction Ltd (in liq) v Yan* [2019] NZHC 255 at [272]. This case is now on appeal. By way of disclosure, Chapman Tripp has represented some Mainzeal directors in the litigation, including the appeal.

[97] NZX Ltd *NZX Corporate Governance Code* (1 January 2019) at 23 and 29; Financial Markets Authority *Corporate Governance Handbook* (2018) at 21–22.

[98] *Wilson & Horton Ltd v Attorney-General* [1997] 2 NZLR 513 at 520, citing *Overseas Tankship (UK) Ltd v Miller Steamship Co Pty* [1967] 1 AC 617 (PC) at 643 per Lord Reid [*The Wagon Mound (No 2)*].

[99] This principle, generally referred to as the "*business judgement rule*", is recognised by New Zealand courts (see for example *Latimer Holdings Ltd v SEA Holdings NZ Ltd* [2005] 2 NZLR 328 (CA) at [71]). This principle – which is really a form of judicial deference, protects directors from liability for negligence simply because, with hindsight, a different action may have been taken. Unlike jurisdictions such as Australia, there is no explicit statutory formulation of the principle in New Zealand law.

[100] For further discussion, see Peter Watts, Neil Campbell and Chris Hare *Company Law in New Zealand* (2nd edition, LexisNexis, Wellington, 2016) at 488–491.

[101] See the discussion from [38].

[102] See the discussion at [54].

[103] See the discussion at [33]–[36].

[104] See the discussion at [44]–[52].

[105] For further discussion of risk management practices, see: in general, "Risk" Institute of Directors in New Zealand <https://www.iod.org.nz/Governance-Resources/Resource-library/Risk>; and, in relation to climate change specifically, World Economic Forum and PwC "How to Set Up Effective Climate Governance on Corporate Boards: Guiding principles and questions" (January 2019) World Economic Forum.

[106] Winkelmann, Glazebrook and France, above n 80, at [117].

[107] Noel Hutley and Sebastian Hartford-Davis "Climate Change and Directors' Duties" (Memorandum of Opinion, 7 October 2016 and Supplementary Memorandum of Opinion, 26 March 2019). This opinion considered the extent to which the duty of care and diligence imposed upon company directors by s 180(1)

of the Corporations Act 2001 (Cth) permitted or required Australian company directors to respond to climate change risks. The directors' duty of care under s 180(1) of the Corporations Act 2001 (Cth) is expressed in very similar terms to section s 137 of the Companies Act 1993.

[108] Hutley and Hartford-Davis, above n 107, at [2].

[109] At [2].

[110] At [2].

[111] At [4].

[112] Winkelmann, Glazebrook and France, above n 80, at [117].

[113] CA 1993, s 138.

[114] See for example *R v Moses*, above n 88, at [81]–[87]; *R v Graham* [2012] NZHC 265 at [30]–[35].

[115] CA 1993, ss 138(1)(a) and (b).

[116] CA 1993, s 138(1)(c).

[117] CA 1993, s 138(2).

[118] Watson and Taylor, above n 86, at [16.18.3.1].

[119] *Holland Corporate Ltd v Holland* [2015] NZHC 1407 at [39] per Duffy J.

[120] See for example Peter Watts *Directors' Powers and Duties* (2nd ed, LexisNexis, Wellington, 2015) ch 6 at 142; and Watson and Taylor, above n 86, at [16.19.3].

[121] Watson and Taylor, above n 86, at [16.18.3.4].

[122] *Hedley v Albany Power Centre Ltd (in liq)* [2005] 2 NZLR 196 (HC) at [64].

[123] For example, see Watts *Directors' Powers and Duties* , above n 120, ch 5.3.2 at 132; and Peter Watts "Judicial review of directors' decisions — another bad idea" [2006] CSLB 75. Watts' argument is that the degree to which directors inform themselves before acting is largely a matter of business judgement.

[124] CA 1993, s 169(3) specifies the duties owed to the company and those owed to shareholders.

[125] In the New Zealand context, contrast, for example, the perspectives of Professor Peter Watts (Watts *Directors' Powers and Duties*, above n 120, at chs 5.3–5.5) with those of Professor Susan Watson (Watson and Taylor, above n 86, at [16.18.4.2–4]).

[126] PM Vasudev "Corporate Stakeholders in New Zealand – The Present, and Possibilities for the Future" (2012) 18 NZBLQ 167 at 176; A Pavlovich and S Watson "Director and shareholder liability at Pike River Coal" (2015) 21 Cant LR 1 at 29; Peter Watts "To whom should directors owe legal duties in exercising their discretion? — a response to Mr Rob Everett" [2019] CSLB 49.

[127] For example, in New Zealand, see Rob Everett "Thinking beyond shareholders" (presentation at the NZ Capital Markets Forum, Wellington, 21 March 2019); and Watts "To whom should directors owe legal duties in exercising their discretion? — a response to Mr Rob Everett", above n 126.

[128] Peter Watts "Shareholder primacy in corporate law — a response to Professor Stout" (ch 2) in P Vasudev and S Watson (eds) *Corporate Governance After the Financial Crisis* (Edward Elgar, England, 2012) at 43; Watts *Directors' Powers and Duties*, above n 120, ch 5.5 at 137; Watts "To whom should directors owe legal duties in exercising their discretion? — a response to Mr Rob Everett", above n 126.

[129] Watts *Directors' Powers and Duties*, above n 120, ch 5.3.1 at 126; Watson and Taylor, above n 86, at [16.18.4.4]; Watts "To whom should directors owe legal duties in exercising their discretion? — a response to Mr Rob Everett", above n 126.

[130] For example, see Rob Everett "Thinking beyond shareholders" (presentation at the NZ Capital Markets Forum, Wellington, 21 March 2019) and Lord Sales JSC "Directors' duties in a post-Hayne world: 'the company' as more than the sum of its shareholders" (Lecture for the 36th Annual Conference of the Banking & Financial Services Law Association, Gold Coast, Australia, 31 August 2019).

[131] Refer to s 172(1) of the UK Companies Act 2006 (an analogue of New Zealand's s 131(1) duty), which requires directors to have regard to factors such as the impact of the company's operations on the community and the environment in their decision-making. There has been much commentary on the impact of this section on directors' duties in the United Kingdom: see for example Lord Sales JSC, above n 130.

[132] Pavlovich and Watson, above n 126, at 29 and 34.

[133] Watson and Taylor, above n 86, at [16.19.2]. See also *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71 at [15].

[134] See for example *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] UKPC 2 and *Eclairs Group Limited v JKX Oil & Gas plc* and *Glengary Overseas Ltd v JKX Oil & Gas plc* [2015] UKSC 71.

135 See for example *Vatcher v Paull* [1915] AC 372, 378 and *Duke of Portland v Lady Topham* (1864) 11 HL Cas 32, establishing the so-called 'fraud on a power' principle. See also, from an administrative law context, *Unison Networks Ltd v Commerce Commission* [2007] NZSC 74, [2008] 1 NZLR 42 at [53] and, from a commercial context, *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 at 460, *British Telecommunications plc v Telefónica O2 UK Ltd* [2014] UKSC 42; [2014] 4 All ER 907 at [37] and *Braganza v BP Shipping Limited* [2015] UKSC 17, [2015] 1 WLR 1661 at [28]-[32].

136 See the discussion at [33]–[36].

137 CA 1993, ss 200–202. Reference to generally accepted accounting practice is to that term as defined in s 2(1) of the CA 1993.

138 CA 1993, s 207G(3).

139 External Reporting Board *New Zealand Equivalent to International Accounting Standard 1 Presentation of Financial Statements (NZ IAS 1)* (November 2012) at [15] and [17], available at <https://www.xrb.govt.nz/dmsdocument/3125> accessed 8 September 2019.

140 CA 1993, s 376(2)(b).

141 NZX Ltd *NZX Listing Rules* (1 January 2019), Rule 3.8.1.

142 NZX Ltd *NZX Corporate Governance Code* (1 January 2019), Recommendation 6.1.

143 NZX Ltd *NZX Corporate Governance Code* (1 January 2019), Recommendation 4.3.

144 CA 1993, s 134. All NZX-listed issuers are required to comply with the NZX Listing Rules and are required to reflect this requirement in their company constitutions (per NZX listing agreement and *NZX Listing Rules* (1 January 2019), Rules 2.18.1, 2.20.1(c)).

145 NZX Ltd *Guidance Note: NZX ESG Guidance* (1 January 2019) at 13.

146 NZX Ltd *NZX Listing Rules* (1 January 2019), Rule 3.1.1.

147 NZX Ltd *NZX Listing Rules* (1 January 2019), Part A – Glossary, definition of "Material Information"; FMCA, s 231(1).

148 NZX Limited *NZX Listing Rules* (1 January 2019), Part A – Glossary, definition of "Aware".

149 FMCA, ss 57, 82.

150 FMCA, ss 510(2), (3).

151 FMCA, s 59(1).

152 The term "*scheme manager*" in this opinion includes the managers of KiwiSaver schemes, workplace savings schemes and superannuation schemes, as well as the managers of all other FMCA-registered managed investment schemes. Some of these schemes are restricted schemes, whose trustees "*managers*" as defined in section 6(1) of the FMCA and therefore have manager responsibilities under section 142(2).

153 Section 170 of the 2019 Act inserts new provisions into the FMCA providing relief for trusts to which the FMCA applies, including a new s 155A. This section (which comes into force at the same time as the 2019 Act) expressly dis-applies (amongst other sections) the sections in the 2019 Act that impose on trustees statutory duties to act honestly and in good faith, to act with due care and skill, to invest prudently, and to act impartially. These duties, as they apply to scheme managers and supervisors, are however effectively replicated (and, in some cases, strengthened) in the FMCA. In general terms, the FMCA Part 4 regime, relating to governance of managed investment schemes, codifies the core standards and duties that apply under trust law and applies them to scheme managers and supervisors.

154 FMCA, s 6: in the case of a managed investment scheme constituted as a trust, "*governing document*" means the one or more trust deeds that constitute the scheme or (in the case of any other managed investment scheme) the one or more deeds, agreements, or instruments that constitute or govern the scheme (for example, a partnership agreement). For the core content requirements for the governing document, see FMCA 2013, s 135-137.

155 Stace and others *Financial Markets Conduct Regulation: A Practitioner's Guide* (LexisNexis NZ, Wellington, 2014) at 178.

156 This standard is mandatory under the FMCA, which trumps the default status of the standard under the 2019 Act (whereby it applies unless contracted out of).

157 See for example the discussion with Harin de Silva, President and Portfolio Manager for Wells Fargo Asset Management's quant unit, Analytic Investors, in Wouter Klijn "Does Your ESG Policy Breach Fiduciary Duty?" (18 September 2019) i3 Investment Innovation Institute, available at <https://i3-invest.com/2019/09/does-your-esg-policy-breach-fiduciary-duty/>. In New Zealand, NZSF has released a CCIS: Matt Whineray and Anne-Maree O'Connor *'How We Invest' White Paper: Climate Change Investment Strategy* (NZSF, March 2019).

[158] If a regulated offer of a managed investment product (ie, an interest in a scheme) is to be made to retail investors, then the scheme must be registered under the FMCA: FMCA s 125(1).

[159] With the exception of 'restricted' retirement schemes, as defined – these are mostly employer- or industry-based workplace savings schemes and some faith-based schemes.

[160] FMCA, ss 127(1)(c) and (d) again, with the exception of restricted retirement schemes.

[161] FMCA, s 142(1).

[162] Or ensures it is held in accordance with the custodian requirements in the FMCA, ss 156–160.

[163] FMCA, s 152(1)(b).

[164] FMCA, s 160.

[165] FMCA, s 164(1).

[166] Examples of standard terms in SIPOs include obligations to regularly review the investment performance of funds and fund managers against their stated performance objectives; review fund underlying portfolios against the manager's own investment and return objectives; and assess fund managers' abilities to contribute successfully to the portfolio's objectives.

[167] FMCA, s 143(2). Unless prohibited by the governing document, managers may contract out the performance of some of their management functions to an investment manager. In doing so, the manager will not be released from liability for the performance of those functions and must take all reasonable steps to ensure that the functions are performed in the same manner and are subject to the same duties as if the manager were performing them directly, and monitor the performance of those functions: FMCA, s 146. We focus in this opinion on scheme managers, who set the investment direction of a scheme and of the fund choices offered to scheme participants.

[168] FMCA, s 143(1)(a).

[169] 2019 Act, s 168. This section amends s 143 of the FMCA to align with the corresponding duty of trustees under the dis-applied s 25 of the 2019 Act.

[170] FMCA, s 143(1)(b)(i).

[171] FMCA, s 143(1)(b)(ii)

[172] FMCA, ss 144(1) and (2).

[173] FMCA, ss 136(1)(a) and (b).

[174] FMCA, s 228(4)(h).

[175] FMCA, s 489(1).

[176] FMCA, s 486(1) (in relation to declarations), s 494(1) (in relation to compensatory orders) and ss 497 and 498 (in relation to other civil liability orders). "*Other civil liability orders*" include orders directing the person in contravention or involved in the contravention to refund fund money, return property to a person who has suffered loss or damage as a result of the contravention, cancelling or varying an agreement or collateral agreement or any other action that the court thinks fit to reinstate the parties to their former positions. The court may also make various orders directing or restraining the exercise of rights of transfer of financial products.

[177] FMCA, s 143(3).

[178] Catalogues of trustee duties were sourced from the 1956 Act, ss 13C and 13D, and also from case law. See Chris Kelly and Greg Kelly "So you want to be a trustee" (paper presented to NZLS CLE Ltd Trusts Conference, Wellington, June 2009) at 31; AS Butler (ed) *Equity and Trusts in New Zealand* (online loose-leaf ed, Thomson Reuters, Wellington, 2009) at ch 5.

[179] 1956 Act (now provisionally repealed), s 13C. Section 13D permitted 'contracting out' of the prudence duty and the limitation of liability clauses.

[180] 1956 Act (now repealed), s 13F.

[181] 2019 Act, s 25.

[182] FMCA, ss 143(1)(a) and 153(1)(a).

[183] 2019 Act, ss 26(a) and (b); FMCA, s 143(1)(b).

[184] 2019 Act, s 27; FMCA, ss 136(1)(a) and (b) and 143(2).

[185] 2019 Act, s 29.

[186] FMCA, ss 144 and 154.

[187] 2019 Act, s 170; FMCA, s 155A. This is because the FMCA provides for an express requirement for all registered schemes to have a SIPO, which sets out the investment powers and objectives of the scheme or relevant fund, which the scheme manager must administer and abide by.

[188] As noted in paragraph [122], above, the FMCA makes it clear that the managers of registered schemes established by trust deed have the same duties and liabilities in the performance of their managerial functions as they would have if they performed those functions as a trustee (except as altered by or inconsistent with the FMCA).

[189] See for example Keith Bryant QC and James Rickards' "The Legal Duties of Pension Funds Trustees and Climate Change" (Joint Abridged Opinion for ClientEarth, December 2016, updated in April 2017); Randy Bauslaugh and Hendrik Garz "Pension Fund Investment: Managing Environmental, Social and Governance (ESG) Factor Integration" (2019) 32(4) Tru LI 264; M Scott Donald, Jarrod Ormiston and Kylie Charlton "The potential for superannuation funds to make investments with a social impact" (2014) 32 CSLJ 540; and Pam McAlister "Are you exposed? Examining the potential liability of superannuation trustee directors for failure to take account of climate change risk" (2015) 31(9) ABFLB 197.

[190] *Merchant Navy Ratings Pension and Anor v Stena Line Ltd and Ors* [2015] EWHC 448 (Ch) [*The Stena*] at [229] per Asplin J.

[191] *Nestle v National Westminster Bank Plc* [1993] 1 WLR 1260 at 1270; *ASIC v Australian Property Custodian Holdings Ltd [No 3]* [2013] FCA 1342 at [485].

[192] *Cowan v Scargill* [1985] Ch 270.

[193] In determining that the union trustees had breached their fiduciary duties, Megarry VC noted that trustees may have strongly held views on particular topics, but under a trust, if investments of this type would be more *beneficial* to the beneficiaries than other investments, the trustees must not refrain from making the investments by reasons of the view that they hold. However, His Honour specifically acknowledged that "*benefit*" has a very wide meaning and may not be solely restricted to a beneficiary's financial benefit, although he thought that such cases were likely to be "*very rare*".

[194] *Cowan v Scargill*, above n 192, at 287; UNEP Finance Initiative "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment" (2005) at 10.

[195] UNEP Finance Initiative "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment" (2005) at 6.

[196] *Cowan v Scargill*, above n 192, at 287.

[197] TG Youdan *Equity Fiduciaries and Trusts* (Scarborough, Carswell, 1989) as cited in UNEP Finance Initiative "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment" (2005).

[198] [1988] SLT 329. Lord Murray ultimately decided that the District Council had breached its fiduciary duties, on the basis that the Council had not made any assessment of whether withdrawing from its South African investments was in the beneficiaries' best interests (and nor had they sought any professional advice).

[199] *Martin v City of Edinburgh District Council* [1988] SLT 329 at 334.

[200] Partially reported at [2007] 3 NZLR 349.

[201] *Kain v Hutton* [2007] NZCA 199 at [30].

[202] *Kain v Hutton*, above n 201, at [31]. The case was appealed to the Supreme Court (*Kain v Hutton* [2008] NZSC 61, [2008] 3 NZLR 589) where it was allowed in part, but the decision of the Supreme Court did not touch on the peripheral best interests issue discussed by the Court of Appeal.

[203] *The Stena*, above n 190, at [229].

[204] *Edge v Pensions Ombudsman* [1998] 2 All ER 547 at 570–571, [1998] Ch 512 at 537 – which concerned not the power of investment, but the proper use of a surplus. On appeal, Richard Scott VC's comments on this issue were cited with apparent approval: *Edge v Pensions Ombudsman* [1999] 4 All ER 546 at 560–561. *Merchant Navy Ratings Pension v Stena Line Ltd*, above n 190, at [231]–[235].

[205] *Edge v Pensions Ombudsman* [1998] 2 All ER 547 at 570–571, [1998] Ch 512 at 537, cited in *Edge v Pensions Ombudsman* [1999] 4 All ER 546 at 560–561 and *The Stena*, above n 190, at [231]–[235].

[206] *Australian Securities and Investments Commission (ASIC) v Lewski* (2018) 132 ACSR 403 (HCA).

[207] *ASIC v Lewski*, above n 206, at [71].

[208] Lord Nicholls of Birkenhead "Trustees and their broader community: where duty, morality and ethics converge" (1996) 70 ALJ 205 at 211.

[209] See for example MM Schanzenbach and RH Sitkoff *The Law and Economics of Environmental, Social, and Governance Investment by a Fiduciary* (Discussion Paper No 971, Harvard Law School, Cambridge, 2018) at 44. Schanzenbach and Sitkoff argue that there is theory and evidence to support risk-return ESG investing, but caution that, particularly given the long term view of environmental, social and governance (*ESG*) investment, the markets will adjust to growing use of ESG so that relative ESG risks become priced

into stocks. This is an issue for scheme managers to assess for themselves, based on their expertise and market knowledge.

[210] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries* (LAW COM No 350, 2014). The Terms of Reference are summarised at [1.14], namely "*(i) investigate how fiduciary duties currently apply to investment intermediaries and those that provide advice and services to them; (ii) clarify how far those who invest on behalf of others may take account of factors such as social and environmental impact and ethical standards; (iii) consult relevant stakeholders; (iv) evaluate whether fiduciary duties...are conducive to investment strategies in the best interests of the ultimate beneficiaries...; and (iv) identify areas where changes are needed.*"

[211] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [5.47], [5.52].

[212] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [6.27], [6.29], [6.30].

[213] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [6.27], [6.32].

[214] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [6.27], [6.34].

[215] Bryant QC and Rickards' Joint Abridged Opinion for ClientEarth, above n 189, at [55].

[216] Bryant QC and Rickards' Joint Abridged Opinion for ClientEarth, above n 189, at [59]-[60]. In addition, we note that last year the UK Department for Work and Pensions found that the then-existing regulatory requirements imposed on trustees were not clearly aligned with the trustees' fiduciary duties in this regard. Accordingly, the UK Secretary of State for Work and Pensions subsequently introduced regulations requiring trust-based pension schemes to have a policy on how they consider financially material ESG factors, including climate change (for further detail, see Explanatory Memorandum to the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018, 2018 no. 988).

[217] Butler, above n 178, at [62.8.2.3].

[218] Butler, above n 178, at [62.8.2.3].

[219] Citing *Harries v Church Commissioners for England* [1993] 2 All ER 300, the Commission agreed that where beneficiaries hold particular religious or social beliefs, acting contrary to those beliefs may not be in the beneficiaries' best interests, even if it is a sensible financial decision: Law Commission *The Duties, Office and Powers of a Trustee; Review of the Law of Trusts* (NZLC IP26, 2011) at [1.46]. Similarly, in *Re BA Vella Trust* [2016] NZHC 1130, the High Court accepted that best interests could encompass considerations that went beyond strict financial gain (in the context of a family trust). In this regard, the NZLC stated that the power to invest, and the duty to do so prudently, "do *not preclude a trustee from taking account of other relevant matters when deciding how to manage a trust fund*" (at [5.7]). For example, the NZLC suggested that there could be good reasons why trustees might want to keep a family home, even though it were not a good investment, or to keep Māori land for future generations. The NZLC recommended that the Trustee Act be amended to clarify that trustees could take account of "*other relevant matters*" when investing, as well as to expressly allow trustees to have regard to their overall investment strategy when investing. However, the Trusts Bill introduced in 2017 did not incorporate the "*other relevant matters*" addition.

[220] The list broadens the considerations beyond those originally inserted into the 1956 Act by the 1988 Trustee Amendment Act. For example, s 13E (inserted pursuant to Trustee Amendment Act 1988, s 3) did not refer to the objectives or purpose of the trust, or overall investment purpose.

[221] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [5.56], [6.23].

[222] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [7.17].

[223] Bryant QC and Rickards' Joint Abridged Opinion for ClientEarth, above n 189, at [46].

[224] NZSF *2019 Climate Change Investment Strategy* at 7 "*We believe that carbon risk is under-priced partly because the time horizon over which the effects will manifest is too long for most market analysts – but it is relevant for the time horizon that matters for the Fund*".

[225] NZSF *2019 Climate Change Investment Strategy* at 10. Note in this regard s 58(2)(c) of the New Zealand Superannuation and Retirement Income Act 2001, which requires the NZSF's manager to invest (and to manage and administer the investments) by reference to avoiding prejudice to New Zealand's reputation as a responsible member of the world community. That is a statutory direction that does not apply to all scheme managers. But the principle that material financial risks should be taken into account is of universal application.

[226] Paula Rebstock "Statement from ACC Board Chair, Dame Paula Rebstock, to the Parliamentary Education and Workforce Committee" (7 August 2019) ACC <www.acc.co.nz/newsroom/stories/how-we-invest-ethically/>.

[227] UNEP Finance Initiative, Principles for Responsible Investment, UN Global Compact "Fiduciary Duty in the 21st Century" (2015). See also UNEP Finance Initiative "Fiduciary Responsibility" (2009) at 61–66, available at <https://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf>.

[228] UNEP Finance Initiative, Principles for Responsible Investment, UN Global Compact "Fiduciary Duty in the 21st Century" (2015) at 9.

[229] This was discussed as a hypothetical possibility in *Cowan v Scargill*, above n 192.

[230] *Harries v Church Commissioners for England*, above n 219.

[231] Note, however, that the Court did state that (at 304) "*where property is* [held by trustees as an investment]*, prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return*". Further, the Court noted that the decision to restrict investments in this case was in part justified because (at 308) "*there has remained open to the commissioners an adequate width of alternative investments.*"

[232] Law Commission (England and Wales) *Fiduciary Duties of Investment Intermediaries*, above n 210, at [6.27], [6.34], [6.57].

[233] See for example P Bennett "Must an occupational pension scheme take into account ESG factors, even if there is a risk of financial detriment to the pension fund" (2019) 32(4) Trust Law Int'l 239 at 239, 256-257 and 262; although the author's financial conclusion does not seem in fact to take issue with a tie-break approach, if there would be no under-performance of the fund in comparison to investing without taking account the putative ESG factor.

[234] Schanzenbach and Sitkoff, above n 209, at 2.

[235] Schanzenbach and Sitkoff, above n 209, at 53.

[236] Bauslaugh and Garz, above n 189, at 266.

[237] Bauslaugh and Garz, above n 189, at 267; unless the governing documents of the fund require consideration of ESG factors by investment decision-makers.

[238] Bauslaugh and Garz, above n 189, at 265.

[239] Which is not a fiduciary duty proper: see for example Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [6.36].

[240] The FMCA requires professional managers to exercise the care, diligence, and skill that a prudent person engaged in that profession would exercise in the same circumstances: s 144. In the 1956 Act, the equivalent duty on professional managers is very similar, but contains a reminder that the trustee is "*managing the affairs of others*": s 13C. The 2019 Act requires: a general duty of care to exercise reasonable care and skill (including special knowledge from an investment professional): s 29 and a more specific duty to invest prudently (to exercise the care and skill that a prudent person of business would exercise in managing the affairs of others, again, including special knowledge from an investment professional): s 30. (As noted above, these 2019 Act duties do not apply to scheme managers and supervisors of registered schemes. This is because the FMCA creates a separate and more prescriptive statutory regime and mandatory duties of care for scheme managers and supervisors, as well as a requirement that a SIPO expressly sets out the investment classes, allocations and performance objectives for the scheme and its relevant funds).

[241] RL Davis and G Shaw *Trustee Investment: The Prudent Person Approach* (2nd ed, Butterworths, Wellington, 1997) at 37.

[242] *Jones v AMP Perpetual Trustee Company NZ Ltd* [1994] 1 NZLR 690 at 706.

[243] *Jones v AMP Perpetual Trustee Co NZ Ltd*, above n 242, per Thomas J at 706*; "[I]t is clear that a trustee is neither an insurer not guarantor of the value of a trust's assets and that the trustee's performance is not to be judged by success or failure, that is, whether he or she was right or wrong. While negligence may result in liability, a mere error of judgment will not."*

[244] Butler, above n 178, at [62.8.2.3].

[245] See s 59 of the Trusts Act 2019. As set out above, these include the objectives or permitted purpose of the trust, the desirability of diversification, the nature of trust investments, the risk of capital loss, the probable duration of the trust, and the trustee's overall investment strategy.

[246] Because the FMCA regime already prescribes detailed governance requirements, including for SIPOs and as to the responsibilities of scheme managers to administer the scheme and its relevant funds in accordance with the governing documents and the SIPO. See the discussion at [119] and above n 187.

[247] See paragraph [125].

[248] Schanzenbach and Sitkoff, above n 209, at 33, referencing the Restatement (Third) of Trusts § 90 (Am Law Inst, 2007).

[249] Butler, above n 178 at [62.8.2.4].

[250] Butler, above n 178 at [62.8.2.3] citing *Re Mulligan (dec'd)* [1998] 1 NZLR 481 at 500.

[251] *Cowan v Scargill*, above n 192, at 289.

[252] C Kelly and G Kelly *Garrow and Kelly Law of Trusts and Trustees* (7th ed, Lexis Nexis, Wellington, 2017) at [21.15].

[253] Butler, above n 178 at [62.8.2.3].

[254] C Kelly and G Kelly, above n 252, at [21.17] citing *Re Whiteley* (1886) 33 Ch D 347 per Lindley J *"the duty of a trustee is not to take such care as a prudent man would take if he had only himself to consider; the duty is to take such care as an ordinary prudent man would take if he was minded to make an investment for the benefit of other people for whom he felt morally bound to provide"*.

[255] UNEP Finance Initiative; Principles for Responsible Investment; UN Global Compact, "Fiduciary Duty in the 21st Century" (2015), available at <https://www.unpri.org/download?ac=1378>.

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Every effort has been made to ensure accuracy in this opinion which is written for the sole benefit of The Aotearoa Circle. The discussion is necessarily generalised and specific legal advice on particular matters should be sought by any other persons or entities.

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