Nature-related risks and directors' duties under the law of England and Wales

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Opinion

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A. EXECUTIVE SUMMARY

1. In this Opinion, we analyse the relevance of nature-related risks to directors' duties under English law.[1]

2. Nature-related risks are the potential threats posed to an organisation that arise from its dependencies and impacts on nature.[2] They include but are not limited to climate related risks. A company's dependencies and impacts on nature can have significant effects on a company's ability to operate successfully. A company which is dependent on nature in its operations and /or its supply chain will suffer where the underlying ecosystem on which the company depends is interrupted. Company operations that result in negative impacts on nature can cause the company financial loss, as well as damaging its reputation, goodwill and ultimately its share price. Financial institutions may face increased exposure where borrower companies suffer these types of losses.

3. Nature-related risks can arise in myriad factual scenarios with a wide range of direct and indirect effects on a company. It is increasingly important that directors are aware of relevant risks and factor them into their decision-making processes. A series of recommendations were published in September 2023 by the Taskforce on Nature-Related Financial Disclosures ("**TNFD**") which capture these points and are likely to result in further scrutiny of directors' responses to nature-related risks.

4. Against that backdrop, we have analysed in this Opinion the relevance of nature-related risks to three distinct aspects of the role of directors in this jurisdiction:

    4.1. The duty to promote the success of the company for the benefit of the members as a whole (s.172 CA 2006);

    4.2. The duty to act with reasonable care, skill and diligence (s.174 CA 2006); and

    4.3. The obligations on directors to disclose information about the company in its narrative reports.

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[1] This Executive Summary is not intended to replace any of the analysis contained in our Opinion, nor to be relied upon as legal advice with respect to any specific factual scenario or director or company with respect to or at all. The terms set out at paragraph 6 also apply.

[2] Nature-related risks are defined by reference to the recommendations of the Taskforce on Nature-related Financial Disclosures.

5. The duty to promote the success of the company under s.172 CA 2006 is a duty of loyalty which is broad and flexible. Section 172 contains a non-exhaustive list of factors to which a director should have regard when determining how to promote the success of the company. These factors are intended to reflect a concept of 'enlightened shareholder value', which focuses on long-term success for the benefit of members as a whole, and extends beyond mere financial considerations. The list of factors in s.172 expressly states that a director should have regard to "*the impact of the company's operations on … the environment*" which we consider encompasses nature-related risks.

6. The standard applied in s.172 is ordinarily a subjective one; whether the director honestly believed that the relevant act or omission was in the interests of the company. However, a director who gives no consideration to whether specific actions or omissions promote the success of the company risks being held to a higher, objective standard.

7. The duty to act with reasonable care, skill and diligence under s.174 CA 2006 is an objective one. Further, a director will be judged by a higher standard if their own general knowledge, skill and experience is higher than that of a reasonable director in their position.

8. We consider that nature-related risks fall within the category of risks to which a director ought to have regard when discharging their duties under s.172 and 174. Although the relevance of nature-related risks to a company is a fact sensitive question, it is easy to envisage circumstances where the success and best interests of a company (whether in the short or long term) can be affected by nature-related dependencies or impacts to which the company is exposed.

9. In our opinion, it would be prudent for directors to identify the nature-related risks facing their company; assess which of those risks are relevant and non-trivial; take expert advice where appropriate; decide in good faith whether a course of action is appropriate to mitigate those risks and take such steps accordingly; and record their decision making process in writing. Directors who fail to give consideration to relevant non-trivial nature-related risks, and take appropriate steps to mitigate them, may be exposed to claims that they have acted in breach of duty.

Disclosure Requirements

10. In relation to disclosure of information by the company in its narrative reports, the English disclosure framework is highly complex and fact-sensitive. The rules are contained in legislation (both national and, for some companies, at an EU level), regulatory guidance and accounting standards. The scope of a company's precise reporting obligations depends on several factors, such as the company's size, the character of its business and whether it is public or private. Directors should therefore seek expert advice from legal and accounting professionals as to what must be disclosed as a matter of law.

11. The current disclosure regime is largely focussed on climate-related matters, reflecting the implementation of the Taskforce on Climate-Related Financial Disclosures (TCFD) Recommendations. The TNFD recommendations were only released recently and have not yet been formally adopted into the disclosure regime.

12. Nonetheless, under the current regime, certain companies are required to disclose environmental matters which are necessary for understanding the development, performance or position of the company's business. We consider that this includes types of nature-related risks as set out in our Opinion below. Recently published regulatory guidance suggests that such disclosure should encompass not only matters which are financially material to the company but also matters where the company has a material impact on nature.

13. Directors are given a degree of protection in relation to deficient disclosure and liability under the regime is not easy to establish. However, a serious failure to comply with an obligation of disclosure is likely to have reputational consequences for a company, given the increasing public scrutiny in this area.

B. INTRODUCTION

1. The interaction between companies and nature is a rapidly evolving area. Boards are under increasing scrutiny with regards to the relationship between their companies and nature. Minority shareholders are seeking to bring derivative actions on behalf of their companies against the board of directors with respect to alleged failures concerning climate and nature-related matters. A host of supra-national NGOs and quangos are publishing guidance, recommendations and other documents concerning how directors should best manage risks relating to the climate and nature more broadly. Institutional investors are increasingly scrutinising board action and inaction in relation to nature-related matters when making investment decisions.

2. In short, the risk that directors will be challenged in respect of alleged failures to identify and manage nature-related risks (which encompass but are broader than climate-related risks) has never been higher.

3. Given both the speed and the extent of national and international developments in this area, there remains uncertainty as to what exactly, as a matter of law, is expected of directors in relation to their management of the relationship between their companies and nature.

4. In that context, we have been instructed to advise on the extent to which nature-related risks are relevant to the scope and discharge of directors' duties as a matter of English law. Specifically, we have been instructed to consider the following questions:

   4.1. Are nature-related risks relevant to directors' duties to promote the success of their company and to act with reasonable care, skill and diligence under ss. 172 and 174 Companies Act 2006 ("**CA 2006**") respectively?

   4.2. Are directors currently required to consider whether nature-related risks intersect with the interests of their company?

   4.3. What forms of board action and inaction in respect of nature-related risks might either discharge or breach the duties under ss. 172 and 174, and could directors who fail to consider nature-related risks be found liable for breaching those duties?

4.4. Are directors who perceive that nature-related risks do in fact present risks to their company permitted and/or required to disclose those risks? Further, are they required to take any action to mitigate those risks?

4.5. What impacts might the recommendations of the TNFD have on the interpretation of directors' duties?

5. In order to answer those questions, we have divided this Opinion into four main sections:

5.1. In Section C, we provide an overview of nature-related risks and their relationship with companies under the law of England and Wales.[3] We also define the concepts which are integral to this Opinion, including the concept of nature-related risks, which is central to our analysis.

5.2. In Section D, we analyse the relationship between nature-related risks and directors' duties under ss. 172 and 174.

5.3. In Section E, we analyse the relationship between nature-related risks and the disclosure regime in this jurisdiction.

5.4. In Section F, we set out our conclusions.

6. The scope for companies to be exposed to nature-related risks is significant. Such risks can arise in relation to all manner of companies, from single director-shareholder enterprises to multinational listed companies. They can also arise in an array of factual scenarios. Nothing in this Opinion should therefore be relied upon as legal advice with respect to any specific factual scenario or director or company. Our analysis is deliberately and necessarily set at a high level of abstraction with a view to identifying broader principles. It is not, and cannot be relied upon as, a substitute for individual legal advice. Directors, boards and companies that need to understand more about the nature-related risks to which their companies are or may be exposed should obtain advice which is specific to their individual situation. Further, the question of what disclosures a company is required to make in financial statements and narrative reporting is a highly complex and technical one, requiring consideration of a variety of different regimes in the context of the size and characteristics of any particular company.

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[3] For reasons of brevity, this is referred to in this Opinion as English law.

Specialist advice should be sought in this area as well. No duty or liability is assumed to any reader of this Opinion.

C. NATURE-RELATED RISKS AND THEIR EFFECTS ON COMPANIES UNDER THE LAW OF ENGLAND

C.1. INTRODUCTION AND KEY CONCEPTS IN THIS OPINION

7. In order to assess how nature-related risks might have implications for directors of companies subject to English law, whether in respect of their obligations with regards to the discharge of the duties they owe to their companies under ss. 172 and 174 CA 2006 or disclosure, we consider that it is first helpful to set out by way of overview what effect nature-related risks might have on such companies generally.

8. The first step is to define the concept of nature-related risks. Throughout this Opinion, we rely on concepts which are derived from or defined in the Recommendations of the TNFD dated September 2023 (the "**TNFD Recommendations**"). Nature-related risk is an integral concept in the TNFD Recommendations and is defined as: "*Potential threats (effects of uncertainty) posed to an organisation that arise from its and wider society's dependencies and impacts on nature.*"[4] Dependencies and impacts are in turn defined in the TNFD Recommendations as follows:

    8.1. "**Nature-related impacts**" are "*changes in the state of nature (quality or quantity), which may result in changes to the capacity of nature to provide social and economic functions. Impacts can be positive or negative. They can be the result of an organisation's or another party's actions and can be direct, indirect or cumulative. A single impact driver may be associated with multiple impacts*".[5]

    8.2. "**Nature-related dependencies**" are "*aspects of environmental assets and ecosystem services that a person or an organisation relies on to function. A company's business model, for example, may be dependent on the ecosystem services of water flow, water quality regulation and the regulation of hazards like fires and floods; provision of suitable habitat for pollinators, who in turn provide a service directly to economies; and carbon sequestration*".[6]

9. Nature-related risks can be classified as:

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[4] TNFD Recommendations, p. 131.
[5] TNFD Recommendations, p. 122.
[6] TNFD Recommendations, p. 115.

9.1. "**Nature-related physical risks**", which are "*risks resulting from the degradation of nature (such as changes in ecosystem equilibria, including soil quality and species composition) and consequential loss of ecosystem services that economic activity depends upon. These risks can be chronic (e.g. a gradual decline of species diversity of pollinators resulting in reduced crop yields or water scarcity) or acute (e.g. natural disasters or forest spills). Nature-related physical risks arise as a result of changes in the biotic (living) and abiotic (non-living) conditions that support healthy, functioning ecosystems. These risks are usually location-specific.*"[7]

9.2. "**Nature-related systemic risks**", which are "*risks arising from the breakdown of the entire system, rather than the failure of individual parts. Nature-related systemic risks are characterised by modest tipping points combining indirectly to produce large failures and cascading interactions of physical and transition risks. One loss triggers a chain of others and stops systems from recovering their equilibrium after a shock. Nature-related systemic risk covers more than only risk to a financial system (i.e. financial stability risk). It also covers the risks from the breakdown of natural systems (i.e. ecosystems).*"[8]

9.3. "**Nature-related transition risks**", which are "*risks to an organisation that stem from a misalignment of economic actors with actions aimed at protecting, restoring and/or reducing negative impacts on nature. These risks can be prompted, for example, by changes in regulation and policy, legal precedent, technology, or investor sentiment and consumer preferences. They can also arise from activities aimed at restoring nature that no longer align with, for example, revised policies.*"[9]

10. Those three concepts (nature-related risks, impacts and dependencies) are central to our analysis. However, we also refer in the course of this Opinion to the following concepts:

10.1. "**Biological Diversity** or **Biodiversity**", which is "*the variability among living organisms from all sources, including, inter alia, terrestrial, marine and other*

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[7] TNFD Recommendations, p. 131.
[8] TNFD Recommendations, p. 132.
[9] TNFD Recommendations, p. 132.

aquatic ecosystems and the ecological complexes of which they are part; this includes diversity within species, between species and of ecosystems."[10]

10.2. "**Ecosystem services**", which are "*the contributions of ecosystems to the benefits that are used in economic and other human activity*."[11]

10.3. "**Natural Capital**", which is "*the stock of renewable and non-renewable natural resources (e.g., plants, animals, air, water, soils, minerals) that combine to yield a flow of benefits to people*".[12]

10.4. "**Drivers (of biodiversity loss or change)**", which are "*all those external factors that affect nature, anthropogenic assets, nature's contributions to people and good quality of life. They include institutions and governance systems and other indirect drivers, and direct drivers (both natural and anthropogenic)*."[13]

11. There are five drivers of biodiversity loss: climate change; changes in land and sea use; direct exploitation of organisms; pollution; and invasion of alien species.[14] Of the risks arising from these drivers, it is probably right to say that climate-related risks have tended to generate the most public scrutiny and understanding to date. They were addressed in recommendations made by the Task Force on <u>Climate</u>-Related Financial Disclosures (the "**TCFD Recommendations**"). The TNFD Recommendations have adopted and built upon the TCFD Recommendations, addressing a wider breadth of nature-related risks that companies may be exposed to. This recognises that nature-related risks are broader than, and encompass, climate-related risks.

12. Finally, we also refer below to the concept of materiality, especially in the context of corporate disclosures. In line with the TNFD Recommendations, we distinguish between 'financial' materiality and 'broader' or 'impact' materiality as follows:

12.1. "**Financial Materiality**" is derived from International Financial Reporting Standard S1 ("**IFRS S1**") as follows: "*An entity shall disclose material information about the sustainability-related risks and opportunities that could*

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10 UN Convention on Biological Diversity (1992), Article 2.

11 TNFD Recommendations, p. 118.

12 See the Natural Capital Protocol (2016), p.12.

13 Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services, Summary for policymakers of the global assessment report on biodiversity and ecosystem services (25 November 2019), pp. 12, 51.

14 Ibid.

reasonably be expected to affect the entity's prospects. In the context of sustainability-related financial disclosures, information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity."[15]

12.2. "**Broader** or **Impact Materiality**" is defined in two ways; it refers to "*topics that represent its most significant impacts on the economy, environment and people, including impacts on their human rights*" or "*information that pertains to an* [undertaking's] *material actual or potential, positive or negative impacts on people or the environment over short, medium and long term.*"[16]

13. Having set out those central concepts, we turn to providing an overview of their relationship with directors' duties. In summary, the scope of a director's role and duty will be shaped by the risks facing their company. This includes any nature-related risks. The nature-related risks which a company faces will always be fact-specific, depending on the type, scope and location of that company's activities. There is an array of nature-related risks to which a company operating or registered[17] in England could find itself exposed. We set out below a high-level summary of the nature-related dependencies and impacts that such a company might face.

C.2. NATURE-RELATED DEPENDENCIES

14. Nature-related dependencies are clearly relevant to the proper management of a company. Two variables are particularly important: (i) the extent to which a company is dependent on natural capital, including biodiversity and associated ecosystem services, for financial success; and (ii) the current and future state of those natural capital assets.

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[15] Global Reporting Initiative (2021) GRI 1: Foundation 2021, Section 2.2.

[16] European Sustainability Reporting: Standard Commission Delegated Regulation supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards', Annex 1, p. 7. The TNFD change the word "*undertaking*" with the word "*organisation*" in the TNFD Recommendations.

[17] A legal distinction must be drawn between companies which operate in England and those which are incorporated here. Although those two categories overlap, they can be subject to different legal rules and regulations. Nevertheless, both types of companies may find themselves exposed to nature-related risks, by virtue either of their incorporation or their operation in England.

15. Generally speaking, the proper functioning of the global economy is to a significant extent reliant on natural capital, including biodiversity and associated ecosystem services. Analysis by PwC and the Swiss Re Institute concluded that 55% of global GDP is highly or moderately dependent on biodiversity and ecosystem services.[18]

16. Internal analysis carried out by the Bank of England in 2022 found 52% of UK GDP and 72% of the stock of UK lending to be dependent on ecosystem services.[19] Analysis carried out in 2019 by the Nature Capital Finance Alliance found that 74% of sectors covered by the UK FTSE All-Share Index, were highly dependent on natural capital.[20]

17. The physical risks a company may face will turn on the characteristics of its dependencies. Some of these risks may affect companies on a global scale. For example:

    17.1. A food wholesaler operating in this jurisdiction would suffer from declines of ecosystem services on arable land from which it sources its products.

    17.2. An agricultural business can face risks from invasive species such as Asian hornets killing pollinators, which can in turn affect large fast-moving consumer goods companies further up the supply chain.[21]

    17.3. The decline of local wildlife that had previously attracted visitors could harm a company in the tourism industry.

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[18] PwC, Managing Nature Risks: From Understanding to Action (19 April 2023), p.3. Swiss Re Institute, Biodiversity and Ecosystem Services: A business case for reinsurance (28 August 2020), p. 32.

[19] Bank of England, The nature of risk – speech by Sarah Breeden (6 September 2022). We understand that these estimates are expected to be updated imminently in a more comprehensive public study currently being conducted by the Green Finance Institute, supported by Defra and the Bank of England, and alongside the UN Environment Programme World Conservation Monitoring Centre and the Universities of Oxford and Reading, which will estimate the scale of nature-related financial risks to the UK economy: Green Finance Institute, UK economy's nature-related risk to be assessed for the first time (5 April 2023). The Green Finance Institute published an update, UK Nature-Related Risk Analysis Update, on 28 February 2024 giving a summary of how the Nature-Related Risk Inventory which they are in the process of compiling was developed, and an overview of its content. Included is an infographic summarising the Institute's assessment of the likelihood of a range of nature-related risks affecting the UK economy and financial system in the years to 2050 and assessing the impact that those risks would have.

[20] Natural Capital Finance Alliance, Blog, New Analysis of Natural Capital Dependencies Launched in London as central banks warn of 'obvious physical risks' (2019); Edie, Three-quarters of UK FTSE All-Share firms 'highly dependent' on natural capital (29th April 2019). Further information on the same underlying analysis is available at https://globalcanopy.org/press/groundbreaking-new-tool-enables-financial-institutions-to-see-their-exposure-to-natural-capital-risk/, including market capitalisation figures and detail on sectors. See also the UN Environment website: https://www.unep-wcmc.org/en/news/groundbreaking-new-tool-allows-financial-institutions-to-see-their-exposure-to-natural-capital-risk.

[21] Cambridge Institute for Sustainability Leadership (CISL), Fauna & Flora International, University of East Anglia, & UNEP-WCMC, The pollination deficit: Towards supply chain resilience in the face of pollinator decline (2018) pp.9 and 17.

17.4. Companies in the UK food production sector are highly dependent on soil health, which is essential for producing crops and livestock. The UK Government Department for Environment, Food & Rural Affairs estimates that "*soil degradation, erosion, and compaction result in losses of about £1.2 billion each year and reduce the capacity of UK soils to produce food.*"[22] This dependency on soil health could therefore result in reduced access to, or higher costs for, key commodities required as inputs for food producers, manufacturers, retailers and financiers in the supply chain.

17.5. Many UK horticultural and agricultural producers are dependent on pollinators for their products, whether fruit, vegetables or arable crops. A reduction in supply may arise as a consequence of the (continued) general decline in pollinators and lead to negative financial effects on both the horticultural/agricultural producers, and the companies in the supply chain which are dependent on the affected products.[23]

17.6. The UK Environment Agency estimates that around 1.9 million homes in England are at risk of coastal flooding. Banks and building societies with mortgages over those homes risk suffering financial losses if natural resilience against erosion fails (such as through a decline in coastal habitats which help to protect against erosion).[24]

17.7. These real economy risks can in turn extend to the financial sector, for example, through exposure to increases in defaults, collateral depreciation, repricing of assets and increased insured losses.[25]

18. Companies can also face transition risks, including as a result of legislation, regulation and policy, legal precedent, technology or investor sentiment and consumer preferences which restrict use of ecosystem services on which they were previously dependent. One example of legal transition risks arising from nature-related dependencies is the government's announcement that it intends to pass regulations under Schedule 17 of the

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[22] United Kingdom Food Security Report 2021: Theme 2: UK Food Supply Sources - GOV.UK (www.gov.uk).

[23] Cambridge Institute for Sustainability Leadership (CISL), The pollination deficit: Towards supply chain resilience in the face of pollinator decline (2018).

[24] Cambridge Institute for Sustainability Leadership (CISL), Physical risk framework: Understanding the impacts of climate change on real estate lending and investment portfolios (2019).

[25] Network for Greening the Financial System, Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors (September 2023).

Environment Act 2021, prohibiting businesses operating in this jurisdiction from using key forest-risk commodities, such as soy, cocoa, palm oil and cattle products, produced on illegally occupied or used land.[26] Legislation passed outside this jurisdiction can also pose transition risks for English companies trading internationally. Taking the same example, the EU Deforestation Regulation (2023/1115) places due diligence requirements on companies in the UK selling specified products in the EU to ensure that they are "deforestation free"; a burden which is in fact higher given that under this Regulation, the deforestation in question does not need to be illegal under the law of the country in which it has occurred.[27]

19. Finally, companies might also face more serious nature-related systemic risks[28] as part of their nature-related dependencies. An example of this might be an aircraft manufacturing company which is heavily dependent on sourcing conductive rubber for aircraft tyres.[29] Almost all conductive rubber in the world is sourced from rubber trees grown in monoculture plantations in tropical Asia. Through its supply chain, the aircraft manufacturer is therefore dependent on a product which is derived from a limited geographical location.[30] If those rubber trees were subject to a catastrophic systemic event (such as widescale destruction by an invasive parasitic species) the aircraft manufacturer, any companies providing lending or other financial services to the manufacturer and the aviation industry as a whole are likely to suffer significantly.[31]

20. In short, nature-related dependencies are capable of affecting a wide range of companies in different factual contexts. By extension, they can in principle be relevant to the role and function of a company's directors.

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[26] Written Statement of the Secretary of State for Environment Food and Rural Affairs, 12 December 2023, HCWS117. Existing regulations cover the use of illegally sourced timber: see the Timber and Timber Products (Placing on the Market) Regulations 2013.

[27] Such transition risks can also arise from a company's impacts on nature, as discussed below.

[28] Defined in the TNFD Recommendations, p.132.

[29] Rousset et al., MDPI Molecules, Guayule (Parthenium argentatum A. Gray), a Renewable Resource for Natural Polyisoprene and Resin: Composition, Processes and Applications (2021).

[30] CCLI, Biodiversity Risk: Legal Implications for Companies and their Directors (13 December 2022), p.32.

[31] Oghenekome Onokpise and Clifford Louime, MDPI Sustainability, The Potential of the South American Leaf Blight as a Biological Agent (2012).

C.3. NATURE-RELATED IMPACTS

21. A company may also be susceptible to physical and transition risks arising from its nature-related impacts. Where a company's activities have a negative impact on nature, this can in turn expose the company to significant financial and other business risks. These risks can arise in various contexts, which we outline below.

C.3.1. Impact on own operations, supply chain and more general financial impacts

22. A company's activities that cause nature-related impacts can negatively affect the company's own operations, both directly and indirectly. For example:

    22.1. Nature-related impacts can have a direct effect on a company's ability to continue its current operations. A company that engages in overfishing may deplete the local population such that it cannot continue its fishing activities in that location.

    22.2. Nature-related impacts might also have more general financial consequences for a company. BloombergNEF published a report in December 2023 which analysed 10 case studies of companies which had suffered material financial losses as a result of various nature-related risks. One such company which had suffered as a result of its nature-related impacts was a meat producer which had purchased cattle from illegally deforested land in the Amazon. In addition to incurring financial penalties, various NGOs are working to block the company's attempts at a public listing, which (if successful) BloombergNEF estimates could prevent a $20 billion gain in market capitalisation.[32] Another example given was a plastic and petrochemical supplier whose discharge of plastic pellets into waterways in Texas had resulted in the revocation of permits for the construction of a $9.4 billion industrial complex.[33]

    22.3. Nature-related impacts can also negatively affect a company's supply chains. If a company causes serious and extensive pollution to a local ecosystem or an area from which it sources natural capital, that impact will cause direct financial

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[32] BloombergNEF, When the Bee Stings: Counting the Cost of Nature-Related Risks (December 2023), pp. 37 - 40.

[33] Ibid., pp. 29 – 32.

harm to the company by increasing operating costs and/or decreasing supply of its manufacturing capital.

C.3.2. Exposure to civil claims

23. A company's impacts may expose it to civil claims for damages. In England, claims for damages cannot be brought on behalf of nature itself.[34] Instead, a claim has to be brought by a natural or corporate person who has suffered harm as a result of the company's impacts on nature. Where such a claim is brought under English law these are likely to fall into the following categories:

    23.1. Private nuisance: Where the company's nature-related impacts have caused a substantial interference to a person's enjoyment of their rights in land, and the company's impacting activities are not themselves an ordinary use of land, then the affected person may have a claim against the company in private nuisance for diminution in the utility and amenity value of their property.[35] Injunctive relief remains the primary remedy, but awards of damages in lieu are increasingly common. A subcategory of private nuisance referred to as Rylands v Fletcher liability exists where a company collects and keeps on their land a substance that if it escapes is likely to do harm. In such circumstances the company is, subject to certain defences, strictly liable for damage caused by the escape of said substance.[36]

    23.2. Public nuisance: Claims in public nuisance arise where a company acts in a manner not warranted by law or breaches a duty such as to "*endanger the life, health, property morals or comfort of the public, or to obstruct the public in the exercise or enjoyment of rights*."[37] A person who has suffered particular loss or

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34 Only natural and corporate persons have standing to sue under English law: see Moosun v HSBC Bank [2015] EWHC 3308 (Ch) at [10]. In some other jurisdictions, flora and fauna have been recognised as having legal personality. See, for example, the decision of the Uttarakhand High Court in India in Lalit Miglani v. State of Uttarakhand MANU/UC/0067/2017.

35 Fearn & ors v Board of Trustees of the Tate Gallery [2023] UKSC 4; [2024] AC 1 at [9]-[27] *per* Lord Leggatt JSC (giving the judgment of the majority at [1]-[133]).

36 Rylands v Fletcher (1865-66) LR 1 Ex 265, p.279-280, but explained by more recent decisions as an extension of the law of nuisance to isolated escapes of dangerous things, and diluted by various restrictions: Cambridge Water Co Ltd v Eastern Countries Leather Plc [1994] 2 AC 264 at 306 (a claim concerning a seepage of solvent from a tannery failed due to lack of foreseeability); Transco v Stockport MBC [2003] UKHL 61; [2004] 2 AC 1 at [9], [27], [52] (leakage of a large quantity of water from a pipe used to supply a block of flats, again the claim failed on the facts).

37 Re Corby Group Litigation [2008] EWCA Civ 463 at [25]-[26].

damage, over and above the impact suffered by the general public, may sue. Unlike private nuisance, there is no requirement that the loss or damage be to a property right. Further, the Attorney General may bring an action for an injunction, or a local authority acting under s. 222 Local Government Act 1972 may sue without the concurrence of the Attorney General.

23.3. Negligence: Where a company owes a person a duty to act with reasonable care and skill, and the company's nature-related impacts have caused that person harm in breach of this duty, the victim of the tort would be able to bring a tortious claim in negligence. In certain cases, legislation has been passed to widen the duty of care owed to include environmentally harmful activities. An example of this is the duty of care imposed towards persons harmed by the handling of waste under ss. 34 and 73(6) Environmental Protection Act 1990.

23.4. Contractual claims: It is becoming increasingly common for companies to include environmental and sustainability warranties in contracts, loan agreements, share purchase agreements, and M&A contracts. If these warranties prove to be false, the counterparty may be able to bring a claim for damages in breach of contract.[38]

24. In order for a company to be held liable in damages for any such claims, it would be necessary for the claimant to show that the company's unlawful acts or omissions had caused them loss. Under English law, this is normally assessed on a "but for" test:[39] would the harm have happened but for the defendant's actions? This is relatively straightforward to establish where a direct nature-related impact of the company is alleged to have been the sole cause of the claimant's loss.

25. However, in the case of cumulative impacts, where the company is one of potentially many contributors to the harm suffered, it may be difficult to prove that any specific actor caused the harm on a "but for" basis. This remains a developing area of the law but the courts have, on occasion, departed from a "but for" test on causation where it would lead to an unjust outcome. In such cases, the court may take into account the

[38] For a recent example of this, see MDW Holdings Limited v Norvill [2021] EWHC 1135 (Ch); [2022] EWCA Civ 883 where claims for breach of environmental warranties were brought in relation to the purchase of shares in a waste disposal company.

[39] Subject to any applicable questions of remoteness, mitigation etc.

nature and circumstances of the loss in deciding how to allocate responsibility between those whose actions led to the loss.[40] Claims relating to pollution have been one area where the courts have been open to adopting this alternative approach. For example, a company that contributes to the pollution of a river can be found liable in private nuisance even if the impact of other sources of pollution would have been sufficient to bring about the harm caused.[41]

26. This does not mean that any and all adverse nature-related impacts caused by a company will necessarily lead to a claim in damages against it under English law. For example, the company's conduct may not violate any legal duty to which the company is subject, meaning that no cause of action arises in respect of that conduct, or it may be too difficult to prove that the impact caused any discernible loss to any specific person, or there simply may be no person who is willing and able to incur the time and expense of bringing a claim against the company.

27. Many companies incorporated in this jurisdiction operate internationally, such that English law is not the only relevant consideration when assessing the legal risks of nature-related impacts. There have, in recent years, been various class actions brought before the English courts under foreign law, in relation to environmental disasters for which English companies' liability was or is alleged.[42]

28. Putting aside the uncertainties over whether a company would be found liable for its nature-related impacts or whether losses could be recoverable from a company in such circumstances, the mere risk of being exposed to legal proceedings for nature-related impacts may be a matter of real concern for a company and its directors. Litigation before the English courts can be expensive and time consuming, particularly in cases where there are multiple claimants. Even if the company successfully defends proceedings, it will not usually recover the entirety of the legal costs incurred. Further,

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40 Kuwait Airways Corp v Iraq Airways Co (No. 5) [2002] 2 AC 883, p.1092, at [73]-[75], FCA v Arch Insurance [2021] 1 AC 649 at [182]-[185] and [189]-[190].

41 Pride of Derby Angling Association Ltd v British Celanese Ltd [1952] 1 All ER 1326 at 1332A-1333A.

42 See for example Vedanta Resources plc v Lungowe and others [2020] AC 1045, brought by over 2,800 claimants in relation to emissions from the Nchanga copper mine in Zambia, or Municipio de Mariana v BHP Group (UK) Ltd [2022] 1 WLR 4691, a £36 billion claim brought by over 700,000 claimants in relation to the collapse of the Fundao dam in Brazil. A first stage trial in the latter case is currently listed to begin in October 2024.

English court proceedings are normally public and the mere existence of a claim may have an adverse reputational impact on a defendant company.

C.3.3. Regulatory Compliance

29. A company may also have obligations under regulatory law to avoid or minimise nature-related impacts. These may expose the company to risk of financial or criminal sanctions.

30. In this section, we do not seek to provide an exhaustive survey of such obligations, but flag the range and depth of regulatory provision that may bear on a company's nature-related activities or impacts. We raise the following examples:

    30.1. Environmental Permits. Operators of a wide range of facilities are required to hold, and operate in accordance with, a permit under the environmental permitting regime (pursuant to the Environmental Permitting (England and Wales) Regulations 2016). Typically, a permit will impose conditions covering the full range of activities at, and actual or potential emissions from, the regulated facility. Breach of the permit conditions by the operator of the regulated facility can lead to criminal prosecution, as well as the possibility of revocation or variation of the permit.

    30.2. Planning Permission. Conditions attached to a grant of planning permission under the town and country planning regime also often guard against environmental impacts, with regulatory enforcement and potentially criminal consequences in the event of breach.

    30.3. Whereas planning permissions run with the land, and a grant of planning permission is rarely made personal to the applicant, if a company's activities risk or cause harm to nature, this may well affect its ability to obtain an environmental permit or the transfer of an environmental permit. Under the environmental permitting regime, the regulator must refuse to grant, or transfer, an environmental permit, subject to modest exceptions, if it considers that the applicant for the grant of an environmental permit, or the proposed transferee, will not operate the regulated facility in accordance with the environmental

permit.[43] This can be the case even for operations which pose risks of harm which may be difficult to quantify in civil proceedings.

30.4. Agricultural Uses. Whilst agricultural use does not require planning permission, legislation regulates, and in some cases prohibits, certain agricultural activities by reason of their environmental effects.[44]

30.5. Natural Interests. Certain types of natural interest are strictly protected from damage, enforced by the relevant public authorities. These include Sites of Special Scientific Interest (SSSIs) notified under the Wildlife and Countryside Act 1981, or certain European protected sites, such as Special Areas of Conservation, or Ramsar sites, which, along with SSSIs, are protected by the Environmental Damage (Prevention and Remediation) Regulations.[45]

30.6. Statutory Nuisances. Environmental legislation also designates certain activities, which may involve nature-related impacts as well as impacts on human health or amenity, as statutory nuisances under the Environmental Protection Act 1990. Where a statutory nuisance occurs, the local authority must serve an abatement notice on the operator, enforceable by the criminal courts. The legislation includes provision allowing private individuals to bring proceedings against a company in the criminal courts: a person "*aggrieved*" by certain forms of statutory nuisance may bring a complaint before the Magistrates pursuant to s. 82 Environmental Protection Act 1990, and the Magistrates may order the defendant to abate the nuisance and/or prevent its recurrence, as well as pay a fine, breach of which order is a criminal offence.

30.7. Waste Activities. Certain waste activities, prohibited and criminalised by legislation,[46] may involve nature-related impacts.

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43 Paragraph 5 of Schedule 13 to the Environmental Permitting (England and Wales) Regulations 2016 (SI 2016/1154).

44 In England, the Environmental Impact Assessment (Agriculture) (England) (No.2) Regulations 2006 (SI 2006/2522); in Wales the Environmental Impact Assessment (Agriculture) (Wales) Regulations 2017 (SI 2017/565).

45 In England by the Environmental Damage (Prevention and Remediation) (England) Regulations 2015 (SI 2015/810, in Wales by the Environmental Damage (Prevention and Remediation) (Wales) Regulations 2009 (SI 2009/995).

46 Ss. 33 – 34A Environmental Protection Act 1990.

31. In addition to these existing statutory obligations, companies can also face transition risk from new regulations relating to nature impacts. For example, the UK and EU forest-risk commodities regulations referred to in relation to dependencies above can manifest as a legal risk arising from a company's impacts on nature if the company does not comply with the regulations.

32. Finally, although we are asked in our instructions only to consider a director's liability in the context of the duties under ss. 172 and 174 of the CA 2006, we note at this juncture that a failure by a company to comply with environmental regulations or environmental legislation could provide grounds for disqualification proceedings against the director under the Company Directors Disqualification Act 1986.[47]

C.3.4. Reputational Consequences

33. A company can also suffer reputational harm in the eyes of customers, employees, investors or governmental bodies, in relation to its adverse nature-related impacts, regardless of whether these activities give rise to actionable damages in court.

34. As regards investors, in recent years there has been a substantial increase in sustainable investing. PwC estimates that ESG assets will constitute 21.5% of assets under management by 2026.[48] There has been increasing scrutiny placed on the sustainability claims of companies by bodies such as the WWF[49] and Planet Tracker.[50] We examine some of these issues in Section E below when considering the relevance of nature-related risks to corporate disclosures. Importantly, one of the issues we address in more detail in that section is the fact that investors are increasingly demanding a "*biodiversity footprint premium*" in respect of firms with a large biodiversity footprint.[51] In some cases, there is a link between a company's nature-related impacts and its share premium,

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[47] For example, in Re Total Waste Management Ltd, Secretary of State for Business, Innovation and Skills v Wagstaff (3 November 2017, unreported, the County Court at Wakefield) District Judge Ellington disqualified the two defendants for nine years and seven years for failing to ensure that the company complied with its statutory obligations under the Environmental Protection Act 1990 (among other things). The case is cited in Mithani, Directors' Disqualification at III-641 [760C, FN 11].

[48] PwC, Asset and wealth management revolution 2022: Exponential Expectation for ESG (October 2022), p. 4. See similar recent analysis by Bloomberg: Global ESG assets predicted to hit $40 trillion by 2030, despite challenging environment, forecasts Bloomberg Intelligence (February 2024).

[49] WWF, Palm Oil Buyers Scorecard: Full Report (September 2021).

[50] Plant Tracker, Voting Against Nature (May 2023). See also paragraph 113 below with regards to complaints made to and upheld by the UK Advertising Standards Authority in respect of misleading environmental claims.

[51] See below at paragraph 166.1.

with companies with large footprints suffering reductions in value in light of those footprints.

C.3.5. Nature-related impacts are not limited to large businesses

35. It is not only large businesses and companies that face direct and indirect transition risks from their nature-related impacts. A freehold management company that allows invasive species like Japanese knotweed to grow and spread from its land could face claims from its neighbours in private nuisance.[52] A small restaurant could suffer reputational harm from using excessive plastic packaging for its takeaway options, causing customers to go to competitors instead.

C.3.6. Conclusion

36. In short, and as with nature-related dependencies, we consider that nature-related impacts are capable of having a wide variety of effects on a range of English companies, and that as a result they can be relevant to the role and function of a company's board.

C.4. OVERALL CONCLUSIONS

37. Drawing the above threads together, it is clear that nature-related impacts and dependencies can have consequences for a wide range of companies, and that in some cases those consequences could be highly damaging or even existential from the company's perspective. In the circumstances, nature-related risks can be relevant to a company's operations, supply chain and financial success over the short, medium and long term and by extension the role of directors in governing the company. We therefore turn to consider how nature-related risks intersect with and impact upon the directors' duties to promote the success of their company and to exercise reasonable care, skill and diligence.

[52] See Williams v Network Rail Infrastructure Ltd [2019] QB 601.

D. NATURE-RELATED RISKS AND DIRECTORS' DUTIES

D.1. INTRODUCTION

38. In this section we consider how nature-related risks relate to and inform a director's duties to the company, in particular those imposed by ss. 172 and 174 CA 2006. We have been asked to address: (i) whether nature-related risks may be relevant to these duties; (ii) what forms of board action and inaction may fulfil or contravene a director's duties; (iii) whether a director who fails to consider nature-related risks could be found liable for breaching a director's duties; and (iv) whether a director who perceives that nature-related risks do present risks to the company is required to take any action to mitigate those risks.

39. In order to answer these questions we have structured this section as follows:

    39.1. In section D.2., we set out and consider the duties owed by a director under ss. 172 and 174, discussing the origins, development and scope of these duties, and identifying overarching points which are relevant to the questions we are instructed to consider in this Opinion.

    39.2. In section D.3., we explain why we consider that nature-related risks are relevant to directors' duties under ss. 172 and 174.

    39.3. In section D.4., we examine how nature-related risks interact with these duties. We discuss: the circumstances in which a director who fails to consider nature-related risks may be susceptible to claims for breach of duty; what conduct will constitute a breach; and the circumstances in which a director may be under a positive obligation to mitigate nature-related risks in order to comply with a director's duties.

    39.4. In section D.5., we discuss the consequences a director may face if found to have breached the director's duties.

D.2. THE KEY DUTIES IN OUTLINE: SS. 172 AND 174 CA 2006

D.2.1. Directors' Duties generally

(i) What duties does a director owe to the company?

40. Before assessing the relationship between nature-related risks and a director's duties, we consider it helpful to first provide an overview of those duties generally.

41. The duties imposed on a director under English law arise from and are informed by a company's status as a corporate person. Given that companies can only act through other legal persons acting as their agent, companies are required to have directors, with primary responsibility for the management of the company, who can act on the company's behalf.[53]

42. Given the position of power over a company that a director's appointment confers, English law imposes various duties and restrictions upon the director's conduct. These duties were originally derived by reference to the duties a trustee owes to the beneficiaries of a trust.[54] Nowadays, however, the duties owed by directors have evolved substantially and enjoy their own distinct characteristics. The duties owed can be broadly placed into two categories:[55]

    42.1. Fiduciary duties: These are duties characterised by an obligation of loyalty. In assuming the power to act on the company's behalf a director enters into a relationship of trust and confidence with the company. As a result of this, the company is entitled to the director's "*single-minded loyalty*". This duty comprises various (non-exhaustive) facets, such as: to act in good faith; to avoid conflicts of interests; and not to act for personal benefit without the informed consent of the principal.[56] Fiduciary duties are equitable in nature, and as a

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53 CA 2006 s. 154.

54 This arose as a result of the historical status of company directors. Prior to the enactment of the Joint Stock Companies Act 1844, most companies were in reality unincorporated trust entities, with the directors acting as trustees: see Keay, Directors' Duties (4th Ed.), §2.34. In some recent cases, there has been an attempt to depart from historical comparisons which treat company relationships as akin to trust relationships (see, for example, Various Claimants v G4S Plc [2023] EWHC 2863 (Ch) in the context of the rule that a company cannot assert privilege against shareholders). Such examples are, however, limited and do not disturb the general principle that directors owe fiduciary duties to their companies in the same way as a trustee. See Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 at 395: "*Directors, no doubt, are not trustees, but they occupy a fiduciary position towards the company whose board they form*."

55 Gore-Brown on Companies, Chapter 15, [1].

56 Bristol and West Building Society v Mothew [1998] Ch 1 at 18B.

result their breach entitles the principal to a range of equitable remedies that are not available in the case of breaches of duty under common law.

42.2. Duty of care and skill: As fiduciary duties are duties of loyalty, incompetence alone will not constitute a breach of them: "*A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty.*"[57] This does not, however, mean that a principal has no remedy against the fiduciary for incompetence. Instead, a separate duty of reasonable care and skill is imposed, such that the fiduciary can be held liable in cases of negligence.[58]

43. While the duties owed by a director were developed by judges as part of the common law, they have subsequently been codified in statute and are now found at ss. 170-181 CA 2006. Although at first sight s. 170(3) CA 2006 might suggest that the statutory rules constitute an exhaustive code of directors' duties, it is clear that the large body of pre-Act case law remains relevant to interpreting those duties, as will new case law exploring the duties of fiduciaries in general.[59] As we explain below, that point is important when considering how a director's duties might evolve in reaction to nature-related risks faced by the company to which those duties are owed.

44. The core[60] duty of loyalty and the duty of care and skill are now set out at ss. 172 and 174 CA 2006 respectively. Under s. 172, a director is required to "*act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole*". Under s. 174 a director must "*exercise reasonable care, skill and diligence*".

45. In addition to the core duty of loyalty owed under s. 172, various other fiduciary duties are imposed on a director, such as the duty to act in accordance with the company's constitution under s. 171 and the duty to avoid conflicts of interest under s. 175. For the purposes of this Opinion, we have been asked to consider the relevance of nature-related risks by reference to ss. 172 and 174 specifically. However, it is important to emphasise

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57 Bristol and West Building Society v Mothew [1998] Ch 1 at 18F.
58 Bristol and West Building Society v Mothew [1998] Ch 1 at 17D-F.
59 Gore-Brown on Companies, Chapter 15, [8A].
60 "*This duty of honest and good faith in the exercise of his powers was arguably the primary fiduciary duty of a director, although in the statutory code it is 'relegated' to second place. However, it clearly remains of central importance...*": Gore-Brown on Companies, Chapter 15, [10].

these other duties will inform the content and requirements of the duties owed by a director under ss. 172 and 174. Thus, for example, a director who is in breach of the duty to avoid conflicts of interest may also be acting contrary to the duty of loyalty under s. 172. Similarly, a director who fails to exercise independent judgment under s. 173 may as a result be found to have breached the duty of reasonable care, skill and diligence under s. 174.

(ii) *General considerations with regards to the content of the duties: the special position of directors*

46. Whilst certain aspects of directors' duties evolved historically by analogy with the duties owed by trustees to beneficiaries, what is now expected of a director in relation to compliance with their duties can diverge quite significantly from what is expected of a trustee. This is primarily due to the difference in purpose of a trust and a company.

47. Most, but not all, companies operate for the purpose of a trade or commercial venture. A certain degree of uncertainty and risk is inherent and necessary in such ventures, which go beyond the risks associated with making investment decisions as a trustee. In recognition of the risks involved in conducting a business, directors "*must act on commercial considerations and are entitled to risk their company's funds upon sensible, though risky, ventures, none of which could possibly be the proper attitude of a trustee*."[61]

48. Directors are therefore generally given a greater degree of flexibility in terms of application of their principal's (i.e. the company's) property. Another distinguishing feature of a director's position in that context is that, as well as being concerned with the profitability of the company's activities, a director will have to consider the indirect impacts of the company's activities, such as on the company's reputation or on its relations with customers, employees or suppliers. English law recognises that it can be in a company's best interests to engage in activities which do not necessarily generate profits.[62]

49. For example, a director who spends company funds on a party for its employees can be said to be benefiting the company by fostering good relations between the company and

[61] Re a Company (No. 004502 of 1988) [1991] BCC 234, at p.239D-E.
[62] Hutton v West Cork Railway Company (1883) 23 Ch. D 654 at 672.

its employees, even if those actions do not bring the company any short-term financial benefit: "*The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company*."[63] In the same vein, it can be in the interests of a chemical manufacturing company to set up a scholarship fund for the promotion of scientific study and research, even if it is not guaranteed that the recipients of this fund will work for the company in the future.[64] Conversely, a director who disregards a company's statutory obligations with a view to maximising profit and minimising expenditure will be in breach of duty: see Antuzis v DJ Houghton Catching Services Ltd [2019] Bus LR 1532, where the directors' failure to comply with statutory employment law obligations in the pursuit of profits caused the company to be "*exposed as a pariah*".[65]

(iii) *The development of directors' duties*

50. The origins of directors' duties in the common law have allowed them to develop over time in response to social and legal developments.

51. For example, a director's duty of reasonable care and skill has evolved in light of rising industry standards and other legal reforms:

    51.1. In the 19th and early 20th centuries, the standard of care required of directors (particularly non-executive directors) was low.[66] In various 19th century cases, it was held that a director would not be liable for negligence unless it was "gross".[67] This requirement of gross negligence received some criticism in early 20th century cases such as Re Brazilian Rubber Plantations and Estates Limited [1911] 1 Ch 425 (where Neville J considered that there was a "*want of precision*" in the statement that "*so long as* [the directors] *act honestly they cannot be made responsible in damages unless guilty of gross negligence*")[68] and Re City Equitable Fire Insurance Co [1925] Ch 407 (where Romer J

63 Ibid.
64 Evans v Brunner, Mond & Co [1921] 1 Ch 359 at pp.366-367.
65 Antuzis v DJ Houghton Catching Services Ltd [2019] Bus LR 1532 at [127]-[128].
66 See generally Keay on Directors' Duties (4th Ed.) at [8.13] – [8.23].
67 Lagunas Nitrate Company v Lagunas Syndicate [1899] 2 Ch 393 at 435.
68 At 436 – 437.

confessed to "*feeling some difficulty in understanding the difference between negligence and gross negligence*").[69]

51.2. In the early 20th century, a director's duty of care was judged against what "*may reasonably be expected from a person of his knowledge and experience*".[70] This gave considerable scope for a director with no relevant experience or knowledge to escape liability for incompetence. For example, in Re Brazilian Rubber Plantations and Estates Limited [1911] 1 Ch 425, a non-executive director who "*was absolutely ignorant of business*" and assumed his role in order to obtain "*a little pleasant employment*",[71] was found not to have acted negligently in approving a false prospectus that the other directors were misled into promoting: "*He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance*. […] *He is not, I think, bound to take any definite part in the conduct of the company's business*".[72]

51.3. Further, historically, the failure by a non-executive director to engage in the governance of a company had been treated as a defence to negligence. In the particularly extreme example of Re Cardiff Savings Bank [1892] 2 Ch 100, the Marquis of Bute, who had been appointed president of the claimant bank at 6-months old and only attended a single meeting over the course of 39 years, was held not to have been negligent due to his lack of participation in the company's affairs.[73]

51.4. By the early 1990s, the duties imposed on a director had become more stringent, with a director's duty of care being assessed both by reference to the director's own knowledge, skill and experience, and by that which could be reasonably expected of a person carrying out the same functions as were carried out by that director.[74] At the recommendation of the Law Commission and the Company

[69] At 427-428.
[70] Re City Equitable Fire Insurance Co [1925] Ch 407 at 428; Lagunas Nitrate Company v Lagunas Syndicate [1899] 2 Ch 392 at 435.
[71] At 427.
[72] At 437.
[73] At 109-110.
[74] Re D'Jan of London Ltd [1993] BCC 646 at 648D. In that case, Hoffmann LJ (as he then was) drew on the standard of care imposed under s. 214(3) Insolvency Act 1986 in relation to trading while insolvent, holding "*with no discussion*" that this represented the common law: Keay on Director's Duties (4th Ed.) at [8.25].

Law Review Steering Group,[75] this standard was incorporated into what is now s. 174 of CA 2006.

51.5. In Bishopsgate Investment Management Ltd v Maxwell [1993] BCC 120, Hoffman LJ (as he then was) noted, by reference to the directors' disqualification legislation, that "*[t]he law may be evolving in response to changes in public attitudes to corporate governance*" so as to place more stringent requirements on directors to participate in the management of a company.[76] Nevertheless, he said that the question of whether a director was under a duty to participate in the management of a company "*must depend upon how the particular company's business is organised and the part which the director could reasonably have been expected to play*".

51.6. As recognised in Bishopsgate, increasing standards of corporate governance have led to much more being expected of company directors. Rather than being considered a defence to a claim in negligence, complete inactivity by a director is now increasingly likely to constitute a breach of the duty of itself.[77]

52. CA 2006 is now the starting point for an analysis of directors' duties. Notwithstanding the codification of directors' duties in that legislation, in interpreting these duties the court is to have regard to the pre-Act case law,[78] and decisions on the proper interpretation and application of ss. 172 and 174 will be relevant to subsequent cases in which breaches of those duties are alleged.[79] As such, developments in societal, industry and regulatory expectations of directors and businesses have influenced and will continue to inform the scope of a director's duties. Indeed, as discussed further below, what "*may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company*" will by its very nature change alongside standards of corporate governance. In the same vein, what is likely to "*promote the success of the company*" will be in part informed by societal, industry and regulatory

[75] Law Commission Report No. 261, Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties, at §5.19-5.20; Company Law Review Steering Group, Modern Company Law for a Competitive Economy: Developing the Framework (2000), Volume 1, Chapter 3, §3.66-3.68.

[76] Bishopsgate Investment Management Ltd v Maxwell [1993] BCC 120, at 139B-C. For a brief summary of the developments in societal standards of corporate governance and "soft law" at around the time this judgment was handed down, see Palmer's Company Law (September 2023) at §1.139.

[77] Lexi Holdings plc v Luqman [2007] EWHC 2652 (Ch) at [218]-[224].

[78] S. 170(3)-(4) CA 2006.

[79] See the reference to Gore-Brown on Companies, Chapter 15, [8A] at FN 59 above.

expectations of proper corporate conduct. Changes in these expectations, including those resulting from advances in scientific understanding, can in turn inform the understanding of a company's own exposure to risks.

53. The fact that directors' duties have developed and continue to develop organically by reference to changes in societal, industry and regulatory standards is relevant to the relationship between those duties and nature-related risks. To the extent that there is a growing expectation that directors should properly manage nature-related risks to which their company is exposed,[80] and growing understanding of the seriousness of these risks,[81] this will in turn inform what is expected of a director under ss. 172 and 174. We explain this in further detail in Section D.3 below.

D.2.2. <u>S 172 CA 2006</u>

54. Under s. 172 CA 2006, a director is subject to the following duty:

> *"(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to–*
>
> *(a) the likely consequences of any decision in the long term,*
> *(b) the interests of the company's employees,*
> *(c) the need to foster the company's business relationships with suppliers, customers and others,*
> *(d) the impact of the company's operations on the community and the environment,*
> *(e) the desirability of the company maintaining a reputation for high standards of business conduct, and*
> *(f) the need to act fairly as between members of the company.*
>
> *(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.*
>
> *(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."*

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80 We discuss in Section E below the fact that, for example, certain institutional investors are now demanding a biodiversity footprint premium in respect of the shares of companies with particularly pronounced nature-related impacts and dependencies. This is the sort of general trend or development which we anticipate is likely to further shape and develop the content of directors' duties.

81 See for example the recent publications and analysis discussed in Section C.2. above in relation to the nature-related dependencies of companies.

55. We emphasise three preliminary points in relation to this duty, which we examine in more detail in turn below:

55.1. First, the duty to promote the success of the company is a broad and flexible one. A company's success is not to be equated exclusively with the pursuit of short-term profit over long-term stability, and factors such as a company's social impact and reputation,[82] as well as its resilience to financial risks,[83] should be taken into account when considering what is in the company's best interests.

55.2. Second, the duty owed under this section is a subjective one that confers on a director a wide discretion to decide how to promote the success of the company.[84] A director who makes these decisions on irrational or unreasonable grounds will not, on this basis alone, be in breach of s. 172; however, such irrationality or unreasonableness may breach other duties that a director owes to the company.

55.3. Third, if a director makes no attempt to consider whether the director's actions are in compliance with this duty, or overlooks a material factor, the director will instead be judged against an objective standard. A director who can show that due consideration has been given to whether the director's actions are likely to promote the success of the company, taking into account all the relevant factors, has significantly more protection from a claim under s. 172 than one who cannot.

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[82] Keay on Director's Duties (4th Ed.) at [6.79]: "*Whether a company is able to be successful is likely to depend on its relations with its trading partners, customers and other stakeholders, so considering the interests of stakeholders could well contribute to success. Also, success, in many ways, is reliant on having a good reputation and this is related, to an extent, as to how it deals with its stakeholders. Of course, 'reputation' is a factor that is included in those that are enumerated in s 172(1) and to which directors are to have regard*." Reputation "*can be seen as the most important intangible asset of the company*": Keay on Director's Duties (4th Ed.) at [6.133].

[83] In previous iterations of the companies legislation, it was suggested that directors should take into account "*material factors*"; see the 2002 White Paper (Modernising Company Law (Cm 5553, 2002, DTI)) which preceded CA 2006 included in the draft Companies Bill the following as part of the precursor to s. 172: "*A director of a company must... in deciding what would be most likely to promote*[the success of the company], *take account in good faith of all the material factors that it is practicable in the circumstances for him to identify* (underlining added)."

[84] Keay on Director's Duties (4th Ed.) states at [6.54] that "*in s 172 we seem to have complete reliance on a subjective test*", notwithstanding some dissatisfaction with that position in some academic commentary and judicial *dicta*. See, most memorably, the comment of Bowen LJ in Hutton v West Cork Railway Company (1883) 23 Ch D 654 (CA) at 671: "*Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide, yet perfectly irrational*".

(i) *What is "the success of the company"?*

56. The duty imposed is for the director to do what the director considers to be likely to promote "*the success of the company for the benefit of the members as a whole*". Save that it is intended to be for "*the benefit of the members*",[85] what constitutes "*the success of the company*" has been left undefined in the legislation. This was a deliberate drafting decision, with the intention of leaving it to the company's directors, acting in good faith and subject to "*the constitutional powers of the general meeting*" (if any),[86] to determine what success means.[87]

57. The success of a company is not to be automatically equated with the maximising of profits or dividends for shareholders. S. 172(2) provides that a company can deliberately adopt purposes other than for the benefit of its members. This may be the case where a company is incorporated for the purposes of operating a charity or other non-profit organisation. For example, what is in the interests of the shareholders of a freehold management company for a shared block of flats may be very different from what is in the interests of the shareholders of a large publicly traded company. Even in the case of a publicly traded company which is seeking to maximise profits or share value, there may be differing views amongst members as to whether it is in the interests of the members to pursue a strategy of aggressive, short-term growth or to prioritise long-term stability.[88]

58. A non-exhaustive list of factors to which a director should have regard in determining how to promote the success of the company is set out at s. 172(1)(a)-(f). These factors are intended to reflect a concept of 'enlightened shareholder value', which focuses on the long-term success of the company for the benefit of members as a whole.[89] However, it is important to bear in mind that the factors listed in s. 172(1)(a)-(f) are subordinate to

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[85] This is subject to the exception, as recognised at s. 172(3) of CA 2006, that where a company is insolvent or approaching insolvency, a director's duty to promote the success of the company may instead be judged by reference to the interests of its creditors: see BTI 2014 LLC v Sequana SA [2022] 3 WLR 709.

[86] Although it will depend on the terms of the company's constitution, it seems doubtful that the members acting in general meeting could pass a resolution which directs or determines what the directors must consider to be the success of the company. Such a resolution would probably fall foul of the rule that where the company's articles vest a particular power in the board (such as the management of the company), the general meeting cannot interfere with the exercise of that power: Automatic Self-Cleansing Filter Syndicate Co v Cunninghame [1906] 2 Ch 34 CA; Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113 CA.

[87] Company Law Review Steering Group, Modern Company Law for a Competitive Economy: Completing the Structure (2000), Volume 1, Chapter 3, §3.16.

[88] Sharp v Blank [2019] EWHC 3096 (Ch) at [620].

[89] Department of Trade and Industry, White Paper: Company Law Reform (March 2005), p.20.

the requirement to promote the success of the company for the benefit of the members: their interests are primary.[90]

59. Further, there are limits on what a director can do to confer financial benefit on a company's members in the short-term, where this harms a company's long-term success in the broader sense:

59.1. The most clear-cut example of this is fraud. A director who uses the company to operate a fraudulent scheme, if not caught, may be able to generate large sums of money which might ultimately benefit the company's shareholders. However, the suggestion that it could be in a company's interests to be run as a fraud has been given short shrift by the court.[91]

59.2. A more specific example is found in the case of Antuzis v DJ Houghton Catching Services Ltd [2019] Bus LR 1532. In that case, the directors of a company that operated the largest chicken-catching operator in the south of England were found to have systematically mistreated and violated the rights of their employees. While the directors had done so with a view to maximising profits, they nonetheless were found to have breached their duty under s. 172. Their conduct, once discovered, had destroyed the company's reputation, rendered it a commercial pariah, and led to the collapse of its business.[92]

59.3. However, the conflict between the members' short-term interests and the company's long-term interests will not always be so extreme, and in fact that conflict will often arise on commercial and strategic issues; for example when a company is deciding whether to make distributions to its members, or have the company retain and spend its funds to promote its future success.[93]

60. Drawing the above threads together, it is clear that the promotion of the success of the company does not simply involve the maximisation of profits or the dividends payable to its members in the short-term. A multi-factorial approach is required, which considers the wider resilience and financial position of the company.

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90 Keay on Director's Duties (4th Ed.) at [6.145].
91 Secretary of State for Trade and Industry v Aurum Marketing Ltd [2002] BCC 31 at 37D.
92 At [124]-[130].
93 LRH Services Ltd v Trew [2018] EWHC 600 (Ch) at [29]-[30].

(ii) *The subjective nature of the duty: the requirement of "good faith"*

61. The duty imposed is expressly a subjective one: "*the question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind*."[94] This reflects the principle that fiduciary duties are at their core duties of loyalty and fidelity, distinct from the separate duties of competence a fiduciary may owe.[95]

62. However, this does not mean that the court will have no regard to the reasonableness or otherwise of a director's alleged beliefs when considering whether the director has breached the duty under s. 172. Where a director puts forward reasons as to why particular conduct was likely to promote the success of the company, and these reasons are considered by the court to be unreasonable or irrational, the court may infer from this that those beliefs were not honestly held.[96]

63. There are certain authorities, pre-dating the CA 2006, that go further than this and suggest that irrationality by itself can constitute a breach of a director's fiduciary duties.[97] In these cases the court sought to apply the "Wednesbury principle"[98] (a concept from the field of public law) to the review of fiduciary duties.

64. The approach set out in these cases, however, has not been applied to s. 172 of the CA 2006. In the recent case of ClientEarth v Shell [2024] Env LR 1, the court rejected the argument that a director who behaves irrationally breaches s. 172 by so doing.[99] That decision is in line with the orthodox approach to s. 172 that irrationality will not without more constitute a breach of the duty to act in good faith pursuant to s. 172.

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94 Regentcrest plc v Cohen [2001] BCC 494 at [120].

95 Bristol and West Building Society v Mothew [1998] Ch 1 at 18F.

96 Extrasure Travel Insurances Ltd v Scattergood [2003] 1 BCLC 598 at [90].

97 Equitable Life Assurance Society v Hyman [2000] 2 WLR 798 at [19]-[21]; Re a Company (No. 00370 of 1987) ex p. Glossop [1988] 1 WLR 1068 at 1077B-C.

98 I.e. the principle that an exercise of discretion can be so unreasonable, that it falls outside the legal authority of the public body making the decision: Associated Provincial Picture Houses v Wednesbury Corporation [1948] 1 KB 223.

99 At [29]-[30].

65. However, the subjective nature of the duty under s. 172 does not mean that a director can behave irrationally without fear of any legal consequences. As discussed immediately below, a director whose decisions are irrational (i.e. outside the range of reasonable decisions) will likely be in breach of their objective duty of care under s. 174.[100] Alternatively, it has been suggested that a director who behaves irrationally may, applying the Wednesbury principle, be in breach of their fiduciary duty under s. 171(b) to only exercise their powers for the purposes they are conferred.[101]

(iii) *The circumstances in which an objective standard may be imposed: failure to consider the interests of the company*

66. One limited exception to the general subjective nature of s. 172 arises where a director acts without considering whether those actions are in the best interests of the company. In those circumstances, instead of holding the director to be in automatic breach of duty, the court applies an objective test and asks "*whether an intelligent and honest man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company.*"[102] Similarly, where a director unreasonably fails to take into account a "*very material interest*" when considering what is in the best interests of the company, the court will apply the objective test.[103]

67. Accordingly, a director who can show that thought has been given to whether the director's acts promote the interests of the company, with regard to all material interests, has significantly more protection against a claim under s. 172 than one who has not.

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[100] Lord Carnwath, writing extra-judicially, has suggested that the discussion of good faith and rationality in the Shell case may have diverted attention from the s. 174 point; in particular, he noted that "*Shell accepted that, for the purpose of s 174, its decisions in that respect must not "fall outside the range of decisions reasonably available to the directors at the time" (JT para 32, citing Sharp v Blank [2019] EWHC(Ch) 3096 [631]). ClientEarth's case, in short, was that the directors had failed that test*": see Lord Carnwath, ClientEarth v Shell: What future for derivative claims? (February 2024).

[101] Gower, Principles of Modern Company Law (11th Ed.), §10-032; Palmer's Company Law (September 2023), §8.2613.

[102] Charterbridge Corp Ltd v Lloyds Bank Ltd [1970] Ch 62, 74 *per* Pennycuick J. This reasoning has subsequently been approved on many occasions in both the English and Commonwealth courts: see the examples given in Keay on Director's Duties (4th Ed.) at [6.56].

[103] Re HLC Environmental Projects Ltd [2013] EWHC 2876 (Ch) at [92]: "*Failing to take into account a material factor is something which goes to the validity of the directors' decision-making process. This is not the court substituting its own judgment on the relevant facts (with the inevitable element of hindsight) for that of the directors made at the time; rather it is the court making an (objective) judgment taking into account all the relevant facts known or which ought to have been known at the time, the directors not having made such a judgment in the first place.*" This is cited as one of three exceptions to the "*general principle of subjectivity*", the others being: (i) the principle in Charterbridge; and (ii) where the duty extends to consideration of the interests of creditors, in which case their interests must be considered as "*paramount*".

Even if the director's beliefs and reasoning were questionable, the current position as a matter of English law is that the director is protected from a claim under this provision if the director acted in good faith. A director who has given no thought to these issues has no such protection and will be judged on objective standards. As we explain below, these points are relevant to the steps that a director can or should take in relation to nature-related risks in order to demonstrate that the duty under s. 172 has been properly discharged.

D.2.3. <u>S 174 CA 2006</u>

68. Under s. 174 CA 2006, a director owes a duty to "*exercise reasonable care, skill and diligence*", this being defined in s174(2) as the "*care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has.*"

69. We emphasise four preliminary points which we expand upon in turn below:

    69.1. <u>First</u>, the duty imposed on a director is an objective one, albeit that (as reflected in our analysis of the development of the law), as standards of corporate governance evolve and become more stringent, so too does the duty imposed on a director under s. 174.

    69.2. <u>Second</u>, a director is obliged to both obtain and maintain sufficient knowledge and understanding of the company's business to discharge the duties under s. 174. However, a director is also permitted to delegate certain functions and place reasonable reliance on expert advice.

    69.3. <u>Third</u>, a director will not have acted negligently simply because the company pursued an opportunity or took a risk that led to an unfavourable outcome.

    69.4. <u>Fourth</u>, the duties under s. 172 and s. 174 have significant overlap, such that the factors relevant to promoting the success of the company under s. 172 may also inform the scope of a director's objective duty under s. 174.

(i) *The objective nature of the duty*

70. Section 174 imposes upon the director an objective duty of care. The standard of care is defined in s. 174(2):

> *(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—*
>
> > *(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and*
> >
> > *(b) the general knowledge, skill and experience that the director has.*

71. S. 174(2)(a) "*sets the floor*" for the standard of care, whilst s. 174(2)(b) makes clear that insofar as the director has greater knowledge, skill and experience than would be reasonably expected of someone carrying out the director's functions, the director is judged by that higher standard.[104]

72. While the duty under s. 174 is objective, this does not mean that it imposes a one-size-fits-all standard of care on all directors of every company. The duty is fixed instead by reference to what may be objectively expected of a director in relation to the company in question and the specific roles and functions the director is expected to carry out within its governance or management. The full extent of the standard of care a director owes will therefore in part be fact specific, including by reference to whether the director acts as an executive or a non-executive director.[105]

73. What is objectively expected of a director will also be informed by standards of corporate governance, both in terms of the sector in which the company operates and more generally. As discussed at section D.2.1(iii) above, what is expected of directors can change and become more onerous, as standards for company directors evolve and become more stringent. In Raithatha v Baig [2017] EWHC 2059 (Ch) at [35] the court

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[104] Brumder v Motornet Service and Repairs Ltd [2013] 1 WLR 2783 at [46].

[105] Secretary of State for BEIS v Selby [2022] BCC 418 at [26], applying the *dictum* of Hoffmann LJ (as he then was) in Bishopsgate Investment Management v Maxwell [1993] BCC 120, 139 that the extent of what is now the s.174 duty "*must depend upon how the particular company's business is organised and the part which the director could reasonably have been expected to play*."

noted that the "*standards required of a director to discharge the duties are higher perhaps than at any time in the past*."

(ii) *The acquisition and maintenance of knowledge and delegation of authority*

74. As part of this duty, a director is required "*to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties as directors*".[106] That requirement becomes more onerous the more senior the position occupied by the director: "*Those who gain high office are required to exercise diligent supervision*".[107] Insofar as a director fails to do so, that will be an abrogation of responsibilities and be a breach of duty under s. 174.[108]

75. This does not, however, mean that a director is under an obligation to micromanage and directly oversee all of a company's activities. A director is permitted to delegate authority so long as the director properly supervises the discharge of any delegated functions.[109]

76. In the same vein, a director is entitled to rely on expert advice on specialist matters. Where a director takes expert advice on an issue the director will often be held to have "*gone a long way*" to discharging the duty under s.174.[110] Conversely, a director may, by failing to seek expert advice where necessary, breach their duty under s.174.[111] However, the director cannot simply adopt the expert's view, unless it is reasonable given all the facts for them to do so. A director should "*ask appropriate and timely questions of their advisers rather than just accepting everything they are told without question*".[112]

(iii) *Business decisions and unlawful acts*

77. In assessing whether a director has breached the duty under s. 174, the court takes into account that the management of a business venture is inherently risky. A director is not held liable simply because a decision previously made turns out to be the wrong choice

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106 Re Barings (No 5) [1999] 1 BCLC 433 at 489.
107 Keay on Director's Duties (4th Ed.) at [8.59].
108 Brumder v Motornet Service and Repairs Ltd [2013] 1 WLR 2783 at [46] - [47].
109 Re Barings (No 5) [1999] 1 BCLC 433 at 489.
110 Sharp v Blank [2019] EWHC 3096 (Ch) at [629].
111 Saxon Woods Investments Limited v Costa [2024] EWHC 387 (Ch) at [211]; Raithatha v Baig [2017] EWHC 2059 (Ch) at [37].
112 Sharp v Blank [2019] EWHC 3096 (Ch) at [630].

in hindsight. Instead, it is necessary to show that the director's decision fell outside the range of decisions open to a reasonably competent director.[113]

78. The risks a director is expected to take on behalf of a company do not include breaking the law. In Brumder v Motornet Service and Repairs Ltd [2013] 1 WLR 2783 a director was held to have breached s. 174 in circumstances where the director was unaware of the company's health and safety obligations and had therefore failed to comply with them. In Antuzis v DJ Houghton Catching Services Ltd [2019] Bus LR 1532 the court observed that the statutory duties imposed by regulatory legislation are reflective of societal disapproval of the act prohibited. Where a director has caused the company to breach such legislation and face reputational damage as a result (in the court's example, where the director of a restaurant substitutes beef for horse meat), this may point towards the director having acted in breach of their duties.[114]

(iv) The interaction between ss. 174 and 172(1)(a)-(f)

79. S. 172(1)(a)-(f) CA 2006 sets out factors that a director ought to take into account when considering how best to promote the success of the company. While the duty owed under s. 172 is a subjective one, we consider that these same factors must also be relevant to the question of whether a director has breached their duty under s. 174.[115]

80. The factors listed at s. 172(1)(a)-(f) are expressly identified in recognition of the fact that they can have a significant impact on the company's success or failure. Accordingly, if a director acts negligently in considering (or failing properly to consider) one of these factors in a manner that causes the company harm, we consider that this would be capable of constituting a breach under s. 174.

81. S. 172 does not serve as a carve out to s. 174; the duties owed by a director will often overlap in scope, and a director's conduct can breach multiple duties.[116] So, for example, in Antuzis, two directors who had breached their duties under s. 172 by failing to

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[113] Sharp v Blank [2019] EWHC 3096 (Ch) at [627]-[631].

[114] See [121]-[122].

[115] We note that a similar view was taken extra-judicially by the Rt Hon Lady Justice Arden DBE (as she then was) in Regulating the Conduct of Directors (2010) 10(1) Journal of Corporate Law Studies, pp.11-12. Similarly, it might in theory be possible for "*activist shareholders to bring a derivative action alleging that directors have negligently failed to have regard to one of the factors in s 172(1) of the CA 2006, or placed undue weight on others*", albeit this does not appear to have occurred thus far: Keay on Director's Duties (4th Ed.) at [8.171].

[116] S. 179 CA 2006.

maintain high standards of business conduct by reference to s. 172(1)(e) were also found (by virtue of the same conduct) to have breached their duty under s. 174.[117]

(v) *Conclusions in relation to ss. 172 and 174*

82. It is useful to set out the content and scope of the duties under ss. 172 and 174 in order to understand their relationship with nature-related risks. Two key takeaways emerge from the analysis.

    82.1. First, in respect of s. 172, it is clear that the duty to promote the success of a company is not simply concerned with short-term maximisation of profits or dividends at the expense of company stability and long-term prospects for growth.

    82.2. Second, in respect of s. 174, the duty of reasonable care and skill is an objective one which has evolved and is evolving in tandem with both societal norms and legislative and regulatory expectations with regards to corporate governance. Given the increasing prominence given to nature-related risk both generally in society and specifically in legislation and regulation (such as in relation to disclosures, as we discuss below), nature-related risks may increasingly be relevant to both the content of the duty under s. 174 and the objective standards by which directors will be measured when they are accused of breach of duty.

D.3. ARE NATURE-RELATED RISKS RELEVANT TO DIRECTORS' DUTIES?

83. One of the questions on which we are asked to advise is whether nature-related risks may be relevant to directors' duties under ss. 172 and 174 CA 2006. We consider that by their very character, such risks are relevant to the discharge of directors' duties under both provisions.

84. The potential threats posed to a company from its dependencies and impacts on nature are plainly relevant to determining what is in the company's best interests for the purposes of s. 172. Crucially, those dependencies and impacts can have direct and material effects on a company's financial performance.

[117] At [124]-[127].

85. By way of example, BloombergNEF and the TNFD published a report in December 2023 that includes case studies and cost quantification which demonstrate where nature-related risks have materialised for companies, including instances when share price has been significantly reduced.[118] Additionally, at the macroeconomic level, the Network for Greening the Financial System (the global network of 114 central banks and financial supervisors) notes its view that "*nature-related risks, including those associated with biodiversity loss, could have significant macroeconomic implications, and that failure to account for, mitigate, and adapt to these implications is a source of risks for individual financial institutions as well as for financial stability*".[119]

86. This is, of course, the substantive premise of the TNFD project, *viz.*, the premise (based on scientific and economic analysis) that nature-related risks can cause companies direct and indirect pecuniary loss.

87. Thus, a company's nature-related risks can cause harm to its financial health in both the short and long term. Where these risks are ignored or overlooked for the sake of short-term saving, the company can be adversely affected by, amongst other things, supply chain disruptions or failures, reputational damage, higher operating costs, direct consequences of its own damage to the ecosystems from which it sources its products, and civil and criminal proceedings.[120]

88. Identification and assessment of nature-related risks are relevant to the promotion of the success of the company. Consideration of nature-related risks is necessary for proper business management, often even in the short term.

89. In addition, the concept of enlightened shareholder value and s. 172(1)(d) CA 2006 make clear that nature-related risks will be relevant to promoting the success of the company even where there are no such direct or material financial effects.

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[118] BloombergNEF and TNFD, When the Bee Stings: Counting the Cost of Nature-related Risks (9 December 2023).

[119] Network for Greening the Financial Sector, Statement on Nature-Related Financial Risks (24 March 2022).

[120] See Sections C.2. and C.3. above.

D.4. BREACH OF DUTY IN RELATION TO NATURE-RELATED RISKS

90. Having set out above our view that nature-related risks will in many circumstances be relevant to directors' duties under ss. 172 and 174, we turn to consider two additional and related questions on which we are asked to advise, namely:

    90.1. What forms of board action or inaction in relation to nature-related risks might fulfil or contravene the duties under ss. 172 and 174 CA 2006?

    90.2. Can directors who fail to consider nature-related risks be held liable for breaching their duties under ss. 172 and 174 CA 2006?

91. We consider those questions below in the context of each of the two duties.

D.4.1. S. 172 CA 2006

92. As noted above, the duty on a director arising under s. 172 is a subjective one. In order to discharge that duty properly, a director must take into account all relevant factors in making a decision for the company. If the director does, there is considerable scope under s. 172 to determine what the director considers to be in the company's best interests.

93. As set out in Section C above, companies of all shapes and sizes face nature-related risks that can be detrimental to their success. It follows that where such potentially detrimental nature-related risks exist, they ought to be taken into account when a director considers how to promote the success of the company. This is consistent with s. 172(1)(d), which requires a director to take into account "*the impact of the company's operations on* […] *the environment*". Although s.172(1)(d) refers expressly to "*impacts*" (which is therefore plainly capable of capturing nature-related impacts), we also consider that s. 172 is broad enough to capture a company's nature-related dependencies, given that directors must consider the impact of the company's "*operations*" on the environment. It is also notable that s. 172(1)(a) requires a director to take into account "*the likely consequences of any decision in the long term.*" An example is a company that is highly dependent upon clean water for its production processes. The company's operations also impact the quality and availability of the ground and surface water sources it draws from. Under s. 172(1), directors of the

company must consider both its impact on those water sources and the long-term consequences of its impact on the quality and availability of those water sources.

94. We consider below (i) how a company's nature-related risks may inform a director's duties under s. 172; (ii) how a director can protect themselves from claims under s. 172 by demonstrating that consideration has been given to a company's nature-related risks and other relevant factors; and (iii) the limits of this protection where a director is merely seeking to "greenwash" the company without actually dealing with its nature-related risks.

(i) The interaction between nature-related risks and the duty under s. 172

95. As we have explained above, the enlightened shareholder value factors listed at s. 172(1)(a)-(f) (including "*the impact of the company's operations on the community and the environment*") are subordinate to the interests of a company's members; those matters can be "*seen in a hierarchical way*", with the latter being regarded more highly than the former.[121] However, those considerations are not necessarily conflicting, and in fact they may often be complementary or aligned. A company's nature-related impacts, even if they do not harm the company directly, can expose the company to fines, civil litigation, reputational damage and ultimately share price deterioration. Dealing with a claim for environmental damage, for example, even if ultimately unsuccessful, can be very time consuming and costly for the company, such that it will often be in the company's interests to avoid the risk of such a claim altogether.[122] Even then, avoiding litigation is not a panacea: the English courts have recognised, since the Victorian era, that the proper conduct of a company's business requires more than the bare minimum expenditure to avoid civil and criminal liability: "[the directors] *are not to keep their pockets buttoned up and defy the world unless they are liable in a way which could be enforced at law or equity. Most businesses require liberal dealings*."[123]

96. In fact, we consider that the point goes further than simply recognising that promotion of the interests of members might in some circumstances align with minimising the company's nature-related risks. In particular, it is arguable that in some circumstances

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[121] Keay on Director's Duties (4th Ed.) at [6.36].

[122] The need to avoid litigation can itself be a weighty factor in considering what is likely to promote the success of the company: see Regentcrest plc v Cohen [2001] BCC 494 at [153].

[123] Hutton v West Cork Railway Company (1883) 23 Ch. D 654 at p. 672.

the success of the company will lie in long-term appreciation of share value rather than immediate profits or payment of dividends; one leading textbook has recognised that "*there appears to be no reason why the focus on share value and profit maximisation is wrong, but equally 'success' may now mean long-term increase in value*".[124] We consider that there is force in that view, such that there may even be circumstances where it is appropriate for a director to prioritise minimising adverse impacts on nature over the immediate financial interests of members. By way of example, a director of a manufacturer, on discovering that its manufacturing process was polluting a local water source, might properly halt production whilst an alternative production process was put in place, notwithstanding that such a course resulted in the company suffering losses or foregoing profits because continuing with production might expose the company to a claim for damage or prosecution or reputational damage.[125]

97. Additionally, actions with respect to the company's dependencies on nature can be aligned with the interests of the company's members. For example, see the discussion above in paragraph 17.4 of soil degradation in the UK which could result in reduced access to, or higher costs for, key commodities required as key inputs for food producers, manufacturers, retailers and financiers in the supply chain. In these circumstances, a director might decide to substitute unsustainable agricultural practices for a more sustainable and regenerative approach, which could make the company more resilient and successful in the long-run despite foregoing some short-term profits whilst the new practices are established. Again, on the assumption that promotion of the success of the company may properly mean achieving long-term increase in value over short-term profit maximisation, it appears to us that nature-related dependencies could in certain circumstances be a relevant factor to promoting the success of the company (vis-à-vis maximisation of long-term shareholder value), even if that might come at the expense of profits or payment of dividends in the short term.

(ii) Taking nature-related risks into proper consideration

98. Having concluded above that nature-related risks facing a company (and a director's response to them) can be relevant to promoting the success of the company, we turn to consider what directors should do in respect of those risks.

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[124] Keay on Director's Duties (4th Ed.) at [6.76].

[125] See FN 82 above to the effect that a company's reputation can be seen as its most important intangible asset.

99. The first question is the extent to which a director ought to factor those risks into their decision making with regards to the management of their company. In short, in our view a director who gives genuine consideration to relevant nature-related risks in reaching a decision for the company will likely be protected if that decision is later challenged under s. 172. That will be the case irrespective of the weight given to those risks in reaching that decision.[126]

100. Conversely, a director who has not given genuine consideration to one or more relevant and material factors in reaching a decision will be held to the objective standard. It may be significantly more difficult for a director to establish that the conduct in question is reasonable when judged on that objective standard as compared to the subjective standard that would apply under s. 172 when all relevant factors have been taken into account.

101. Against that background, we are asked expressly to advise on what forms of action a board might take to fulfil their duties under s. 172 in relation to nature-related risks. We consider that it would be prudent for directors to identify and take into account relevant and non-trivial nature-related risks in reaching their decisions. Directors who record in minutes of any decisions that relevant nature-related risks had been taken into consideration, can rely on this as evidence of their compliance with their duties.

102. In addition, many directors (especially those on the board of large companies with potentially extensive nature-related risks) may be better able to comply with their duty to promote the success of the company (including by having regard to the likely consequences of any decision in the long-term and the impact of the company's operations on nature) by first, obtaining independent expert advice to properly understand the character, scope and seriousness of those risks and, second, contacting stakeholders who are potentially affected by the company's nature-related impacts and dependencies. In this respect, we agree with the following guidance given in Keay on Director's Duties (4th Ed.) at [6.134], [6.151] and [6.201] respectively:

102.1. "*Directors would be best advised, one would think, to instruct independent consultants who have expertise in environmental and health matters to assist*

[126] See above at paragraphs 61 to 65.

them in determining what effect decisions might have on communities and the environment and even what actions might be taken to good effect."

102.2. "*It would seem to be wise for directors, where appropriate, to contact people or groups covered by the factors when having to make critical decisions so that they can learn about the concerns and position of these people and groups. Not only would such action demonstrate having regard to the factors, it might mean that it will influence stakeholders not to withdraw their input in the company. Naturally if directors do this then they will have a harder time ignoring them. Nevertheless directors could ignore them, legally, if, in good faith, they believe that to ignore them would promote the success of the company for the benefit of the members*."

102.3. "*All in all it would seem prudent for directors to include in their minutes, as a minimum, a standard reference to the fact that the board adhered to the decision-making requirements in s 172 of the CA 2006 in relation to their considerations*."

103. That process of obtaining advice for the purposes of s. 172 could, in many circumstances, dovetail with the process of obtaining advice to understand the nature-related risks facing a director's company, which we recommend in the context of discharging the duty under s. 174 (discussed below). In other words, a director can help ensure compliance both with ss. 172 and 174 by obtaining independent advice as to the nature-related risks facing the company.

104. In two recent claims brought for breach of s. 172 in relation to addressing climate-related risks, the directors were able to defeat these claims at a summary stage by, amongst other things, showing they had subjectively considered those risks:

104.1. In McGaughey v Universities Superannuation Scheme Ltd [2022] Bus LR 797,[127] members of a pension scheme brought a multiple derivative claim against the directors of the scheme's corporate trustee. One of the claims alleged that the directors had breached their duties under s. 172 in causing the scheme to continue to invest in fossil fuels. The directors were able to show that they had given consideration to the risks associated with that investment by giving

[127] Upheld on appeal at [2023] Bus LR 1614.

voluntary disclosure of its climate-related risks and the legal advice the company had taken in relation to its investments. This was one of the bases on which permission to continue the claim was refused.[128]

104.2. In ClientEarth v Shell plc [2024] Env LR 1, the claimant, a shareholder in Shell, sought permission to continue derivative claims against its directors for, amongst other things, breach of s. 172 in relation to the company's climate change risk management strategy. In refusing permission, the court pointed to the fact that the directors had considered the relevant risks by adopting policies and targets to achieve net zero by 2050 (the allegation having been made that the directors had acted in breach by choosing pathways which did not align with that target). That consideration of itself meant that the claimant could not have a *prima facie* case of breach under s.172(1)(d).[129] We examine the significance of this decision in more detail below, but at this stage it simply suffices to underscore the point that a director who gives active consideration to a nature-related risk will, *ceteris paribus*, be in a far better position with respect to complying with s. 172 than a director who does not consider those risks.

105. These cases both concerned allegations relating to climate-related risks which, as we have set out in Section C above, constitute one aspect of nature-related risks. Nevertheless, we do not see any reason why the principles which underpin these decisions would not be equally applicable to attempts to bring derivative claims against directors for failing to properly consider nature-related risks. The decisions highlight the importance of directors: (i) considering the nature-related risks (including but not limited to climate-related risks) their company faces when deciding how to act in the best interests of the company; and (ii) keeping a proper record of their decision-making process.

106. As to the question of record-keeping, it appears to be generally accepted that directors should not feel obliged to minute every aspect of their consideration of the factors listed at s. 172(1). This was certainly a point that was emphasised during the legislative process of CA 2006; there should not be an overabundance of red tape.[130] Nevertheless,

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[128] At [125]-[127] and [196].

[129] At [65].

[130] For discussion of these points in the legislative context of the passing of CA 2006, see: Palmer's Company Law (September 2023) at [8.2614]; Keay on Director's Duties (4th Ed.) at [6.191] – [6.195].

record-keeping in the form of detailed board minutes and proper reporting in the narrative reports (which we consider in more detail in Section E below) will assist directors in proving compliance with s. 172: "*The more detailed, complete, and structured the board's explanation is, and the more the board's approach relies on professional advice and rational performance benchmarks, and adopts an integrated legal, economic-financial and social view, the more likely it is that shareholders will be advised that they will be unable to establish that directors have breached s 172 of the CA 2006*".[131]

107. Whether a company's nature-related risks are a material factor that ought to be taken into account in relation to a particular decision[132] is a fact-sensitive question. In some cases, nature-related risks will be plainly relevant. For example, a company sourcing timber has to ensure compliance with the Timber and Timber Products (Placing on the Market) Regulations 2013. In other cases, such factors may be more indirectly of relevance, or of no relevance at all. Existing toolkits, such as those produced by the TNFD, can be of significant assistance to a director, in determining the circumstances in which nature-related risks ought to be taken into account, and keeping a record of such considerations.

108. In our view, it is in principle possible for a director to be liable for breach of duty under s.172 CA 2006 if the director fails to consider relevant nature-related risks in making a decision. However, that possibility is highly fact-sensitive and will depend principally on: (i) the relevance and magnitude of any nature-related risk to the company's operations, whether direct (such as an immediate impact of a decision on local biodiversity) or indirect (such as impacts and dependencies on the company's supply chains); (ii) whether an intelligent and honest person in the position of the director would have reasonably believed that the decision was for the benefit of the company; and (iii) the harm, if any (whether direct, indirect, short-term or long-term), actually suffered by the company as a result of the failure by the director to consider the risk in making the relevant decision.

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[131] Keay on Director's Duties (4th Ed.) at [6.190], citing J Loughrey, A Keay and L Cerioni, Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance (2008) 8 Journal of Corporate Law Studies 79 at 103.

[132] So that failure to do so brings about application of an objective standard, as to which see paragraph 66 above.

(iii) *The limits of greenwashing*

109. It is important to emphasise that the subjective nature of the duty under s. 172 does not mean that a cynically minded director can be shielded from liability by 'going through the motions'. A director who 'greenwashes' the company, by creating a paper trail falsely purporting to show action in relation to a company's nature-related risks, is likely to expose the company to (i) latent financial risks arising from unaddressed nature-related impacts and dependencies, (ii) the risk of shareholder and investor claims (including for deceit) and (iii) reputational risk. In this respect, there is academic support for the view that to properly "*have regard... to*" the factors listed in s. 172(1), a director must not only have considered them but also have determined how each decision will affect those factors.[133]

110. Whilst acting in good faith is a defence under s.172 for a director who is challenged for making an allegedly irrational or unreasonable decision regarding how to handle the company's nature-related risks, the same is not the case under s. 174.

111. Further, as discussed at paragraph 65 above, although the point has not yet been tested before the English Courts, irrational conduct may arguably give rise to a claim for breach of s. 171(b) as constituting an act *ultra vires* the director's powers *qua* director.

112. A director can expressly consider a company's nature-related risks but nevertheless be held to an objective standard under s. 172 if other material factors have been overlooked. For example, where a director fails to do anything to mitigate a company's nature-related risks because of the short-term expense of doing so, this may expose the director to a claim for not having properly considered the long-term consequences of that decision in accordance with s. 172(1)(a).[134]

113. In recent years there has been action by investors and action groups to scrutinise statements by companies in relation to their environmental policies, and penalise greenwashing activity.[135] By way of example, the UK Advertising Standards Authority has recently received and upheld numerous complaints against different companies for

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133 Keay on Director's Duties (4th Ed.) at [6.149].

134 See the discussion as to the balance between achieving long-term shareholder value and short-term maximisation of profits and dividends above at paragraphs 56 to 60.

135 See for example Planet Tracker's report Voting Against Nature (May 2023), tracking the voting patterns of sustainability funds on shareholder resolutions.

containing misleading environmental claims in their advertising.[136] A director caught in the act of greenwashing could thereby cause the company reputational damage and financial loss.

114. As we set out below in Section E, for certain companies part of the board's disclosure function is to produce a 'Section 172(1) Statement' (i.e. a statement explaining how the board has had regard to the matters set out in s. 172(1)(a)-(f)). There is a risk of liability for producing a false 'Section 172(1) Statement' or for including false or misleading material in narrative reporting documents, which we explain in further detail below.[137]

115. Further, as noted above, keeping a paper trail does not give a director a free pass. Where a director's decision in relation to a company's nature-related risks appears irrational or unreasonable, this could be a basis for the court to infer that the paper trail is a mere pretence.

(iv) *Conclusion*

116. Accordingly, our view is that a director who wishes to demonstrate compliance with s.172 of CA 2006 should:

116.1. Identify and assess the nature-related risks the company faces;

116.2. Assess which of those risks are relevant and non-trivial (with the benefit of independent, expert advice in an appropriate case);

116.3. Acting in good faith, decide on a course of action best suited to mitigate such risks in the interests of the company; and

116.4. Properly record each of the above steps in detailed minutes and in the company's narrative reports (to the extent that it is required to produce them).

D.4.2. S. 174 CA 2006

117. We have been asked to provide our opinion on the forms of board action or inaction in relation to nature-related risks that might constitute a breach of s.174 CA 2006, and

[136] See for example the ASA's rulings on complaints against Ryanair Ltd (5 February 2020), Unilever UK Ltd (31 August 2022), and Shell UK Ltd (7 June 2023).

[137] See Section E.6. below.

whether a director who fails to consider those risks might by virtue of that alone be acting in breach of s.174.

118. Ultimately, whether a director will be held liable for such harm under s.174 will be fact-dependent. However, there are certain points of general application which can be made which we explore below, and which broadly reflect the four aspects of the s.174 duty which we highlighted above at paragraph 30:

118.1. First, a director who takes advice and appropriate steps to mitigate a company's nature-related risks is in a far better position than one who does nothing at all.

118.2. Second, a director will normally be under a duty to understand the nature-related risks facing the company.

118.3. Third, what a director will be expected to do to understand the company's nature-related risks will be greater in the case of larger and more complex businesses.

118.4. Fourth, it will typically be more difficult to prove a director has breached their duty under s. 174 in relation to what is properly characterised as a 'business' decision.

(i) *The risks of inaction*

119. At the outset, it is worth making clear that a director who takes action to mitigate a company's nature-related risks, and takes appropriate advice in this regard, will be in a far better position than one who does nothing at all. Even if, with hindsight, it transpires that a decision taken by a director in respect of nature-related risks was 'wrong', the director can nevertheless argue that the decision fell within the reasonable range of decisions available. A director who takes specialist advice as to the company's nature-related risks and properly considers this advice, can argue that there has been satisfactory compliance with the director's duties (albeit a director is not entitled to blindly accept all professional advice and should consider asking reasonable questions where appropriate). [138] A director who takes no advice and makes no decision at all cannot rely on any such defence. The director would instead be left with the argument that the risk is not one of which the director was required to be aware. That is an

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[138] See the reference to Sharp v Blank [2019] EWHC 3096 (Ch) at [629]-[630] above at FN 110.

inherently dangerous line of defence because where a director has failed to acquire sufficient knowledge, the director will have abrogated the responsibilities of a director and will be in breach of duty under s. 174.[139]

120. In other words, giving active consideration to nature-related risks and, where appropriate, obtaining specialist advice as to whether and if so the extent to which those risks should be mitigated, are factors which we consider would assist in proving that a director has acted with reasonable care, skill and diligence and has therefore complied with the duty under s.174 CA 2006.

(ii) *The duty to understand the nature-related risks facing the company*

121. While inevitably a fact-sensitive question, we consider it likely that, in most cases, a director of a company will be under a duty to understand the nature-related risks facing the company. Nature-related risks are not conceptually distinguishable from any other categories of risk in this regard. We take account of the following:

121.1. Various legal obligations are placed on larger companies in relation to their nature-related impacts and dependencies. We explain below that under s. 414CZA CA 2006, the directors of a company not falling under the small companies' exemption[140] are required to produce a 'Section 172(1) Statement' in the strategic report, and that certain larger or public companies are required to provide climate-related financial disclosures and disclosures on environmental matters. It is difficult to see how a director could comply with these obligations properly without taking steps to understand the nature-related risks the company may face.

121.2. Even in the absence of codified legal obligations, a rise in industry standards on corporate environmental, social and governance considerations will in turn inform what is required of a company director on the objective basis. To give a few examples of such trends:

121.2.1. There has been significant support for and institutional engagement with the work of the TNFD. The members of the TNFD represent

[139] For illustrations of this see Brumder at [47] and Raithatha at [37].
[140] See s. 414B.

institutions with over USD20 trillion in assets.[141] There are over 1,400 members of the TNFD consultative forum, with over USD26.6 trillion assets under management, including 320 institutions from the United Kingdom.[142] On 16 January 2024, the TNFD announced that 320 institutions globally, including 46 UK headquartered institutions, have already signed up as 'Early Adopters', intending to make disclosures aligned with its September 2023 Recommendations.[143] The UK is second only to Japan in terms of the number of domestic companies which have signed up as 'Early Adopters'. The UK Government, itself one of the TNFD's funders, has stated in its 2023 Green Finance Strategy, that it intends to incorporate the TNFD Recommendations into the UK policy and legislative architecture.[144] Similarly, we note that a number of UK companies are amongst the 400 institutions which supported Business for Nature's "*Make it Mandatory*" campaign at COP15 for governments to adopt requirements for all large businesses and financial institutions to assess and disclose their risks, impacts and dependencies on biodiversity by 2030.[145]

121.2.2. In a similar vein, in June 2023 the ISSB issued its reporting standards on sustainability-related financial information and climate-related disclosures (IFRS S1 and IFRS S2). As we discuss in further detail in Section E.5. below, the UK government has, as part of its Green Finance Strategy, stated that it intends to assess these standards and introduce mandatory reporting requirements as against endorsed standards by July 2024.

121.2.3. In the field of finance, 163 institutions with over EUR21.7 trillion in assets have signed the Finance for Biodiversity Pledge. Under the terms of the pledge, signatories commit to assess the impacts of their financing activities on biodiversity, to set and disclose targets, and to

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141 TNFD, Who We Are (accessed March 2024).

142 TNFD, TNFD Forum: At a Glance (accessed March 2024).

143 TNFD, TNFD Early Adopters (accessed March 2024).

144 UK Government, Policy paper: Mobilising green investment: 2023 green finance strategy - annexes (Updated April 2023), Section 2.2.

145 Source: https://www.businessfornature.org/make-it-mandatory-campaign#MIM-signatory-list.

report publicly on their positive and negative contribution to global biodiversity.[146]

121.2.4. The Financial Reporting Council's 2022 Annual Review of Corporate Governance Reporting noted that 46 of 100 companies surveyed had board level committees responsible for considering environmental issues, almost a quarter of which had been created in the previous year.[147] The number of companies identifying climate change (itself a nature-related risk) as a principal risk had increased from 41 in 2021 to 60 in 2022.[148]

121.2.5. A survey by the Pensions and Lifetime Savings Associations published in November 2023 found that 68% of pension funds had net zero commitments in place, compared to 57% in May 2022.[149]

(iii) The different obligations on large and smaller companies

122. We also consider that, as a general rule of thumb, the duties owed in respect of nature-related risks under s. 174 are likely to be more onerous for higher remunerated directors of large companies: "*the higher the level of reward the greater the responsibilities.*"[150]

123. In the case of larger companies, the duties of directors in identifying and managing nature-related risks is likely to be more extensive, and to extend beyond compliance with environmental or related regulations to which the company is subject. Larger companies are more likely to be exposed to compounding risks with regards to nature-related dependencies (especially in their supply chains) and impacts on nature of their activities, which can affect the company's business model, risk management and reputation.

124. However, even small companies are likely to face specific nature-related risks that the directors will be required to identify and in respect of which they will be required to acquire and maintain knowledge. A director of, for instance, a small company that runs

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[146] Finance for Biodiversity Foundation, Finance for Biodiversity Pledge (accessed March 2024).
[147] Financial Reporting Council, Annual Review of Corporate Governance Reporting (November 2023), p.26.
[148] Ibid, p.28.
[149] Pensions and Lifetime Savings Association, Number of Pension Funds with Net Zero Commitment Continues to Rise (November 2023).
[150] Re Barings plc (No. 5) [1999] 1 BCLC 433 at p.488E.

a single restaurant could hardly be expected to hire consultants and risk modellers to advise on nature-related risks. However, such a director would be subject to certain nature-related risks, such as a lack of access to key ingredients due to a decline in ecosystem services or outbreaks of an invasive species. It is reasonable to expect those directors to take steps to inform themselves of those risks and how to mitigate them.[151]

(iv) *Challenges to business decisions*

125. We consider that it would be easier to evidence a breach of s.174 where a director has failed to deal with or identify a nature-related risk and thereby exposed the company to liability, than where the director has made a business decision in relation to that risk that has not paid off. Continuing the above example of a small restaurant:

125.1. The restaurant provides single use plastic cutlery to all customers ordering takeaway meals. While the director is aware of adverse nature-related impacts of single-use plastics and the increasing legislative restrictions on their use, the costs of purchase are cheaper than FSC-certified wooden cutlery and the director considers the reputational and transition risks to be limited. In 2022, a campaign on social media to 'name and shame' and boycott businesses using single use plastics is launched and quickly gains traction. The restaurant is named and loses a significant part of its regular clientele in a short period of time, causing significant losses.

125.2. The restaurant continues to provide single-use plastic cutlery to its customers, even after legislation is passed in 2023 prohibiting this.[152] The director is completely unaware of the passage of this legislation, and only discovers its existence after the company is subjected to heavy fines.

126. Making out an allegation of breach under s. 174 in relation to the latter example will be easier than in relation to the former:

126.1. In the former case the director takes into account a relevant risk but decides not to do anything about it. This might be described as the exercise of a commercial

[151] As another example, see Brumder v Motornet Service and Repairs Ltd [2013] 1 WLR 2783, where a director of a small MOT garage was found to have breached s. 174 in circumstances where he had given no consideration to the company's obligations under relevant health and safety legislation.

[152] The Environmental Protection (Plastic Plates etc. and Polystyrene Containers etc.) (England) Regulations 2023, reg. 4.

judgment or a business decision. Unlike in certain jurisdictions, such as the United States and Australia, English law does not contain a "business judgment rule" that would shield a director from the consequences of a negligent decision made in good faith on an informed basis.[153] Nevertheless, there is some authority[154] in English law for the proposition that the Court will not substitute its opinion for that of a company's management, albeit this question is far from settled as a matter of English law, and English cases tend not to expressly identify a particular action as a business decision, such that directors in this jurisdiction should not feel that they are automatically protected from judicial scrutiny of their commercial judgments.

126.2. In the latter case, the company has suffered loss because the director has failed to comply with a strict legal duty to which the company is subject. There was no judgment or discretionary decision for the director to make.

127. The nature of the evidence necessary to demonstrate a breach of s. 174 by a director in making a decision on the management of nature-related risks was considered by the court in ClientEarth v Shell [2024] Env LR 1. The following themes can be drawn from that judgment:

127.1. The judgment suggests that a claimant would likely need to produce expert evidence on standards in the relevant industry and show that the director's conduct fell outside the range of decisions that was reasonably available to them. Such evidence could comprise both best practice standards and guidance in relation to nature-related risks (such as documents produced by ISSB, the UK's Transition Plan Taskforce, TNFD, OECD etc.) and data with regards to practices which similar companies are in fact following and implementing with regards to reporting, assessing and managing nature-related risks. This aspect of the decision has been criticised extra-judicially, as we explain below.

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[153] Keay, Directors' Duties (4th Ed.), §8.123-8.132. However, as discussed at section D.5.1. below the court can in its discretion partially or fully relieve a director of the consequences of breach where the director has acted honestly and reasonably.

[154] See e.g. Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 *per* Lord Wilberforce at 832. C.f. Andrew Keay, Joan Loughrey, Terry McNulty, Francis Okanigbuan & Abigail Stewart (2020) Business judgment and director accountability: a study of case-law over time, Journal of Corporate Law Studies, 20(2), 359-387.

127.2. The claimant should address not only the director's consideration of nature-related risks, but the other potential competing considerations and risks relevant to the company's business.[155]

(v) *Conclusion*

128. Having regard to the above, a prudent director wishing to gain protection from allegations of breach of duty under s. 174 would be well advised to identify and consider the nature-related risks the company faces. Keeping informed of the risks facing the company is a central facet of the s. 172 duty, and nature-related risks are conceptually no different to any other forms of risk. Toolkits such as those provided by the TNFD can be useful for a director in this regard. We consider that a director should both obtain and maintain sufficient knowledge of the relevant and non-trivial nature-related risks which the company may face, and in certain circumstances it may be advisable to obtain expert advice in this respect. It is not sufficient for a director to show mere awareness of the relevant risks in order to establish a defence to a claim under s. 174. A director should show that consideration has been given to the nature-related risks and that a reasonable conclusion has been reached as to what actions (if any) should be taken in light of those risks.

D.4.3. The other side of the coin: are directors under positive obligations to take action to mitigate nature-related risks?

129. As discussed above, if a director fails to identify and mitigate the nature-related risks the company faces, the director can be exposed to liability both under ss. 172 and 174. It follows from this that there will be circumstances where a company director will be required to act to mitigate these risks in order to comply with these duties.

130. In some cases, the question of what is to be done will be very straightforward. For example, a director who discovers the company is using illegally sourced timber in breach of the Timber and Timber Products (Placing on the Market) Regulations 2013 must cause the company to stop doing so. However, in a case where there is no such strict legal requirement on the company, a director will have a range of legitimate

[155] At [62]-[67]. Note, however, that it does not seem to have been Shell's case that the reason it was failing to meet the Directors' Strategy was because it had other "*competing considerations*" to balance: www.clientearth.org/media/be1h3si3/legal-briefing-clientearth-v-board-of-directors-of-shell-v2.pdf at pp. 9-10.

options as to how to manage and mitigate the nature-related risks which the company faces. The scope of the duty of good faith owed under s. 172 recognises that directors can come to differing decisions as to how to promote the success of the company. Similarly, as discussed at paragraph 77 above, in most cases there will be a range of decisions open to a reasonably competent director to comply with the duty under s.174. The key point is that, in certain situations, giving active and good faith consideration to nature-related risks might not be sufficient to discharge either duty under ss. 172 and 174, and active steps may need to be taken to address those risks in order to fully comply with the obligations to promote the success of the company and to act with reasonable care, skill and diligence. Such situations are invariably fact-specific, but could arise, for example, where there is a material chance that a nature-related risk might result in breach by the company of an environmental regulation, or reputational damage to the company, or direct financial harm resulting from supply chain interruption.

D.5. CONSEQUENCES OF BREACH

D.5.1. Relief from breach under section 1157

131. Where a director is found to have been in breach of duty to the company, the court retains a discretion under s. 1157 CA 2006 to relieve the director from the consequences of their breach (either wholly or partly) if they have acted honestly and reasonably. The court will exercise this discretion having regard to what is fair in all the circumstances of the case. A person can be found to have acted "*reasonably*" for the purposes of s. 1157, even where they have breached their duty of reasonable care and skill under s. 174.[156]

132. Both the question of whether a director has behaved reasonably, and whether the circumstances of the case justify relief, are highly fact-specific. However, in the case of breaches pertaining to nature-related risks, all else being equal, we consider that a director who has attempted to identify and consider those risks will be in a better position to evidence that they have acted reasonably than one who has not. In other words, we see no reason why any attempt to invoke s.1157 in respect of a claim for breach of duty concerning a nature-related risk would be any different, conceptually, from any other claim.

[156] See Re D'Jan of London Ltd [1993] BCC 646, 649.

D.5.2. Who can bring claims for breach of duty against a director?

133. A director's duties are owed to the company. Where these duties have been breached, the general rule is that a claim can only be brought by the company following a decision of its appropriate organ.[157] In the case of a solvent company, this will normally be its board of directors.[158] Where a company becomes insolvent and is placed into liquidation or administration, it is the liquidator or administrator who has the power to make such a decision.[159]

134. As an exception to this rule, a derivative claim can be brought by a shareholder or group of shareholders against a director on behalf of the company, under the provisions of Part 11 CA 2006.[160] In order to litigate such a claim, the permission of the court is needed under s. 261 CA 2006. This consists of a two-stage process under which, first, the claimant must demonstrate a *prima facie* case for giving permission, and second, the court then invites the company and other interested parties to provide evidence and submissions as to whether permission should be granted. The court must refuse permission if a person acting in accordance with the duty under s. 172 would not continue the claim, or if the claim relates to acts that have been ratified or authorised by the company.[161]

135. In the recent case of ClientEarth v Shell [2024] Env LR 1, the court (Trower J) refused permission at the first stage to continue a derivative claim against the directors of Shell for breaches of ss. 172 and 174 in relation to their management of climate risk.[162] It was alleged that the directors had breached their duties in: (i) failing to set an absolute emissions target to be met before 2050 or to have adequate interim targets in relation to

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[157] Foss v Harbottle (1843) 2 Hare 461.

[158] This is because the decision to issue a claim is generally considered a management decision vested in the board under the articles of association. However, in some circumstances the members may pass ordinary resolutions authorising litigation on behalf of the company, including (pertinently) where a claim is to be initiated against the directors for breach of duty: Marshall's Valve Gear Co v Manning, Wardle & Co [1909] 1 Ch 267; Danish Mercantile Co Ltd v Beaumont [1951] Ch 680. The scope of the ability of a majority of the members to take such action is doctrinally unclear, and the question is not settled: see Palmer's Company Law, §8.3703.

[159] Under s. 212 Insolvency Act 1986, a creditor or (with the leave of the court) shareholder is also entitled to apply for an order that a director who has breached their duties make payment to the company in liquidation.

[160] Assuming they do not constitute a sufficient majority to pass an ordinary resolution and come within the scope of the principle by which members acting in meeting may initiate litigation on behalf of the company (see FN 158 above).

[161] S. 263(1) CA 2006.

[162] ClientEarth separately alleged that the directors were in breach of their duty to comply with an order of the Dutch court.

Scope 3 emissions;[163] (ii) taking a strategy to manage climate risks that did not establish a reasonable basis for achieving Shell's net zero target; and (iii) failing to have complied with emission reduction obligations imposed on Shell by an order of the Dutch Court.[164] ClientEarth emphasised that Shell in particular faced stranded asset risks, assets it had already acquired being at risk of becoming unviable or less profitable as a result of the effects of climate change.[165] ClientEarth did not claim for damages, instead seeking a mandatory injunction requiring the directors to adopt and implement a strategy to manage climate change that complied with their statutory duties, and a declaration that the directors were in breach.[166]

136. While the court found that ClientEarth had established a *prima facie* case that Shell faces material and foreseeable risks as a result of climate change, it failed to establish a *prima facie* case of breach.[167] The court rejected ClientEarth's argument that irrationality alone could constitute a breach of s. 172.[168] In relation to the allegations of breach under s. 174, the court placed particular weight on the fact that no expert evidence had been adduced, and that, further, what evidence had been adduced failed to properly consider the other interests and duties that the directors would have to take into account when considering how to act in Shell's best interests.[169] As to the remedies, the court held that it would not grant a mandatory injunction that required constant supervision, and that a declaration would have no utility.[170] Further, while the claimant may have believed that the claim was in the company's best interests, its primary purpose for bringing the claim was to advance its own policy agenda.[171]

137. We draw the following points in relation to derivative claims pertaining to the managing of nature-related risks from the Client Earth v Shell decision:

137.1. Unlike in cases of negligence against, for example, doctors or accountants, claims against directors under s. 174 have been proven without use of expert

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163 Scope 3 emissions are the indirect emissions which arise when a company's products are used by its customers, whilst Scope 1 emissions are direct emissions from (e.g. in the case of Shell) its production of oil and gas and Scope 2 emissions are indirect emissions from the generation of energy used to carry out a company's operations (e.g. in the case of Shell the refining of oil). See the judgment at [42].

164 At [39].

165 At [44].

166 At [19].

167 At [45]-[46].

168 At [30].

169 At [59]-[68].

170 At [81]-[83].

171 At [87]-[92].

evidence.[172] However, it has been increasingly expected that cases brought against professional directors where the breach is not "*glaring and obvious*" be supported by expert evidence.[173] Thus, even at the first stage of an application for permission, it may be necessary for a claimant to adduce expert evidence as to what a reasonable board in the position of the relevant company would have done, to demonstrate a *prima facie* case of breach of s. 174. While this element of the ClientEarth v Shell judgment has been subject to extra-judicial criticism,[174] and may well not be the final word on the matter, it would be prudent to assume, as matters stand, that a complex claim in negligence against a director where the alleged breach is not "*glaring and obvious*" would be assisted by, if not require, expert evidence.

137.2. Trower J considered that a declaration that a director is in breach of duty to the company has no "*substantive effect and which fulfil[s] no legally relevant purpose*."[175] We note that Lord Carnwath, writing extra-judicially, has criticised this element of the decision, drawing an analogy with the court's practice of making declarations of unlawfulness in relation to the acts of public authorities on judicial review.[176] We see the force in that criticism. In particular, a public declaration that a director or directors on the board of a large, listed company have acted in breach of duty is likely to be highly material to the question of whether those directors ought to remain in office. It might constitute a catalyst for removal of the directors by the members acting in general meeting under s. 168 CA 2006, not least given the scope for reputational damage to the company in retaining defaulting directors. No mention is made in the judgment of the general principles governing the conditions for grant of declaratory relief, such as those set out by the Court of Appeal in Rolls-Royce plc v Unite the Union [2009] EWCA Civ 387.

137.3. As regards the relevance of the motivations behind the derivative claim, Trower J, applying the principles set out in Iesini v Westrip Holdings Ltd [2010] BCC 420, held that the claim had not been brought in good faith because its primary purpose was an ulterior motive in advancing ClientEarth's own policy agenda. However, this element of the decision has also been criticised by Lord

172 Whessoe Oil & Gas Ltd v Dale [2012] PNLR 33 at [33].
173 Sharp v Blank [2019] EWHC 3096 (Ch) at [632].
174 See in particular Lord Carnwath, ClientEarth v Shell: What future for derivative claims? (February 2024) at p. 5.
175 At [83].
176 Lord Carnwath, ClientEarth v Shell: What future for derivative claims? (February 2024)' at p. 6.

Carnwath, writing extra-judicially, who has highlighted that in almost all cases of derivative action the claimant will have brought the proceedings, at least in part, for an ulterior purpose, rather than out of pure altruism: *viz.*, the protection of the value of their shareholding. We agree that it is difficult to see why ClientEarth's interest in having Shell comply with its net zero targets (for the financial benefit of Shell) and ClientEarth's own interest in seeking such compliance (because it aligns with its policy goals) should necessarily be treated as distinct rather than complementary. Nevertheless, as matters stand, we consider that in cases, like ClientEarth v Shell, where the claimant appears to have acquired its shares (particularly in small numbers) for the purposes of pursuing a derivative action, permission to continue will typically be difficult to obtain.[177]

138. The judgment in ClientEarth v Shell should not be read as a general bar to derivative claims in relation to nature-related risks being brought in the future. Lord Carnwath's writings on the topic are a reminder that a different judge could have come to a different decision to that reached by Trower J. Further and in any event, in each case the question of whether a *prima facie* breach of duty can be shown will turn on the evidence put forward.[178] An investor who is concerned generally with the company's approach to nature-related risks and who holds a significant shareholding in a company may be able to persuade a court that the proceedings had been commenced with the company's interests in mind, notwithstanding that a not-for-profit charity with a small holding like ClientEarth was unable to do so in this instance.

139. Taking these points together, the key theme emerging from the decision in ClientEarth v Shell, and which accords with our general view, is that a director who has identified and considered the company's nature-related risks is much better protected in relation to a claim brought against them than a director who does not take those steps.

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177 See by analogy Harley Street Capital Limited v Tchigirinsky [2006] BCC 209 at [134]-[141].

178 In this regard, we note that there are emerging best practice standards in relation to nature, and existing ones in relation to climate. See, for example, CCLI and Climate Governance Initiative's commentary on the ClientEarth case: *"Guidance on credible transition plans developed by the Science-based Targets Initiative, the ISSB, the UK's Transition Plan Taskforce (expected to have global influence), TCFD, GFANZ and OECD (and a wider range of organisations) on transition plans, combined with proposed UK, EU and US regulatory requirements will soon demonstrate consensus best practice methodology on emissions reductions. When combined with evidence that thousands of companies across the world are already preparing (although not necessarily publishing) transition plans, and investor expectations coalescing around the 'say on climate' initiative, the expectation of a viable transition plan is emerging as a business norm"*: https://hub.climate-governance.org/article/developments_litigation_dsclosures_due_diligence_Nov_23.

D.5.3. <u>Proving the claim following breach: compensation and loss</u>

140. As we discuss below in relation to the disclosure framework,[179] liability cannot be assessed in a vacuum. We consider it necessary to analyse how likely in practice it is that a director may be found liable for breach of duty in respect of defaults concerning nature-related risk, because that will in turn inform the answer to the question of whether a director <u>in practice</u> will be liable in respect of actions or inactions which concern nature-related risks.

141. Our analysis so far has focused on the effect that nature-related risks have on the content of directors' duties, and whether certain forms of action or inaction by a director in relation to nature-related risks might amount to a breach of duty under ss. 172 and/or 174 CA 2006.

142. However, even assuming that a director is in breach of duty in relation to nature-related risks, that does not of itself mean that the company is able to obtain a remedy against the defaulting director. One of the most important remedies to which the company is *prima facie* entitled is compensation, and as with most other areas of civil liability, the company must generally prove that the breach in question has caused it some form of loss.

143. In this section, we consider how the concepts of causation and loss might affect a claim against a director for compensation (whether equitable compensation or damages[180]), before turning in the next section to other remedies to which the company might be entitled and additional, more general consequences of breach of duty.

(i) *<u>Causation and loss: general principles</u>*

144. CA 2006 codifies the general duties owed by directors. However, those duties exist independent of the provisions of the Act. In that context, CA 2006 does not set out expressly what remedies are available when a director acts in breach of duty. Rather, s. 178(1) confirms that "*the consequences of breach (or threatened breach) of sections*

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[179] See Section E.6. below.

[180] Both remedies operate on similar principles of compensating the company for the loss caused by the director's actions. In the case of equitable compensation a director is also entitled to substitutive compensation for any company property misapplied by the director; see <u>Davies v Ford [2023] EWCA Civ 167</u> at [125]-[132]. We consider that the type of breaches of s. 172 discussed in this Opinion are generally unlikely to give rise to this form of compensation.

171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied". S. 178(2) then goes on to state that "*the duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors*".

145. The duty under s.172 is equitable or fiduciary in nature with the remedy for financial loss being equitable compensation. In contrast, the duty under s.174 is a duty of care owed at common law for which the remedy for financial loss is an award of damages. The compensatory principles which underpin both remedies are similar although not identical and the distinction between these two forms of redress remains controversial. For the purpose of this Opinion, it suffices to note that:

    145.1. The duty under s.174 is not treated differently to any other duty of care in tort simply because it is owed by a fiduciary. As Millett LJ (as the then was) pointed out in Bristol and West Building Society v Mothew [1998] Ch 1: "*it is inappropriate to apply the expression* [breach of fiduciary duty] *to the obligation of a trustee or other fiduciary to use proper skill and care in the discharge of his duties*".[181]

    145.2. Claims for both equitable compensation and damages must involve proof of a causal connection between the breach of duty and the loss suffered. Claims for equitable compensation are not unlimited (in the sense that causation must always be proved), but such claims are assessed at the date of judgment with the benefit of hindsight, such that questions of remoteness and foreseeability do not arise.[182]

146. It follows that, generally speaking, the loss aspect of a claim for equitable compensation under s. 172 will be easier to prove than the equivalent aspect of a claim for damages under s. 174, given that the claimant company will not need to prove that the loss suffered as a result of the director's breach was reasonably foreseeable, or that the company failed to mitigate its loss. However, in claims under both ss. 172 and 174, it

[181] At 16F.

[182] See AIB Group (UK) Plc v Mark Redler & Co Solicitors [2015] AC 1503 at [135]. To that extent, Millet LJ's observation in Mothew that the distinction between equitable compensation and damages is a "*distinction without a difference*" must be treated with some caution.

will still be necessary to prove that the director's breach has caused the company loss. We consider how that requirement might apply in the context of breaches in respect of nature-related risks below.

(ii) *Causation and loss: specific examples*

147. As to identifying the adverse consequences a company faces from its nature-related risks, each case will be highly fact-sensitive. In the circumstances, it is only possible to provide high-level observations as to what impact the rules of causation, remoteness etc. might have on claims in respect of such breaches. Nevertheless, we consider that such claims will probably fall into one of the following three categories:

147.1. Breaches which result in regulatory or criminal sanctions for the company;

147.2. Breaches which result in direct damage to the company, such as the loss of a lucrative contract with a customer or increased costs where a supply chain is damaged or interrupted; or

147.3. Breaches which result in indirect damage to the company, such as reputational damage to the company and/or a diminution of the company's share premium.

148. First, in respect of breaches of duty which result in regulatory or criminal sanctions such as fines, we consider that these are conceptually the most straightforward in terms of proving that the breach has caused the company loss. It should be relatively straightforward to prove that a breach of duty in respect of a nature-related risk (such as a fine on the company because of a failure by a director to ensure that the company complies with environmental regulations) has caused loss to the company. Such loss is likely to be reasonably foreseeable. There are two points worth noting about such losses:

148.1. First, care must be taken to distinguish between regulatory or criminal sanctions imposed upon the company, and those imposed expressly on the director. For example, we explain below that a director who fails to comply with obligations in respect of preparing the strategic report may be subject to a fine for having committed a criminal offence.[183] The latter are not losses suffered by the company and therefore cannot be the subject of a claim for compensation.

[183] S. 414D CA 2006. See below at paragraph 199 and FN 253.

148.2. Second, it should be noted that there are some limitations on when a company can bring a claim against its director to recover losses suffered by the company as a result of criminal or regulatory fines. In Safeway Stores Ltd v Twigger [2011] Bus LR 1629, for example, the Court of Appeal held that a company sanctioned under the Competition Act 1998 for anti-competitive activity could not seek to recover this loss by way of a claim against the company's directors, the claim being based on the company's own wrongdoing.

148.3. The scope of the decision in Safeway has been substantially narrowed by the subsequent decision of the Supreme Court in Bilta v Nazir [2016] AC 1. A fine or penalty will only be irrecoverable by the company against its directors as a matter of policy, where under the relevant regulatory framework responsibility for the fine is meant to fall on the company alone.[184] We therefore consider that there remains scope for a company to claim against directors for losses the company has suffered in the form of penalties, where those penalties have been caused by the director's breach of duty in relation to the company's nature-related risks (albeit each case will turn on its own facts and the relevant legislation or regulation in question).

149. Second, in respect of breaches of duty in relation to the company's nature-related risks which result in direct losses to the company, we consider that these are also capable of being the subject of a claim for compensation. In practice, such scenarios might be rare. One example may arise where a director fails, in breach of ss. 172 and 174, to stop an ongoing and serious nature-related impact caused by the company (such as highly dangerous and extensive pollution to a local ecosystem). The discovery of that impact may then result in direct financial loss, such as ongoing negotiations with a third party falling through because the third party refuses to contract with the company as a result of that impact, or damage to the company's supply chain, insofar as it was dependent upon the local ecosystem, pushing up operating costs.

150. In those circumstances (or in any comparative examples of direct loss), we consider that it will be necessary to distinguish between claims under s. 172 and under s. 174. This is because, as we have set out above, claims in respect of the former duty are not subject to questions of foreseeability and remoteness, whereas the latter are. It may therefore be

[184] Re Mobigo Ltd [2022] EWHC 1349 at [52]-[53].

easier to prove breach under s.174 (because of the objective standard), but proving causation is likely to be more difficult.

151. The relationship between nature-related risks and pecuniary losses to companies is as yet untested in the English courts. However, we regard it as axiomatic that nature-related risks are capable of causing financial loss (both direct and indirect) to companies.[185]

152. Our view is that losses suffered by the company which are directly caused by a breach of duty concerning a nature-related risk should not be treated any differently, conceptually, from any other type of loss. The question will be whether a causal link can be proved between the breach and the loss.

153. Third, even where the loss suffered is more difficult to quantify because it is an indirect loss (for example where a director has caused reputational damage to a company that has led to a general loss of trade)[186] a director may nevertheless be exposed to a claim for damages or compensation. As with our analysis of direct losses, we see no reason why, conceptually, indirect losses which are caused by breaches concerning nature-related risks should be treated any differently than other types of breach causing indirect loss. The real question in such cases is whether the claimant will be able to prove a causal link between the breach and the indirect loss suffered. That will inevitably be a more difficult task, as is the case with any claim based on indirect loss as opposed to direct loss (i.e. this is unrelated to the fact that we are concerned here with nature-related risks).

154. This is an area which remains relatively untested in the English courts.[187] It may be that such claims for indirect losses would in practice centre around reputational damage

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185 Of course, there is also not always a bright-line distinction between direct and indirect losses (and we only draw the distinction here to demonstrate that the burden of proving a causal connection between the breach and the loss suffered sits on a sliding scale). Where, for example, breach in respect of a nature-related risk results in damage to a company's supply chain, the actual pecuniary loss suffered by the company might be considered an indirect loss. For instance, a consumer goods company which fails to invest in natural capital in its sourcing regions to protect its supply chain may be exposed in the future to reductions or increased prices in its supplies. There is no clear right answer as to whether the losses associated with the failure to protect the supply chain are better described as direct or indirect losses.

186 This is conceptually distinct from the example of direct loss given above, where it is assumed that a specific contract, which was in the course of being negotiated, falls through as a result of the discovery of the breach, or the company has an easily quantifiable increase in operating costs.

187 It is worth noting, for example, that in ClientEarth v Shell, the remedies sought did not include any compensation on behalf of Shell.

caused by a breach concerning nature-related risks, although such losses will be difficult to quantify.

(iii) *Causation and loss: conclusions*

155. A breach of ss. 172 and/or 174 by a director may give rise to a variety of losses suffered by the company, both direct and indirect. That is just as much the case in respect of breaches concerning nature-related risks. We do not consider that breaches in respect of nature-related risks are conceptually different (and likely would not be treated by a court as being conceptually different) to any other breach, with regards to the relevant rules of causation, remoteness and mitigation.

156. Nevertheless, breaches of duty in respect of nature-related risks do give rise to unique factual scenarios in terms of the losses suffered by the company. Fines and other penalties in respect of breaches of environmental regulation are an obvious example. Similarly, we refer below to evidence that investors are demanding a biodiversity footprint premium in respect of publicly traded shares.[188] It seems to us to be increasingly likely that a breach of duty concerning nature-related risks might lead to large-scale reputational damage and both direct and indirect losses to the company. Whether a claim is brought under ss. 172 or 174 may affect whether in practice such losses can be claimed; liability is harder to establish under s.172 (as a result of the subjective nature of the duty), but the rules of causation are easier to satisfy. The opposite is true in respect of s. 174. In short, defaulting directors cannot wholly discount the possibility that they may be ordered to pay compensation to their company for breach of duty concerning nature-related risks.

D.5.4. Equitable relief: injunctions

157. In addition or alternatively to any order for damages or compensation, an injunction can be ordered to restrain a director from breaching the relevant duties so as to prevent any loss to the company arising. The court is unlikely to order a mandatory injunction that requires a director to take active steps to manage a company's business in a certain manner.[189] However, where a director is proposing to act in a way that would expose the company to civil and criminal action in relation to its nature-related impacts, we

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[188] See paragraph 166.1.

[189] ClientEarth v Shell [2024] Env LR 1 at [80]-[81].

consider that the court would, in principle, be able to grant injunctive relief to prevent such breaches of duty.

D.5.5. Other consequences: declaratory relief, termination of appointment and "bad leaver" provisions

158. We have referred above to the fact that Trower J in ClientEarth v Shell considered that declaratory relief in that case would not have fulfilled a legitimate purpose in that it would have had no substantive effect or fulfilled a legally relevant purpose. We have also set out above our reasons for doubting that view, in circumstances where declaratory relief in respect of director misconduct is likely to have powerful practical consequences with regards to the ability of that director to remain in office (and especially where compensatory relief against the directors might be impractical or unavailable for the reasons we have discussed above). Nevertheless, the decision in ClientEarth v Shell is likely to make obtaining declaratory relief more difficult in the context of derivative claims.

159. Even where no claim is, or can be, brought on behalf of a company, a director can suffer serious adverse consequences as a result of breaching duties under ss. 172 and 174. In particular, the question of whether a director has breached those duties is of importance in cases involving the termination of employment or the departure of a company's director. Whether a person has been validly removed as a director or had a contract of employment terminated may turn on whether or not that director's duties had been breached.[190]

160. It is not uncommon for an executive director's contract of employment to include "good leaver" and "bad leaver" clauses, dictating financial remuneration on termination of the contract. A company may seek to rely on alleged breaches of duty by a director in relation to the company's nature-related risks to contend that the director is a bad leaver, even where such breaches have not caused the company any financial loss. This can have significant financial consequences personally for a director. For example, in Richard v IP Solutions [2016] EWHC 1835 (QB), it was (unsuccessfully) alleged against two director shareholders that they had breached their duties to the company, such that

[190] See for example Stobart Group Limited v Tinkler [2019] EWHC 258 (Comm).

they constituted "bad leavers" under the terms of its articles of association, and were obliged to sell all their shares for a nominal sum.

D.6. CONCLUSIONS IN RELATION TO NATURE-RELATED RISKS AND DIRECTORS' DUTIES

161. A prudent director ought to be giving, in accordance with the duties under ss. 172 and 174, proper consideration to all relevant and non-trivial nature-related risks faced by the company.

162. As discussed above, we consider that failure by a director to mitigate or properly address the nature-related risks which the company faces can, in certain circumstances, constitute a breach of the duties under ss. 172 and 174. A director can face serious consequences for breaches of these duties including substantial claims for damages or compensation. Even in cases where it is difficult to quantify the loss the company has suffered, a director can face adverse consequences for the breach, such as termination of employment, or a challenge to any remuneration or exit package.

163. Further, in a world where activist shareholders are prepared to bring claims against directors for failing to discharge their duties in relation to climate and nature risks, boards are well advised to protect themselves by putting relevant natured-related risks (which include climate-related risks) on their agendas and by being able to demonstrate that they have given those risks proper weight and consideration in the discharge of their duties. This will give them the greatest protection against possible derivative claims or accusations of breach and will assist in demonstrating that their directors have at all times promoted the success of the company and acted with reasonable care, skill and diligence.

E. NATURE-RELATED RISKS AND DISCLOSURE

E.1. INTRODUCTION

164. In this section, we consider the relevance of nature-related risks to disclosures made, or which are required to be made, by the company's board.

165. Disclosure has been described as "*the bedrock of company law*."[191] It performs a dual function. First, disclosure allows investors and shareholders in the company (both current and prospective) to assess how the company has performed in the past and how it may perform in the future, not only by reference to its financial performance but also by reference to "*information about future plans, opportunities, risks and strategies* [which] *is just as important as the historical review of performance*".[192] Second, disclosure provides a regulatory vehicle through which the government can shape policy by either requiring or encouraging companies to disclose their impact on, or the impact on them, of a chosen area.[193]

166. Nature-related risks may be relevant to both of these functions of the disclosure regime in this jurisdiction:

    166.1. A recent stock market event study examining the impact of the Kunming Declaration and also the launch of the TNFD in June 2021 indicates that investors are demanding a "*biodiversity footprint premium*" in light of an "*increase of policy uncertainty associated with*" the introduction of regulation or litigation targeting firms with a large biodiversity footprint.[194] Thus, the extent to which a company's board chooses (or fails) to make disclosures of both nature-related dependencies and nature-related impacts could theoretically affect their company's share premium.

    166.2. BlackRock, said to be the world's largest asset manager, has stated expressly that "*we seek to understand, from company disclosures and engagement, the strategies companies have in place to manage material risks to, and*

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[191] Gower, Principles of Modern Company Law (11th Ed.), §22-001.
[192] Company Law Review Steering Group, Modern Company Law for a Competitive Economy: Final Report (2001), Volume 1, §3.33.
[193] See generally: Webster, E., Information Disclosure and the Transition to a Low-Carbon Economy: Climate-related risk in the UK and France, J. Env. L., 2020, 32(2), 279-308.
[194] Swiss Finance Institute Research Paper No. 23-24, European Corporate Governance Institute – Finance Working Paper No. 905/2023, Do Investors Care About Biodiversity? (updated February 2024), p. 7.

opportunities for, their long-term business model associated with a range of climate-related scenarios."[195] BlackRock also states that, for companies who are heavily reliant on natural capital, they will look for disclosures as to how the company manages any reliance and impact on, as well as use of, natural capital.[196]

166.3. In addition, there have been various national and supra-national efforts to introduce guidance in relation to narrative reporting which are aimed at encouraging companies to disclose information concerning certain nature-related risks, with the purpose of promoting environmental policy and objectives. One example of this so-called 'reflexive regulation'[197] is the TCFD recommendations, which have largely been incorporated into and are reflected in the English disclosure framework. The TNFD recommendations (which incorporate TCFD-aligned climate disclosure, as part of their broader framework) are also likely to impact further the disclosure regime, for reasons which we explain below.

166.4. Further, both existing accounting standards and accounting standards that are soon to be introduced (namely the UK Sustainability Disclosure Standards) may require companies to disclose information about nature-related risks, either in their financial statements or narrative reporting, as we explain at section E.5 below.

167. In that context, we have been asked to provide our opinion on whether directors of a company who perceive that nature-related risks do present risks to that company now are permitted or required to disclose those risks. We have also been asked to consider how the recommendations of the TNFD in respect of disclosures might affect the interpretation of directors' duties.

168. In order to answer those questions, we have structured this section as follows:

168.1. In Section E.2. to E.6., we provide an overview of the legislative and regulatory framework for disclosure in England and Wales, including the rules governing

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195 BlackRock, BlackRock Investment Stewardship Global Principles (January 2024), p. 12.

196 Ibid., p. 13.

197 Eric W Orts, A Reflexive Model of Environmental Regulation (1995) 5(4) BEQ 779.

disclosure of nature-related risks and the potential sources of liability for directors who fail to comply with disclosure requirements.

168.2. In Section E.7., we summarise the TNFD Recommendations, and explain how those recommendations currently fit conceptually within the disclosure framework.

168.3. In Section E.8., we examine the impact of nature-related risks on disclosure by directors. We set out when a director might be permitted or required to disclose nature-related risks, and the manner and likelihood of liability arising in respect of a failure to disclose such risks. We also briefly examine the prospect of challenges to decisions by the regulator to approve listing prospectuses on the grounds of failure to properly disclose nature-related risks.

168.4. In Section E.9., we summarise our conclusions as to whether nature-related risks can or should be disclosed by directors.

169. As we explain in further detail below, our overall conclusions are that:

169.1. The focus of the English disclosure framework is in some circumstances on the disclosure of climate-related risks,[198] because a significant section of the framework has been drafted by reference to the TCFD Recommendations. Nonetheless, the framework does presently make some provision for the disclosure of certain types of nature-related risks[199] by certain companies and in particular circumstances, most notably where disclosure of "*environmental matters*" is required. The framework itself is complex, and different disclosure standards apply to a variety of different companies. Nonetheless there is a clear and discernible trend towards the disclosure of more information regarding nature-related risks.

169.2. The TCFD Recommendations, published in 2017, are in some circumstances incorporated expressly into regulatory guidance, and in other circumstances have been used as the basis for drafting disclosure rules *de novo*. By contrast, and given their relatively recent publication, the TNFD Recommendations have not yet had any direct effect on the disclosure framework. However, the

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198 As we explain in Section C above, these are only one component of nature-related risks.
199 I.e. nature-related risks which are not, or are not solely, climate-related risks.

disclosure framework already makes some provision for disclosure of certain types of nature-related risks (beyond only climate-related risks) which underpin the TNFD Recommendations; and there is some regulatory guidance which suggests that such disclosures might sometimes be made on the equivalent of an Impact Materiality basis (i.e. not only a Financial Materiality basis).[200] We consider that the disclosure framework is conceptually capable of applying to nature-rated risks.

169.3. Whether a director is permitted or required to disclose nature-related risks will depend on the facts and circumstances of the individual company in question. However, we consider that it would be unusual for a director not to be permitted to make such disclosures, and we address below the question of whether a director might be exposed to liability for 'over-disclosure' (our view being that such liability would be difficult to establish). As to whether a director is under an obligation to make those disclosures, this will principally turn on the application of the statutory and regulatory rules governing the disclosure concepts of "*environmental matters*" and "*climate-related financial disclosures*".

169.4. There is an express statutory link between the disclosure given by the directors and the discharge of their duties under s. 172 CA 2006. We consider that compliance with the statutory disclosure rules and, to a lesser extent, voluntary compliance with the TNFD recommendations where appropriate, is likely to be a factor which is relevant to assessing whether the s. 172 duty (and, possibly, the s. 174 duty) has been discharged.[201]

169.5. There is no straightforward mechanism for imposing *ex post facto* liability on directors for failures to comply with disclosure requirements. Directors are given a relatively high level of discretion and protection as a matter of English law in this area. Nevertheless, the increased public prominence of nature-related

[200] See paragraphs 179.4 and 179.6 below on s. 414C(7) CA 2006 (in relation to quoted companies), s. 414CZA (in relation to reporting on the s. 172 duties) and paragraph 188.2 below in relation to The Financial Reporting Council Guidance on the Strategic Report. See also paragraph 196.

[201] Australian law appears to recognise that a director can be subject to distinct responsibilities with regards to complying with disclosure rules: see ASIC v Healey [2011] FCA 717 *per* Middleton J: "*There is a responsibility* [on the directors] *to read, understand and focus upon the contents of those reports which the law imposes a responsibility upon each director to approve or adopt.*"

risk disclosures is likely to act as an incentive for directors to ensure proper compliance with their obligations in respect of disclosure, and we consider that directors should give careful thought as to whether nature-related risk disclosures ought to be given even where there may be no strict statutory obligation to do so.

E.2. OVERVIEW OF THE DISCLOSURE REGIME IN ENGLAND AND WALES

170. Disclosure is a fundamental component of English company law.[202] The rules giving rise to obligations in respect of corporate disclosure are principally statutory, although those rules are supplemented significantly by both regulatory guidance and accounting standards. The English disclosure framework is thus derived from three distinct sources. It is highly technical and complex. What a company[203] must disclose is determined by a range of factors, such as: its turnover; the number of its employees; whether it is private or public (and in respect of the latter, whether it is a "*quoted*" and/or "*listed*" company); and whether it is subject to additional EU law requirements as a result of, for example, operating a large branch in a Member State. A director will need to take advice from legal and accounting professionals who are experienced in these reporting requirements to understand how to properly present the company's disclosures. The purpose of this section of our Opinion is not to detail the technical application of that regime; rather, its purpose is to illustrate that, for financial reporting purposes, certain directors will often need to have regard to nature-related risks.

171. As at the date of this Opinion, the UK government has not yet adopted a system of wholesale, mandatory nature-related risk disclosure for all English companies. Rather, the disclosure framework draws a distinction between different corporate entities on the basis of size and company type, with certain companies obliged to report on environmental matters which principally concern the relevant company's nature-related dependencies and its nature-related impacts. Further, the current regime places greater

[202] Since 1862, every successive Companies Act has introduced additional obligations in respect of disclosure requirements: *Op. cit.*, FN 191.

[203] We refer throughout this section of the Opinion to the position governing limited companies. However, it should be noted that climate-related financial disclosures must also be given by certain large occupational pension schemes and LLPs with more than 500 employees and a turnover of more than £500 million: see the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (SI 2021/839) and Limited Liability Partnerships (Climate-related Financial Disclosures) Regulations 2022 (SI 2022/46) respectively. Given our focus on the duties of directors, analysis of those Regulations is outside the scope of this Opinion.

focus on the narrower concept of climate-related disclosures, at least in respect of larger companies.

172. The primary vehicle through which such reporting is conducted is the relatively recent[204] concept of a strategic report, the stated purpose of which is to help the members of the company assess how the directors have performed their duty under s. 172 CA 2006.[205] There is therefore a direct statutory link between a company's disclosure requirements (including, in certain circumstances which we identify below, disclosure of certain types of nature-related dependencies and impacts) and the assessment of whether the directors have discharged their duties to promote the success of the company.

173. In the remainder of this section, we set out the aspects of the disclosure framework which are relevant to the question of whether nature-related risks can or must be disclosed. We also set out the primary mechanisms by which those disclosure obligations can be enforced, in circumstances where "*company law itself gives* [stakeholders] *no particular platform from which to take action on the basis of the information* [contained in the strategic report]."[206]

174. In order to properly examine the relationship between nature-related risks and the disclosure framework, our analysis proceeds in the following stages:

174.1. First, we set out the primary statutory rules which are the foundation for the disclosure regime. We identify the provisions which are relevant to disclosure of nature-related risks, in particular with regards to the strategic report, where disclosure of nature-related risks is in practice likely to take place.

174.2. Second, having set out those statutory rules, we turn to consider the areas of 'soft law' which supplement and clarify the statutory rules. We start by

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204 Relative in company law terms. The concept of the strategic report was first introduced by way of the Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005 (SI 2005/1011), albeit those regulations were repealed shortly thereafter. For an overview of the convoluted history of the introduction of the strategic report, see Gower, Principles of Modern Company Law (10th Ed.), §21-24.

205 S. 414C(1) CA 2006.

206 Gower, Principles of Modern Company Law (11th Ed.), §22-027. Our instructing solicitors have made us aware of recent cases in Australia in which shareholders have relied on s. 247A Corporations Act 2001 to apply to court to inspect their company's books and records to enable scrutiny of public-facing sustainability disclosures. English law does not have an equivalent provision to s. 247A Corporations Act 2001, and in fact the Model Articles for both private and public companies expressly provide that "*except as provided by law or authorised by the directors or an ordinary resolution of the company, no person is entitled to inspect any of the company's accounting or other records or documents merely by virtue of being a member*."

examining three areas of regulatory guidance which provide further insight into disclosure of nature-related risks.

174.3. Third, we then consider the other area of 'soft law' which is relevant to nature-related risks: accounting standards. We look in particular at the recent introduction of accounting standards governing sustainability-related financial information and climate-related disclosures.

174.4. Fourth, having set out the primary and secondary sources of law governing nature-related risk disclosures, we analyse their impact on the obligations of directors and whether directors might attract liability in respect of failures to properly comply with the disclosure framework.

E.3. THE STATUTORY RULES AND THE NARRATIVE REPORT

E.3.1. Introduction to the statutory rules governing disclosure

175. Broadly speaking, CA 2006 distinguishes between two types of disclosure which must be given by a company: financial reporting and narrative reporting.

176. In relation to financial reporting, directors are obliged to maintain accounting records and to prepare a set of accounts for each financial year.[207] They must also only approve those accounts if they are satisfied that they "*give a true and fair view of the assets, liabilities, financial position and profit and loss*" of the company: s. 393(1) CA 2006.[208] The question whether financial reporting might fail to give a true and fair view of the company if nature-related risks are not factored into that reporting is not a topic for this Opinion. However, we note that Mr George Bompas KC gave an Opinion on 8 January 2024 which considered the extent to which directors and auditors need to consider whether "*sustainability related information*" must be disclosed in the financial reports to satisfy the true and fair requirement (the "**Bompas KC Opinion**"). We therefore say very little about the impact of nature-related risks on financial reporting in this Opinion,

[207] Ss. 386 and 394 CA 2006 respectively.

[208] The company's auditors must also give their view on whether the accounts give a true and fair view: s. 495(3) CA 2006.

save to state that the conclusions of the Bompas KC Opinion are consistent with our view as to the impact of nature-related risks on narrative reporting.[209]

177. In relation to narrative reporting, company law requires the directors to prepare three separate narrative reports each year: a strategic report; a directors' report; and a directors' remuneration report.[210] It is in these reports, and in particular the strategic report, that the prospect of disclosures concerning nature-related risk becomes most relevant.[211] We therefore focus on the rules concerning narrative reporting in the remainder of this Opinion.

E.3.2. <u>Statutory requirements in relation to the strategic report</u>

178. The rules governing the preparation of the strategic report are set out in Part 15, Chapter 4A, CA 2006. A strategic report must be prepared by all companies for each financial year unless the company is subject to the small companies exemption: s. 414B CA 2006.[212] Its purpose is explained expressly as being to "*inform members of the company and help them assess how the directors have performed their duty under section 172*": s. 414C(1) CA 2006.

179. The contents of the strategic report are prescribed by s. 414C CA 2006. Relevant for the purpose of this Opinion are the following:

    179.1. The strategic report must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company: s. 414C(2).

    179.2. The review required is a balanced and comprehensive analysis of the development and performance of the company's business during the financial

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209 Namely, that directors must be "*aware of possible impacts on the financial statements* [and, in the context of this Opinion, the narrative reports] *flowing from sustainability-related issues* [and, in the case of narrative reports at least, nature-related risks], *just as they must be in the case of any other areas of material risk or probable or possible change which may be relevant to the company's activities*": Bompas KC Opinion at §67.

210 These requirements are modified depending on company type: see <u>Gore-Brown on Companies</u>, Chapter 36A at [1].

211 The other primary facets of narrative reporting are the directors' report and the corporate governance statement. Neither of these is likely to be the primary vehicle through which disclosure of nature-related risks will in practice take place in any significant way (if at all), and so we do not consider them further in this Opinion.

212 I.e. companies which are entitled to prepare small company accounts. These are companies which satisfy two or more of the following: a turnover of no more than £10.2 million; a balance sheet total of no more than £5.1 million; and no more than 50 employees (s. 382 CA 2006).

year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business: s. 414C(3).

179.3. The report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include analysis using financial key performance indicators,[213] and where appropriate, analysis using other key performance indicators, "*including information relating to environmental matters and employee matters* (underlining added)": s. 414C(4). However, the requirement for the strategic report to include analysis using non-financial key performance indicators (such as information relating to environmental matters) is expressly disapplied in relation to medium-sized companies[214] by s. 414C(6).

179.4. Additional reporting requirements are imposed upon quoted[215] companies. Relevant for the purpose of this Opinion is the fact that the strategic report must, "*to the extent necessary for an understanding of the development, performance or position of the company's business*", include "*information about environmental matters (including the impact of the company's business on the environment)... including information about any policies of the company in relation to those matters and the effectiveness of those policies.*": s. 414C(7)(b)(i). This obligation is additional to s. 414C(4) and broadly reflects what we have referred to throughout this Opinion as a company's nature-related impacts.

179.5. There is a carve-out in respect of information about "*impending developments or matters in the course of negotiation*." The directors are not required to include such information in the strategic report if in their opinion it would be "*seriously prejudicial to the interests of the company*": s. 414C(14).

179.6. Unless the company in question is a medium-sized company, the strategic report must include a "**Section 172(1) Statement**", being a statement which "*describes*

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[213] "*Key performance indicators*" are defined as "*factors by reference to which the development, performance or position of the company's business can be measured effectively*": s. 414C(5) CA 2006.

[214] I.e. companies which satisfy two or more of the following: a turnover of no more than £36 million; a balance sheet total of no more than £18 million; and no more than 250 employees (s. 465(3) CA 2006).

[215] I.e. companies whose equity share capital has been included in the official list in accordance with the provisions of Part 6 of FSMA 2000, or is officially listed in an EEA State, or is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq: s. 385(2) CA 2006.

how the directors have had regard to the matters set out in section 172(1)(a) to (f) when performing their duty under section 172": s. 414CZA. We have set out above in section D.4.1 how nature-related risks may impact upon a director's compliance with their duty under s. 172, and the fact that s. 172 expressly requires a director to have regard to the impact of the company's operations on the community and the environment.

180. In addition to the above, specific provision has been made in the CA 2006 since 2016 for the inclusion of a 'non-financial information statement' in the strategic report which must contain information relating to environmental matters. The level of detail which must be included in that statement has increased over time, culminating most recently with the coming into force of the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (the "**2022 Strategic Report Regulations**"), whose amendments to ss. 414CA and 414CB CA 2006 apply to financial years commencing on or after 6 April 2022. Those regulations have enlarged both the scope and the content of what is now the 'non-financial <u>and sustainability</u> information statement' (underlining added) and were intended to reflect the TCFD Recommendations.[216] In particular:

180.1. A non-financial and sustainability information statement must be included in the strategic report of five types of company: traded companies; banking companies; authorised insurance companies; companies carrying on insurance market activity; and companies whose securities are admitted to trading on the AIM: s. 414CA(1) CA 2006.[217] It must also be included where the company, or a member of its group if it is the parent, has a turnover of more than £500 million: s. 414CA(2A).

180.2. There are exceptions to the requirement to provide a non-financial and sustainability information statement, such as where the company is a small or

[216] As we have set out above in Section C, the TCFD Recommendations preceded and are distinct from the TNFD Recommendations. Although the latter have incorporated the former, there are some substantive distinctions. The TNFD Recommendations, for example, include three additional nature-specific disclosures which cover topics such as priority locations and stakeholder engagement. They also place more emphasis on impacts than the TCFD Recommendations.

[217] The application to companies listed on the AIM was an addition expressly introduced by the 2022 Strategic Report Regulations, albeit the obligation to include information relating to "*environmental matters*" (which we explain in more detail below) applies only to the other four categories of companies which must produce a non-financial and sustainability information statement: s. 414CB(1).

medium-sized company or where it has no more than 500 employees: s. 414CA(3)-(4).

180.3. The contents of the non-financial and sustainability information statement are set out in s. 414CB CA 2006. The 2022 Strategic Report Regulations have significantly added to the disclosures required in respect of "*climate-related financial disclosures*", which must be contained in the non-financial and sustainability information statement: s. 414CB(A1). Although that phrase suggests a narrower category of information than nature-related risks disclosure, nevertheless it is clear from s. 414CB CA 2006 itself that climate-related financial disclosures could extend to, for example, nature-related dependencies which might impact a company's financial outlook.[218] Thus, the information to be included is set out in s. 414CB(2A) as follows:

(2A) In this section, "climate-related financial disclosures" mean—

(a) a description of the company's governance arrangements in relation to assessing and managing climate-related risks and opportunities;

(b) a description of how the company identifies, assesses, and manages climate-related risks and opportunities;

(c) a description of how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management process;

(d) a description of— (i) the principal climate-related risks and opportunities arising in connection with the company's operations, and (ii) the time periods by reference to which those risks and opportunities are assessed;

(e) a description of the actual and potential impacts of the principal climate-related risks and opportunities on the company's business model and strategy;

(f) an analysis of the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios;

[218] This is a result of both the breadth of matters identified in s. 414CB(2A) and also the fact that, for traded companies, banking companies, authorised insurance companies and companies carrying on insurance market activity, the information required includes "*environmental matters (including the impact of the company's business on the environment)*", where necessary "*for an understanding of the company's development, performance and position*" (s. 414CB(1)).

(g) a description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; and

(h) a description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based.

180.4. These required disclosures are undermined to a certain extent by s. 414CB(4A), which in essence allows the directors to omit the whole or part of the climate-related financial disclosures if they reasonably believe that those disclosures are "*not necessary for an understanding of the company's business*". We consider the impact of that exception on the extent to which directors are required to disclose nature-related risks in section E.8.1. below.[219]

E.3.3. Other relevant statutory rules governing disclosure

181. There are certain other statutory rules which are relevant to the extent to which nature-related risks can or must be disclosed. The most important example is the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, Sch. 7, Parts 7 and 7A, which concern "*disclosures concerning greenhouse gas emissions, energy consumption and energy efficiency action*" by quoted and unquoted companies respectively. These regulations are broadly aimed at requiring companies (subject to a practicability exception) to disclose in either the directors' report or the strategic report information regarding their annual greenhouse gas (carbon dioxide equivalent) emissions (expressed as a ratio to a quantifiable factor associated with the company's activities) and steps taken to increase energy efficiency during the financial year. Plainly, greenhouse gas emissions and energy consumption figures are principally climate-related concepts; but, as we have set out above, climate change has been identified as a driver of biodiversity loss and itself constitutes one aspect of the broader concepts of nature-related impacts and dependencies. These rules are therefore a clear example of mandatory disclosure requirements with regards to two particular facets of nature-related risks.

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[219] See paragraph 188.4 below for the Financial Reporting Council's guidance on the limits of this carve-out in relation to materiality.

182. In addition, certain companies domiciled in England may be subject to requirements under EU law to give disclosure in respect of "*sustainability matters*" under the 2023 Corporate Sustainability Reporting Directive ("**CSRD**").[220] "*Sustainability matters*" means environmental, social and human rights, and governance factors.[221] Notwithstanding the UK's exit from the EU, an English-domiciled company might nevertheless be subject to the requirements of the CSRD as a result of its securities being admitted to trading on a regulated market in the EU, or as a result of having a branch within the EU which meets the qualifying criteria for reporting on "*sustainability matters*".[222] The disclosure required is detailed and captures both nature-related impacts and dependencies. It requires disclosure of, for example "*a description of the principal risks to the undertaking related to sustainability matters, including a description of the undertaking's principal dependencies on those matters, and how the undertaking manages those risks*" and "*a description of... the principal actual or potential adverse impacts connected with the undertaking's own operations and with its value chain, including its products and services, its business relationships and its supply chain, actions taken to identify and monitor those impacts, and other adverse impacts which the undertaking is required to identify pursuant to other Union requirements on undertakings to conduct a due diligence process*."[223]

E.3.4. <u>Conclusions in relation to the statutory disclosure rules</u>

183. Drawing the above threads together, the statutory disclosure framework is conceptually capable of permitting, and in certain cases requiring, directors of companies to disclose nature-related risks.

184. We have intentionally set out the statutory framework in detail to highlight the fact that the rules are piecemeal and complex, with different requirements applying to different sizes and types of companies. Doing so also makes clear that there is at present no statutory framework which expressly places the concept of <u>nature</u>-related risk, as we have used that term in this Opinion, at the centre of environmental disclosures. Rather,

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[220] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

[221] Article 1(2)(b) CSRD.

[222] Discussion of these criteria is outside the scope of this Opinion, and specialist advice should be sought as to whether an English-domiciled company might nevertheless be subject to EU reporting requirements, whether under CSRD or otherwise.

[223] Article 1(4) CSRD.

the two separate concepts of "*environmental matters*" and "*climate-related financial disclosures*" instead form the current springboard for environmental disclosures, albeit that we consider that the concept of "*environmental matters*" in particular (which is undefined in the legislation) is broad enough to capture certain categories of nature-related risks.[224]

185. This means that the extent to which company directors can or must disclose nature-related risk will vary on a company-by-company basis, such that it is only possible to provide a high-level view as to what the statutory disclosure framework requires in respect of nature-related risk disclosure. Nevertheless, there is a clear trend in favour of increasing the extent to which nature-related risks must be disclosed. That trend is also evident in the introduction of regulation and accounting guidance relating to such disclosures, to which we now turn.

E.4. REGULATORY GUIDANCE RELEVANT TO NATURE-RELATED RISK DISCLOSURES

E.4.1. Introduction

186. The statutory requirements relating to disclosure which have been described above are augmented by two categories of 'soft law', one of which is regulatory rules and guidance. There are three sources in particular which we consider to be relevant to the question of the extent to which nature-related risk can or must be disclosed. These are:

    186.1. The Financial Reporting Council Guidance on the Strategic Report (the "**FRC Guidance**")[225];

    186.2. The Listing Rules in the UK Corporate Governance Code (the "**Listing Rules**"); and

    186.3. The UK Corporate Governance Code more generally.

E.4.2. FRC Guidance

187. The FRC Guidance was updated in 2022 *inter alia* to incorporate climate-related financial risks and opportunities into the guidance in line with the TCFD

[224] We have set out above at FN 216 the fact that the climate-related financial disclosures are intended to reflect the TCFD Recommendations, which preceded and are narrower in scope than the TNFD Recommendations.
[225] Financial Reporting Council, Guidance on the Strategic Report (June 2022).

Recommendations. The guidance has not yet been updated to incorporate the more extensive TNFD Recommendations, albeit there are indications that this is under consideration.[226] As such, the FRC Guidance does not expressly discuss the distinction between 'Financial Materiality' (i.e. the sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects)[227] and 'Broader or Impact Materiality'[228] (which is the impact of the business on the economy, environment and people). Rather, as we explain below, the guidance adopts a general materiality criterion in relation to all disclosures which broadly mirrors Financial Materiality; but in the context of disclosure relating to "*environmental matters*", it recommends a broader approach which is more akin to Impact Materiality.

188. The most significant points for the purpose of this Opinion are that:

188.1. The strategic report and the annual report more broadly should contain information that is material to shareholders, including information that enables shareholders to assess the directors' stewardship. Information is considered material if "*its omission or misrepresentation could reasonably be expected to influence the economic decisions which shareholders take on the basis of the annual report as a whole*".[229] Materiality depends on the nature of the matter and magnitude of its effect, with qualitative factors having the greater influence on determining materiality of non-financial information. The FRC Guidance states in general terms[230] that when considering whether information on the impact of an entity's activities on the environment is material, the directors should consider the implications for the company's long-term value generation arising from stakeholder, legal or regulatory responses.[231]

188.2. One section of the FRC Guidance is devoted to quoted companies. Here, the guidance builds upon the obligation under s. 414C(7)(b)(i) CA 2006 to disclose

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[226] The House of Commons Environmental Audit Committee recommended in a 22 November 2023 report that the compulsory reporting in line with TNFD Recommendations should be phased in for the largest companies over the next 3 to 5 years (although c.f. FN 239 below): House of Commons Environmental Audit Committee, The Financial Sector and the UK's Net Zero Transition (First Report of Session 2023-24), 22 November 2023.

[227] See Section C above.

[228] See Section C above.

[229] Financial Reporting Council, Guidance on the Strategic Report (June 2022), p. 19, §5.1.

[230] I.e. by reference to its own definition of materiality; not by reference to the statutory provisions which we have examined above.

[231] Financial Reporting Council, Guidance on the Strategic Report (June 2022), p. 19, §5.5.

information about "*environmental matters*". It states that information concerning environmental matters should be integrated throughout the report and not considered in isolation, and that when determining the appropriate level of information to disclose in the strategic report in this respect, entities should consider amongst other things the potential severity or frequency of impacts on the environment (which, although it does not itself adopt this language, broadly reflects the concept of nature-related impacts).[232] They should also consider the extent to which a particular matter has an effect on an entity's business model, its sources of value (such as intangible assets, including its goodwill and reputation, in addition to its tangible assets), its market share or whether it constitutes a major issue facing the sector in which the entity operates. These aspects of the guidance are broadly similar to disclosure of nature-related risks on an Impact Materiality basis, which therefore reinforces our view that the obligation to make disclosures of "*environmental matters*" may be broad enough in certain circumstances to encompass disclosure of certain types of nature-related risks on an Impact Materiality basis.

188.3. The FRC Guidance gives the following as example questions for a board to consider in relation to the obligation to disclose information relating to "*environmental matters*", which encompass both nature-related impacts and nature-related dependencies: "*Is the entity's business model reliant on natural resources such as water, land or minerals? Does the use of these resources result in other secondary impacts on natural resources? What is the entity's impact on the environment? What are the pollution risks from the entity's activities? Will the entity's business be affected by climate change, either as a result of regulation or climate change affecting how the business can operate? What are the effects of an entity's activities on climate change?*"[233]

188.4. Although a separate section[234] of the FRC Guidance is dedicated to climate-related financial disclosures in the strategic report, there is little material which adds to the express terms of s. 414CB CA 2006. The FRC Guidance does, however, link the carve-out in s. 414CB (which permits directors to omit

[232] Financial Reporting Council, Guidance on the Strategic Report (June 2022), pp. 34-35, §7A.37 and §7A.40.
[233] Financial Reporting Council, Guidance on the Strategic Report (June 2022), p. 35.
[234] Financial Reporting Council, Guidance on the Strategic Report (June 2022), Section 7C, pp. 59-60.

climate-related financial disclosures where those are not necessary for an understanding of the company's business) with the concept of materiality, suggesting that only where the directors have concluded that climate-related risks are immaterial should they be omitted from the strategic report.

E.4.3. The Listing Rules

189. The Listing Rules were updated in January 2021 to introduce an additional set of disclosure rules for 'premium listed' companies, i.e. companies on the Main Market of the London Stock Exchange ("**LSE**") which have chosen 'premium' rather than 'standard' listing.[235] Such companies are required to disclose, on a 'comply or explain' basis, whether they have made "*climate-related financial disclosures consistent with the TCFD Recommendations*" and, if not, the reason for not including those disclosures.[236] As with the FRC Guidance, the Listing Rules have therefore been directly influenced by the TCFD Recommendations. By contrast, the TNFD Recommendations, which were published much more recently, are not yet referred to in the Listing Rules, albeit as we have explained above, the integration of the TCFD Recommendations into the regulatory framework may provide a precedent for something similar to happen with respect to the TNFD Recommendations in the future.

E.4.4. The UK Corporate Governance Code

190. The Corporate Governance Code does not make express reference to the types of issues which might constitute nature-related risks. Instead, high-level guidance is provided in relation to which nature-related risks might be relevant. For example, the Corporate Governance Code recommends that the board should assess the basis on which the company generates and preserves value over the long-term.[237] An assessment of the basis on which a company generates and preserves value could in some circumstances encompass an assessment of nature-related dependencies (for example, in relation to a particular dependency on natural capital in the company's supply chain) as described in Section C above. The Corporate Governance Code also recommends that the board should carry out a robust assessment of the company's emerging and principal risks.[238]

[235] See Listing Rules 1.5.
[236] Listing Rules 9.8.6(8).
[237] Financial Reporting Council, UK Corporate Governance Code (July 2018), Provision 1.
[238] Ibid., Provision 28.

There is no conceptual or theoretical reason why nature-related risks might not, in certain circumstances, fall within these recommendations. One example might be a company producing diesel or petrol-fuelled vehicles, which would likely face emerging nature-related transition risks in the form of macroeconomic transitions to hybrid and electric vehicles. Another example might be a company which uses manufacturing or farming techniques which are associated with drivers of biodiversity loss and which are therefore subject to transition risks relating to the possible regulation of those techniques. In any event, what is clear is that the UK Corporate Governance Code offers less direct guidance on the provision of nature-related risk disclosure. Although at one stage a revised code was proposed which would have required the board to report on how environmental matters had been taken into account in the delivery of the company's strategy, those plans appear to have recently been dropped.[239]

E.5. ACCOUNTING STANDARDS

191. The other category of 'soft law' which supplements the statutory rules on disclosure is accounting standards.

192. The International Sustainability Standards Board ("**ISSB**")[240] published two sets of standards on 26 June 2023, being 'General Requirements for Disclosure of Sustainability-related Financial Information' (IFRS S1) and Climate-related Disclosures (IFRS S2).

193. IFRS S1 does not itself include mandatory nature-related risk disclosures, but instead provides a framework within which such disclosures may be made indirectly as part of an entity's disclosure of its sustainability-related risks and opportunities. For example, paragraph 55(b) of IFRS S1 provides that an entity "*may refer to and consider the applicability of CDSB Framework Application Guidance for Water-related Disclosures and the CDSB Framework Application Guidance for Biodiversity-related Disclosure*" when identifying sustainability-related risks and opportunities that ought to be disclosed.

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[239] See https://www.frc.org.uk/news-and-events/news/2023/11/statement-frc-policy-update/.

[240] The creation of the ISSB was first announced at COP26 for the purpose of creating a global baseline for sustainability reporting.

194. IFRS S2, on the other hand, is expressly designed to "*require an entity to disclose information about its climate-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity*."[241] Again, and as with the FRC Guidance and the Listing Rules, the focus of IFRS S2 is on climate-related disclosures, which form only a part of nature-related risk. IFRS S2 requires disclosure of a wide range of information concerning an entity's climate-related risks and opportunities, such as how the entity "*takes into account climate related risks and opportunities when overseeing the entity's strategy, its decisions on major transactions and its risk management processes and related policies, including whether the body(s) or individual(s) has considered trade-offs associated with those risks and opportunities*."[242]

195. Three things should be borne in mind with regards to these IFRS standards:

195.1. First, there are, broadly speaking, two sets of accounting standards applicable in the UK, namely: (i) UK Generally Accepted Accounting Practice ("**UK GAAP**") standards; and (ii) UK-adopted international accounting standards.[243] IFRS standards only have effect in the UK to the extent that they are adopted by the UK under the latter regime.[244] However, the UK government has stated that it plans to adopt both ISSB standards through the introduction of UK Sustainability Disclosure Standards by July 2024 (which presumably will standardise sustainability disclosure requirements whichever accounting standards a company has chosen to report under) and that the UK standards will only diverge from international standards if absolutely necessary for UK-specific matters.[245]

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[241] IFRS S2, paragraph 1.

[242] Ibid., paragraph 6(a)(iv).

[243] Certain listed entities are obliged to prepare their accounts in accordance with the latter under s. 403(1) CA 2006. All other entities can choose between the two standards by s.395(1) and s.403(2) CA 2006.

[244] By regulation 5 of the International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/685), the Secretary of State is tasked with the responsibility of adopting international accounting standards for use in the UK. The Secretary of State has since delegated this responsibility to the UK Endorsement Board (UKEB) under the International Accounting Standards (Delegation of Functions) (EU Exit) Regulations 2021 (SI 2021/609).

[245] https://www.gov.uk/guidance/uk-sustainability-disclosure-standards. See also Gore-Brown on Companies, Chapter 36A at [7].

195.2. Second, whilst IFRS S1 and S2 might seem to be focused predominantly on narrative reporting,[246] there are accounting standards already in existence which might require disclosure of certain types of nature-related risks as part of a company's financial statements in order to give a true and fair view of those statements.[247] In addition paragraphs 21 to 24 of IFRS S1 require reporting entities to provide information that enables users to understand the connection between sustainability-related financial disclosures and the related financial statements. We note in this respect that the UK Endorsement Board ("**UKEB**") has established a website which examines the connection and overlap between accounting standards and sustainability standards, with the UKEB collecting data "*to obtain insight on UK companies' existing experience of reporting on climate-related matters*."[248] The UKEB's final comment letter to the ISSB in August 2023 emphasised the need for ISSB and the IASB to work together to deliver standards and guidance that produce connected information for investors, where appropriate.[249]

195.3. Third, IFRS S2 centres on climate-related disclosures, rather than the broader potential for nature-related disclosures. However, in line with what appears to reflect an emerging trend over the last few years towards increasing disclosure of matters relating to environment, nature and climate, the FCA has recommended that the ISSB should launch "*a comprehensive work programme to build out a suite of investor-material sustainability-related disclosure standards beyond climate*", focussing on nature "*in the short term*."[250] We note in this respect that the UK Endorsement Board ("**UKEB**") has established a website which examines the connection between accounting standards and

[246] Paragraph 61 of IFRS S1 explicitly envisages its disclosures being made in a management commentary or strategic report.

[247] See the examples given in the Bompas KC Opinion at §35.1 – §35.4 in relation to international accounting standards. The FRC produced a factsheet for climate-related matters in November 2021 which provides similar examples for companies reporting under UK-GAAP: https://www.frc.org.uk/news-and-events/news/2021/11/frc-staff-factsheet-climate-related-matters/.

[248] https://www.endorsement-board.uk/Connectivity-Projects.

[249] UKEB Final Comment Letter (August 2023) at §21-§24, §28 and §38-§41. See the link to the letter at: https://www.endorsement-board.uk/Connectivity-Projects.

[250] https://www.fca.org.uk/publication/corporate/issb-request-information-response.pdf.

sustainability, with the UKEB collecting data "*to obtain insight on UK companies' existing experience of reporting on climate-related matters*."[251]

196. The regulatory and accounting rules and guidance we have discussed above supplement the statutory disclosure framework by both clarifying and expanding the circumstances in which nature-related risk disclosure can and must take place. As with the statutory framework, the regulatory framework is piecemeal, insofar as different standards apply to different types and sizes of entity and are found in different sources. It is also (at present) geared towards disclosure of the narrower category of climate-related risks, rather than nature-related risks. However, the FRC Guidance in particular suggests that nature-related risks which are material on an Impact Materiality basis should in some cases be disclosed under the obligation to provide disclosure of "*environmental matters*" under s. 414C(7)(b)(i) CA 2006. Thus, although at present the regulatory and accounting guidance in respect of disclosure does not expressly incorporate reference to the TNFD Recommendations:

196.1. Nature-related risks which are 'Impact Material' in accordance with the TNFD recommendations may fall to be disclosed by virtue of them being "*environmental matters*";

196.2. The TNFD Recommendations may in future be incorporated expressly into either the statutory or regulatory guidance; and

196.3. Existing and future accounting standards may require disclosure of nature-related risks, including when their effect is "*material*" in the context of the financial statements taken as a whole (i.e Financial Materiality) or they affect the fair value measurement of a company's assets and liabilities in the financial statements.

E.6. DIRECTORS' LIABILITY IN RESPECT OF DEFICIENT DISCLOSURE

197. In order to assess whether directors are permitted or required to disclose nature-related risks, we consider that it is necessary to set out the mechanisms by which any alleged failures of such disclosure can be remedied. Plainly, if there were no effective mechanism for holding directors to account for disclosure-based failings, the extent to

[251] https://www.endorsement-board.uk/Connectivity-Projects.

which those directors could in practice be said to be under an obligation to make those disclosures would be restricted.

198. As we have noted above, CA 2006 does not provide a specific platform through which stakeholders (including shareholders) can enforce a director's compliance with the disclosure regime.[252] Instead, such compliance is predominantly to be enforced indirectly through the provision of ex post facto liability in one of three ways: (i) through s. 463 CA 2006; (ii) through claims under the Financial Services and Markets Act 2000 ("**FSMA**"); and/or (iii) through claims at common law.

199. First, the key provision[253] in the CA 2006 relating to director liability for false or misleading disclosure in a company's financial and narrative reporting is s. 463 CA 2006, which provides in relevant part:

> *(2) A director of a company is liable to compensate the company for any loss suffered by it as a result of–*
> *(a) any untrue or misleading statement in a report or statement to which this section applies, or*
> *(b) the omission from a report or statement to which this section applies of anything required to be included in it.*
>
> *(3) He is so liable only if–*
> *(a) he knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading, or*
> *(b) he knew the omission to be dishonest concealment of a material fact.*
>
> *(4) No person shall be subject to any liability to a person other than the company resulting from reliance, by that person or another, on information in a report [or statement] to which this section applies.*
>
> *[...]*

200. The scope of s. 463 is curtailed by what have come to be known as the 'safe harbour' provisions in s. 463(3) and (4). First, those provisions entirely preclude liability to third parties in respect of misstatements in narrative reports, subject only to s. 90A/Sch 10A

[252] See, in comparison, the position in Australia, described above at FN 206.

[253] There are other provisions relevant to compliance with disclosure requirements but which are unlikely to prove as strong a vehicle for board accountability. For example, an offence is committed by every director who fails to take all reasonable steps to ensure compliance with the requirement to prepare a strategic report under s. 414A(5) CA 2006. Further, an offence is committed if a strategic report which does not comply with the requirements under CA 2006 is approved by a director who knew it did not so comply or was reckless as to whether it complied and failed to take reasonable steps to secure compliance or prevent the report from being approved (s. 414D CA 2006). However, breach of those provisions gives rise to the possibility of a fine only.

FSMA (which we discuss below).[254] Second, there is no liability for negligent misstatement or omission. In fact, the wording of s. 463 makes it clear that a genuine belief by the director in the truth of the statement, no matter how unreasonable, will save the director from liability.[255]

201. Second, there is the prospect of directors' obligations being enforced indirectly through claims against them under FSMA. In this respect, FSMA creates two regimes for liability:

201.1. Under s. 90 FSMA, a person responsible for listing particulars (i.e. prospectuses) will be liable to pay compensation to a person who has acquired securities to which the particulars apply and who has suffered a loss as a result of any untrue or misleading statement in the particulars or the omission from the particulars of any matter required to be included under ss. 80 or 81 FSMA. Importantly, s. 80 states that the listing particulars "*must contain all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities...*".

201.2. Under s.90A and, now, Sch 10A FSMA,[256] liability may arise on the part of an issuer of securities in respect of a person who acquires securities in reliance on untrue or misleading statements or omissions in "*published information*" and thereby suffers loss, but only if a person discharging managerial responsibilities ("**PDMR**") within the issuer knew the statements to be untrue or misleading or was reckless as to the same, or knew the omission to be a dishonest concealment of a material fact. There is both an objective and subjective element[257] to this test: the relevant information must be demonstrated to be "*untrue or misleading*" or the omission a matter "*required to be included*" in the published information; and a PDMR must know that the statement was untrue or misleading, or know such omission to be a "*dishonest concealment of a material fact*". Although any such liability arises on the part of the issuer in the first instance, in ACL

[254] ACL Netherlands BV & Ors v Lynch & Ors [2022] EWHC 1178 (Ch) at [438(3)].
[255] Gower, Principles of Modern Company Law (11th Ed.), §22-033.
[256] Sch 10A applies from 30 September 2010.
[257] ACL Netherlands BV & Ors v Lynch & Ors [2022] EWHC 1178 (Ch) at [448].

Netherlands BV & Ors v Lynch & Ors [2022] EWHC 1178 (Ch) it was expressly recognised that it is possible for a 'dog-leg' claim to subsequently be brought by the issuer against its directors for breach of duty, once the issuer's liability to the third party acquirer of the securities has been established.

202. Third, there is the prospect that claims might be made against the directors under more general avenues for establishing liability. We referred above to the prospect of activist shareholders bringing derivative claims against directors for breach of their duties under ss. 172 and 174 CA 2006,[258] although the scope for such claims in the context of disclosure failings is unclear and likely to be limited given the express statutory carve out in the safe harbour provisions of s. 463 CA 2006 in respect of negligence liability.[259] There is also the prospect of claims against directors at common law in the torts of deceit or negligent misstatement. However, both of those claims are likely to face difficulties.[260] In the case of deceit, it may be difficult to prove that the relevant director intended that the recipient of the statement should rely on it. In the case of negligent misstatement, liability will only arise where the statement was given to a known recipient for a specific purpose of which the maker was aware.

203. Overall, we consider that the legal mechanisms by which directors can be held liable for failing to comply with disclosure obligations (whether obligations owed by the director personally, or whether owed by the company itself for which the director is subsequently held liable) are disjointed and not easy to satisfy. Whether that limited scope for liability is satisfactory as a matter of company law is outside the scope of this Opinion. However, we highlight it at this juncture because, as we explain in more detail below, the extent to which directors are required to disclose nature-related risks is, in our view,

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258 See paragraphs 134 to 139.

259 That being said, Middleton J suggested in the Australian case of ASIC V Healey [2011] FCA 717 at [20] - [21] that: "*Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in these financial statements call for such enquiries. No less is required by the objective duty of skill, competence and diligence in the understanding of the financial statements that are to be disclosed to the public as adopted and approved by the directors.*" It is important to note there the safe harbour provisions in s. 463 CA 2006 only apply to the strategic report, directors' report, directors' remuneration report and any separate corporate governance statement, and so do not apply to the financial statements (such that the link between the duty to exercise reasonable care, skill and diligence and financial reporting, as described by Middleton J, is clearer than with regards to narrative reporting). Further judicial consideration of the interaction between the duties under ss. 172 and 174 and the obligations imposed upon directors in relation to both financial and narrative reporting (including under s. 463) is required in this jurisdiction.

260 ACL Netherlands BV & Ors v Lynch & Ors [2022] EWHC 1178 (Ch) at [438(1)-(2)].

undermined to some extent by the limited avenues of redress in respect of failures to discharge those requirements.

204. Putting aside matters of whether a claim in damages could be mounted against a director for breach of duty in these circumstances, it is of course possible that a director who causes the company to breach its obligations with respect to disclosure will face the prospect of removal from office by the shareholders acting in general meeting. Thus, directors should be aware that failures in respect of disclosure may still have serious consequences for them, even if such consequences do not give rise to a liability sounding in damages.

E.7. THE TNFD RECOMMENDATIONS

205. We have been expressly instructed to provide our opinion on the potential effects of the TNFD Recommendations on the interpretation of directors' duties in light of the recommendations as to disclosures of nature-related dependencies, impacts, risks and opportunities; the board's oversight of these matters; and the approach to nature-related risk and impact management.

206. The final version of the TNFD Recommendations was published in September 2023. The key aspects of the recommendations in respect of disclosure are as follows:

206.1. Building on the TCFD, the TNFD organises its recommended disclosures around four 'pillars': governance, strategy, risk and impact management and metrics and targets. The central principle for disclosure is materiality: "*Organisations should disclose material information about their nature-related dependencies, impacts, risks and opportunities*."[261]

206.2. The TNFD adopts the ISSB approach to Financial Materiality which is found in IFRS S1. Information is material in this sense if "*omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity*."

[261] TNFD Recommendations, p. 41.

206.3. In addition to complying with the recommended 'baseline' of ISSB Financial Materiality reporting, the TNFD recommends that companies also adopt Broader or Impact Materiality which involves reporting "*on those topics that represent its most significant impacts on the economy, environment and people, including impacts on their human rights*".[262] This is significant: a company which elects to comply with the Broader or Impact Materiality approach would be required to disclose significant impacts on nature even where those impacts do not fall within the concept of Financial Materiality.

206.4. The TNFD has produced its own framework for identifying and assessing nature-related issues, known as the 'LEAP (i.e. Locate, Evaluate, Assess and Prepare) Approach'.[263]

206.5. The TNFD then recommends 14 separate disclosures which fall under one of the four pillars identified above. For example, as part of the 'Governance' pillar, it is recommended that companies "*Describe the board's oversight of nature-related dependencies, impacts, risks and opportunities*." Under the 'Strategy' pillar, companies are recommended to "*Describe the nature-related dependencies, impacts, risks and opportunities the organisation has identified over the short, medium and long term*".[264]

207. In our view, the TNFD Recommendations are likely to become relevant as a matter of English company law (albeit on a fact sensitive basis) to the scope and content of the directors' duty under s. 172 (and possibly also s. 174 CA 2006), in light of the fact that the purpose of the strategic report is to assess how a director has discharged the duty under s. 172. There are two reasons for this.

208. First, although they are conceptually distinct, the TNFD Recommendations build upon the TCFD Recommendations insofar as the latter are embedded in the wider framework of the former. Under the current disclosure framework, the TCFD Recommendations have become expressly incorporated into English law, for example under s. 414CB(2A)

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262 GRI (2021) GRI 1: Foundation 2021, Section 2.2.

263 See TNFD, Guidance on the identification and assessment of nature-related issues: the LEAP approach (October 2023).

264 TNFD Recommendations, p. 47.

CA 2006.[265] It may be that the TNFD Recommendations are similarly integrated into English legislation in the future, although we are at an early stage in that respect.

209. Second, and more importantly, the current disclosure framework is broad enough to encompass disclosure of certain nature-related risks beyond those concerning climate. This is principally because:

209.1. S. 414C(4), which applies to all companies that must prepare a strategic report, states that the strategic report must contain "*information relating to environmental matters*" to the extent necessary for an understanding of the development, performance or position of the company's business.

209.2. S. 414C(7)(b)(i), which applies to quoted companies, states that the strategic report must include "*information about environmental matters (including the impact of the company's business on the environment)*", to the extent necessary for an understanding of the development, performance or position of the company's business.

209.3. SS. 414C(2) and 414CB(1), which apply to traded companies, banking companies, authorised insurance companies and companies carrying on insurance market activity, states that for those companies, the strategic report must include a non-financial and sustainability information statement, which must contain "*information... relating to... environmental matters (including the impact of the company's business on the environment*", to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity.

210. The term "*environmental matters*" is not defined in CA 2006 but the FRC Guidance that we have referred to above suggests that disclosure of "*environmental matters*" is not limited to either (i) climate-related risks; and/or (ii) risks that are material from a Financial Materiality standpoint. That guidance refers to some types of nature-related risk that are material from an Impact Materiality perspective. In addition, the strategic report must include a Section 172(1) Statement explaining how the directors have had

[265] The explanatory memorandum to the 2022 Strategic Report Regulations states expressly that that instrument "*makes changes to reporting requirements by certain companies to produce additional disclosures in line with the recommendations of the Taskforce on Climate-related Financial Disclosures which were published in 2017.*"

regard to "*the impact of the company's operations on the community and the environment*" under s. 172(1)(d). In short, although the current disclosure regime does not make express reference to the TNFD Recommendations, where disclosure of "*environmental matters*" must be given, the TNFD Recommendations represent a sensible framework for analysing such potential disclosure.

211. It follows that if the TNFD Recommendations in future influence the mandatory disclosure regime (as seems likely), they are also capable of influencing director's duties under ss. 172 and 174 CA 2006. We have referred above to the express statutory link between a director's duty to facilitate proper disclosure by the company and the duty under s. 172 CA 2006, because the stated purpose of the strategic report is to enable the members to assess whether the directors have complied with their duties under that provision. Further, and by way of example, if a director failed to give disclosure of a nature-related impact or dependency which was material on an Impact Materiality basis, in certain circumstances that might constitute a failure to properly disclose an "*environmental matter*", and there may be an argument that this would constitute a breach of s. 174 if a reasonable director in that position would have made the disclosure.[266] This is not something which is unique to nature-related risks. The key point is that if a director fails to disclose information which was required to be disclosed under the mandatory rules of the disclosure framework, that might constitute a breach of duty; and in some circumstances disclosure of information concerning 'Impact Material' nature-related risks might be compulsory.

212. We also consider that the TNFD Recommendations may become relevant to directors' duties over time to the extent that they are adopted voluntarily and therefore lead to increase in industry standards or expectations in respect of nature-related risk disclosures.[267] However, that is not to say that a director who gives voluntary disclosure in accordance with the TNFD Recommendations now will thereby increase the scope for potential liability under ss. 172 or 174 CA 2006. Rather, in line with our explanation in Section D above, it seems more likely that over time the standard of care under s. 174

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[266] But see FN 259 above as to the fact that it is unclear as a matter of English law how s. 174 might interact with the disclosure framework and in particular the protection that a director has generally against liability for negligence in this area under the 'safe harbour' provisions.

[267] The same might also be said of the CSRD, whose disclosure obligations in respect of "*sustainability matters*" (including environmental matters) may also result in voluntary adoption by non-EU entities, especially where those entities are considering expansion into EU markets.

will continue to develop, as it has in the past.[268] Although it is difficult to predict to what extent a rise in industry standards will occur, there are at least some early signs of voluntary adoption of the TNFD Recommendations. A body of "*early adopters*"[269] are choosing to comply with recommendations of the TNFD, even though they are not mandatory. In particular:

212.1. 46 of the 320 'Early Adopters' of TNFD are companies incorporated in the UK, operating across a wide range of sectors and, importantly, including companies which are not even subject to mandatory reporting requirements in respect of the TCFD Recommendations, because they are not premium listed companies on the LSE. In other words, it appears that companies that are not even required to provide TCFD-complaint disclosures are nevertheless planning to voluntarily give the broader range of TNFD disclosures.

212.2. A number of English companies are at the date of this Opinion taking part in a TNFD piloting programme. Tesco plc, for example, has produced a case study in partnership with Global Canopy in which it adopted the TNFD's 'LEAP Approach' to identify and assess nature-related issues in the context of its palm oil supply chain.[270]

213. We note that there were previously suggestions that the TCFD Recommendations would become a global best-practice standard, which might suggest that there is a precedent for the TNFD Recommendations to achieve the same status. KPMG had previously observed that the TCFD Recommendations "*while voluntary, are likely… to be accepted as de-facto global best practice... Board directors, as part of their fiduciary duty, will be expected to ensure they are applied so that the corporation reports appropriately on climate-related risk along with other material risks*."[271] Thus, even before the TCFD Recommendations had been incorporated into mandatory legislative and regulatory reporting requirements in England, a professional service firm had already identified that those standards would be considered a *de facto* global best practice. The TNFD

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[268] See above at paragraph 51.

[269] A list of 357 such institutions are found on the TNFD website at https://tnfd.global/engage/inaugural-tnfd-early-adopters/.

[270] https://globalcanopy.org/wp-content/uploads/2024/01/Tesco-TNFD-case-study.pdf.

[271] FSB Task Force on Climate-Related Financial Disclosures: KPMG Client Briefing (2017) https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2017/01/fsb-task-force.pdf.

Recommendations, which build upon the TCFD Recommendations, may well in due course be viewed in the same light.

214. There are various examples of UK companies voluntarily adopting the TCFD Recommendations soon after its launch. Four UK companies were named in the TCFD's Good Practice Handbook in 2019: HSBC, Lloyds Banking Group, Prudential and Unilever.[272] Aviva Group plc has voluntarily incorporated the TCFD Recommendations, including disclosing its Scope 1, 2 and 3 emissions, in its reports since 2017.[273]

215. Given the public scrutiny that generally attaches to public companies with large nature-related impacts, we consider that there will be a real incentive for such companies to consider early, voluntary adoption of the TNFD disclosures in a similar way. Indeed, we observe that some UK companies (Aviva plc,[274] Diageo plc[275] and HSBC Holdings plc[276]) have disclosed information in their narrative reports which arguably go beyond mandatory climate-related disclosures and also address matters relating to, for example, nature-related impacts or dependencies.

216. Drawing together the above threads, it is clear that the current disclosure framework is capable of accommodating TNFD-compliant disclosure, and that in some circumstances the disclosure of nature-related risks might be required under the provisions of s. 414C CA 2006 and the FRC Guidance (albeit this is coincidental to, and not as a result of, the TNFD Recommendations). In time, we consider that this is likely to influence the scope and content of the duties under ss. 172 and 174: both in terms of promoting the success of the company and acting with reasonable care and skill in ensuring that the company

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272 TCFD Good Practice Handbook, First Edition: https://www.cdsb.net/tcfd-good-practice-handbook.

273 Aviva plc, Annual report and accounts 2017 (https://www.aviva.com/investors/reports/) and Aviva's Climate-Related Financial Disclosure 2017 (https://www.aviva.com/sustainability/reporting/climate-related-financial-disclosure/).

274 Aviva's Section 172(1) linked sustainability strategy references its Biodiversity Report which includes a deforestation risk assessment and starts to explore impacts and dependencies. Aviva Annual Report 2022, p. 1.52 and 1.60, Biodiversity Report 2022. https://www.aviva.com/sustainability/reporting/.

275 The preface to Diageo's 2022 TCFD disclosures states *"our business depends on natural resources and we are directly affected by changes in climate and the related challenges of nature and biodiversity loss"*. Its TCFD disclosure includes regenerative agriculture programmes with nature related objectives. Diageo Annual Report 2023, pp. 71 and 83 (https://www.diageo.com/en/esg/esg-governance-and-reporting-centre/reporting-archive).

276 HSBC's TCFD disclosures reference natural capital investing, natural resource consumption, presence in protected areas of biodiversity and sustainable finance policies to mitigate impacts on nature (in particular relating to deforestation and palm oil). HSBC Holdings plc Annual Report 2023, pp. 52, 63 and 66. https://www.hsbc.com/investors/results-and-announcements/all-reporting/group.

complies with its disclosure obligations; and to the extent that the TNFD Recommendations might result in changes in industry best practice standards.

217. The TCFD Recommendations have already had a significant impact on the disclosure framework, both in respect of shaping statutory requirements and regulatory guidance, and also in respect of increasing voluntary additional climate-related risk disclosures. Although we are still at an early stage, there are already early adopters who are choosing to comply voluntarily with the TNFD Recommendations. It remains to be seen whether the TNFD Recommendations will be given a statutory or regulatory basis as the TCFD Recommendations have been.

E.8. THE IMPACT OF NATURE-RELATED RISKS ON DISCLOSURE REQUIREMENTS: PERMISSIONS, OBLIGATIONS AND LIABILITIES

218. Having set out the disclosure framework, and the impact of the TNFD recommendations on that framework, we turn to consider the following questions:

    218.1. Are directors permitted or required to disclose nature-related risks if they perceive that nature-related risks present risks to their company ?

    218.2. What is the impact of the TNFD Recommendations on the interpretation of directors' duties?

    218.3. What liabilities might directors face for failing to disclose nature-related risks?

    218.4. What challenges might be brought against regulators in respect of alleged failures to properly disclose nature-related risks?

E.8.1. <u>Are directors permitted or required to disclose nature-related risks?</u>

219. We are asked to advise on whether directors of a company who perceive that nature-related risks do present risks to that company are <u>permitted</u> or <u>required</u> to disclose those risks. In answering that question, it is necessary to distinguish between permission and obligation.

220. We consider that the position is clearer with regards to the question of permission. This is because, generally speaking, there is nothing to prevent a director or board of directors

from disclosing nature-related risks where it is not compulsory to do so.[277] Indeed, as we have set out above, there is a body of institutions which are already electing to provide disclosure in accordance with the TNFD Recommendations notwithstanding that there is no requirement that they do so. This reflects an emerging trend in favour of voluntary additional disclosure in relation to nature-related risks. Consistent with such an approach, the FCA has encouraged listed companies to consider reporting on a voluntary basis against IFRS S1 and IFRS S2, ahead of potential future requirements.[278]

221. It is not easy to conceive of situations where a director or board of directors would not be permitted to disclose nature-related risks. The statutory disclosure framework does not impose any restrictions in this respect, and the regulatory guidance we have referred to above generally favours 'over-disclosure', if anything.[279]

222. However, we are aware that there was some concern raised at the time of the publication of the TCFD Recommendations (albeit not specific to this jurisdiction) that voluntary compliance with those recommendations might expose either the company or its directors to risk of liability, given that climate-related risks are uncertain and therefore raised concerns about inaccurate disclosure.[280] Similar concerns relating to the "*inherent difficulty of measuring nature-related impacts*" have also been expressed in response to the TNFD Recommendations.[281] Whilst each case will turn on its own facts, where a company voluntarily provides in the narrative reporting clear and comprehensive TNFD-compliant disclosure, based on expert advice, and which explains the assumptions and analysis underlying the disclosure, our view is that a director[282] is unlikely to attract liability. This is because, as we have discussed above, the standard for imposing personal liability on the directors in respect of deficient disclosures is generally high: there is usually no liability for negligent misstatement; the director

[277] We note in this regard that s.414CA(10) CA 2006 explicitly permits companies to include a non-financial and sustainability information statement in their strategic report even where not required to.

[278] https://www.fca.org.uk/publications/newsletters/primary-market-bulletin-45.

[279] We note that, consistent with this, the Bompas KC Opinion states at §25 that "*as a general proposition it is permissible for companies voluntarily to move up in the reporting hierarchy and to apply a more elaborate regime than necessary, it is not possible to "trade down", as it were*". We agree with that proposition, which we consider applies with equal force with regards to whether a company is permitted to disclose nature-related risk where it is not otherwise obliged to do so. See also the Bompas KC Opinion at §51.

[280] https://commonwealthclimatelaw.org/concerns-misplaced-will-compliance-with-the-tcfd-recommendations-really-expose-companies-and-directors-to-liability-risk/.

[281] https://www.whitecase.com/insight-alert/eight-things-know-about-taskforce-nature-related-financial-disclosures.

[282] It is principally the liability of individual directors which would be in issue, rather than the company itself.

would have the benefit of the safe harbour provisions in s. 463 CA 2006; and liability under s. 90A FSMA requires proof that the PDMR knew that the relevant statement was untrue or misleading. As we have discussed in the context of liability under ss. 172 and 174, the taking of expert advice by a director will generally assist in defeating accusations of breach of duty:

> *Thus, where a director understands, on the basis of guidance from the company's auditors on an issue as to the intended scope of an accountancy statement, that such accountancy statement and practice do not require the disclosure of a particular fact in the company's published information, the omission of that fact on the basis of that advice is unlikely to amount to a dishonest concealment of a material fact. Even if the Court takes the view that disclosure of the fact was required, the requirement for dishonesty is unlikely to be satisfied where the director was acting in accordance with the advice of reputable professionals in such a context. Similarly, if a PDMR has been advised by auditors that a particular statement included in the accounts was a fair description of some aspect of the company's business required to be disclosed under the acts or accountancy standards or statements of practice, it may be unlikely that he knew the statement to be untrue or misleading, or that he was reckless as to its truth, unless the auditors did not have the full picture or were misled.*[283]

223. Leaving aside the question of personal liability on behalf of the directors, there might be situations where, for example, the provision of disclosure in line with the TNFD Recommendations would involve costs of compliance which would be out of all proportion with the size of the company, the industry it operates in, its known nature-related risks (or lack thereof) and the opportunity cost of incurring those compliance costs at the expense of developing the company's business.[284] There might also be confidentiality obligations that may be breached by disclosing information relevant to nature-related risks (such as the details of the negotiation of a contract which would result in significant nature-related impacts, where those negotiations are subject to express confidentiality obligations agreed by the parties).

224. Nevertheless, in practice we consider that examples where there are serious obstacles to disclosure will be rare. Bearing in mind that each case must be assessed on its individual facts, company directors are generally permitted to disclose nature-related risks.

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[283] ACL Netherlands BV & Ors v Lynch & Ors [2022] EWHC 1178 (Ch) at [475].

[284] A similar point arises in the case of a company's financial (as opposed to narrative) reporting, in circumstances where cost-effectiveness will play a part in deciding the amount of information which makes the accounts true and fair: "*If information can be provided only with great expense and difficulty, it would not be reasonable to insist upon it*": Bompas KC Opinion at §15.3.

225. As to whether a director or board of directors is required to disclose nature-related risks, we consider that the answer to this question will necessarily vary from company to company given that, as we have explained above, the disclosure framework makes a large set of distinctions between companies of different types and sizes, with different disclosure requirements applicable to each. The question also has two constituent parts. First, is a director obliged to disclose nature-related risks as a result of the express provisions of the disclosure framework? Second, and perhaps separately, may a director nevertheless be required to disclose nature-related risks in order to discharge their duties to their company?

226. The starting point is to assess whether the company is under an obligation to disclose information in a strategic report:

226.1. The directors of a medium-sized company are under no obligation to disclose nature-related risks in the strategic report;[285] but

226.2. As we have set out above, where a company is required to disclose "*environmental matters*", including for quoted companies the impact of the company's business on the environment,[286] that may include or apply to information with respect to material nature-related risks; and

226.3. The directors of a traded company must include a non-financial and sustainability information statement in the strategic report and, if that company also has a premium listing on the LSE, the directors must disclose on a 'comply or explain' basis whether they have made climate-related financial disclosures consistent with the TCFD Recommendations.[287] As noted above, the TCFD Recommendations are narrower than the TNFD Recommendations.

227. The position, however, is further complicated by the terminology used in the statutory framework:

227.1. The information which must be disclosed under the statutory framework does not overlap precisely with the concept of nature-related risks. Nature-related risks are broader as a concept and are capable of encapsulating risks that fall

285 S. 414C(6) CA 2006.
286 S. 414C(7)(b)(i) CA 2006.
287 See s. 414CA(1) CA 2006 and Listing Rules 9.8.6(8) respectively.

outside the scope of the statutory framework which in places is focussed on the separate concept of disclosing climate-related risks. However, the content of the required disclosures vary from provision to provision and no universal definition has been adopted to identify which nature-related information must be disclosed. Thus, for example, although we have stated above that s. 414C(7) CA 2006 requires the disclosure by quoted companies of "*environmental matters (including the impact of the company's business on the environment)*", and that this may in some circumstances require disclosure of nature-related risks, there is no clear guidance as to when a nature-related risk might not constitute an "*environmental matter*" or vice versa.[288] The lack of a clear definitional taxonomy will make it more difficult to establish whether a particular nature-related risk must be disclosed on a case-by-case basis. The express reference in s. 414C(7) to the impact of the company's business on the environment at least makes clear that nature-related impacts can often be expected to be disclosed, but the more nuanced concept of nature-related dependencies is not expressly identified in the statutory code, and reference must instead be made to the regulatory guidance which provides some limited further detail on these separate types of risk.

227.2. Even where a company might at first sight satisfy the requirements for nature-related risk disclosures, nevertheless there are various statutory carve-outs which might mean that in practice nature-related risks are not required to be disclosed. The directors do not have to disclose nature-related risks in the strategic report if they concern impending developments or matters in the course of negotiation and where to do so would be "*seriously prejudicial to the interests of the company*."[289] Where a relevant nature-related risk constitutes a 'key performance indicator' under s. 414C(4)(b), such risks only need to be included in the strategic report insofar as that information is "*necessary for an understanding of the development, performance or position of the company's business*."[290] Although the concept of nature-related risks does not sit naturally

[288] There is not even consistency between the use of the terms 'environmental', 'climate-related' or 'nature-related', each of which is capable of capturing different types of risk.
[289] S. 414C(14) CA 2006.
[290] S. 414C(4) CA 2006. See also, to similar effect, s. 414CB(4A) CA 2006.

with the phrase 'key performance indicator', the definition of that term[291] appears rather broad. In the circumstances, for certain companies, analysis of environmental matters will be necessary to understand the "*development, performance or position of the company's business*".

227.3. The assessment of materiality under the FRC Guidance is likely to be highly-fact sensitive and involve value judgments. Whilst the FRC Guidance is clear in anchoring climate-related financial disclosures to the concept of Financial Materiality, the application of that concept to nature-related risks in practice is not straightforward. Further, as we have explained above, the FRC Guidance also appears to recommend disclosure of certain nature-related information which is material in an Impact Materiality sense (although it does not use this terminology), adding a further layer of difficulty to an already complex area.

228. A more difficult question is whether a director is required to disclose nature-related risks either as an adjunct to or irrespective of whatever statutory or regulatory reporting requirements apply, because a failure to do so would amount to a breach of that director's duty under, in particular, s. 172 CA 2006.

229. In our view, and again subject to the caveat that each case must turn upon its own facts, it is possible that a director might be required to disclose their company's nature-related risks in order to comply with their duties under s. 172 CA 2006. If, as appears to be the case (as noted above), investors are placing a biodiversity footprint premium on certain shares then this is likely to increase the pressure on directors to disclose information about their nature-related risks.

230. It is conceivable that companies which do not provide nature-related risk disclosures, even where such disclosures are not mandatory, could adversely affect the reputation of the business and its ability to raise capital from investors, or damage the company's ability to contract with parties who might not want to be reputationally associated with a company that fails to give such disclosure. This may especially be the case if, as we have alluded to above, voluntary nature-related disclosures (such as in line with the TNFD Recommendations) become industry-wide best practice in the future. Larger, listed companies in particular might consider that providing such voluntary disclosure

[291] "*Key performance indicators*" means factors by reference to which the development, performance or position of the company's business can be measured effectively, S. 414C(5) CA 2006.

would alleviate the risk of harm arising out of both Financial and Impact Material nature-related risks; or that they should provide such disclosure as a matter of practicality to harmonise their reporting to a higher standard, or to bring their reporting in line with that of competitors. It is therefore possible that failure to give such disclosure might in certain factual circumstances amount to a breach of the director's duty to promote the success of the company under s. 172 CA 2006.

231. Our views in this respect are corroborated by the strong linkage in the CA 2006 between the statutory disclosure requirements and compliance with s. 172. The stated purpose of the strategic report is to help assess whether the directors have complied with their duty under s. 172, and the strategic report must include a Section 172(1) Statement.

E.8.2. Other potential challenges to disclosure failures: judicial review of decision to approve listing prospectus

232. Climate (and possibly nature) related risk disclosures are not only relevant to the actions of a company's directors. In R. (on the application of ClientEarth) v Financial Conduct Authority [2023] EWHC 3301 (Admin), ClientEarth sought permission to apply for judicial review of the FCA's decision to approve the prospectus of Ithaca Energy plc, on the basis that Ithaca had failed adequately to disclose or describe its assessment of the materiality of its climate-related financial risks, in breach of Article 16 of the Prospectus Regulation (which requires the disclosure of material risks), and that the conditions for approval of the prospectus under s. 87A FSMA were therefore not satisfied.

233. That application was ultimately dismissed as having no realistic prospect of success, with Lang J noting at [21] that "*the requirements of Article 16(1) are not hard-edged and whether they have been met requires an evaluative judgment which may admit of more than one view. In such a case, the court may not substitute its own view if the FCA's assessment is rational*."

234. This decision is significant for two reasons. First, it is noteworthy that Lang J concluded that ClientEarth had standing to pursue its application on a public interest basis. The door has therefore been left ajar for similar challenges to be brought in the future (even if the prospects of success are slim, for the reasons given by Lang J and recorded above). Second, we consider that this method of challenging the regulator's decision to approve

a prospectus for failure to comply with nature-related risk disclosure could influence directors' behaviour.[292] The prospect of public challenge to a listing prospectus is likely to draw unfavourable attention to the company and may prompt heightened scrutiny of the company's narrative reporting. We therefore consider that the prospect of such an application could also be a factor which indirectly encourages a director to make nature-related risk disclosures.

E.9. CONCLUSIONS IN RELATION TO DISCLOSURE AND NATURE-RELATED RISKS

235. The disclosure of nature-related risks is an evolving area of law. The current disclosure regime accommodates such disclosures, but further regulation in this sphere is likely.

236. The TNFD Recommendations do not currently form part of the disclosure regime. However, we do consider that there is scope in the regime for providing disclosure in respect of nature-related risks, given the obligation on certain companies to disclose "*environmental matters*."

237. Whilst each case will necessarily turn on its own facts, we consider that:

    237.1. Directors who perceive that nature-related risks do present risks to their company now are generally permitted to disclose those risks where such disclosure is not mandatory. However, as such disclosure is voluntary, they may, of course, decline to do so. Further, there may be circumstances where voluntary disclosure is not appropriate for example, where the costs of providing such disclosure are out of proportion to the size of the company and the relevance and materiality of its nature-related risks to its business.

    237.2. Whether such directors are required to disclose those risks is highly fact-sensitive and dependent upon the size and type of the company in question.

    237.3. If the company falls within one of the categories of company which is required to disclose information concerning nature-related risks under the current statutory disclosure framework (for example, as an "*environmental matter*" which is necessary for an understanding of the company's development,

[292] The decision concerned climate-related disclosures, but we see no reason why the position in relation to alleged nature-related disclosure failures would be any different.

performance or position of its business), and if the directors consider that those risks are material, in that their omission or misrepresentation could reasonably be expected to influence the economic decisions of shareholders, it is likely that the directors will be obliged to disclose those risks.

237.4. Directors may act in breach of their duty under ss. 172 and 174 CA 2006 by failing to properly make such disclosures, albeit the routes of redress in respect of such breaches are currently limited.

F. CONCLUSIONS

238. Whilst it would not be possible (nor fruitful) to attempt to define all the different ways in which nature-related risks might be relevant to a company's operations, supply chains and financial success, we consider that four key trends emerge from our analysis above:

    238.1. First, we do not consider that nature-related risks are conceptually distinct as a matter of legal perspective from any other types of risk that companies may face. Whilst nature-related risks might in some circumstances receive specific or individual legislative or regulatory attention (as is the case with disclosure obligations, and environmental approvals and licensing), they do not represent a distinct or special category of risk when it comes to a director's duties to promote the success of the company or to act with reasonable care, skill and diligence. In short, a director should approach the identification and assessment of nature-related risks in the same way as any other risks the company faces.

    238.2. Second, nature-related risks are capable of causing a variety of types of harm to a company. Such harm could be direct or indirect. It could interfere directly with an ecosystem upon which the company depends, adversely affecting the company's supply chain, operations or financing arrangements. It could indirectly impact the company's reputation, its share price and the market within which the company operates and upon which it depends. Given the possible extent of those harms, directors will generally be better able to demonstrate compliance with their duties by performing an assessment of nature-related risks, including by obtaining expert advice where appropriate.

    238.3. Third, all else being equal, a director who gives active consideration to nature-related risks and who properly documents such consideration in the company's records is more likely to have discharged the relevant duties to the company than a director who gives no consideration at all to such risks.

    238.4. Fourth, when actively considering nature-related risks, directors ought to identify and assess risks which are both relevant and non-trivial to the company. Having identified and assessed those risks, there is a separate question of the disclosure implications. The disclosure regime is complex and technical but in essence, only the larger listed entities will have mandatory disclosure

obligations. Where such disclosure is not mandatory, directors may wish nevertheless to give consideration to disclosure. Materiality will usually be a good framework or guiding principle by which to establish whether voluntary disclosure might be desirable. In larger, listed companies with extensive nature-related dependencies and impacts, directors may wish to consider assessing nature-related risks on an Impact Materiality basis, especially where the prospect of harm arising out of those risks could be extensive and may have a material effect on the company's share price.

239. Against that background, we set out our overall conclusions by reference to the individual questions that we were instructed to consider, as set out in Section B above:

239.1. Nature-related risks are relevant to directors' duties under ss. 172 and 174 CA 2006. A director who properly identifies and manages a company's nature-related risks will generally be promoting the success of the company. A director who becomes familiar with the nature-related risks which the company is facing and takes steps to identify, assess and (if necessary) disclose those risks in accordance with recognised industry standards and best practice will likely be acting with reasonable care, skill and diligence.

239.2. Whilst it will necessarily vary on a case-by-case basis, we consider that there are circumstances in which a director will be required to consider whether nature-related risks intersect with the interests of their company. For example, this will be the case where the company is required to disclose nature-related impacts and dependencies as part of the disclosure framework. That disclosure cannot properly or meaningfully take place in the absence of consideration by the director of nature-related risks. Similarly, where a company is materially exposed to nature-related impacts or dependencies, a director will arguably be required to consider those risks in order to discharge the duties to promote the success of their company and to act with reasonable care, skill and diligence. A director will not be able to establish whether such risk exposure exists without first considering whether and the extent to which nature-related risks intersect with the interests of the company.

239.3. There are five main types of director action (and inaction) in relation to nature-related risks which we consider may be relevant to whether a director has

properly discharged the duties under ss. 172 and 174. The manner and the extent to which directors will need to follow these steps (if at all) will vary on a case-by-case basis, but we consider that they represent a high-level guide to the types of action that a director might wish to consider when deciding how to properly consider the nature-related risks facing the company:

239.3.1. Identification: The starting point is identification and active consideration of the extent to which a company faces nature-related risks. A director who fails to take this first step will find it harder to justify action or inaction than a director who properly identifies and considers nature-related risks but elects to take no further action.

239.3.2. Assessment/evaluation: Having identified the extent to which the company faces nature-related risks, a director might then assess and evaluate those risks and the potential they have to cause harm to the company. Toolkits such as the TNFD Recommendations and the Financial and Impact materiality approaches may be of assistance in this respect, and it may also be appropriate to consider whether expert advice is required.

239.3.3. Risk management/mitigation: Once the extent to which nature-related risks pose potential harm to the company is known, a director ought then to consider how best to manage and/or mitigate those risks, and may wish to design and implement a framework for systematically managing those risks.

239.3.4. Disclosure: In addition to assessing and managing nature-related risks, a director should consider the extent to which those risks should be disclosed. This will at a minimum involve compliance with the legislative and regulatory rules which govern such disclosure. In addition, a director may feel that compliance with the duties under ss. 172 and 174 can be better achieved by giving voluntary disclosure of nature-related risks which go beyond what is required by law. That might be the case, for example, where there is an emerging market standard or investor expectation for giving such additional disclosure.

239.3.5. Documentation: Whichever steps a director decides to take in identifying, assessing and (where appropriate) mitigating nature-related risks, such steps should always be properly documented in (for example) board minutes, agendas, memorandums and/or reports.

239.4. There are unlikely to be many situations where a director who perceives that nature-related risks present a risk to the company would not be permitted to disclose those risks. Companies are generally permitted to disclose whatever they wish to disclose, and there is no barrier to a company voluntarily complying with more extensive disclosure rules which otherwise would not apply to it by virtue of its size or status. We consider the scope for potential director liability in respect of such voluntary 'over disclosure', if given clearly, comprehensively and properly corroborated, to be small. In certain situations, the disclosure framework will require such risks to be disclosed. This will principally apply to large public companies, and companies where nature-related risks are financially material.

239.5. The TNFD Recommendations are likely to influence the scope and content of the duties under ss. 172 and 174 CA 2006 in the coming years (in a way which will likely increase standards when directors are assessing and managing nature-related risks). The fact that the TCFD Recommendations, having first been articulated as a voluntary framework in 2017, were subsequently implemented in legislation, is a likely precedent for the TNFD Recommendations to have similar influence. There are already signs that the UK may, in the short or medium term, incorporate the TNFD Recommendations into the English disclosure framework, at least for certain companies. Similarly, to the extent that the TNFD Recommendations result in widespread voluntary compliance, we would expect industry standards and investor expectations to be raised, such that directors offer TNFD-compliant disclosure even where such disclosure is not compulsory.

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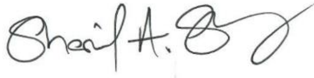
4 Stone Buildings



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11 March 2024