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9 February 2024
By email

Dear Director

Submission on the Treasury Laws Amendment Bill 2024: Climate-related Financial Disclosure (Cth)

Scope of this submission

This submission is made by Herbert Smith Freehills (**HSF**) in response to the Exposure Draft Treasury Laws Amendment Bill 2024: Climate-related Financial Disclosure (Cth) (**Draft Legislation**), which seeks to amend parts of the *Corporations Act 2001* (Cth) (**Corporations Act**) and *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) to require corporations to disclose their climate-related financial risks and opportunities. The Draft Legislation was released by the Australian Government on 12 January 2024.

Key submissions in response to the Draft Legislation

We continue to welcome the introduction of a mandatory climate reporting regime in Australia, which aligns to the International Sustainability Standards Board's (**ISSB**) standards on climate-related disclosure, as adapted by the Australian Accounting Standards Board (**AASB**) for the Australian context. While the Draft Legislation addresses a number of issues raised in our previous submissions, we make the following key submissions:

- the directors' declaration should be phased in to reflect the lack of (reasonable) assurance during the initial transitional period;
- the modified liability regime should be expanded to include protection for broader forward-looking statements, namely transition plans, and disclosures reproduced outside of the sustainability report;
- labelling of the "sustainability report" should be reconsidered given the implications for broader reporting on sustainability-related matters;
- revisions to the Draft Legislation should be made to clarify applicability to foreign entities;
- an extension to the proposed commencement date should be considered to allow for adequate preparation and to facilitate quality reporting; and
- safeguards should be included with respect to the Minister's ability to expand the regime, most relevantly to ensure appropriate industry consultation and due process.

In addition, we make several submissions related to technical or administrative drafting consequences.

The proposed changes to the ASIC Act and Corporations Act are extensive and our submissions are focused on issues relevant to corporate governance and market disclosure. Our submissions are set out in the tables at Attachment 1.

Given the volume of changes, it might be useful for stakeholders if the Australian Government undertakes to review the implementation of the Draft Legislation after 12 months and invites submissions to correct unintended consequences or matters that are not workable in practice.

Further questions

If you have any questions or comments about our submissions, please do not hesitate to contact us using the details below.

Yours sincerely

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Attachment 1

HSF submissions in response to Treasury's consultation on the Draft Legislation

1.1 Submissions on policy decisions and operational provisions

No.	Issue	Reference	HSF submission
1	Directors' declaration and transitional assurance period	Item 23 of the Draft Legislation (Inserts sections 296A(1)(d) and 296A(6) into the Corporations Act)	Due to the transitional assurance period outlined in proposed section 301B of the Draft Legislation, there is now a disconnect between the directors' declaration requirements and the assurance process. This is inconsistent with the approach to general financial reporting, where the full audit and assurance of financial statements occurs alongside the directors' declaration of compliance. We recognise that regardless of any level of audit or assurance, directors will need to turn their own minds to the information contained in public disclosures, including assessing whether the information is accurate and complete, as well as in compliance with relevant reporting obligations. Notwithstanding this, it is unreasonable to expect directors to provide an unqualified sign-off on compliance with the new sustainability standards in circumstances where there is limited assurance over limited disclosures only (i.e. scope 1 and 2 emissions). This issue is particularly pronounced given many of the broader disclosures are inherently uncertain, novel and forward-looking. Simply put, if the Government is not anticipating that auditors will be able to assure the reporting's compliance with the new standards in the early phases of the regime (given evolving practice, capability gaps, bandwidth, etc), it seems unreasonable to expect that directors will be able to declare such compliance. For the reasons set out above, and also with reference to the limited protections from liability available in Australia (as compared to broader safe harbour positions overseas) this draft position undermines the alignment between the Australian position and the international baseline. We recommend that either the directors' declaration be confined to disclosures over which reasonable assurance has been obtained, or that the relevant declaration be partially qualified given the state of market maturity. For example, that directors be required to declare that, in their opinion, "there are reasonable grounds to believe" that the climate disclosures comply with the sustainability standards and the Corporations Act.

No.	Issue	Reference	HSF submission
2	Modified liability approach	Item 129 of the Draft Legislation (Inserts section 1705B into the Corporations Act)	**Scope of modified liability should be expanded** The Draft Legislation provides relief to entities from private actions for a fixed three-year period for disclosures relating to Scope 3 greenhouse gas (**GHG**) emissions and scenario analysis. This proposal differs from the previous approach in the second Treasury consultation paper (June 2023), which proposed a broader relief for disclosures relating to Scope 3 GHG emissions and forward-looking statements, including scenario analysis and transition planning. The modified liability proposal in the Draft Legislation does not achieve its aims as it does not address the most difficult and uncertain content in the sustainability report (i.e. targets, transition plans and broader forward-looking statements). Without providing meaningful protection for forward-looking statements, the Draft Legislation may inhibit the transparency and quality of reporting in the initial transitional phase of the regime and result in inconsistent and incomplete disclosures (to the extent forward-looking statements are excluded due to perceived litigation risk). Notably, Scope 3 GHG emissions are only one aspect of the required disclosures that rely on estimation and third parties. Transition plans in particular will form a large part of an entity's disclosures (the International Financial Reporting Standards (**IFRS**) S2 defines "climate-related transition plans" as "an aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions") and are heavily reliant on contingencies and third-party data. We recommend that the modified liability provisions apply to the full scope of disclosures related to transition plans (including disclosures of targets, actions and resources), as originally proposed in Treasury's second consultation paper. **Modified liability should apply to statements outside sustainability report** The Draft Legislation also includes a note that statements made outside the sustainability report will not have the benefit of the modified liability regime. This exclusion will prevent entities from communicating effectively with stakeholders as entities will be deterred (due to lack of liability protection) from disclosing Scope 3 GHG emissions and scenario analysis in a way that is readily digestible by the public, such as through presentations, website content and other reports. The detail, length and complexity of the Chapter 2M reporting format can discourage readership and in practice, communicating through more concise means is often more effective in keeping the market and the public informed. Accordingly, we recommend that the same legal protections apply to any re-publication of statements made in sustainability reports. Similarly, where the continuous disclosure obligations on entities would require an update to a previous disclosure made in the sustainability report, for example, a regulatory expectation that materially impacts a corporate transition plan, any attempt to update that original disclosure should have the same modified liability protections. A failure to extend the immunity may have the adverse effect of supressing necessary market updates due to the fear of litigation risk. The current proposal risks distorting market information flows and creates legal risks when entities are discussing their climate strategies in different forums as is current market practice.

No.	Issue	Reference	HSF submission
3	Requirement to prepare a "sustainability report"	Generally; proposed section 292A of the Corporations Act	**"Climate Report" may be more applicable for some entities** The Draft Legislation requires certain entities to prepare a sustainability report as part of their annual report for a financial year, which contains climate-related disclosures. Given the IFRS framework is comparably less prescriptive, and in the context of current integrated reporting practices, reporting entities would benefit from further clarification as to the purpose and format of the proposed sustainability report. Our preliminary feedback on the proposed separate, identifiable "sustainability report" is that this label risks confusing the scope of its content, which we understand to be limited to climate-related financial disclosures initially (rather than broader sustainability concepts such as "biodiversity", "nature", "habitat restoration" and "water"). A sustainability report infers that the entirety of an entity's sustainability-related disclosures should be included. Given most Australian entities are more advanced in the rigour and breadth of their climate-related disclosures as compared to their broader sustainability-related disclosures, there may be discomfort combining the more rigorous and comprehensive climate disclosures with other voluntary sustainability reporting. Accordingly, we propose that reporting entities be given the choice to label the report as a "climate report" rather than a "sustainability report". Flexibility to call the report a "climate report" will also avoid duplication for larger entities that already prepare voluntary "sustainability reports" that sit outside of their annual reports. For example, a large entity might prepare a voluntary "sustainability report" based on the Global Reporting Initiative Standards and would benefit from the scope to separate disclosures into: a) a "climate report" as part of their annual report, as required by the Draft Legislation; and b) a "sustainability report", which sits outside of their annual report and is a voluntary disclosure. Recognising Treasury's longer-term intention to mandate broader sustainability-related disclosures, the label of the report can be revised at the time of this broader expansion (rather than pre-emptively). **Flexible approach to location of primary disclosure required and cross-referencing should be permitted** In terms of the format, it is not clear whether Treasury intends for the sustainability report (including the metrics underlying the climate disclosures) to be in a separate identifiable section in the annual report which would contain the entirety of an entity's climate-related disclosures or whether (and to what extent) cross-referencing would be acceptable. Practically, quantitative disclosures would suit the format of a 'databook' or similar, and in our view, any mandated disclosure format should expressly allow for cross-referencing. Requiring the sustainability report to be in a separate identifiable section in the annual report could interfere and inhibit integrated reporting practices and could jeopardise an entity's ability to avoid duplication. For example, an entity's annual remuneration report would need to include any climate-related metrics and performance targets, and these disclosures will also be required under the Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information (**ASRS**). We propose that Treasury does not mandate where primary disclosures will be (e.g. whether the primary disclosure sits within the remuneration report and is cross-referred to in the sustainability report or vice versa) and instead provides clear guidance on the:

No.	Issue	Reference	HSF submission
			• scope of cross-referencing allowed (and if cross-referencing is not permitted, whether the metrics underlying the climate disclosures can be separately disclosed in a "databook"); and • index table within the annual report that enables users to easily navigate the climate disclosures.
4	Whether foreign entities are required to prepare a sustainability report	Item 22 of the Draft Legislation (Inserts section 292A(1) into the Corporations Act)	**(Inadvertent) potential application to foreign entities** The Draft Legislation requires an "entity" to prepare a sustainability report for a financial year under proposed section 292A(1). However, the Draft Legislation, Explanatory Memorandum, Policy Impact Analysis and Policy Statement do not provide guidance on the term "entity" in this context, and there appears to be a potential unintended application of the Draft Legislation to foreign entities with respect to phasing-in Group 3. Proposed section 1705 (see Item 129 of Draft Legislation) limits the scope of Group 1 and Group 2 to "applicable entities". Proposed section 1705(2) defines an "applicable entity" as "a company, disclosing entity, registered scheme or registrable superannuation entity". This clarifies that the legislative intent is that foreign entities are not captured in Groups 1 or 2 as they are not "companies" for the purposes of the Corporations Act (i.e. companies registered under Chapter 2A which does not include foreign companies registered under Part 5B.2). However, with respect to the phase-in of Group 3 there is no equivalent qualification and it could be interpreted as including foreign entities. (Note: Foreign disclosing entities would not be caught by the scope of proposed section 292A by the operation of Corporations Act section 285(2)). In light of the above and to clarify this point in respect to all entities (not only Group 1 and Group 2), we recommend that the Draft Legislation incorporate the definition of "applicable entity" in proposed section 1705(2) into proposed section 292A (e.g. by placing a "Note" under proposed section 292A(1)). **Duplication of sustainability reporting obligations** The Draft Legislation does not address whether an Australian subsidiary which is required to prepare a sustainability report, can rely on a sustainability report (or similar) prepared by a foreign parent where that report captures the Australian subsidiary (**Foreign Parent Report**). In other words, it is unclear whether an Australian subsidiary included in a consolidated sustainability report (or similar) by a foreign parent will be exempt from obligations to report under the Draft Legislation. It is possible that a Foreign Parent Report, although not prepared in line with the Draft Legislation, has been prepared in accordance with the ISSB or ASRS. An inability to rely on the Foreign Parent Report to satisfy obligations under the Draft Legislation will cause duplication and significant costs to be incurred preparing a separate report for the Australian regime – and many categories of the information may not be meaningful (e.g. duplication of governance content), may be onerous to prepare (e.g. separate scenario analysis at that level) or may not exist (e.g. regional transition plans or targets). We recommend that clarification be provided on the ability to rely on a Foreign Parent Report. If there is a legislative intention for Australian-level reporting, we would submit that affected entities have the ability to cross-refer to content in the Foreign Parent Report where it adequately addresses the applicable content requirements.

No.	Issue	Reference	HSF submission
5	Commencement date	Item 129 of the Draft Legislation (Inserts section 1705(1)(a) into the Corporations Act) Page 2 of Policy Position Statement	The Draft Legislation proposes a commencement date for Group 1 entities of 1 July 2024. Given the submissions for the present consultation close on 9 February 2024 and the submissions for the ASRS close on 1 March 2024, the Legislation and Standards are likely to be finalised very close to the commencement of the regime. Based on client discussions, it appears the short timeframe for implementation will be insufficient for entities to establish the governance processes and reporting systems required for effective, accurate and compliant disclosures. In addition, substantial changes to the Draft Legislation and ASRS have occurred throughout the consultations undertaken to date, which means that entities will require time to understand the disclosure requirements once settled. We recommend amending the Draft Legislation to require a commencement date of 1 January 2025 for Group 1 entities, as contemplated in the Policy Position Statement. An alternative proposal would be to amend the Draft Legislation to allow for Group 1 entities to submit their sustainability report a maximum of two months following the issue of financial and directors' reports, provided that the sustainability report is issued before the entity's annual general meeting. However, this is a less preferred alternative because it fails to address the timing challenge of changing underlying systems and processes ahead of the 1 July commencement. Additionally, we recommend that the Draft Legislation or Explanatory Memorandum make clear that ASIC may use its powers under sections 340 and 341 of the Corporations Act to provide an extension of time to prepare, lodge and / or distribute a sustainability report (as is the case for financial reports). This could cover circumstances such as where an entity changes the timing of its financial year, where it would often be onerous for the entity to prepare a sustainability report for a shortened financial year.
6	Minister can prescribe statements concerning environmental sustainability to be included in an entity's sustainability report	Item 23 of the Draft Legislation (Inserts section 296A(3) into the Corporations Act)	The Draft Legislation requires an entity's sustainability report for a financial year to include any statements concerning environmental sustainability that is prescribed by the Minister. Consulting with clients, the scope of this broad power is concerning given it would effectively provide the Minister with powers to enact progressively more comprehensive sustainability reporting obligations without safeguards such as due industry consultation or fulsome legislative oversight. We recommend that the power be removed or qualified, recognising that any expansion of the regime (e.g. to include 'nature' as foreshadowed in Treasury's consultation) should entail extensive industry consultation, due process and allow time for preparation by companies. It would be more appropriate for further legislative reform to be the vehicle for such significant change. At a minimum, the reference to "concerning environmental sustainability" should be qualified to provide some parameters as to what is, and is not, meant by "environmental sustainability" and to require industry consultation more directly.

1.2 Submissions on technical and administrative provisions

No.	Issue	References	HSF submission
1	Definition of "books" under the Corporations Act to include "sustainability reports or sustainability records"	Item 2 of the Draft Legislation (Amends section 9 of the Corporations Act)	There may be unintended consequences in amending the definition of "books" under the Corporations Act to include "sustainability reports or sustainability records". This includes impacts to the following provisions under the Corporations Act: a) Section 247A provides a member of a company the right to apply to inspect the "books" of the company. b) Sections 422C–422D require a company under external administration to transfer its "books" to the new controller or to ASIC. c) Section 530B allows the liquidator of a company to retain possession of "books" of the company. We do not expect that Treasury intended that members have a right to inspect a company's sustainability records, recognising the broad range of documents that this could potentially encapsulate. While we understand and support the need for entities to retain appropriate records and papers that support their sustainability report disclosures, we recommend that the terms: • "sustainability reports" (i.e. "an annual sustainability report required under section 292A"); and • "sustainability records" (i.e. "documents and working papers needed to explain the methods, assumptions and evidence from which climate statements, notes to climate statements, and statements mentioned in paragraph 292A(1)(c) are made up"), be standalone terms in the Corporations Act, rather than being included in the term "books".
2	Providing written notice to ASIC of the place where sustainability records are kept	Item 18 of the Draft Legislation (Inserts section 289A into the Corporations Act)	The Draft Legislation requires an entity that keeps sustainability records outside of Australia to give ASIC written notice of the place where the records are kept. We recommend that this requirement be deleted because in practice, entities will not be able to confirm with ASIC exactly where those records are kept. We expect that most entities (particularly entities with global operations or offices) will keep their records on computer systems which are linked to data centres and cloud-based services in other countries. This means that the records could potentially be stored at any one of those data centres or cloud-based services, making it impossible for entities to confirm with ASIC exactly where those records are kept. In addition, climate-related disclosures require entities to produce, and disclose, large volumes of data and granular levels of detail. We expect that most entities will keep their records in a range of assets and locations, including information technology systems, third-party data sources and benchmarks, and spreadsheets. This will make it difficult for entities to precisely identify where their records are kept to ASIC. As noted above, we still believe that it is appropriate that the Draft Legislation requires entities to keep sustainability records (item 15 of the Draft Legislation which inserts section 286A into the Corporations Act).

No.	Issue	References	HSF submission
3	Lodging amendments to a sustainability report with ASIC	Items 38–39 of the Draft Legislation (Amends section 322(1) of the Corporations Act)	The Draft Legislation requires the entity to lodge the amended sustainability report with ASIC within 14 days after the amendment is made. Existing practices for broader financial reporting are for entities to correct and update their reports where a material amendment is required to their disclosures. A material amendment may include correcting a disclosure that has become stale or potentially misleading or deceptive, or a material restatement for accounting purposes. If Treasury's intention is for entities to relodge reports with any material or immaterial amendments, this would be unduly onerous on both ASIC and entities given the uncertain and complex nature of the disclosures, and the probability that entities will need to update data, hyperlinks or sources and to fix typographical errors. There are also flow-on implications for disclosures made by way of cross-reference. For instance, it would not be practical for any underlying source document that is incorporated into the sustainability report by way of cross-reference to be lodged with ASIC if there is an amendment made. We recommend that the Draft Legislation should only require entities to lodge an amended sustainability report with ASIC if material amendments have been made. In the context of climate-related financial disclosures, and particularly in the preliminary transition phase, there may not be a clear line as to what is and is not considered to be material. It would be helpful for ASIC to provide guidance on what might constitute a material amendment, which could include: - an amendment that substantively impacts the current or anticipated financial effects of a (material) climate-related risk or opportunity; - a material restatement of any quantitative metric; or - any other correction required to ensure a material statement is not misleading.
4	Consolidated reporting with reference to the National Greenhouse and Energy Reporting legislation	Item 22 of the Draft Legislation (Inserts section 292A(2) into the Corporations Act)	As outlined above, we are supportive of the proposed election for consolidated reporting provided for in the Draft Legislation. However, we submit that there is a (presumably unintentional) issue with respect to registered corporations under the National Greenhouse and Energy Reporting (**NGER**) legislation given that legislation's focus on "operational control". Registered corporations under the NGER legislation are one of the categories of entities that would be required to prepare sustainability reports. Registered corporations are determined by reference to "operational control" (as defined in the NGER legislation) over NGER facilities. Joint arrangements where two or more entities have joint control of business activities are common and may be structured so that the participants have rights to the underlying assets and obligations for the liabilities relating to the arrangement but appoint an incorporated entity as the manager / operator (which may be jointly owned by the participants). An example would be an unincorporated joint venture, with the operator being held by the participants on a 50:50 basis. The application of "operational control" in the NGER legislation means that the operator entity may be the NGER registered corporation, and under the Draft Legislation would need to be producing a sustainability report. The operator could not rely on the exemptions for consolidated reporting proposed in the Draft Legislation, given it would not be included in the consolidated reporting of either joint venture participant. Instead, it would need to prepare separate climate disclosures, notwithstanding

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			that it does not have economic exposure to the assets or liabilities of the venture. We recommend that Treasury resolves this gap as it appears misaligned with the intention of the Draft Legislation if an NGER registered corporation that does not own the assets and is not exposed to the liabilities of an operation, is required to prepare a sustainability report disclosing the material climate-related financial risks and opportunities etc. for that operation.
5	Reporting on controlled vs non-controlled assets	Item 22 of the Draft Legislation (Inserts section 292A(7) into the Corporations Act)	For the purpose of proposed section 292A(7) and the "value of assets" threshold, our understanding is that this will be calculated in accordance with accounting standards in force at the relevant time (as per proposed section 292A(9)(b)). However, where an asset manager has determined that it meets the reporting threshold, the Draft Legislation does not provide clarity on the following practical matters about preparing a sustainability report: • in respect to superannuation funds, whether the reporting obligation is on the entity which manages the assets or the fund itself; or • whether there is any requirement to report on non-operated assets. For example, assets which are not controlled by the reporting entity but instead held through a joint venture arrangement. We assume there is no intention for non-operated assets to be captured by the reporting obligations given the practical difficulties in obtaining the required information. Recognising that the above matters may be difficult to resolve through legislative drafting, we recommend that specific guidance is provided on these matters in conjunction with the final version of the legislation.
6	Distinction between "climate statements" and "notes to climate statements"	Item 23 of the Draft Legislation (Inserts section 296A(1) into the Corporations Act)	The Draft Legislation requires an entity's sustainability report for a financial year to include: a) the climate statements, which are the required disclosures under the ASRS; and b) the notes to the climate statements, which include, amongst other things, notes prescribed by the Minister on the preparation of the climate standards, anything included in the climate statements or any other environmental sustainability matters. We recognise that the notes to the climate statements are largely positioned as required disclosures from the Minister in relation to the preparation of the climate statements or anything included in the climate statements (or other matters concerning environmental sustainability). It is not clear why any of these additional requirements would not be included within the climate statements themselves. In addition, the IFRS S1 and S2 do not include a similar distinction, and in our view, there is no clear rationale for diverging from the international standards and it reduces the simplicity of the legislation and regime.

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7	Cross-references	Item 23 of the Draft Legislation (Inserts section 296C)	We recommend that Treasury revises the cross-reference in proposed section 296C: "The climate statements, the notes to the climate statements and the statements mentioned in paragraph 292A(1)(c) must comply with:…" We submit that paragraph 292A(1)(c) does not exist and should instead be a cross-reference to paragraph 296A(1)(c).
8	Definition of "scope 3 emissions" to be included in the Corporations Act	Item 3 of the Draft Legislation (Amends section 9 of the Corporations Act)	The Draft Legislation defines "scope 3 emissions" as "having the same meaning as in the Corporate Value Chain (Scope 3) Accounting and Reporting Standard, published by the World Business Council for Sustainable Development and the World Resources Institute, *as existing on the commencement of this definition*" (our emphasis). If a new version of the Standard was to be released, the reference to "scope 3 emissions" in the Draft Legislation would be hardwired to the version of the Standard as at the Draft Legislation's commencement date. To provide flexibility and to allow new versions of the Standard to be reflected, we recommend defining "scope 3 emissions" as: … "having the same meaning as in the Corporate Value Chain (Scope 3) Accounting and Reporting Standard, published by the World Business Council for Sustainable Development and the World Resources Institute, as existing on the commencement of this definition *or such other date as is notified by the Minister*" (our emphasis).
9	Commercially sensitive information	N / A	Unlike the ISSB standards, the Draft Legislation does not allow entities to omit information about a climate-related opportunity that is commercially sensitive from its sustainability report. This includes information that is not already publicly available or could reasonably be expected to seriously prejudice the entity. We recommend including the following exemption in the final legislation, which is consistent with the exemption in section 299A(3) of the Corporations Act in relation to an entity's operating and financial report (**OFR**): "The sustainability report may omit material that would otherwise be included under section 296A if it is likely to result in unreasonable prejudice to the entity." Importantly, we note that the existing exemption in respect of the OFR has not been problematic in practice; and it would better align with the approach anticipated by the ISSB standards.