Environmental
Defenders Office

Submission to Treasury on the Sustainable Finance Strategy Consultation Paper

1 December 2023

About EDO

EDO is a community legal centre specialising in public interest environmental law. We help people who want to protect the environment through law. Our reputation is built on:

Successful environmental outcomes using the law. With over 30 years' experience in environmental law, EDO has a proven track record in achieving positive environmental outcomes for the community.

Broad environmental expertise. EDO is the acknowledged expert when it comes to the law and how it applies to the environment. We help the community to solve environmental issues by providing legal and scientific advice, community legal education and proposals for better laws.

Independent and accessible services. As a non-government and not-for-profit legal centre, our services are provided without fear or favour. Anyone can contact us to get free initial legal advice about an environmental problem, with many of our services targeted at rural and regional communities.

Environmental Defenders Office is a legal centre dedicated to protecting the environment.

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Acknowledgement of Country

The EDO recognises First Nations Peoples as the Custodians of the land, seas, and rivers of Australia. We pay our respects to Aboriginal and Torres Strait Islander Elders past, present, and emerging, and aspire to learn from traditional knowledge and customs so that, together, we can protect our environment and cultural heritage through both Western and First Laws. In providing submissions, we pay our respects to First Nations across Australia and recognise that their Countries were never ceded and express our remorse for the deep suffering that has been endured by the First Nations of this country since colonisation.

EXECUTIVE SUMMARY

The Environmental Defenders Office (**EDO**) welcomes the opportunity to comment on Treasury's Consultation Paper on a Sustainable Finance Strategy (**Strategy**).

As part of a national community legal centre specialising in public interest environmental law, the work of the EDO Safe Climate (Corporate and Commercial) lawyers includes examining greenwashing by companies. To avoid facilitating greenwashing, and to maintain domestic and international credibility, it is critical that science-based criteria are central to the development of a Strategy in particular to the design of the Sustainable Finance Taxonomy (**Taxonomy**) and sustainable investment labelling regime.

Without credible and science-based criteria, we are concerned that the Strategy will facilitate greenwashing by including in the Taxonomy activities that are not aligned with the Paris Agreement's 1.5°C temperature goal and by awarding sustainable labels to financial products invested in companies involved in activities that are similarly not aligned.

We set out below a summary of our key recommendations and detailed responses to select questions identified in the Consultation Paper.

SUMMARY OF RECOMMENDATIONS

Recommendation 1 – Sustainability disclosure requirements should be expanded to cover nature-related disclosures when the International Sustainability Standards Board (**ISSB**) develops international nature-related disclosure standards based on the recommendations of the Task Force on Nature-related Financial Disclosures (**TNFD**). In the interim, the TNFD should be incorporated into regulatory guidance on a 'comply or explain' basis.

Recommendation 2 – To avoid the Sustainable Finance Taxonomy facilitating greenwashing and embedding fossil fuels in Australia's energy future, EDO recommends:

(a) the Council of Financial Regulators (**CFR**) specifically address the potential for commercial conflicts of interest impacting the Taxonomy given the Australian Sustainable Finance Institute (**ASFI**) is primarily constituted of industry participants;

(b) a transitional activity category is not incorporated into the Taxonomy; and

(c) natural gas-related activities and carbon capture and storage (**CCS**) technology are excluded from the Taxonomy.

Recommendation 3 – Transition planning disclosure requirements that go beyond ISSB-aligned standards should be implemented as a priority. ASX-listed companies and financial institutions should be required to disclose transition plans consistent with the Paris Agreement's 1.5°C temperature goal and should be supplemented by guidance on what is required for transition plans to satisfy that requirement.

Recommendation 4 – Financial products with investments in entities not aligned with the temperature goals of the Paris Agreement are not eligible for a sustainable label to avoid the regime facilitating greenwashing. Instead, those products should be labelled "unsustainable" to ensure the labelling regime applies to the full spectrum of financial products and to increase transparency for retail investors.

Recommendation 5 – In relation to the fit for purpose regulatory framework, EDO recommends:

(a) repeal the 2021 amendments to to s 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth) and redefine duties owed by superannuation trustees to explicitly allow the consideration of sustainability-related matters;

(b) introduce an "environmental judgment rule" into the *Corporations Act 2001* (Cth) to shield directors from liability where they have made reasonable decisions to improve their company's environmental performance despite those decisions not aligning with the financial interests of the company;

(c) amend the *Public Governance, Performance and Accountability Act 2013* (Cth) to include a public derivative action mechanism and a statutory injunction provision to ensure that officials (including directors) of government-owned corporations are as accountable as private company directors; and,

(d) extend the "two strikes rule" in relation to listed entities' remuneration reports to listed entities' reporting on sustainability-related matters to increase directors' accountability in relation to mismanagement of sustainability-related risks.

Recommendation 6 – Regulators issue guidance on the requirements of active stewardship, in particular where funds rely on an active stewardship approach as justification for their continued investment in the fossil fuel industry.

Recommendation 7 – The EDO supports the statutory prohibition on the Clean Energy Finance Corporation investing in carbon capture and storage (**CCS**) technology and recommends that CEFC does not facilitate finance for hydrogen produced using fossil fuels.

This submission addresses the following priorities and questions:

Priority 1: Establish a framework for sustainability-related financial disclosures

How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD?

Priority 2: Develop a Sustainable Finance Taxonomy

What are the most important policy priorities and use cases for an Australian sustainable finance taxonomy? What are the key insights from international experience to date?
What are priorities for expanding taxonomy coverage after the initial focus on climate mitigation objectives in key sectors?
What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture?

Priority 3: Support credible net zero transition planning

What are key gaps in Australian capability and practice, including relative to 'gold standard' approaches to transition planning developed through the TPT and other frameworks?
To what extent will ISSB-aligned corporate disclosure requirements improve the transparency and credibility of corporate transition planning? What additional transition disclosure requirements or guidance would be most useful in the medium-term?
Are there related priorities and opportunities for supporting enhanced target setting and transition planning for nature and other sustainability issues?

Priority 4: Develop a labelling system for investment products marketed as sustainable

What should be the key considerations for the design of a sustainable investment product labelling regime?

Priority 5: Enhancing market supervision and enforcement

Are Australia's existing corporations and financial services laws sufficiently flexible to address greenwashing? What are the priorities for addressing greenwashing?

Priority 8: Ensuring fit for purpose regulatory frameworks

Do you agree that existing regulatory and governance frameworks and practices have adapted well to support better integration of sustainability-related issues in financial decision making? Are there barriers or challenges that require further consideration? This may include: Corporate governance obligations, including directors' duties; Prudential frameworks and oversight, including in relation to banks and insurers; Regulation of the superannuation system and managed investment schemes.

Superannuation fund trustees' duties
Directors' duties
Enforcement of public directors' duties
Extension of 'two strikes' rule

What steps could the Government or regulators take to support effective investor stewardship?
What are the key expectations of the market around issuance of, and reporting against, sovereign green bonds? What lessons can be learned from comparable schemes in other jurisdictions?

Priority 10: Catalysing sustainable finance flows and markets

What role can the CEFC play to support scaling up of sustainable investment in Australia, as part of a more comprehensive and ambitious sustainable finance agenda?

Priority 11: Promoting international alignment

What are the key priorities for Australia when considering international alignment in sustainable finance?

Priority 12: Position Australia as a global sustainability leader

What are other key near-term opportunities for Australia to position itself as a global leader in sustainable finance and global climate mitigation and adaptation?

DETAILED RESPONSES TO FEEDBACK QUESTIONS

Priority 1: Establish a framework for sustainability-related financial disclosures

How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD?

EDO **supports** expanding sustainability disclosure requirements to cover nature-related disclosures. This should occur as soon as practicably possible when the ISSB develops international nature-related financial disclosure standards based on the recommendations of the TNFD.

The Australian *State of Environment Report 2021* stated that overall, the state and trend of the environment of Australia are poor and deteriorating as a result of increasing pressures from climate change, habitat loss, invasive species, pollution and resource extraction. Changing environmental conditions mean that many species and ecosystems are increasingly threatened. Multiple pressures create cumulative impacts that amplify threats to our environment, and abrupt changes in ecological systems have been recorded in the past 5 years.[1] Goven the deteriorating state of environment and natural capital, sustainability disclosure is crucial to the long term health of both our economy and environment.

In the interim, as with the Task Force on Climate-related Financial Disclosures (**TCFD**), the TNFD should be incorporated into regulatory guidance on a 'comply or explain' basis.

The EDO considers this is appropriate and necessary for at least three reasons.

First, in December 2022, Australia agreed to the Kunming-Montreal Global Biodiversity Framework (**GBF**)**.** Target 15 of the GBF requires signatories to:

> *Take legal, administrative or policy measures to encourage and enable business, and in particular to ensure that large and transnational companies and financial institutions:*
>
> *(a) Regularly monitor, assess, and transparently disclose their risks, dependencies and impacts on biodiversity, including with requirements for all large as well as transnational companies and financial institutions along their operations, supply and value chains, and portfolios;*
>
> *(b) Provide information needed to consumers to promote sustainable consumption patterns;*
>
> *(c) Report on compliance with access and benefit-sharing regulations and measures, as applicable;*
>
> *in order to progressively reduce negative impacts on biodiversity, increase positive impacts, reduce biodiversity-related risks to business and financial institutions, and promote actions to ensure sustainable patterns of production.*

The TNFD recommendations are designed to allow companies and financial institutions to disclose nature-related matters in accordance with Target 15.[2] The implementation of the TNFD is therefore an important step toward fulfilling Australia's commitments under the GBF.

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[1] See: Key findings | Australia state of the environment 2021 (dcceew.gov.au)

[2] TNFD, *Recommendations of the Taskforce on Nature-related Financial Disclosures* (Report, September 2023) p 9.

Second, Australia's economy is acutely exposed to nature-related risks. It has been reported that approximately half of Australia's GDP has a moderate to very high direct dependence on ecosystem services.[3] There is abundant evidence that those ecosystem services are at risk, with recent research concluding that all 19 Australian ecosystems under examination in that study have collapsed or are collapsing.[4] That is consistent with the Swiss Re Institute pointedly identifying Australia as a country that "should prepare for ecologically driven disturbances".[5]

It follows that Australian companies and financial institutions are *already* exposed to material nature-related risks, should be disclosing those risks in accordance with the disclosure requirements contained in the *Corporations Act 2001* (Cth) and related regulatory guidance. The EDO is concerned that this is nonetheless not occurring. Already, proceedings have been commenced against an Australian bank for allegedly failing to adequately disclose and manage nature-related risks.[6] Incorporating the TNFD recommendations into regulatory guidance and, ultimately, disclosure requirements will help improve Australian entities' awareness, understanding, disclosure and management of nature-related risks. That will in turn ensure that investors and other stakeholders are being provided with transparent and adequate information to inform capital allocation decisions.

Third, disclosing nature-related risks will require a significant uplift in corporate expertise. That is in part because the TNFD's definition of nature-related risks includes risks arising from dependencies *and impacts* on nature.[7] Further, the TNFD recommends the disclosure of nature-related impacts that *do not* pose a risk of harm to an entity if that entity wants to align with Target 15 of the GBF.[8] Identifying and assessing nature-related impacts may prove challenging for Australian entities that are not already engaged in this exercise. Nature-related impacts may be more difficult to measure and quantify than climate-related impacts, partly due to the absence of a single unit of comparison, such as tonnes of carbon dioxide-equivalent. It is therefore prudent for regulatory guidance to require Australian entities to disclose nature-related risks on a 'comply or explain' basis *now*, so they have developed the requisite expertise and processes to comply with future nature -related disclosure requirements.

Priority 2: Develop a Sustainable Finance Taxonomy

The EDO **supports** the development of a Taxonomy provided it does not facilitate greenwashing.

In this context, the EDO is concerned that the Taxonomy may be influenced by the commercial interests of those responsible for its design. We note that the CFR has outsourced the development of the Taxonomy to the Australian Sustainable Finance Institute (**ASFI**). Given that ASFI is a financial sector body whose board and membership is comprised almost entirely of financial market participants,[9] we are concerned that that commercial conflicts of interest may take priority

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[3] Australian Conservation Foundation, *The nature-based economy: How Australia's prosperity depends on nature* (Report, September 2022) p 6.
[4] Dana M. Bergstrom et al., 'Combating ecosystem collapse from the tropics to Antarctica' (2021) 27 *Global Change Biology* 1692, 1694.
[5] Swiss Re Institute, *Biodiversity and Ecosystem Services: A business case for re/insurance* (Report, September 2020) p 35.
[6] *Rossiter v ANZ Group Holdings Limited* (NSD1315/2023).
[7] TNFD, *Recommendations of the Taskforce on Nature-related Financial Disclosures* (Report, September 2023) p 131.
[8] TNFD, *Recommendations of the Taskforce on Nature-related Financial Disclosures* (Report, September 2023) p 41.
[9] Australian Sustainable Finance Institute, Membership of the Taxonomy Technical Expert Group (Website accessed 20 November 2023) <TTEG+Member+List.pdf (squarespace.com)>.

over rigour necessary to develop a Taxonomy that is fit for purpose. To mitigate that risk, the EDO **recommends** that the oversight role of the CFR should specifically address the potential for commercial conflicts of interest impacting the development of the Taxonomy. We consider a key priority should be incorporating the views of stakeholders other than industry participants and industry bodies to minimise the risk of greenwashing.

We further note that the Taxonomy Technical Expert Group (**TTEG**) is responsible for providing strategic direction over, input into, and final endorsement of a Taxonomy. In relation to the composition of TTEG, the ASFI website states that:[10]

> *The TTEG collectively represents a mix of skills and experience that are critical to informing the taxonomy's development, including in sustainable finance; whole-of-economy decarbonisation; climate and environmental science and policy; human rights; and Indigenous rights and perspectives.*

We note that the composition of the TTEG is weighted heavily towards industry participants; there are currently no representatives of human rights organisations, consumer organisations, one representative of a First Nations organisation and few independent experts in climate science. We consider that the development of a robust Taxonomy that captures all aspects of a sustainable economy should more accurately reflect the statement extracted above, which requires an even balance of industry participants and other stakeholders.

In relation to the climate mitigation objective in particular, the full participation of independent experts in climate science in the design of the Taxonomy is critical in to ensure that the Taxonomy is consistent with Treasury's proposal that it is "credible and science-based".[11] Developing credible and science-based criteria for eligible activities, i.e. activities which are aligned with goals of the Paris Agreement to limit global warming to 1.5°C above pre industrial levels, is an inherently scientific undertaking and requires the skills and expertise of climate and environmental scientists.

Accordingly, the EDO **recommends** that the TTEG should be comprised equally of industry participants and other stakeholders whose expertise are critical to the development of a Taxonomy that incorporates *all* perspectives relevant to the development of a sustainable economy.

What are the most important policy priorities and use cases for an Australian sustainable finance taxonomy? What are the key insights from international experience to date?

The EDO **supports** Treasury's proposal that the overarching purpose of the Taxonomy is to contribute to climate mitigation and other sustainability objectives by providing a set of criteria to assess whether economic activities are aligned with those objectives. The EDO considers it critical that the criteria is credible and science-based to ensure that the Taxonomy does not attract sustainable finance and new investment to activities which are not aligned with the goals of the Paris Agreement. Accordingly, the EDO **opposes** the incorporation of a transitional activity category into the Taxonomy for at least two reasons.

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[10] Australian Sustainable Finance Institute, *Australian Sustainable Finance Taxonomy Project Governance* (Website, accessed 10 November 2023) <Governance Arrangements — ASFI>.
[11] The Treasury, *Sustainable Finance Strategy Consultation Paper* (November 2023) p13.

First, the EDO considers that including a transitional activities category in the Taxonomy would facilitate greenwashing by rendering activities that are inconsistent with the goals of the Paris Agreement eligible for inclusion, including gas-related activities. This would effectively allow entities involved in unsustainable activities, such as the production and processing of gas, to claim that such activities are sustainable. The EDO considers there is an inherent contradiction in deeming any activity involving the extraction, processing, transportation or combustion of fossil fuels as "sustainable". To avoid facilitating greenwashing, the Taxonomy must be based on credible, scientific criteria, developed by scientific experts, and should exclude all fossil fuels related activities.

Second, the EDO is concerned that a transitional activity category would embed fossil fuels into Australia's future energy system at a time when the International Energy Agency's (**IEA**) modelled pathways see fossil fuel demand peak by 2023 and include no new fossil fuel projects or the expansion of existing projects.[12] We further note that incorporating a transitional activity category resulting in sustainable capital flowing to the fossil fuel industry would significantly undermine Australia's legislated emissions reduction targets to reduce greenhouse gas emissions by 43% below 2005 levels by 2030 and to net zero by 2050.[13] In that regard, we note the latest Production Gap Report found that governments plan to produce around 110% more fossil fuels in 2030 than would be consistent with limiting warming to 1.5°C.[14] A Taxonomy should enable recipients with credible transition pathways to access sustainable finance to diversify the Australian economy *away* from fossil fuels, not channel finance *towards* fossil fuel lock-in. Further, financing transitional activities would increase climate and other sustainability-related risk to the Australian economy including loss of GDP, government revenue and export receipts and the risk of asset stranding of resource and production infrastructure.

If Treasury intends to pursue a transitional activity category in the Taxonomy, it is critical that it is confined and that it excludes fossil fuel-related activities. Accordingly, the EDO **recommends** that the Taxonomy criteria distinguish between "transition" and "transitional activities" to make clear that those terms are not synonymous: whilst some individual transitional activities are part of an economy in transition, not all activities that are part of an economy in transition are transitional activities.[15] The EDO considers that a transitional activity must *at least* be consistent with a pathway to limit global warming to 1.5°C and must not lead to the lock-in or continued investment in fossil fuels assets into Australia's economy.

Accordingly, the EDO **strongly opposes** the inclusion of gas-related activities as transitional activities for at least three reasons.

First, the production, transportation and processing of gas produces significant greenhouse gas emissions through venting and flaring CO2 during processing, methane leakage during production and significant CO2 emissions during combustion. In some instances, the life-cycle emissions of natural gas can be as emissions intensive as the life-cycle emissions of coal.[16] **Second**, including

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[12] IEA, *World Energy Outlook 2023, Pathways for the energy mix*, available at: Pathways for the energy mix – World Energy Outlook 2023 – Analysis - IEA

[13] *Climate Change Act 2022* (Cth) s 10(1)(a) and (b).

[14] SEI, Climate Analytics, E3G, IISD, and UNEP *The Production Gap: Phasing down or phasing up? Top fossil fuel producers plan even more extraction despite climate promises* (November 2023) p4.

[15] Platform on Sustainable Finance, *Transition Finance Report* (March 2021) p14.

[16] D Gordon et al., 'Evaluating net life-cycle greenhouse gas emissions intensities from gas and coal at varying methane leakage rates' (2023) 18 *Environmental Research Letters* 1; Hardisty et al., 'Life Cycle Greenhouse Gas

natural gas as a transitional activity would divert capital *away* from activities that are genuinely aligned with the temperature goals of the Paris Agreement and embed natural gas in Australia's future energy with the correlating risks to Australia's economy identified at above. **Third**, categorising any gas-related activity as sustainable facilitates greenwashing given the significant greenhouse gas emissions associated with its production, transportation, processing and combustion which risks undermining the credibility of an Australian Taxonomy in global markets.

In that regard, we note that the European Commission (**EC**) agreed conditions which allowed gas-related activities to be included as transitional activities in the European Union Taxonomy (**EU Taxonomy**) despite the European Union Platform on Sustainable Finance, the EC's scientific expert advisory group, recommending that natural gas not be included.[17] In April 2023, four environmental groups commenced proceedings against the EC, seeking a reversal of that decision.[18] Concerns were also raised by the Institutional Investors Group for Climate Change which wrote an open letter to the European Commission asking that gas be excluded from the EU Taxonomy,[19] and by a group of financial services organisations which wrote to the UK Prime Minister opposing the inclusion of natural gas activities in the UK Taxonomy.[20] We note that the exclusion of gas from the proposed Australian Taxonomy would not deprive gas-related activities from finance; rather it would prevent sustainable capital flowing to activities that are not consistent with the goals of the Paris Agreement and would prevent the Taxonomy facilitating greenwashing.

We further note that the draft Association of Southeast Asian Nations Taxonomy for Sustainable Finance includes "coal phase-out" criteria which renders coal-fired power plants in the process of early retirement eligible for sustainable finance.[21] Combusting coal produces significant greenhouse gas emissions, is a major contributor to global warming and is entirely inconsistent with the goals of the Paris Agreement. The EDO considers that including coal fired power plants as a transitional activity would mislead investors wanting assurance that their assets are sustainable and would divert sustainable finance to an activity that is not aligned with the climate mitigation objective and other sustainability objectives. As such, the EDO **strongly opposes** the classification of coal fired power plants as sustainable.

For similar reasons, the EDO considers that carbon capture and storage (**CCS**) technology should *not* be classified as a transitional activity for at least three reasons.

First, research conducted by the Institute for Energy Economics and Financial Analysis titled "The Carbon Capture Crux"[22] (**IEEFA Report**) found that 73% of operational CCS projects in the gas

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Emissions from Electricity Generation: A Comparative Analysis of Australian Energy Sources' (2012) 5 *Energies* 872 [available: https://www.mdpi.com/1996-1073/5/4/872]. See, in particular, '5. Conclusion', See also Glen P Peters et al, 'Carbon dioxide emissions continue to grow despite emerging climate policies' (2020) 10(3-6) *Nature Climate Change* 3, 6, citing Zeke Hausfather, 'Bounding the climate viability of natural gas as a bridge fuel to displace coal' (2015) 86(C) *Energy Policy* 286.

[17] Platform on Sustainable Finance, *Response to the Complementary Delegated Act* (21 January 2022).

[18] ClientEarth, *EU Taxonomy: Environmental groups take EU to court over 'green' gas label* (Website, accessed 15 November 2023), <Environmental groups take EU to court over 'green' gas label | ClientEarth>

[19] IIGCC, *IIGCC CEO sends letter on EU Renewable Energy and Energy Efficiency Directives* (Website, accessed 20 November 2023) <IIGCC CEO sends letter on EU Renewable Energy and Energy Efficiency Directives>

[20] IIGCC, PRI and UKSIF, *Letter to the UK Prime Minister from the CEOs of IIGCC, PRI and UKSIF* (Website, accessed 10 November 2023) <Letter to the UK Prime Minister from the CEOs of IIGCC, PRI and UKSIF>

[21] ASEAN Taxonomy Board, *ASEAN Taxonomy for Sustainable Finance version 2* (9 June 2023).

[22] Bruce Robertson and Milad Mousavian, *The Carbon Capture Crux: Lessons Learned* (September 2022) (**IEEFA Report**).

processing sector are dedicated to Enhanced Oil Recovery (**EOR**) rather than the permanent storage of CO2 which *increases* the production and combustion of fossil fuels.[23]

Second, there are economic and environmental risks associated with CCS including low sequestration rates and low sequestration of total greenhouse gas emissions. In that regard, we refer to the reasons we provide in our response to Priority 10.

Third, by extending the life of fossil fuel assets, financing CCS would embed fossil fuels in Australia's energy future at a time where sustainable capital should flow towards proven, cost-effective investment alternatives such as renewable energy.

In relation to fossil fuel infrastructure, the EDO **recommends** that decommissioning should attract sustainable finance given that it is a critical aspect of the energy transition. However, the criteria for decommissioning activities should exclude those that maintain existing fossil fuel infrastructure and those that enable the continued production of fossil fuels, including infrastructure related to the production of coal, oil and gas.

What are priorities for expanding taxonomy coverage after the initial focus on climate mitigation objectives in key sectors?

The EDO considers that the immediate priority must be to expand taxonomy coverage to climate adaptation objectives. The Government must prioritise the attraction of capital to support the extent of adaptation required for a climate-resilient nation and region such as green infrastructure.

The second priority should be to expand taxonomy coverage to nature objectives. We refer to the reasons we provide in our response to Priority 1 with regard to the expansion of sustainability disclosure requirements to cover nature-related disclosures in alignment with the TNFD.

The third priority should be to safeguard minimum standards in relation to the conduct of responsible business practices and respect for human rights, in particular with regard to the rights of First Nations peoples. This would mitigate the risk of attracting investment towards activities that pursue environmental objectives without regard for the requirements to obtain Free, Prior and Informed Consent in accordance with the *UN Declaration on the Rights of Indigenous Peoples*.

Subsequent priorities for expanding taxonomy coverage must focus on social objectives.

What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture?

The EDO **supports** Treasury's proposal to give the Taxonomy legislative force by including the underlying criteria in legislation. We consider that the alternative proposed voluntary options do not provide sufficient certainty and would undermine the Taxonomy's purpose of providing clear guidance, transparency and consistency for firms, investors and regulators.

[23] IEEFA Report, p32.

Priority 3: Support credible net zero transition planning

The EDO **strongly supports** the Treasury's proposal to introduce transition planning disclosure requirements that go beyond ISSB-aligned standards. As explained below, we consider that such requirements would help rectify current deficiencies in Australian entities' transition planning that may not be adequately addressed by the implementation of ISSB-aligned standards.

However, we consider that such requirements should be implemented as a priority. The deficiencies in Australian entities' transition planning risk undermining Australia's ability to fulfil its international and statutory climate-related commitments and exposing entities to liability risks for alleged greenwashing and are already a source of frustration for investors and other stakeholders.

What are key gaps in Australian capability and practice, including relative to 'gold standard' approaches to transition planning developed through the TPT and other frameworks?

A significant amount of the EDO's work relates to the analysis of company transition plans. The EDO is concerned by the prevalence of transition plans that are not aligned with Australia's international and statutory climate-related commitments, and the scientific consensus on what is required to achieve those commitments.

The term "net zero" is derived from Article 4.1 of the Paris Agreement, which requires "a state by which the greenhouse gases going into the atmosphere are reduced as close to zero as possible and any residual emissions are balanced by permanent removals from the atmosphere by 2030".

The UN High-Level Expert Working Group on Net Zero Emissions Commitments of Non-State Entities has provided ten recommendations to create a universal definition of net zero and standardise net zero claims. According to the Working Group, "net zero" targets should:[24]

(a) include interim targets (including targets for 2025, 2030 and 2035) and plans to achieve net zero that are consistent with the Intergovernmental Panel on Climate Change (**IPCC**) or IEA modelled pathways that limit warming to 1.5°C with no or limited overshoot, and with global emissions declining at least 50% by 2030;
(b) include Scope 1, 2 and 3 emissions across the entities' entire value chain;
(c) account for all greenhouse gases (i.e., not just carbon dioxide);
(d) include specific targets to end the use of and/or support for fossil fuels in line with the IPCC and IEA modelled pathways that limit warming to 1.5°C, including no new fossil fuel projects or the expansion of existing projects;
(e) prioritise urgent and deep emissions reductions; and
(f) only use carbon credits to offset residual emissions, and not count offsets towards interim emissions reductions required by a net zero pathway.

This is broadly aligned with the Science Based Targets initiative's Corporate Net Zero Standard,[25] which is accompanied by sector-specific guidance for all sectors except oil and gas.[26]

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[24] United Nations' High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities, *Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities and Regions* (Report, November 2022).
[25] Science Based Targets initiative, *SBTi Corporate Net-Zero Standard* (April 2023).
[26] Science Based Targets initiative*, Sector Guidance* (Website, accessed 15 November 2023) <https://sciencebasedtargets.org/sectors>.

The EDO is concerned by the prevalence of climate transition plans and targets that are premised on a misunderstanding of the concept of “net zero” and do not align with the international science-based standards identified above. For example, contrary to those standards, transition plans may involve:

(a) expanding fossil fuel production or investing in companies engaged in such activities;
(b) excluding certain greenhouse gas emissions from emissions reduction targets, such as greenhouse gases other than carbon dioxide and/or Scope 3 emissions; and
(c) using carbon credits to offset emissions to achieve emissions reduction targets.

In this context, we note a recent study found that production by nearly two-thirds of the world’s fossil fuel companies are not aligned with the temperature goals of the Paris Agreement.[27] In Australia, the three companies whose production is not aligned are Woodside, Santos and Whitehaven Coal.

This has significant implications for Australia’s ability to achieve its international and statutory climate-related commitments, and thereby mitigate the risks posed by climate change. If entities’ transition plans do not prioritise urgent and deep emissions reductions, this will both increase the Australian economy’s exposure to physical climate-related risks, such as extreme weather events, and transition climate-related risks, by increasing the extremity of future actions required to keep warming within safer limits and embedding emissions-intensive assets at risk of stranding.

To what extent will ISSB-aligned corporate disclosure requirements improve the transparency and credibility of corporate transition planning? What additional transition disclosure requirements or guidance would be most useful in the medium-term?

As explained in our submission to the Treasury’s first Consultation Paper on climate-related financial disclosure, ISSB-aligned corporate disclosure requirements will improve the transparency of corporate transition planning by requiring entities to disclose specific information about their climate-related targets.[28]

However, the EDO considers that ISSB-aligned corporate disclosure requirements will *not* markedly improve the *credibility* of corporate transition planning. That is because the ISSB standards allow entities to continue to disclose climate-related targets that are not aligned with Australia’s statutory and international climate-related commitments, and the scientific consensus on what is required to achieve those commitments.

For example, ISFR S2 requires entities to disclose *how* the latest international agreement on climate change, including jurisdictional commitments that arise from that agreement, has informed the target; *which* greenhouse gas emissions are covered by a target; *whether* Scope 1, 2 or 3 emissions are covered by the target; and the *extent* to which, and how, the entity intends to use

[27] Saphira Rekker and Belinda Wade, *Nearly two-thirds of the top fossil fuel producers in Australia and the world aren’t on track for 1.5°C* (Website, accessed 23 November 2023) <Nearly two-thirds of the top fossil fuel producers in Australia and the world aren’t on track for 1.5°C climate target (theconversation.com)>
[28] IFRS Sustainability, *IFRS S2: Climate-related Disclosures* (June 2023) paragraphs 33-37.

carbon credits to offset emissions to achieve any target.[29] This permits targets that do not align with the critical Paris Agreement's 1.5°C temperate goal, and do not even align with Australia's inadequate Nationally Determined Contribution, as enshrined in the *Climate Change Act 2022* (Cth). Contrary to the scientific consensus on what is required to achieve those commitments, it also contemplates that targets may rely on the use of carbon credits and not cover all greenhouse gas emissions.

The EDO **recommends** that, as in the European Union,[30] ASX-listed companies and financial institutions should be required to disclose transition plans consistent with the Paris Agreement's 1.5°C temperature goal. This should be supplemented by guidance that clearly stipulates what is required for transition plans to satisfy this requirement, based on the Science Based Targets initiative's Corporate Net Zero Standard and the recommendations of the UN High-Level Expert Working Group on Net Zero Emissions Commitments of Non-State Entities.

This would improve the credibility of entities' transition planning, ensure that planning is consistent with Australia fulfilling its international and statutory commitments, and ultimately reduce entities' exposure to liability risks for potential greenwashing. It would also ensure greater consistency with entities' transition planning and the AASB's proposal to require reporting entities to disclose the findings of their climate resilience assessment against a 1.5°C degree scenario.[31]

Are there related priorities and opportunities for supporting enhanced target setting and transition planning for nature and other sustainability issues?

Yes. Implementing requirements for nature-related transition planning *now* would help pre-emptively avoid the deficiencies that have been observed in Australian entities' climate-related transition planning. Fortunately, science-based guidance on nature-related transition planning is already available. In May 2023, the Science Based Targets Network released the first corporate science-based targets for nature.[32] As with climate-related transition planning, this guidance and any related updates should be incorporated into Australian regulatory guidance.

Priority 4: Develop a labelling system for investment products marketed as sustainable

What should be the key considerations for the design of a sustainable investment product labelling regime?

The EDO **supports** the introduction of standardised and transparent sustainable product labelling provided it does not facilitate greenwashing. As with the Taxonomy, our overarching concern is that none of the proposed labels should be structured, or made available, in a way that enables greenwashing or otherwise misleads consumers. To ensure that the labelling regime does not

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[29] IFRS Sustainability, *IFRS S2: Climate-related Disclosures* (June 2023) paragraph 33(a), (b), (e) and (h).
[30] *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* [2022] OJ L 322/15, arts 19a(2)(iii), 29a(2)(iii).
[31] AASB, *Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information* (Exposure Draft SR1, October 2023) BC51-BC52.
[32] Science Based Targets Network, *The first science-based targets for nature* (Website, accessed 15 November 2023) <https://sciencebasedtargetsnetwork.org/how-it-works/the-first-science-based-targets-for-nature/>.

facilitate greenwashing, we consider that the criteria for sustainable labelling should address the following four issues.

First, financial products which invest in companies that are not aligned with the goals of the Paris Agreement, such as companies involved in the production of fossil fuels, including natural gas, should not be eligible for sustainable labelling. We consider that it is not reasonable to assume that retail investors, to whom Treasury proposes the labelling regime is directed, would consider fossil fuel activities to be sustainable. As such, the labelling regime should not permit providers of financial products to label a product "sustainable" when it is not to avoid misleading consumers.

Second, investments labelled as sustainable may target a single sustainability objective, whilst giving the misleading impression that the product is sustainable overall. For example, a financial product labelled "sustainable" may have the single objective of limiting plastic waste but nevertheless invest in companies involved in fossil fuels or those whose activities cause deforestation. A retail investor may mistakenly assume that a sustainable label provides assurance that a product is sustainable overall when in fact it invests in unsustainable activities such as fossil fuel production. Accordingly, it is critical that the labelling criteria is credible and science-based and, as with the Taxonomy, that those involved in its development extend beyond industry participants to all stakeholders with relevant expertise.

Third, in relation to green bonds, it is critical that the bond's proceeds are used for a sustainable purpose, the funds are applied to that purpose, and adhere to the principle of additionality which asks whether they have enabled an activity that would not have happened without them. In 2019 the Woolworth's Group raised $400 million by issuing green bonds. However, Woolworths spent $70 million on solar panels and LED lights, with the remainder spent on discharging their rent obligations under existing leases and spent none of the proceeds on building new sustainable supermarkets. In addition, where a sustainability label is awarded to a green bond, there should be assurances that is "ringfenced" for the financing of sustainable activities so that proceeds cannot be transferred to unsustainable activities within the same business.

Fourth, the labelling regime should apply to the full spectrum of financial products and not just those marketed as "sustainable". As such, the EDO **recommends** that the regime includes a label indicating when a product is *un*sustainable to ensure that Treasury's proposed objective of informing retail investors of the sustainability characteristics of *different* investment products is met and to increase transparency. Under this category, financial products that invest in companies whose activities are inconsistent with the goals of the Paris Agreement, including fossil fuel companies, would be labelled "unsustainable".

Priority 5: Enhancing market supervision and enforcement

Are Australia's existing corporations and financial services laws sufficiently flexible to address greenwashing? What are the priorities for addressing greenwashing?

Yes. Australia's existing corporations and financial services laws are sufficiently flexible to address greenwashing. However, as noted in relation to Priority 3 above, there are ways that those laws and related regulatory guidance could be strengthened to better address key greenwashing trends in entities' sustainability transition planning.

Further, in our view, the proliferation of misleading or deceptive conduct provisions across different laws, overlapping in certain instances, creates unnecessary complexity and warrants simplification. This is consistent the Australian Law Reform Commission's conclusion that misleading or deceptive conduct provisions in corporations and financial services laws give rise to significant complexity and increase compliance and other costs, to the detriment of all stakeholders.[33] The Commission proposed a solution of strengthening some of the key legislative "highways" (the core provisions) and removing the relatively unused and more complex "back streets and alleyways" (the lesser used provisions).[34] The Commission also noted that there is a need for simplification of misleading or deceptive conduct provisions in other contexts, including in the *Australian Consumer Law*.[35] The EDO supports the Commission's recommendations.

In terms of priorities for addressing greenwashing, the EDO supports strong action being taken across various sectors of the market to address key greenwashing trends. While ASIC has taken some civil enforcement and penalty notices to date, the ACCC is yet to bring any actions or issue any fines. While ASIC has produced a report outlining trends, the ACCC has not reported on its enforcement action to date. We welcome the ACCC draft Guidance on Sustainability Claims but further education and guidance material is also needed. Strong action on broader greenwashing trends in the market would maximise the efficacy of enforcement actions by signaling to other market participants that such conduct may run afoul of prohibitions on misleading or deceptive conduct. Examples of current greenwashing trends in Australia are contained in the EDO's Submission to the Senate Standing Committee on Environment and Communications' Inquiry on Greenwashing, dated 9 June 2023.

Priority 8: Ensuring fit for purpose regulatory frameworks

Do you agree that existing regulatory and governance frameworks and practices have adapted well to support better integration of sustainability-related issues in financial decision making? Are there barriers or challenges that require further consideration? This may include:

- ***Corporate governance obligations, including directors' duties***
- ***Prudential frameworks and oversight, including in relation to banks and insurers***
- ***Regulation of the superannuation system and managed investment schemes***

The EDO's Safe Climate (Corporate and Commercial) team's work does not generally include prudential frameworks and oversight. The EDO's response to this question is therefore confined to the following matters:

(a) superannuation fund trustees' duties as contained in the *Superannuation Industry (Supervision) Act 1993* (Cth);
(b) directors' duties as contained in the *Corporations Act 2001* (Cth);
(c) enforcement mechanisms for duties owed by directors of government-owned corporations; and
(d) extending the 'two strikes' rule in relation to listed entities' remuneration reports to listed entities' sustainability-related reporting.

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[33] Australian Law Reform Commission, *All roads lead to Rome: unconscionable and misleading or deceptive conduct in financial services law* (Background Paper FSL9, December 2022) pp 1, 20, 36.
[34] Australian Law Reform Commission, *All roads lead to Rome: unconscionable and misleading or deceptive conduct in financial services law* (Background Paper FSL9, December 2022) pp 1, 37.
[35] Australian Law Reform Commission, *All roads lead to Rome: unconscionable and misleading or deceptive conduct in financial services law* (Background Paper FSL9, December 2022) p 19

Superannuation fund trustees’ duties

Section 52 of the *Superannuation Industry (Supervision) Act 1993* (Cth) imposes duties on superannuation trustees comparable to those contained in ss 180-184 of *Corporations Act 2001* (Cth), including a duty to exercise reasonable care and diligence (s 52(2)(b)) and to act in the best *financial* interests of the fund’s beneficiaries (s 52(2)(c)).

In 2021, s 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth) was amended to substitute “best interests” with “best *financial* interests”.[36] This presents a potential barrier to superannuation trustees’ consideration and management of sustainability-related matters where there is doubt about whether those matters align with the best financial interests of the fund’s beneficiaries. While some superannuation funds have divested from fossil fuels on the basis that it is in the best financial interests of their members,[37] other funds the EDO has engaged with have justified reneging or not complying with their climate-related commitments on the basis that they may otherwise breach their duty to act in the best financial interests of members.

Those concerns are somewhat understandable in circumstances where claims for alleged breaches of comparable duties have been made in other jurisdictions due to the pursuit of sustainability-related objectives. In May 2023, four New York City employees and a non-profit organisation commenced proceedings against three New York City public employee retirement systems, alleging they had breached their fiduciary duties, including their duty to act in the “best interests” of fund participants and beneficiaries, by divesting from fossil fuels.[38]

This state of affairs should be of grave concern. The Australian superannuation industry has approximately $3.5 trillion under management.[39] The size of their holdings means that superannuation funds are uniquely positioned to engage with companies and other asset owners to drive the energy transition and deliver long-term investment outcomes. Failure to support the transition to a low-carbon economy could cost Australians billions in retirement savings as the financial risks from climate change increase.[40] The Swiss Re Institute estimates that close to 10% of total economic value could be lost by 2050 if climate change continues its current trajectory.[41] That figure increases to 18% if warming reaches 3.2°C.[42] In those circumstances, it is alarming that some superannuation trustees consider that their duties inhibit their consideration of sustainability-related matters and long-term financial objectives.

Accordingly, the EDO **recommends** the repeal of the 2021 amendments to s 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth).

However, as demonstrated by the claim against three New York City public employee retirement systems, that in itself may not be sufficient. The EDO **endorses** the Australia Panel of Experts on

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[36] *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth) Schedule 3, item 9.
[37] See, for example, NGS Super, *Annual Report 2021-22* (Report, 30 June 2022) p 4.
[38] *Wong & Ors v New York City Employees’ Retirement System & Ors* (Complaint, Supreme Court of the State of New York, 11 May 2023).
[39] Association of Superfunds Australia, *Super Statistics* (Website, September 2023) <https://www.superannuation.asn.au/resources/superannuation-statistics?icid=learn_more_content_click>.
[40] Association of Superfunds Australia, *ASFA targets net-zero greenhouse emissions by 2050* (Website, 1 October 2021) <https://www.superannuation.asn.au/media/media-releases/2021/media-release-1-october-2021?icid=learn_more_content_click>.
[41] Swiss Re Institute, *The economics of climate change: no action not an option* (Report, April 2021) pp 1, 2, 9.
[42] Swiss Re Institute, *The economics of climate change: no action not an option* (Report, April 2021) p 9.

Environmental Law's recommendation that the duties owed by superannuation trustees be redefined to explicitly allow the consideration of sustainability-related matters.[43]

Directors' duties

Company directors owe duties at both common law and pursuant to ss 180-184 of the *Corporations Act 2001* (Cth). The duties of primary relevance to the integration of sustainably-related issues in financial decision-making are the duties to exercise reasonable care and diligence and act in the best interests of the company, contained in ss 180 and 181, respectively.

In relation to the duty to exercise reasonable care and diligence contained in s 180, Noel Hutley SC and Sebastian Hartford-Davis have stated that it requires directors to at least consider climate-related risks to their company.[44] Similarly, Sebastian Hartford-Davis and Zoe Bush have stated that the duty requires directors to also at least consider *nature*-related risks to a company, and, where appropriate, take reasonable steps to disclose those risks.[45]

In relation to the duty to act in the best interests of the company contained in s 181, Bret Walker SC and Gerald Ng have concluded that the duty provides directors with "considerable leeway" in terms of how they identify the company's best interests.[46] This flexibility extends to both the time horizon over which the best interests are assessed as well as the nature of the interests, and certainly permits directors to consider impacts of a decision on the company's reputation.[47]

Both duties are therefore sufficient to *permit* the consideration of sustainability-related matters, and perhaps even *require* the consideration of those matters. However, this is confined to the extent that sustainability-related matters intersect with the interests of the company. Accordingly, where a company's sustainability-related impacts *do not* pose a risk of harm to a company or otherwise intersect with its interests, those impacts will fall outside the scope of the duties contained in ss 180 and 181 of the *Corporations Act 2001* (Cth).

Legislative reforms in other jurisdictions have sought to rectify this problem by introducing a corporate 'hybrid' model that combines both commercial and environmental objectives into corporate governance.

In 2006, the UK's corporations law was amended to require directors to act in the way they consider, in good faith, "would be most likely to promote the success of the company for the benefit of its members as a whole".[48] In doing so, they *must* have regard to, amongst other matters, the impact of the company's operations on the community and the environment.[49] However,

[43] Australian Panel of Experts on Environmental Law, *The Private Sector, Business Law and Environmental Performance* (Technical Paper 7, April 2017) p 26.
[44] Noel Hutley SC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties* (Memorandum of Opinion, 7 October 2016); Noel Hutley SC and Sebastian Hartford-Davis, *Climate Change and Directors' Duties* (Supplementary Memorandum of Opinion, 26 March 2019).
[45] Sebastian Hartford-Davis and Zoe Bush, *Nature-related risks and directors' duties* (Joint Memorandum of Opinion, 24 October 2023).
[46] Bret Walker SC and Gerald Ng, *The Content of Directors' "Best Interest" Duty* (Memorandum of Advice, 24 February 2022) [28].
[47] Bret Walker SC and Gerald Ng, *The Content of Directors' "Best Interest" Duty* (Memorandum of Advice, 24 February 2022) [28].
[48] *Companies Act 2006* (UK) s 172(1).
[49] *Companies Act 2006* (UK) s 172(1)(d).

empirical research indicates that UK directors still consider that their overriding objective is to maximise shareholder profit.[50]

The German Corporate Governance Code recommends that boards:[51]

> *… systematically identify and assess the risks and opportunities associated with social and environmental factors, as well as the ecological and social impacts of the enterprise's activities. In addition to long-term economic objectives, the corporate strategy shall also give appropriate consideration to ecological and social objectives. Corporate planning shall include corresponding financial and sustainability-related objectives.*

If directors do not comply with this recommendation, they are required to disclose and explain the reasons for that departure.[52]

These reforms are commendable. Additionally, the EDO **endorses** the Australian Panel of Experts on Environmental Law's recommended introduction of an "environmental judgement rule" comparable to the business judgment rule contained in s 180(2) of the *Corporations Act 2001* (Cth).[53] The rule would shield a director from liability for any alleged breach of the best interests duty in s 181 in circumstances where the director made reasonable decisions to improve their company's environmental performance, despite those decisions not necessarily aligning with the financial interests of the company. This is particularly pertinent in light of "anti-ESG" claims in the US that allege certain duty holders have breached their duties to act in the best interests of an entity by pursuing sustainability-related objectives, as discussed further below.

Enforcement of public directors' duties

Corporations that are owned (wholly or partially) by the Commonwealth and/or established under statute (collectively referred to as **government-owned corporations**) are subject to a more complex set of governance arrangements. These will depend on the particular corporate form of the government-owned corporation and the obligations contained in its enabling legislation (if any).

For example, directors of a company incorporated under the *Corporations Act 2001* (Cth) that the Commonwealth controls will be subject to the duties contained in ss 180-184 of the *Corporations Act 2001* (Cth) as well as a duty to keep the responsible Minister and Finance Minister informed of certain matters.[54] These companies are defined to be 'Commonwealth companies' under s 89(1) of the *Public Governance, Performance and Accountability Act 2013* (Cth).

In contrast, officials of body corporates established under a law of the Commonwealth (other than a Commonwealth company) are subject to the duties contained in Pt 2-2, Div 3 of *Public Governance, Performance and Accountability Act 2013* (Cth) and any duties imposed by the body

[50] David Collison et al, *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence* (Report, 2011) pp 41-42.
[51] Regierungskomission Deutscher Corporate Governance Kodex, *German Corporate Governance Code* (Regulatory Guide, 28 April 2022) Recommendation A.1.
[52] Regierungskomission Deutscher Corporate Governance Kodex, *German Corporate Governance Code* (Regulatory Guide, 28 April 2022) p 2.
[53] Australian Panel of Experts on Environmental Law, *The Private Sector, Business Law and Environmental Performance* (Technical Paper 7, April 2017) p 25.
[54] *Public Governance, Performance and Accountability Act 2013* (Cth) s 91.

corporate's enabling legislation (if any). These body corporates are defined to be 'Commonwealth entities' under s 10 of the *Public Governance, Performance and Accountability Act 2013* (Cth).

Division 3 of Pt 2-2 imposes duties on officials of Commonwealth entities comparable to those contained in ss 180-184 of the *Corporations Act 2001* (Cth), except to the extent they do not explicitly require those officials to act in the "best interests" of the entity.

However, in both instances, enforcement of those duties is difficult and very rare. The vast majority of legal enforcement mechanisms are only available to the responsible Minister, resulting in an "apparent near-total lack of enforcement of directors' duties in the [government-owned businesses] context".[55] This raises the risk that "these duties do not serve the same deterrent effect as they do in the private sector".[56] That is concerning given that the financial and social significance of government-owned corporations demands that directors of those corporations be held to at least as high a standard as directors of private sector companies.[57]

The EDO considers that it would strengthen deterrence if non-governmental bodies could play a role in enforcing directors' duties where governments fail to act. The public has a claim to this role due to its status both as the ultimate owner of public assets, including government-owned corporations, and due to citizens' other stakeholder relationships with those corporations.[58]

Accordingly, the EDO **recommends** that the *Public Governance, Performance and Accountability Act 2013* (Cth) be amended to include:

- (a) a public derivative action mechanism modelled on ss 236 and 237 of the *Corporations Act 2001* (Cth); and
- (b) a statutory injunction provision modelled on s 1324 of the *Corporations Act 2001* (Cth), which is available to members of the public.

Those mechanisms should apply to the duties owed by officials of Commonwealth entities under Pt 2-2 Div 3 of the Act, as well as the duties owed by directors of Commonwealth companies under ss 180-184 of the *Corporations Act 2001* (Cth).

Extension of 'two strikes' rule

The EDO supports the extension of the 'two strikes' rule in relation to listed entities' remuneration reports, as contained in Div 9 of Pt 2G.2 of the Corporations Act 2001 (Cth), to listed entities' reporting on sustainability-related matters. This would mean that, if at least 25% of shareholders vote against the adoption of a listed entity's sustainability-related report for two consecutive annual general meetings (**AGM**), shareholders must vote at the latter AGM on whether the directors (except the managing director) need to stand for re-election.[59] If the 'spill resolution' passes with a

[55] Victoria Baumfield, 'Locating the Public in Australian Public Enterprise: Reinforcing the Public Objectives and Public Accountability of Australian Government-Owned Businesses' (PhD thesis, University of Queensland, 2021) p 223.
[56] Victoria Baumfield, 'Locating the Public in Australian Public Enterprise: Reinforcing the Public Objectives and Public Accountability of Australian Government-Owned Businesses' (PhD thesis, University of Queensland, 2021) p 223.
[57] Victoria Baumfield, 'Locating the Public in Australian Public Enterprise: Reinforcing the Public Objectives and Public Accountability of Australian Government-Owned Businesses' (PhD thesis, University of Queensland, 2021) p 223.
[58] Victoria Baumfield, 'Locating the Public in Australian Public Enterprise: Reinforcing the Public Objectives and Public Accountability of Australian Government-Owned Businesses' (PhD thesis, University of Queensland, 2021) p 223.
[59] As provided for in relation to remuneration reports in ss 250U and 250V of the *Corporations Act 2001* (Cth).

majority of eligible votes cast, then a ‘spill’ meeting must take place within 90 days at which shareholders will elect new directors.[60]

Already, shareholders are using AGMs to vote on listed entities’ transition plans. For example, 48.97% of shareholders voted against Woodside Energy Ltd’s transition plan at its 2022 AGM, partly because of its heavy reliance on offsets. 36.93% of shareholders voted against Santos’ transition plan at its 2022 AGM. The EDO **recommends** the introduction of the ‘two strikes’ rule in relation to these disclosures as an important accountability mechanism for shareholders frustrated with directors’ continued mismanagement of sustainability-related risks. This could be enhanced by requirements for mandatory voting on disclosures and sustainability reporting.

What steps could the Government or regulators take to support effective investor stewardship?

In response to increasing demand for the superannuation industry to take stronger action on climate, there has been an uptick in superfunds making commitments to align their portfolios with the achieving net zero emissions by 2050 consistent with the goals of the Paris Agreement. The EDO is concerned that the prevalence of net zero commitments carries the risk of greenwashing when coupled with claims that “active stewardship” is a means by which those commitments will be achieved. Our concerns are heightened in the context of continued investment by superfunds into companies involved in the exploration and production of fossil fuels whose net zero commitments do not align with the goals of the Paris Agreement according to the standards set out in our response to Priority 3 above.

The EDO is concerned that claims of active ownership may constitute greenwashing if superfunds maintain claims that engagement is an effective means to influence investee companies whilst those same investee companies continue to pursue a fossil fuel expansion strategy that is not consistent with achieving net zero.

We note a recent report published by Market Forces found that Australia’s five largest super funds – AustralianSuper, Commonwealth Super Corp, Australian Retirement Trust, Aware Super and AMP - have failed to adopt effective active engagement practices according to principles set by major responsible investment initiatives, of which those superfunds are signatories, being: [61]

(a) investors identify and prioritise high climate-exposed companies or sectors targeted for engagement;
(b) investors set time-bound engagement objectives for priority companies;
(c) investors report on the progress towards priority company objectives;
(d) investors identify consequences or escalation measures for companies failing to meet objectives; and
(e) investors identify divestment and/or exclusions as the ultimate escalation measure for companies failing to meet their objectives.

We further consider that superfunds that justify holding positions in fossil fuel companies on the basis of active ownership should ensure that their voting practices are consistent with those claims. Whilst we understand that not all shareholder proposals warrant support, we consider that, where a superfund commits to transitioning its portfolio to net zero emissions by 2050, then it

[60] As provided for in relation to remuneration reports in ss 250W and 250X of the *Corporations Act 2001* (Cth).
[61] Market Forces, *Stewards of Climate Disaster: How Australia’s biggest super funds are failing to deliver on climate claims through ‘active ownership’* (Website, accessed 20 November 2023) <Stewards of Climate Disaster - Market Forces>

should vote in support of proposals aimed at strengthening a company's climate action. The EDO has observed a trend of inconsistent voting practices across the superannuation industry and is concerned that greenwashing is widespread.

Accordingly, the EDO **recommends** that regulators provide superfunds with guidance on the requirements of effective and transparent engagement, and guidance in relation to claims they make on their voting policies and/or practices, in particular that they must not be inconsistent with claims made in relation to their own climate commitments. This would ensure that superfunds are clear on how they should demonstrate effective climate-related active ownership practices to justify their broad climate-related statements without engaging in greenwashing.

What are the key expectations of the market around issuance of, and reporting against, sovereign green bonds? What lessons can be learned from comparable schemes in other jurisdictions?

Capital raised by sovereign green bonds must set the standard for corporate green bonds and should not be used to facilitate greenwashing of inadequate climate policies or by funding projects that would have been financed regardless. As such, it is crucial that sovereign green bonds are used to finance government projects which are aligned with the temperature goals of the Paris Agreement and generate additional finance for the transition.

Accordingly, the EDO considers that the criteria for selecting eligible projects should be credible and science-based and should exclude projects that maintain or extend fossil fuel production. Exclusions should extend to natural gas related projects and CCS projects for the reasons provided in response to Priority 2 above. In that regard, we note recent criticism by investors and industry groups of the UK government's announcement to approve new licenses to drill for oil and gas in the North Sea and invest in two carbon capture and utilisation storage facilities two weeks after issuing a sovereign green bond.[62] Sovereign green bonds should not distract from the need to reduce reliance on fossil fuels and should not embed a fossil-based energy system in Australia.

Priority 10: Catalysing sustainable finance flows and markets

What role can the CEFC play to support scaling up of sustainable investment in Australia, as part of a more comprehensive and ambitious sustainable finance agenda?

In line with the recent amendment of the statutory objectives of the Clean Energy Finance Corporation (**CEFC**) to include the facilitation of "the achievement of Australia's greenhouse gas emissions reduction targets",[63] it is important that the CEFC's efforts are directed toward initiatives that will actually reduce Australia's greenhouse gas emissions. The CEFC should not be facilitating finance for initiatives that will further embed fossil fuels in Australia's energy system.

For this reason, the EDO **supports** the statutory prohibition on the CEFC investing in CCS technology.[64] The EDO agrees with the views expressed by the Labor Senators' dissenting report on the *Clean Energy Finance Corporation Amendment (Carbon Capture and Storage) Bill 2017* (Cth), that removing this statutory prohibition would "potentially divert CEFC resources into assessments of

[62] Responsible Investor, Investors criticise UK climate policy backslide, raise green gilts concerns (Website, accessed 20 November 2023) <Investors criticise UK climate policy backslide, raise green gilts concerns (responsible-investor.com)>.
[63] *Clean Energy Finance Corporation Act 2012* (Cth) s 3.
[64] *Clean Energy Finance Corporation Act 2012* (Cth) s 62(a).

applications for CCS support that are not commercially viable, and potentially divert clean technology funding to risky and expensive CCS projects".[65]

The risks associated with CCS have only become more evident since that time. The world's largest commercial CCS project at Chevron's Gorgon LNG Project is an instructive example of both disappointing sequestration rates and low sequestration of total greenhouse gas emissions. By July 2021, the project had missed its CO2 injection target by more than 50%, due to unforeseen engineering challenges.[66] In the 2022-23 financial year, Chevron still only buried a third of the carbon dioxide it committed to annually burying at the project.[67]

Even if CCS was implemented perfectly, it would capture less than 6% of the project's total emissions (including Scope 3).[68] This is consistent with research that suggests the "28 CCS facilities currently operating globally have a capacity to capture only 0.1 percent of fossil fuel emissions, or 37 megatons".[69] This demonstrates the inability of CCS technology, even if perfectly implemented, to reduce emissions in line with the Paris Agreement and Australia's greenhouse gas emissions reduction targets. It is no substitute for the actual emissions reductions associated with phasing out fossil fuels.

CCS also comes with its own environmental concerns, including:

(a) Injection and storage in reservoirs create risks of reservoir failure and potential for contamination, including of drinking water.[70]

(b) CCS, whether it involves pre- or post-combustion capture of carbon dioxide, requires significant energy use, and therefore may increase greenhouse gas emissions in Australia unless the energy required to power CCS operations is renewably sourced.[71] This, coupled with the significant potential for CCS developments to leak CO2, means that, rather than providing a solution to the problem of climate change, there is a risk that CCS developments could in fact cause a net increase in greenhouse gas emissions.

(c) CCS is also water-intensive because water is needed during the cooling process at the power-plant level and as part of the carbon capture process.[72] Consequently,

[65] The Senate Environment and Communications Legislation Committee, *Clean Energy Finance Corporation Amendment (Carbon Capture and Storage) Bill 2017 [Provisions]* (Report, May 2018) p 28 [1.9].

[66] Institute for Energy Economics and Financial Analysis, *The Carbon Capture Crux: Lessons Learned* (Report, September 2022) p 30.

[67] Chevron, *Gorgon Gas Development and Jansz Feed Gas Pipeline: Environmental Performance Report 2023* (7 November 2023) pp 63-64.

[68] Chevron, *Gorgon Gas Treatment Plant Greenhouse Gas Management Plan* (17 August 2022).

[69] N MacDowell et al., 'The role of CO2 capture and utilization in mitigating climate change' (2017) 7 *Nature Climate Change* 243.

[70] See, for example, The Royal Society, *Locked Away: Geological Carbon Storage Policy Briefing* (2022) p 12, Ming Hà Dương and David W Keith, 'Carbon storage: The economic efficiency of storing CO2 in leaky reservoirs' (2003) 5 *Clean Technologies and Environmental Policy* 181, 182.

[71] Intergovernmental Panel on Climate Change, *Climate Change 2022: Mitigation of Climate Change, Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (Report, 2022) p 642.

[72] Intergovernmental Panel on Climate Change, *Climate Change 2022: Mitigation of Climate Change, Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (Report, 2022) p 643 ("CCS requires considerable increases in some resources and chemicals, most notably water. Power plants with CCS could shut down periodically due to water scarcity. In several cases, water withdrawals for CCS are 25–200% higher than plants without CCS (Rosa et al. 2020b; Yang et al. 2020) due to energy penalty and cooling duty. The increase is slightly lower for non-absorption technologies. In regions prone to water scarcity such as the Southwestern USA or Southeast

> broad adoption of CCS "could strongly affect [] local and global water resources" where they compete with municipal and industrial uses, irrigated agriculture, and agro-ecosystems.[73]

EDO also considers that it would be inappropriate – and indeed, contrary to the CEFC's statutory objectives – for the CEFC to facilitate finance for hydrogen produced using fossil fuels. The Intergovernmental Panel on Climate Change and the International Energy Agency are clear that no new fossil fuel projects should be approved if the world is to achieve the Paris Agreement's goal of limiting warming to 1.5°C,[74] and that the world must transition rapidly to renewable energy sources. There is therefore no place for new fossil fuel derived products.

For the reasons explained above, the application of CCS would not adequately abate the emissions associated with hydrogen produced using fossil fuels. Indeed, scientific research suggests that blue hydrogen – hydrogen produced using natural gas with CCS – may have a greater greenhouse gas emissions footprint than burning natural gas or coal for heat, if CCS efficiency averages below 80%.[75] Even if the 90% "gold standard" of capture efficiency was achieved, every tonne of blue hydrogen would still produce a tonne of carbon dioxide. Accordingly, it would be contrary to the CEFC's statutory objective to facilitate the achievement of Australia's greenhouse gas emissions reduction targets if the CEFC were to facilitate finance for hydrogen produced using fossil fuels.

Priority 11: Promoting international alignment

What are the key priorities for Australia when considering international alignment in sustainable finance?

The EDO **supports** the international alignment of sustainable finance frameworks to maximise consistency across jurisdictions but only to the extent that doing so does not import weaker standards into the Australian framework. As such, international alignment should only be prioritised if standards are science based and aligned with Australia's domestic emissions reduction targets and its international obligations under the Paris Agreement and the UN Convention on Biological Diversity. In that regard, we note our concerns in relation to the proposed transitional activity category in the Australian Taxonomy in our response to Priority 2 above, inclusion of which may be required if international alignment is pursued as an overarching priority. Given the carbon intensive nature of the Australian economy, the primary priority should be ensuring large capital flows of sustainable finance to support activities of entities with credible, science-based pathways.

Noting that future objectives in relation to sustainable finance will address sustainability issues other than climate, we anticipate the development of frameworks addressing the disclosure of inequality and social risks, opportunities and impacts and the introduction of global baseline social standards. In that regard, we note the Task Force on Inequality-related Financial Disclosures (**TIFD**) is in the process of developing guidance, thresholds, targets and metrics for companies and

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Asia, this may limit deployment and result in power plant shutdowns during the summer months (Liu et al. 2019b; Wang et al. 2019c).")

[73] Lorenzo Rosa et al., 'The water footprint of carbon capture and storage technologies' (2021) *Renewable and Sustainable Energy Reviews* 3, 20.

[74] International Energy Agency, *Net Zero by 2050: A Roadmap for the Global Energy Sector* (May 2021) p 21; Hoesung Lee et al., *Synthesis Report of the IPCC Sixth Assessment Report* (2023) p 56, Figure 3.5.

[75] Robert Howarth and Mark Jacobson, 'How green is blue hydrogen?' (2021) 9 *Energy Science Engineering* 1676.

investors to measure and manage their impacts on inequality and the risk that inequality presents to the company's performance. Given that Australia acted as strategic funding partner for TNFD, we consider that Australia should support the development of TIFD which would support capacity building across the private and public sector and would position Australia well to ensure international alignment with future sustainability disclosure requirements.

Priority 12: Position Australia as a global sustainability leader

What are other key near-term opportunities for Australia to position itself as a global leader in sustainable finance and global climate mitigation and adaptation?

First, EDO considers that the most pressing and immediate opportunity for Australia to be a leader in global climate mitigation is for the Government to end its support for the development or expansion of new or existing fossil fuel projects. EDO considers this an essential pre-requisite for achievement of the Government's stated ambitions with respect to the Sustainable Finance Strategy.

Second, EDO considers that there is a key opportunity for Australia in the near- and medium-term to pursue a sustainable finance agenda that encompasses social and environmental objectives that are critical for national and regional resilience and future prosperity.

For example, Australia can offer world-leading opportunities for investment in renewable energy projects that deliver economic benefits to the communities and First Nations peoples on whose lands the projects are situated. This would bolster Australia's credibility and influence in global discussions on issues such as just transition.

These opportunities can be realised through the development of a cohesive sustainable finance strategy that respects and embeds Australia's international commitments on human rights, in particular the *United Nations Declaration on the Rights of Indigenous Peoples.*