

17 January 2023

Committee Secretariat
Economic Development, Science and Innovation Committee
Parliament Buildings
Wellington

SUBMISSION ON COMPANIES (DIRECTORS DUTIES) AMENDMENT BILL

Introduction and summary

- 1 Lawyers for Climate Action NZ Inc (**LCANZI**) is a registered charity made up of almost 500 lawyers and associate members. Our purpose is to ensure more effective action in New Zealand against climate change. As part of delivering this purpose, we advocate for legislation and policies to ensure Aotearoa New Zealand meets or exceeds its commitment under the Paris Agreement to achieve net zero carbon emissions as soon as possible and no later than 2050. More information about us can be found on our website: <https://www.lawyersforclimateaction.nz/>.
- 2 This submission responds to the Economic Development, Science and Innovation Committee's call for submissions on the Companies (Directors Duties) Amendment Bill (**Bill**), proposing to amend section 131 of the Companies Act 1993 (**Companies Act**).
- 3 In this submission we:
 - (a) support the Bill as useful clarification that directors are not prevented by law from taking account of non-financial factors when determining the best interests of the company. However, we also believe the Bill does not go far enough to achieve the material change in corporate behaviour needed to address the climate emergency without supporting measures or further amendment.

Notwithstanding, we still support progression of the Bill for its potential to generate greater adoption of stakeholder-informed discussion and models in New Zealand governance. We believe that even small changes such as those promoted by the Bill can help Aotearoa transition to a net zero economy;
 - (b) propose amendments to the list of factors directors may turn their minds to under the umbrella of "environmental, social and governance considerations" (notwithstanding that it is drafted as a non-exhaustive list). In particular, we submit that given its critical importance to our society, reference to adaption and mitigation of climate change should be expressly included. This will enable the Bill to better foster business practice that aligns with limiting global warming to 1.5°C.

- (c) propose that, although it may be beyond the scope of the current Bill, further reform should be undertaken to make consideration of environmental, social and governance factors mandatory for directors when determining “best interests of the company”. This could be achieved by:
- (i) amending the Companies Act to clarify that determining “best interests” in section 131 means considering the best interests of the company in the long term; and/or
 - (ii) amending the proposed section 131(5) of the Bill to create an obligation for directors (rather than just a clarification that consideration is permitted) to consider environmental, social and governance factors.

These further changes would better reflect modern thinking on corporate governance and would help to shift focus away from short term thinking and promote more effective social, environmental and climate action decisions, whilst still affording directors wide commercial discretion to govern companies with sufficient freedom to ensure continuing innovation and value creation for shareholders. A precedent exists in s172 of the Companies Act 2006 (UK).

Proposed amended Bill

- 4 We propose that the Bill be amended, if it remains clarificatory only, so that section 131(5) is drafted as followed:

(5) To avoid doubt, a director of a company may, when determining the best interests of the company, take into account ~~recognised~~ environmental, social and governance factors, such as:

(a) recognising the principles of the Treaty of Waitangi (Te Tiriti o Waitangi):

*(b) **identifying, avoiding and** reducing adverse environmental impacts:*

*(c) upholding **human rights and** high standards of ethical behaviour:*

(d) following fair and equitable employment practices:

(e) recognising the interests of the wider community:

(f) the impact of any decision in the long term;

(g) the need to prepare for and adapt to the effects of climate change;

(h) the need to reduce greenhouse gas emissions to mitigate the effects of climate change;

(i) the 2050 target, emissions budgets and emissions reduction plan adopted under the Climate Change Response Act 2002.

- 5 We emphasize that, although we support the progress of the amended Bill as set out above, we would like to see further changes to New Zealand companies law which can deliver greater change in corporate behaviour and accountability, in particular in relation to our climate. Our proposed further changes are outlined below.

Context

- 6 Under the existing section 131 of the Companies Act, directors must act in good faith and what the director believes to be the best interests of the company. The purpose of this duty is to ensure that directors are not pursuing their own self-interest to the detriment of the company when acting in the capacity of director. To the extent that directors are not clearly putting their own interests ahead of the company's, directors are generally given wide discretion as to what constitutes “best interests” of the company. The courts are reluctant to second guess individual business decisions and opinions of directors, who are deemed to be the subject matter experts.
- 7 The Bill’s explanatory note states that the Bill seeks to align with “modern corporate governance theory that recognises that corporations are connected with communities, wider society, and the environment and need to measure their performance not only in financial terms, but also against wider measures including social, and environmental matters.” We support the transition to this more modern theory of governance which we believe will encourage greater consideration of wider matters beyond just profit and growth, often described as stakeholder governance.
- 8 As noted above, directors have very wide discretion in determining how to act in the best interests of the company. It is common for people to confuse the nature of the legal structure (which is not inherently driven by economics) with its activities (which in the majority of cases are about generating profits) and assume that company directors are required to focus solely on profit making. However, companies can (and do) exist for many reasons. For example, a company can have charitable status, which means that it exists for charitable purposes and that it may not distribute profits.
- 9 Technically this means that no law change is required to enable company directors to consider (and prioritise) matters other than profit generation in decision making; shareholder primacy – a corporate governance theory that suggests the financial interests of shareholders are the primary concern of a company – is not a legal requirement in New Zealand. Despite this, we believe that the clarification provided by the Bill will help to dispel lingering misconceptions about the nature of directors’ duties. Further, LCANZI supports Parliament in any initiatives that require companies (as legal persons) to consider and take responsibility for negative impacts caused by their activities – in particular, in relation to climate change.
- 10 The Intergovernmental Panel on Climate Change (**IPCC**) has unequivocally stated that global warming caused by anthropogenic sources is having significant adverse impacts on our planet, including extreme weather events, droughts, flooding, sea level rise and significant loss of biodiversity (amongst other impacts).¹ The frequency and intensity of these events are increasing, with the IPCC noting that immediate and large-scale

¹ See IPCC Sixth Assessment Report, [Climate Change 2021: The Physical Science Basis](#) August 2021.

reductions in global emissions are required to limit global warming to 1.5°C, which will mitigate some of the worst and irreversible adverse effects of climate change. To limit global warming 1.5°C in the near term, the IPCC has estimated that global emissions need to roughly halve between 2010 and 2030.²

- 11 It is therefore essential that businesses identify and then take action on their climate-related risks and opportunities, so that they are not only in a position to respond to climate change but actively participate in decarbonising our economy. In this context, we support movements and initiatives that facilitate New Zealand companies to take approaches and make decisions in a manner that better contemplate their impacts on the climate – both in the immediate and longer-terms. Such existing initiatives include the adoption of mandatory climate related financial disclosures and the related practices of strategizing, governing and setting targets around climate-related impacts.
- 12 As such, we submit that emphasising the focus on long-term interests and greater integration of stakeholder governance principles where the environment and climate are explicitly recognised will aid more effective climate change and encourage directors to:
- (a) understand the importance of educating themselves on wider, non-financial issues relevant to the business – most importantly, climate change;
 - (b) better make decisions that will support (or at least not adversely impact) our ability to keep global warming to as close to 1.5°C as possible; and
 - (c) consider the wider implications of their decisions, including on future generations, when determining what approaches to take.

Support for the Bill

- 13 Provided the amendments to the proposed section 131(5) described further below are included, we support the progress of the Bill. While from a technical legal standpoint this Bill may not significantly change the law, we see merit in providing directors who are uncertain about taking wider, non-financial considerations into account (or are afraid of facing criticism if they do), clarity that they are entitled to take such an approach. The Bill will remove any such uncertainty as a barrier to potential integration of environmental, social and governance considerations by directors.
- 14 We also see that the Bill could act as a catalyst for greater adoption of decision-making practices that better consider wider stakeholder interests. Whilst it does not create an obligation to do so, we anticipate that the Bill may help to advance New Zealand’s business practices towards a more stakeholder driven approach.

² See IPCC Special Report, [Global Warming of 1.5C](#), October 2018.

- 15 However, despite our overall support, in our view the Bill does not go far enough to achieve substantive change in order to address the significant crises – climate, biodiversity, social inequality – that our society is facing. As such, we propose that the Bill (as amended) be passed as an interim measure, acknowledging that adopting more wide-ranging changes to director’s obligations (such as mandating a requirement to consider environmental, social and governance factors in determining best interests – see paragraphs 22 to 36 below) poses a considerable challenge and one that the Committee would likely want to consult on specifically and in more detail before adopting.
- 16 Ultimately, we submit that measures that create additional accountability for directors to inform themselves and contemplate their decisions’ wider impacts on society will promote better climate action and, ultimately, better outcomes for Aotearoa. We encourage the Committee to evaluate any proposed amendments to the Bill and any future reform proposals in this light.
- 17 As indicated in the Institute of Directors’ summary of feedback to its *Stakeholder governance* White Paper,³ one way of creating this greater accountability could be to provide directors with further guidance around what acting in the best interests of the company means in the current day. We support submissions that advocate for development of guidance and training information that supports directors to determine “best interests” of the company with a long-term view. Developing strategies to ensure that a business is climate resilient (including through measuring emissions, having meaningful emissions reduction plans and a climate change strategy) should form a central part of this additional guidance and support materials.

Amendments to proposed section 131(5)

- 18 To be more comprehensive, a number of amendments should be made to the Bill’s list of “environmental, social and governance factors” that directors may consider when determining best interests. We submit the following subparagraphs should be added to the current draft section (the text of the proposed addition is in bold and quotations, followed by our explanatory comment):
- (a) **“(f) the impact of any decision in the long term;”**: short-term thinking is commonly identified as a cause of detrimental and exploitative social and environmental corporate behaviour and, ultimately, behaviour that adversely impacts our climate (and climate action). We believe directors should be actively encouraged to think with a long-term view.

³ See Institute of Directors – *Stakeholder Governance: next steps* – available: <https://www.iod.org.nz/news/articles/stakeholder-governance-next-steps/>.

- (b) **“(g) the need to prepare for and adapt to the effects of climate change;”**: this emphasises the need for companies to identify and understand how they will adapt to climate change impacts.
 - (c) **“(h) the need to reduce greenhouse gas emissions to mitigate the effects of climate change;”**: this recognises the urgent need for New Zealand to reduce our emissions and for companies to contribute to such reductions.
 - (d) **“(i) the 2050 target, emissions budgets and emissions reduction plan adopted under the Climate Change Response Act 2002.”** this reflects the need to promote climate action in Aotearoa and for companies to actively contribute to the transition to a net zero economy. It also underlines that all New Zealand directors should understand what a “net zero” economy is what their company’s role is as part our New Zealand’s wider plan to achieve net zero by 2050.
- 19 Including proposed factors (g) – (i) also recognises that although directors of larger companies and issuers now have obligations to understand, strategize and incorporate climate risks and opportunities in their decision making with the adoption of New Zealand’s climate-related financial reporting regime, the Bill presents an opportunity to promote further climate action and accountability in all companies (no matter their size).
- 20 We also submit that:
- (a) the word “recognised” be removed from paragraph (5). We believe that the reference to “recognised environmental, social and governance factors” adds an unnecessary and potentially contentious qualification that will not assist with clarity or certainty.
 - (b) “identifying, avoiding and...” should be added to the beginning of subparagraph (b) so that it reads “**identifying, avoiding and** reducing adverse environmental impacts”. This broader wording reflects the critical state of our environment, and the dependence of society on environmental resources and ecosystem services for effective functioning.⁴ Related to their need to contribute to effective climate action, businesses should also contribute to environmental remediation to ensure our environment is preserved for future generations.
 - (c) “human rights” should be added to subparagraph (c) so that it reads “upholding **human rights** and high standards of ethical behaviour:”: Although outside the scope of LCANZI’s core climate advocacy work, we believe that human rights poses a critical responsibility for businesses to uphold and one that should be expressly referenced in the Bill.

⁴ See for example, the Stockholm Resilience Centre’s planetary boundaries framework - <https://environment.govt.nz/publications/a-safe-operating-space-for-new-zealand-aotearoa-translating-the-planetary-boundaries-framework/>.

21 The amended section 131(5) the Bill should therefore read:

(5) To avoid doubt, a director of a company may, when determining the best interests of the company, take into account ~~recognised~~ environmental, social and governance factors, such as:

(a) recognising the principles of the Treaty of Waitangi (Te Tiriti o Waitangi):

*(b) **identifying, avoiding and** reducing adverse environmental impacts:*

*(c) upholding **human rights and** high standards of ethical behaviour:*

(d) following fair and equitable employment practices:

(e) recognising the interests of the wider community:

(f) the impact of any decision in the long term;

(g) the need to prepare for and adapt to the effects of climate change;

(h) the need to reduce greenhouse gas emissions to mitigate the effects of climate change;

(i) the 2050 target, emissions budgets and emissions reduction plan adopted under the Climate Change Response Act 2002.

Mandatory consideration of environmental, social and governance factors

22 As discussed above, while we support the Bill, we would like to see stronger measures that go beyond simply clarifying the existing law. In particular, we recommend that in order to create the greatest change in director's behaviour, the Committee should amend section the Companies Act to clarify that acting in the "best interests of the company" does not merely permit but *requires* directors to consider environmental, social and governance factors. We propose amendments to the Companies Act below to effect this change.

23 In this context, we suggest the Committee should consider how the Bill (and related amendments) present an opportunity for New Zealand to become a leader in facilitating companies to take responsibility for their social and environmental impacts, as well as climate action.

24 We recognise that creating an obligation to consider stakeholder interests will initially pose some uncertainty for directors. However, we do not believe such an obligation will have a detrimental or paralysing effect on New Zealand companies. Creating this obligation would ensure that directors must turn to their mind to environmental, social and governance factors, including most importantly, climate change and the long term when making key business decisions, without dictating the outcome of that consideration. Where directors can evidence clear discussion and consideration of the wider impacts of a decision alongside commercial considerations and explain how they have balanced these, directors will be protected from liability. We see this as an important step in making companies accountable for their wider and long-term impacts. Directors would be able to evidence such consideration through board papers and notes, as well as use of tools and other frameworks.

- 25 We suggest that the initial uncertainty created by the new obligation could be abated by guidance and support provided to directors in the lead up to its implementation. Such guidance could include frameworks that illustrate tools for assessing decisions in light of wider stakeholder considerations and managing conflicts in interests.
- 26 We strongly submit that general training resources to upskill directors on core environmental, social and governance matters would also be helpful and support better implementation of this obligation. This is particularly so in respect of climate change, where we believe director knowledge on the impacts of climate change and the transition to net zero economy could be greatly improved.
- 27 The Committee should consider whether appropriate lead in times and/or phased approach to implementation (e.g. depending on the size of the company) could allow the business community to understand and develop comfort around this new obligation.

Amend section 131(1)

- 28 As an additional proposal to the existing Bill, we propose the Committee also consider an amendment to section 131(1) of the Companies Act to provide for directors to act in the long-term interests of the company. We consider this would help to encourage greater weight being given to any adverse human rights, environmental and climate impacts caused by the company, which are likely to carry significant consequences in the long term but tend to be discounted against short term interests. The proposed section 131(1) would read:

*(1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company **in the long term.***

- 29 The proposed section 131(5) as introduced by the Bill would still colour how the best interests in the long term is determined, as currently drafted. Guidance as to what should be appropriately considered long term could be provided in further materials or left for directors to determine more generally in their specific context.
- 30 By explicitly clarifying that best interests requires directors to take a long-term approach, we believe the Bill will better transition directors' mindsets away from near-term thinking and facilitate greater understanding of concepts such as the circular economy as well as how to contribute to company commitments or pledges (particularly in the climate space) that may not need to be met during that director's tenure. This is particularly important given that climate change is an intergenerational problem, with those likely to suffer the worst consequences currently without a voice.

31 Including reference to long term interests would also align with advice from the Australian Institute of Corporate Directors which advises that “acting in the best interests of the company means directors should focus on sustainable value creation over time, rather than short-term profit maximisation.”⁵ We believe this amendment would encourage directors to see their role as stewards of the company assets (in line with the common law role of directors) rather than being driven by shareholder returns.

Amend section 131(5) to be an obligation

32 In addition or alternatively to the proposal above, the new section 131(5) could be extended to *require* directors to consider environmental, social and governance factors when determining the best interests of the company. This could be drafted as:

*(5) To avoid doubt, a director of a company **must** ~~may~~, when determining the best interests of the company, take into account **recognised- the following** environmental, social and governance factors, such as:*

...

33 We believe that this would generate a positive and material impact on director behaviour and more effective climate action by New Zealand companies in the long term. Making it obligatory to include the non-financial factors included in the proposed section 131(4) reflects the position in the United Kingdom (under section 172 of the Companies Act 2006) as well as B Lab’s stakeholder governance clause.⁶ Framing the duty to consider stakeholder interests as proposed would also be consistent with the Better Business Act proposal, currently being advanced in the United Kingdom and supported by over 1,500 UK businesses.⁷

34 Extending how to determine “best interests” in this manner aligns with legal developments in the European Union which seek to create a duty on companies to avoid adverse impacts on stakeholders from both social and environmental perspectives.⁸

35 However, due to the challenges of providing a comprehensive, fit for purpose and generally accepted list of factors that must be considered by directors, we recommend that the Committee consults on this matter specifically and in detail. Any drafting of such a provision must carefully consider:

⁵ See <https://www.aicd.com.au/company-policies/corporate-social-responsibility/examples/best-interests-duty.html>

⁶ See B Lab further details: <https://bcorporation.com.au/wp-content/uploads/2022/09/B-Corp-Legal-Requirement-How-to-Guide-AUNZ-September-2022.pdf>

⁷ See <https://betterbusinessact.org/>.

⁸ See for example France’s Loi de Vigilance and the EU’s Corporate Sustainability Due Diligence Directive proposal: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145.

- (a) who would have standing to sue directors in the event the duty is breached in the future. If the duty to determine best interests remains owed to the company only, it would remain difficult for action to be brought by affected stakeholders who are not shareholders of the company. The Committee should consider whether this appropriately balances the need to incentivise compliance by directors and ensures directors are not overly exposed to potential action; and
- (b) The exact drafting of each factor should be carefully considered and assessed in light of guidance which can be produced to clarify its scope and application. This guidance would also need to illustrate the extent to which common considerations should be considered and weighted, as well as how to robustly balance competing interests. Similarly, this guidance should be used to clarify the scope of any listed factors – in particular those that present the greatest uncertainty such as “upholding high standards of ethical behaviour” and “recognising the principles of the Treaty of Waitangi (Te Tiriti o Waitangi)”.

36 In the context of a climate emergency and the need to urgently transition our economy to net zero, we believe a requirement that mandates directors to, at a minimum, consider the wider impacts of their decisions will have a positive impact on New Zealand’s ability to engage in effective climate action. We see this as an opportunity to empower directors to take positive action that they might otherwise feel constrained from taking as well as creating greater accountability for their important role in mitigating, avoiding and remediating adverse impacts on the environment and society. We believe, where we do not have time to spare, creating an obligation to do so poses the most direct and effective way to promote important and necessary action.

Submitted on behalf of Lawyers for Climate Action NZ Inc. by **Jenny Cooper KC (President), Emma Geard and Frankie McKeefry (Committee Member)**.
