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Government Bonds on trial for climate disclosure in the case: Commonwealth of Australia vs. O'Donnell

Overview

A suit filed by an Australian law student in late July is being billed as Australia's answer to the landmark Urgenda decision in the Netherlands. The plaintiff is arguing that the Australian Government is required to disclose climate change risks associated with government bonds before selling those bonds to investors.

Although in substance different to Urgenda, the case should be on the radar of any institution dealing in long-term financial investments, and could have significant ramifications for directors' duties more generally. The case relates to recent developments that suggest that directors, superannuation funds (and fund managers) and companies also have legal obligations to consider and disclose their exposure to climate-change related risk.

How does it affect you?

Although this case is brought against the Commonwealth of Australia, the relevant legal obligations are very similar to the obligations placed on financial institutions and company directors. This means that the Court's decision in this case will give important insight into what is expected of institutions and directors when it comes to climate change disclosures.

This also means that if the plaintiff is successful, it could open the way for 'copycat litigation' against corporate entities alleging their climate disclosures are inadequate. This serves as a timely reminder to ensure that companies' corporate disclosures at least meet the minimum standards recommended by ASIC and the ASX.

Background

On 22 July 2020, Kathleen O'Donnell filed an Originating Application and Concise Statement in the Federal Court of Australia, naming as respondents the Commonwealth of Australia, the Secretary to the Department of Treasury and the CEO of the Australian Office of Financial Management.[1] Ms O'Donnell is claiming that as long-term investments, exchange-traded Australian Government Bonds (s) face material risks caused by climate change, and that the Commonwealth and its officers are required to disclose those risks to investors.

Ms O'Donnell's claims are based on:

(a) the prohibition on misleading and deceptive conduct set out in the Australian Investments and Securities Commission Act 2001 (Cth);

(b) the common law duty of 'utmost candour and honesty' owed by a promoter to investors; and

(c) the duty of Commonwealth officers to exercise due care and diligence under the Public Governance, Performance and Accountability Act 2013 (Cth) (Public Governance Act).

1 The Concise Statement can be accessed at https://www.equitygenerationlawyers.com/wp-content/uploads/2020/07/200722-Concise-Statement-stamped.pdf.

If successful, Ms O'Donnell seeks declarations that the Commonwealth and its agents breached their duties of disclosure, and injunctions preventing the Commonwealth from promoting eAGBs until it adequately discloses the climate risks associated with them.

Unlike McVeigh v Retail Employees Superannuation Trust, or the Urgenda litigation in the Netherlands, Ms O'Donnell does not claim that the Commonwealth must implement better climate change policies: rather, her claim is confined to the obligation to disclose climate change risks.

The misleading and deceptive conduct claim

Ms O'Donnell is relying on section 12DA of the ASIC Act, which requires that in relation to financial services, a person cannot engage in conduct that is misleading or deceptive or is likely to mislead or deceive. Her argument is that the Commonwealth Government has failed to disclose any information about Australia's climate change risks in Information Statements relating to the issue of eAGBs. As a result of this, and because the Information Statements refer to other risks, Ms O'Donnell argues that the Commonwealth is representing that climate change does not pose a risk to the value of eAGBs, and as a result is engaging in misleading or deceptive conduct.

Currently, the Investor Information Statement published for each bond lists a small number of risks: changes in market price in response to a variety of influences, particularly changes in interest rates; conversion by the Australian Government; and, for indexed bonds, deflation. Ms O'Donnell will need to establish that the omission of climate change from this list would lead investors to believe that it did not pose a threat to the value of eAGBs.

The 'duty of utmost candour and honesty' claim

As an alternative, Ms O'Donnell also claims that because the Government is a promoter of a financial product, it owes a duty of 'utmost candour and honesty' to investors. Relevantly, it must disclose the risks associated with that product in a candid and honest way. This claim is based on the common law, and not on statute.

The case law establishing this duty requires the promoter to disclose all 'information that will influence a prospective participant in the venture to decide whether or not to become an actual participant' where the prospective participant has no other information on the subject than that which the promoter chooses to convey.[2]

Given information that is available to modern investors today concerning climate change and its impacts on Australia, a particular focal point will be on whether the Court will conclude that the Commonwealth will in fact owe these duties to investors.

The Public Governance Act claim

Finally, Ms O'Donnell claims that the Commonwealth's officers breached their obligations under s 25(1) of the Public Governance Act, which requires Commonwealth officers perform their functions with the degree of care and diligence that a reasonable person in their position would exercise. This aspect of the claim is particularly noteworthy because it is brought against the officers themselves.

In general terms, the standard imposed under the Public Governance Act is the same standard imposed on directors by s 180 of the Corporations Act 2001 (Cth) (although public officials are not given the protection of the 'business judgment rule' under s 180(2)).[3] This means any findings the Court makes about the duties of public officials will shed light on the duties of company directors when it comes to climate change disclosures.

It also means that Ms O'Donnell will likely rely on recent developments in legal opinion that directors are in fact required to respond to climate change risks – in particular, a series of recent legal opinions by Noel Hutley SC arguing that climate change is an obvious and foreseeable risk to which directors must respond as part of their general obligations as company directors.[4]

Prospects of success

The claim's prospects of success are naturally difficult to ascertain at this very early stage. Unlike many other climate change-based cases, Ms O'Donnell is relying on well-established law governing financial disclosures, rather than trying to create new law. That being said, some aspects of the claim create obvious difficulties.

The success of the claim will depend on, among other things, the plaintiff's ability to establish that climate change does in fact pose a significant risk to the value of eAGBs; that the Commonwealth's disclosure of such climate risks was inadequate; and that the Commonwealth's failure to refer to climate risks was objectively likely to mislead or

2 Directors, etc of Central Railway Co of Venezuela v Kisch (1867) LR 2 HL 99 at 113; United Dominions Corp Ltd v Brian Pty Ltd (1985) 157 CLR 1 at 5-6 per Gibbs CJ; Fitzwood Pty Ltd v Unique Goal Pty Ltd (in liq) [2001] FCA 1628 at [31], citing Walden Properties Ltd v Beaver Properties Pty Ltd [1973] 2 NSWLR 815, 837-838.
3 https://cpd.org.au/wp-content/uploads/2019/02/CPD-Discussion-Paper-Public-authority-directors-duties-and-climate-change.pdf
4 The Hutley opinions can be accessed at https://cpd.org.au/2019/03/directors-duties-2019/.

deceive a reasonable investor. On the first point, the Court's findings in McVeigh v REST, which is scheduled to be heard in November 2020, will be relevant.

Additionally, Australian courts are typically reluctant to override the Federal Government on matters of policy. In the United States, Juliana v United States of America failed on appeal because the decision considered policy questions outside the Court's scope, even though the Court agreed that climate change posed the risk alleged by the plaintiffs.

However, even if unsuccessful in the broader claim, if the Court agrees that the Commonwealth did owe a duty to disclose climate change risks, that would be significant and probably sufficient for other plaintiffs to bring cases against company directors or financial institutions.

How might this decision impact existing trends?

As noted above, we expect that this decision will have ramifications for the private sector as well as in the public sector, because the duties owed by the Commonwealth are so analogous to those owed by private sector entities. We expect that the decision would be of particular note for two groups.

(a) First, whatever finding the Court makes in respect of this claim could shape the obligations of the rest of the Australian financial market, especially for other long-term investments.

(a) Second, company directors should pay particular attention to the Court's findings regarding the Public Governance Act claim. Although directors will still be protected by the business judgment rule if they make an informed decision not to take steps to reduce climate change risk, they will still be expected to consider those risks carefully and disclose them to the market.

The decision may also provide clarity on the quality of reporting expected of Australian entities if they want to avoid liability. Currently, the major corporate regulators encourage reporting according to the recommendations of the Taskforce for Climate-related Financial Disclosures (**TCFD**). The TCFD recommendations provide a detailed risk reporting structure focused around the analysis of multiple hypothetical scenarios, including a sub-1.5 degree transition and a 'business-as-usual' climate change scenario.

Our Brussels team has explored recent developments in the European Union in a further insight here. In Europe too, non-financial disclosures have become a hot topic, with certain countries such as France adopting extensive climate risk disclosure requirements for companies, and the European Union soon revising its Non-Financial Reporting Directive. In addition to relying on these bases, environmental activists are also leveraging softer forms of regulation such as the OECD Guidelines for Multinational Enterprises to obtain greater reporting commitments on the part of companies. But Europe has yet to see a disclosure case brought against a State as is the case in O'Donnell.

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