A climate for nature: what duties do company directors need to consider in relation to nature-related risks?

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Nature-related risks are becoming increasingly important for companies and their directors, as they face growing legal, regulatory and societal expectations to address the impacts of their activities on the environment and biodiversity. As we look ahead to the COP16 biodiversity conference in Columbia next month, which will focus attention on actions being taken to restore nature, we approached a number of senior executives to explore how nature-related issues are changing the way their business operates.

In this third article in our 'a climate for nature' series, we turn to focus on the regulatory backdrop to how organisations measure, report and share their impact on nature and biodiversity. Here, **our Sustainability Partner Ben Stansfield talks with James Burton, a barrister practising from 39 Essex Chambers and specialising in environmental and planning law,** about duties for company directors to consider in relation to nature-related risks.

Discussion highlights:

The duties of directors to consider nature-related risks

The duty of directors to consider nature-related risks is not new, but rather a reflection of the existing statutory and common law duties that directors have to act in the best interests of 'the company', and to do so with reasonable care, skill and diligence. These duties, codified respectively in sections 172 and 174 of the Companies Act 2006, require directors to have regard to a range of factors, including the environment, when making decisions that affect a company.

In essence, these duties are inevitably informed by the changing expectations of society, industry and regulators, which have been raising the bar for the consideration of nature-related risks - especially in light of the climate crisis and the loss of biodiversity. Those directors who have particular knowledge or expertise in environmental matters will also be held to a higher standard of care and skill.

The consequences of failing to consider nature-related risks

Directors who fail to properly consider nature-related risks may expose themselves and the company to various claims and liabilities, depending on the circumstances. For directors, these may include claims by the company for breach of duty, claims by investors for derivative actions, regulatory sanctions, reputational damage, termination of employment and loss of remuneration. For the company, these may

include claims by third parties for nuisance, tort, breach of environmental permits or regulations, and loss of market value or opportunities.

The general position is that if a director can show, subjectively, that they have acted in good faith, they won't be found to be in breach of their s.172 duty to act in the best interests of the company, even if their position is irrational. However, if their position is irrational, a court will look hard at their subjective evidence that they acted in good faith. There is also a carve out from that subjective duty, and the court may apply an objective test, if the director has not even considered the company's best interests, or if they have missed something very material to the company's interests. Then the court may apply an objective test under section 172 and ask whether the reasonable director in the same shoes would have arrived at the same position.

But sections 172 and 174 go together, and even if a director can pass the s.172 test, there is still s.174, which holds a director to an objective standard of reasonable care, skill and diligence. Section 174 also means that if a director has particular knowledge or expertise, they will be held to a higher standard in terms of the actual content of that duty.

The trends in environmental litigation and legislation

There are some notable trends in environmental litigation and legislation that directors should be aware of. In the case of *ClientEarth v Shell*, for example, the environmental NGO challenged Shell's transition strategy and policies in a derivative action, and although it lost the case, it generated significant publicity and commentary, and brought attention to the organisation and the case. The increasing trend of ESG litigation is likely to see more non-governmental organisations using legal mechanisms to challenge the actions or inactions of companies and directors in relation to nature-related risks. These will naturally act to drive further policy change and, potentially, legislative changes - so the regulatory environment will continue to evolve.

Q&A with James:

So James, is the duty for directors to consider nature something new? And what does the duty entail?

There is a yes and no answer to this.

It's a yes due to section 172 - and specifically 172(1)(d) - of the Companies Act 2006. Section 172(1)(d) marks the first time there has been a statutory codification imposing a duty on directors to, in this case, have regard to the environment among the list of other factors when discharging their duty to, in good faith, act in the way that is most likely to promote the interests of the company. The "company" being a shorthand for the interest of all the members.

Section 172(1) introduces a duty for directors to act in a way that promotes the interests of the company, and then there is this long non-exhaustive list of (a) through to (f) of items to which the director is obliged to have regard.

In addition, directors are also obliged to have regard to section 174, which is the statutory codification of the duty to act with reasonable care, skill and diligence.

These sections are part of a suite of statutory codifications that are one of the big innovations of the Companies Act 2006. So in that sense, yes, it is new.

The other way that it could be said to be new is that those duties are inevitably informed by expectation - societal expectation, industry expectation, regulatory expectation - and it is quite clear that the direction of travel, so far as nature-related risks are concerned, is ever upwards.

Finally, if you call 2006 new in legislative terms, which it probably is, then this is still slightly shiny legislation.

But the answer is also a no, the duty is not new, because directors have always had a common law duty, that is sometimes referred to as the fiduciary duty, or the duty of loyalty. They have always had a duty to, in good faith, act in the best interests of the company. They have got to use the powers they are given for the purpose for which they are given, and they have always had that responsibility; I say always, because common law has recognised a duty to act with reasonable care and skill and diligence for a very long time.

We could go back through the centuries in this country's history of judge-made company law and what constitutes 'the company' and we would see countless examples of occasions in which directors, in performance of their duties, certainly should have had to have regard to nature-related risks; whether that is because their company was impacting nature in a way that interfered with someone else's interest in land, or their company's own interests were being impacted, or whether it is because their company was impacting nature in a way that put them in breach of regulation. Whatever the facts, this should - for a very, very long time - have been part of the framework of directors' thinking in discharge of their duties, which is why it is a yes and no response to the question.

When we talk about this duty being new, are you saying it is new because it was codified in 2006 and so is only 18 years' old?

In the history of company law, the law of companies, yes, 2006 is relatively new. But it is the combination of that, and the fact of the statutory codification, and that societal expectations have been rising ever upwards. The TNFD (Taskforce on Nature-Related Financial Disclosures) framework is a prime example. The TNFD framework is not yet mandatory, but we've had hundreds of early adopters. So it illustrates the events on the ground that have contributed to informing the substantive content of that duty in a way that is actually new and novel.

The legal opinion you co-authored on nature-related risks and directors' duties under the law of England and Wales packaged a number of things together in a new way for organisations to think about, but key elements were always there?

It was always there, exactly, and I don't think that we as authors in any way shied away from that. We made the point repeatedly that nature-related risks are just like any other risk. It is simply that I think it really struck us that people - not everyone, of course, but many people - were failing to think about these risks sufficiently. So, it was meant to be a wake-up call to what really should be obvious but perhaps wasn't obvious to many people.

It was partly prompted by the overwhelming focus on climate change and mandatory climate change reporting. That was almost having a perverse effect: producing a form of tunnel vision in people that focused only on the climate and greenhouse gases (GHGs), not on wider nature-related risks. As you said before we started this interview, there seemed to be an assumption that, "well, climate change is just, you know, flip the switch on/off" and all is well, but actually nature-related impacts are a bit more complicated.

What happens when things go wrong and nature is not given proper consideration? What risks, or what claims, are companies and their directors opening themselves up for?

I'm going to stick with those two statutory duties and also bring in the other very striking innovation, which is the section 260 derivative claim.

Firstly, the section 172(1) duty is a subjective duty, a duty of good faith. This means that the general position is that if a director can show that they have acted in good faith, then they won't be found to be in breach of that duty - even if their position is irrational. However, we can expect a court to be relatively ready to infer that a director hasn't acted in good faith if their position is irrational, as it just doesn't stand up, it doesn't seem credible. There is also a carve out from the subjective nature of the duty, and the subjective nature of the test: if the director hasn't even considered what is in the best interests of the company, or if they have missed something that is very material in terms of the company's interests - then the court may apply an objective test and ask whether the reasonable director in the director's shoes would have arrived at the same position.

Secondly, though, we always have to remember the way that the section 172 and 174 duties sit alongside each other. So, if a director is able to shelter, as it were, behind that shield of acting honestly and in good faith under section 172, there is still section 174 that holds them to an objective standard of reasonable care, skill and diligence. Section 174, of course, quite importantly has this upwards ratchet mechanism in it, so if a director has particular knowledge or expertise of whatever it is - and that means if that is factored in they would be held to a higher standard - well they will be held to that higher standard in terms of the actual content of that duty.

Thirdly, we have these statutory duties and we have discussed what they entail, but the question now is what does that mean for claims? Imagine you're a director. Firstly, as a director, if you breach those duties, the company (your company) can come after you. Strictly, this would be a claim brought against you by the other members of the board of directors. Secondly, and these are matters that you and Gowling WLG are much better versed in than me, you could very well face regulatory consequences as an individual in addition, depending on the particular circumstances. Thirdly, an investor could bring a section 260 derivative claim against the board, alleging breach. With any of these options, arguably it almost doesn't matter so much whether there is actually a financial or other penalty at the end of the process, because your reputation as a director will potentially take a very serious hit, come what may.

On the one hand, with a nature-related risk, it might be the case that it is just too difficult to identify actual financial damage linked to a director's breach of duty. So if things go wrong, then they might not face an actual bill. But, on the other hand, they could still find themselves with their employment terminated, and terminated on bad leaver terms because of the breach of duty.

For the company itself, if its directors fail to have regard to nature-related risks, whether or not due to a breach of section 172 or section 174, then the company can find itself exposed in various ways, depending on the facts. It might be exposed to a private law claim in nuisance, or a fuller range of tortious claims, or regulatory action due to breach of general environmental laws, or breach of specific conditions under an environmental permit, and so on and so forth.

Do you expect an increase in focus on nature-related 'wrongdoing' by businesses or allegations of wrongdoing by claimants?

As a general rule of thumb, when considering whether nature-related risk is rising up the agenda, it's helpful to think about the fact that we had the climate change stripes first, and their popularisation, but that we now also have the biodiversity stripes; and they are catching up in the public consciousness, including as people understand the interrelationship with the climate and the threat to the world and our own species. There has been this lag between the emergence and popularisation of climate-focused issues, and broader biodiversity and nature-related issues, but the one is pulling the other along behind it and catching up, and the two sets of stripes are a great example.

The other thing that has really struck me over the past decade - is the inextricable rise of litigation-interested and capable non-governmental organisations (NGOs), coupled with this really deep pool of good lawyers who are willing to act either by pro bono or on heavily reduced fees and bring these cases to court. *ClientEarth v Shell* - which Lord Carnwath's insightful article discusses - is such a good example, because the interest that it generated, arguably, turned that defeat into what feels like more of a win for the NGO.

In the legal opinion you co-authored, you talked about existing legal mechanisms by which directors can be held liable and say that these can be disjointed and not easy to satisfy. Do you see that changing?

The point we make in the opinion about the regime concerns the ability, or inability, to enforce disclosure obligations; and that is a valid point and I stand by it, but what it isn't is a point that is specific to cases of nature-related risk: if we consider the disclosure regime that applies to all risks, essentially, the ability or inability to enforce is not going to turn on whether or not the particular risk in question is nature-related.

Are there any trends in environmental litigation that we should be aware of?

We have had two judgments from the Supreme Court in recent weeks that in different ways are very important for the environment, but I think they are indicative of a feature of the workings of our justice system that should never be overlooked. The courts do reflect societal mores, shifts in what is acceptable or unacceptable in the eyes of the person on top of the omnibus etc. Of the two cases - *Manchester Ship Canal v United Utilities* and *Finch v Surrey County Council* - it is *Finch* that I want to use to illustrate my point.

You could call this simply an example of the court acting on the evidence, but for me it does not fit entirely neatly into that rubric, and it might better be seen as an example of the court taking judicial notice, but either way, what is so notable about *Finch* is the way that Lord Leggatt starts the majority judgment with statements to the effect that the world is facing climate-change-crisis-time and the greenhouse effect is racing away.

Of course, this is all absolutely established scientifically, and various courts have been saying these things and this is not an isolated one-off event. But it is an incredibly powerful way to start a Supreme Court judgment. While the *Finch* case turned - technically, legally turned - on the interpretation of The Town and Country Planning (Environmental Impact Assessment) Regulations 2017, as is clear from the judgment, where it really turned was the absolutely inescapable, unavoidable conclusion that if you extract hydrocarbons, they will be burnt and they will contribute to the greenhouse effect.

Lord Leggatt starts the Supreme Court judgment in *Finch* with this, at paragraph 2: "The whole purpose of extracting fossil fuels is to make hydrocarbons available for combustion. It can therefore be said with virtual certainty that, once oil has been extracted from the ground, the carbon contained within it will sooner or later be released into the atmosphere as carbon dioxide and so will contribute to global warming."

So that reflection of what opinion polls will tell you society is thinking, does find its way through to the courts and the way the judiciary approach matters.

The other case is the *Manchester Ship Canal v United Utilities*, which is a much less obvious example of that. It is a very technical, very erudite, work through of where the law of essentially private nuisance and trespass stood before the Water Act 1989 and the Water Industry Act 1991, and then a consideration of the 1991 Act to see if it altered that position. At paragraph 131 of that judgment, it ends with this sentence: "A successful claim for damages for an incident or incidents of pollution of a watercourse will impose costs on a sewerage undertaker; but the effect is merely to prevent it from externalising the costs of its operations by leaving them to be borne by the victims of its unlawful behaviour". Here, it neatly sums up the societal-attitude shift that companies and their directors are facing when it comes to nature.

Are there any overseas trends you have noticed in terms of giving nature a legal personality?

We need to recognise that whereas in other jurisdictions, such as some nations in South America, they have legislated to give nature legal personality, the UK has not. So we need to be very wary, as we always are when considering judgments from those jurisdictions that have so legislated, to bear in mind what may be a radically different legislative context. None of which will stop the NGOs that I've talked about finding ways to challenge in our courts. It just may be that the litigation they can bring is different to the litigation that can be brought overseas. I am sure we are going to continue to see some examples of nature-related litigation that are successful, and some that are not, as we have in recent years. But in a sense, it's almost by-the-by, because these challenges drive policy change and they drive legislative change, as well as prompting judge-made-law - and so the cycle builds.

I am sure we are going to see challenges in due course concerned with the Environment Act 2021 and whether or not X, Y, Z policy is actually going to achieve this or that environmental target set under that Act. As we get closer to the shorter-term targets, e.g. those pegged at 2030, the prospect of those challenges will only increase. We have already seen the first challenge relying on alleged breach of section 19 of the Environment Act 2021, a challenge that Mrs Justice Lieven recently dismissed. But the fact a challenge has already been brought relying specifically on the Act is indicative.

Hard-edged climate change obligations, reporting obligations and the like can be used to lever, in many cases, adjunct, broader nature-related issues: e.g. deforestation, climate change due to deforestation,

loss of biodiversity due to deforestation, are all tangled together. So if a claimant works out, "well, ok I can challenge this thing because it is causing climate change", even though their major goal might be due to their worries about biodiversity, they will not shrink from pulling the climate-change-related litigation lever to achieve their biodiversity aim, because so often these areas are closely interlinked.

Looking for more insight into nature-related issues for businesses?

To sign up to receive more articles in this series and insight on related topics, sign-up to our mailing list. Over the coming weeks we'll be sharing more nature-related insights from interviews with a number of other senior executives from a diverse range of sectors. You can read the first two articles in the series here:

- Emma Toovey, Chief Ecology Officer at Environment Bank, shares perspectives on identifying and tackling nature-related threats in your business.
- Dr Samuel Sinclair, Co-founder and Director of Biodiversify, talks about how biodiversity is becoming more of a priority for businesses and shares insight into the challenges and opportunities for organisations as they evolve their approach.

Our ESG team is experienced in the full breadth of legal issues relating to ESG, including nature and biodiversity and will be closely monitoring the key discussion points at the 16th UN Biodiversity Conference. Look out for more insight and content via our LoupedIn blog.

To talk further on any of the issues discussed in this series, please contact Ben Stansfield.

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James Burton is a barrister, practising from 39 Essex Chambers, specialising in environmental and planning law and related areas. He co-edits the bulletin of the Encyclopedia of Environmental Law and, over the years, has been both named, and nominated, as Chambers and Partners' "Environmental and Planning Junior of the Year".