

## FOSSIL FUELS DIVESTMENT: IS IT LAWFUL?

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### I ORIENTATION

An ebullient global campaign against investment in fossil fuel industries is attracting a diverse entourage that includes community activists, universities and even some mainstream financial institutions.<sup>1</sup> The movement is coagulating around anti-fossil fuel networks, such as 350.org's Fossil Free,<sup>2</sup> and the Fossil Fuel Divestment Student Network<sup>3</sup> as well as numerous local hubs of activism such as Divest Harvard<sup>4</sup> and Fossil Free UNSW.<sup>5</sup> Frustrated by government prevarication, the campaign avows to curb greenhouse gas emissions by pressuring investors to shun fossil fuel industries such as oil firms and coal miners in the hope that they adopt more environmentally benign practices or go out of business altogether. 'Divestment' conventionally means withdrawing financial ties from a company, usually by selling stocks or bonds,<sup>6</sup> but may extend to other financial sanctions such as a bank declining a loan.

The foregoing campaign is opposed by many financiers, and governments too, for reasons that include the belief that divesting is financially irresponsible,<sup>7</sup> it cannot leverage positive change and that it is unlawful or legally dubious.<sup>8</sup> The British government in February 2016 warned municipal councils against fossil

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1 Julie Ayling and Neil Gunningham, 'Non-State Governance and Climate Policy: The Fossil Fuel Divestment Movement' (2015) *Climate Policy* 1 <<http://www.tandfonline.com/doi/full/10.1080/14693062.2015.1094729>>.

2 See *Fossil Free* <<http://gofossilfree.org>>.

3 See *Fossil Fuel Divestment Student Network (DSN)* <<http://www.studentsdivest.org>>.

4 See, eg, *Divest Harvard* <<http://divestharvard.com>>.

5 See *Fossil Free UNSW* <<https://www.facebook.com/FossilFreeUnsw>>.

6 See Fossil Free, *What is Fossil Free Divestment* <<http://gofossilfree.org/what-is-fossil-fuel-divestment>>.

7 For example Lisa Cox, 'Tony Abbott Attacks ANU's "Stupid Decision" to Dump Fossil Fuel Investments', *The Sydney Morning Herald* (online), 15 October 2014 <<http://www.smh.com.au/federal-politics/political-news/tony-abbott-attacks-anus-stupid-decision-to-dump-fossil-fuel-investments-20141015-116a0y.html>>.

8 The Greens, 'Minerals Council's Desperate Spin Shows Fossil Fuel Divestment Campaign is Working' (Media Release, 23 June 2014) <<http://greens.org.au/node/5174>>.

fuels divestment and threatened to financially punish those who defy it.<sup>9</sup> A number of United States universities, which have faced concerted pressure from students to divest, have similarly resisted for the foregoing reasons.<sup>10</sup> The legal context is ambiguous, partly because of the paucity of case law or legislative guidance on whether and how climate change risks and impacts can be criteria in financial decision-making. Legal opinions tend to be couched with many qualifications, such as one given to the Interfaith Center on Corporate Social Responsibility – the leading faith-based investor network in the United States – that the law likely ‘preclude[s] a fiduciary from eliminating the entire [fossil fuel] industry [from its portfolio] without considering each investment [that would be affected] on a case-by-case basis’.<sup>11</sup>

This article assesses the legality of fossil fuels divesting. Divesting is a form of socially responsible investing (‘SRI’), and therefore the analysis draws on understandings of SRI’s legal context. The article focuses on the major Anglophile jurisdictions because they are either globally preeminent financial markets (United States (‘US’) and United Kingdom (‘UK’)) or host large fossil fuel sectors such as oil sands (Canada) and coal mining (Australia). The discussion is not directly applicable to civil law systems, such as Germany or Japan, where some different legal doctrines and procedures govern investing. Neither the merits of fossil fuel investing nor its impact on corporate behaviour are assessed: the focus is strictly on understanding the legal scope to practise fossil fuels divestment.

There is no simple black-and-white answer to this enquiry, as conclusions about the legality of divestment are modulated by the following considerations:

- First, although SRI is increasingly viewed as legally defensible, such opinion does not necessarily mean that fossil fuels divesting itself is lawful, as SRI is highly heterogeneous in its goals and methods. For instance, climate-conscious investors might prefer to ‘engage’ with fossil fuel companies, through dialogue, rather than divest in order to leverage change.
- Second, unlike much SRI that is driven by the financial sector, often for risk management and due diligence, the movement for fossil fuels divesting is led by civil society actors, such as environmental non-governmental organisations (‘NGOs’) and student networks. Such pressure, while reflective of changing social values that might be relevant to one putative legal justification of SRI, is certainly not determinative of its legality.

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9 Arthur Nelsen, ‘UK Councils Warned of “Severe Penalties” of Fossil Fuel Divestment’ *The Guardian* (online), 19 February 2016 <<https://www.theguardian.com/environment/2016/feb/18/uk-councils-warned-of-severe-penalties-of-fossil-fuel-divestment>>.

10 Yimian Wu, ‘Fossil Fuel Divestment Movement Has Unintended Consequences’ *US News & World Report* (online), 10 December 2015 <<http://www.usnews.com/news/articles/2015/12/10/fossil-fuel-divestment-movement-has-unintended-consequences>>.

11 Covington & Burling LLP, ‘Ability of Plan Fiduciaries to Follow the Investment Approach Advocated by the Fossil Fuel Movement’ (Memorandum to Interfaith Center on Corporate Social Responsibility, 10 March 2014) 4.

- Third, the legality of divesting also hinges on the type of financial institution. The legal milieu of banks, pension funds and mutual funds are far from identical despite market deregulation leading to some convergence of roles.
- Finally, the question of legality also depends on what ‘fossil fuels’ means. A ‘ubiquity’ problem confronts divestment practitioners, as carbon is everywhere in our economy, from agriculture to transportation. Divesting that targets major fossil fuel producers (for example, coal mining and oil companies) will likely be more legally defensible than a broadbrush approach that ostracises all who are tainted by carbon.

The next Part of this article introduces SRI and its agenda including climate change. Thereafter, Part III examines the legality of divesting by trust funds, such as pension plans and endowment funds, a sector of particular relevance to universities that are currently at the coalface of the divestment campaign. Part IV focuses on financial corporations, such as banks and insurers, who have relevance especially for major projects such as coal mines. Divesting by public financial institutions, focusing on sovereign wealth funds, is analysed in Part V. The article in Part VI concludes with some remarks about how fossil fuels divesting might be legally advanced. The purpose of the article however is not to dwell on possible law reform in this field. Throughout, the analysis examines the general legal parameters rather than nuanced jurisdictional details or variations because there is considerable common ground in the legal context among the Anglophile jurisdictions.

## II SOCIALLY RESPONSIBLE INVESTING

Sanctioning carbon polluters is one of many possible forms of SRI,<sup>12</sup> a longstanding movement by which investors voluntarily try to change the social and environmental behaviour of others or simply to invest with a clean conscience. SRI dates from about the 18<sup>th</sup> century when the Quakers proscribed financial ties to the transatlantic slave trade. During the early 20<sup>th</sup> century, other faith-based investors began screening their portfolios to eschew alcohol, gambling and other ‘sin’ stocks.<sup>13</sup> In the 1970s, SRI attracted a broader entourage as it tried to unseat South Africa’s apartheid regime by targeting companies that profited from it. Since then, SRI has embraced numerous causes, especially environmental issues such as climate change mitigation.<sup>14</sup> Like the fair trade movement and ethical consumerism, SRI has become a means for enlightened individuals and institutions to express their values in an economic system that

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12 Also sometimes known as ‘ethical investment’, ‘mission investment’, ‘social investment’ or ‘sustainable finance’.

13 Jack A Brill and Alan Reder, *Investing from the Heart: The Guide to Socially Responsible Investments and Money Management* (Crown Publishers, 1992) 27.

14 See, eg. Mercer LLC, ‘Climate Change Scenarios – Implications for Strategic Asset Allocation’ (Public Report, 2011).

they believe governments have failed to regulate appropriately for its social and environmental sequelae.

SRI lacks any authoritative or agreed definition, in terms of its rationale or aims, and as a voluntary movement involving a potpourri of actors from churches to banks, the movement spans a wide variety of activities.<sup>15</sup> Since the early 2000s, the movement has splintered between proponents who simply wish to ‘take into account’ environmental, social and governance (‘ESG’) issues that might affect financial performance,<sup>16</sup> and those who prioritise ethical considerations.<sup>17</sup> The former stance is mostly associated with mainstream financial institutions while the latter is aligned with philanthropic investors and civil society groups entering the market.

Divestment, as championed by anti-fossil fuel crusaders, was until recent decades SRI’s principal tactic and used in the foregoing historical examples. Divestment essentially means avoiding ownership of shares or bonds in certain industries or companies because of the characteristics of their products or operations. The rationales of divestment are firstly, to damage the public reputation of a targeted company, and thereby affect its relationship with consumers, employees, regulators and other stakeholders and, secondly, to financially punish a company (eg, by reducing its share price) in the expectation of inducing positive behavioural changes. The former effect is certainly possible,<sup>18</sup> while the latter is less assured when other (non-social) investors stand by to purchase the company’s stock.<sup>19</sup>

The main alternate method of SRI, which has become more prevalent, is corporate engagement: it means acquiring a financial stake in a company in order to wield influence from within, such as by filing shareholder resolutions, seeking access to corporate documentation, and informal dialogue with corporate managers and directors. Corporate engagement may be used in conjunction with divesting, in which the latter is resorted to if engagement fails. Other methods of SRI that have been used in regard to climate change issues include ‘impact investing’ (targeted, positive investment in specific localities or economic sectors) and ‘best-in-class’ (selecting the best performing companies in an industry sector as measured against social and environmental expectations).<sup>20</sup> These strategies might involve funding companies specialising in renewable

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15 William Ransome and Charles Sampford, *Ethics and Socially Responsible Investment: A Philosophical Approach* (Ashgate Publishing, 2011) 9.

16 Brokerage House Analysts, ‘The Materiality of Social, Environmental and Corporate Governance Issues in Equity Pricing’ (Report, United Nations Environment Programme Finance Initiative, June 2004).

17 Benjamin J Richardson and Wes Cragg, ‘Being Virtuous and Prosperous: SRI’s Conflicting Goals’ (2010) 92(supp 1) *Journal of Business Ethics* 21, 21–2.

18 Ayling and Gunningham, above n 1, 5.

19 See generally Pietra Rivoli, ‘Making a Difference or Making a Statement? Finance Research and Socially Responsible Investment’ (2003) 13(3) *Business Ethics Quarterly* 271; Michael S Knoll, ‘Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment’ (2002) 57 *Business Lawyer* 681.

20 Antony Bugg-Levine and Jed Emerson, *Impact Investing: Transforming How We Make Money while Making a Difference* (Jossey-Bass, 2011); G Jeffrey MacDonald, ‘Evaluating Performance: Is Best-in-Class Best for SRI?’ on *CSRwire Talkback* (14 October 2013) <<http://www.csrwire.com/blog/posts/1057-evaluating-performance-is-best-in-class-best-for-sri>>.

energy or supporting fossil fuels businesses that are the most successful in diversifying their energy portfolio and reducing carbon emissions.

Another SRI strategy that purports to promote systemic change rather than target individual companies is the development of voluntary codes of conduct for investors.<sup>21</sup> Prominent examples that provide a mix of performance and process standards for investors and lenders include the Equator Principles,<sup>22</sup> the UN-supported Principles for Responsible Investment ('PRI')<sup>23</sup> and the UN Environment Programme's Finance Initiative ('UNEP FI').<sup>24</sup> Several codes specifically target climate change issues: the Carbon Principles,<sup>25</sup> the Climate Principles<sup>26</sup> and the greenhouse gas emission reporting scheme of the Carbon Disclosure Project.<sup>27</sup> The first of these examples, to illustrate, expects participatory banks to provide a consistent approach for themselves and their US power clients to evaluate and address carbon risks in the financing of electric power projects.<sup>28</sup> Furthermore, each signatory is expected to improve its due diligence for assessing potential investments in power generation, and encourage clients to switch to low-carbon alternatives. Overall, these voluntary initiatives, to which institutions may subscribe on a take-it-or-leave-it basis, furnish both principles for improved performance and procedures for more transparent and accountable financial decisions.<sup>29</sup>

Despite its diversity of goals and methods that might make it difficult to verify trends in SRI, market surveys suggest that the SRI 'sector' has grown dramatically in the past 20 years. But while recent surveys in North America, Oceania and Western Europe depict the sector as having captured between 10 to 50 per cent of investment markets,<sup>30</sup> these numbers likely exaggerate the trend owing to overly inclusive survey criteria and broad definitions of SRI, such as

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21 Benjamin J Richardson, 'Socially Responsible Investing through Voluntary Codes', in Pierre-Marie Dupuy and Jorge E Viñuales (eds), *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards* (Cambridge University Press, 2013) 383.

22 See *Equator Principles* <<http://www.equator-principles.com>>.

23 See *Principles for Responsible Investment* <<https://www.unpri.org>>.

24 See *UNEP Finance Initiative* <<http://www.unepfi.org>>.

25 Citi, JP Morgan Chase and Morgan Stanley, 'The Carbon Principles' (Agreement) <<http://www.morganstanley.com/globalcitizen/environment/CarbonPrinciplesFinal.pdf>>.

26 The Climate Group, 'The Climate Principles: A Framework for the Finance Sector' (Report, 2 December 2008) <<https://www.theclimategroup.org/sites/default/files/archive/files/The-Climate-Principles-English.pdf>>.

27 See *CDP: Driving Sustainable Economies* <<https://www.cdp.net/en>>.

28 See Citi, JP Morgan Chase and Morgan Stanley, above n 25.

29 See Kate Miles, 'Targeting Financiers: Can Voluntary Codes of Conduct for the Investment and Financing Sectors Achieve Environmental and Sustainability Objectives?' in Nathalie J Chalifour et al (eds), *Critical Issues in Environmental Taxation: International and Comparative Perspectives* (Oxford University Press, 2008) vol V, 947; Oren Perez, 'The New Universe of Green Finance: From Self-regulation to Multi-polar Governance' in Olaf Dilling, Martin Herberg and Gerd Winter (eds), *Responsible Business: Self-Governance and Law in Transnational Economic Transactions* (Hart Publishing, 2008) 151.

30 Eurosif, 'European SRI Study 2014' (2014) 7; US SIF Foundation, 'Report on Sustainable and Responsible Investing Trends 2014' (Report, 2014) 12; Responsible Investment Association Australasia, 'Responsible Investment Benchmark Report 2016 Australia' (Report, 2016) 4, 9; see also Responsible Investment Association Australasia, 'Responsible Investment Benchmark Report 2016 New Zealand' (Report, 2016).

counting an entire investment portfolio as ‘SRI’ when the portfolio is subject only to one criterion, such as exclusion of tobacco stocks. And many institutions that profess to practise SRI, including climate-safe investing, use methods of unverified efficacy, such as engagement. Contrary to such surveys, other research suggests some financial industry analysts, while perceiving climate change to be a long-term financial risk, view it as presently too nebulous for serious consideration in investment decisions.<sup>31</sup> But some investors are supporting the burgeoning renewable energy sector in the hope of high returns, and the financial sector is providing brokerage services to facilitate carbon trading.<sup>32</sup>

Because of its voluntary nature and diverse goals and standards, the emerging global SRI market has been able to accommodate a wide variety of financial actors pursuing various levels of climate-conscious investment. That a financier may pledge commitment to SRI, such as by signing one of the relevant codes, does not in itself reveal very much about what it does in practice and whether that practice is lawful. In other words, the seeming growth in SRI should not be interpreted per se as evidence of its legality without further enquiry into the specific financial actor, its methods and its jurisdictional context.

### III TRUST FUNDS

#### A Fiduciary and Trust Law

Questions about the legality of SRI often focus on fiduciary and trusts law since many financial institutions in common law jurisdictions use a trust structure.<sup>33</sup> When individuals manage their own investments without a trustee or other intermediary, they may freely buy into a fossil fuels company or dispose of any financial ties at their discretion. Conversely, when someone invests on behalf of another, that investing may be governed by fiduciary and trusts law. Fiduciary relationships typically arise in pension/superannuation funds that manage the contributions of workers, and in donor-sponsored endowment funds established by universities, charities and religious organisations. A fiduciary relationship may also apply to mutual funds that sell investment portfolios directly to the public.

A ‘fiduciary’ means a person holding the character of a trustee and obliged to act loyally for another’s benefit – the ‘beneficiary’ – with regard to specific property or affairs.<sup>34</sup> Fiduciary law in common law jurisdictions such as England, Canada and Australia has evolved along similar but not identical paths, and the following remarks focus only on the general legal norms rather than jurisdictional details. Fiduciary responsibilities overlap with trust law rules that

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31 Jill Solomon, *Pension Fund Trustees and Climate Change* (Report No 106, Association of Certified Chartered Accountants, 2009) 21–3.

32 Janelle Knox-Hayes, ‘The Developing Carbon Financial Service Industry: Expertise, Adaptation and Complementarity in London and New York’ (2009) 9 *Journal of Economic Geography* 749.

33 See generally James P Hawley et al (eds), *Cambridge Handbook of Institutional Investment and Fiduciary Duty* (Cambridge University Press, 2014).

34 Bryan A Garner (ed), *Black’s Law Dictionary* (West, 10<sup>th</sup> ed, 2014).

prescribe specific standards of conduct for managing assets. As Campbell JA of the NSW Court of Appeal summarised their legal relationship: “[t]he trust is a fiduciary relation, but not every fiduciary relation is a trust.” The correct position is that trusts are a subclass of fiduciary relations.<sup>35</sup> The trust differs from other fiduciary relationships, such as between a doctor and patient, primarily because of the presence of trust assets such as real estate and financial capital.

The impact of fiduciary and trusts law on SRI has generated much debate and continuing uncertainty.<sup>36</sup> The influential UK Law Commission touched on the subject in its 2014 report on the fiduciary responsibility of investment intermediaries.<sup>37</sup> How we define ‘socially responsible’ influences this debate: if SRI means merely to ‘take into account’ ESG issues perceived to be financially material to investment performance, then such practices are generally lawful. Indeed, if fiduciaries ignore such issues, and consequently incur foreseeable and avoidable financial losses, legal liabilities might arise. More problematic is where SRI entails wholesale changes to an investment portfolio based on non-financial, ethical criteria.

## B The Scope for Fossil Fuels Divesting

### 1 Legal Duties

Apart from legislative requirements tailored to financial industry sectors, the general legal duties of a financial trust are to:

- (a) obey the governing trust deed;
- (b) act loyally in the best interests of the beneficiaries;
- (c) treat beneficiaries impartially; and
- (d) invest prudently with care and skill.

Briefly, these four elements will be described before assessing their implications for fossil fuels divesting. The trust deed creates the framework within which trustees must operate. It is drafted by the ‘settlor’ (eg, employer who sponsors a pension plan) and delineates the rights and powers of the trustees, benefits to accrue to beneficiaries and other procedures and standards. Rarely, the deed may stipulate investment criteria. Although the duty to obey the trust deed may itself ensure that fiduciaries act for beneficiaries, there is a separate, overarching duty to act loyally towards beneficiaries (to ensure that a fiduciary does not act for its own self-interest or any third-party interests).<sup>38</sup> For a charitable trust, fidelity is owed to the purpose of the trust rather than any beneficiaries. Where beneficiaries exist, they may not have homogenous interests, and in such circumstances fiduciaries must treat them even-handedly. This duty of impartiality obliges fiduciaries to identify and impartially balance

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35 *Visnic v Sywak* (2009) 257 ALR 517, 527 [48], quoting J D Heydon and M J Leeming, *Jacobs' Law of Trusts in Australia* (LexisNexis Butterworths, 7<sup>th</sup> ed, 2006) 6–7 [202].

36 See generally *Benjamin J Richardson*, ‘Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?’ (2007) 22 *Banking & Finance Law Review* 145; Johann A Klaassen and George R Gay, ‘Fiduciary Duty and Socially Responsible Investing’ (2003) 10(1) *Philosophy in the Contemporary World* 49.

37 Law Commission (UK), *Fiduciary Duties of Investment Intermediaries*, Report No 350 (2014).

38 Susan P Serota and Frederick A Brodie, *ERISA Fiduciary Law* (BNA Books, 1995) 25.

any conflicting interests.<sup>39</sup> Finally, there is a trust law duty of care, which requires the exercise of reasonable diligence, skill and caution that a person would exercise under similar trustee circumstances. In the financial context, this is known as the duty of prudent investing, and is commonly demonstrated by a well-diversified investment portfolio that avoids the risks of putting all of one's eggs in one basket.<sup>40</sup>

The foregoing legal framework governing fiduciary finance *may* allow fossil fuels divesting in five situations.

## 2 Beneficiaries' 'Best Interests'

Divesting may be permissible where it can reasonably be rationalised as in the best interests of beneficiaries to take defensive measures against climate change threats. For an institution established for investing, the 'best interests' are normally framed in financial terms. Legislation often dictates such an orientation; for instance, British Columbia's *Pension Benefits Standards Act*, SBC 2012, c 30 provided: '[p]ension plan investments ... must be made ... in the *best financial* interests of plan members'.<sup>41</sup> Thus, climate change or other SRI concerns must be *financially material* to investment performance, based on expert advice, research and due diligence. Evolving understandings of fiduciary finance responsibility, according to a report prepared for the United Nations, not only depict ESG issues as financially material but that 'failing to consider long-term investment value drivers, which include [ESG] issues, in investment practice is a failure of fiduciary duty'.<sup>42</sup> This advice, however, does not determine which specific forms of SRI, such as fossil fuels divestment, are lawful.

Divestment and corporate engagement may be acceptable tactics, depending on their financial sequelae. Engagement does not reduce the diversity of an investment portfolio (unless as a result of unsuccessful engagement a recalcitrant firm is excluded), and active shareholding is arguably a fiduciary responsibility because shareholder rights are valuable assets for trustees to safeguard.<sup>43</sup> Divesting, which may reduce portfolio diversity, may also be acceptable if justified by financial due diligence. Already, retrospective research on the financial impact of screening out major companies with large carbon footprints suggests that fossil fuel free funds would have performed similarly on financial risk and return metrics over the survey period.<sup>44</sup>

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39 American Law Institute, *Restatement of the Law – Trusts: The Prudent Investor Rule* (1992) § 379 cmt (a).

40 Paul G Haskell, 'The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory' (1990) 69 *North Carolina Law Review* 87, 110.

41 Section 60(1), (1)(b) (emphasis added).

42 Rory Sullivan et al, 'Fiduciary Duty in the 21<sup>st</sup> Century' (Report, United Nations Environment Programme – Finance Initiative, United Nations Global Compact, Principles for Responsible Investment and United Nations Environment Program Inquiry, 2015) 9.

43 Gil Yaron, 'Acting Like Owners: Proxy Voting, Corporate Engagement and the Fiduciary Responsibilities of Pension Trustees' (Shareholder Association for Research and Education, 28 June 2005) 14–22.

44 MSCI, 'ESG Issue Brief: Options for Reducing Fossil Fuel Exposure' (Brief, MSCI, January 2014) 4.

A special challenge in resources-based economies is that the sheer size of the fossil fuels sector might make it hard to achieve a balanced, diversified portfolio for a divesting practitioner. In Canada, fossil fuel companies comprise approximately 24 per cent of the value of firms listed on Canada's major S&P/TSX composite stock market index.<sup>45</sup> Australia is similar: on 30 September 2016, mining and energy companies comprised six of the top 20 companies traded on the ASX by share value, followed by financial institutions such as banks represented with six entries (and all these financiers have significant business ties with mining and energy firms).<sup>46</sup> On the other hand, such significant clusters of high emitting carbon polluters might help to target divestment against the worst offenders and thereby ameliorate the 'ubiquity' problem noted earlier. Recent research by Heede suggests it may be possible to isolate the worst carbon polluters for investment sanctions: his quantitative analysis of historic producers of oil, natural gas, coal and cement concluded that 63 per cent of cumulative worldwide emissions of carbon dioxide and methane between 1854 and 2010 were attributable to these 'carbon major' entities.<sup>47</sup> Thus, while some economies have a disproportionate number of fossil fuels that may hinder portfolio diversification, by investing globally greater overall portfolio diversification can be achieved while these fossil fuel clusters can be discretely targeted for financial sanctions.

The duty of prudent investing does not require sheer maximization of financial returns. In the Scottish case of *Martin v City of Edinburgh District Council*, involving a challenge to divestment from South African assets, Lord Murray clarified: 'I cannot conceive that trustees have an unqualified duty ... simply to invest trust funds in the most profitable investment available. To accept that without qualification would ... involve substituting the discretion of financial advisers for the discretion of trustees'.<sup>48</sup> In *Board of Trustees of Employees' Retirement System of City of Baltimore v City of Baltimore* ('*City of Baltimore*'), the Maryland Court of Appeal (in another South African divestment case) explained that a trustee's duty is not to maximize returns on investments but to secure a 'just' and 'reasonable' return, and that incidental SRI is tolerable if its costs are *de minimis*.<sup>49</sup> In the English case of *Cowan v Scargill*, also involving an SRI issue, the judge explained: 'I am not asserting that the benefit of the beneficiaries which a trustee must make his paramount concern inevitably and solely means their financial benefit, even if the only object of the trust is to provide financial benefits'.<sup>50</sup> The foregoing case law thus implies some room for climate-conscious investing that takes a broader view of beneficiaries' long-term interests.

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45 Dustyn Lanz, Gavin McLaughlin and Deb Abbey, 'The Climate has Changed: Exploring the Investment Potential of Fossil Fuel Free Portfolios' (Report, Responsible Investment Association, 2014) 5.

46 Australian Securities Exchange, *Top 20 Shares by Value* (30 September 2016) <[http://www.asx.com.au/data/dw\\_sharesbyvalue.pdf](http://www.asx.com.au/data/dw_sharesbyvalue.pdf)>.

47 Richard Heede, 'Tracing Anthropogenic Carbon Dioxide and Methane Emissions to Fossil Fuel and Cement Producers, 1854–2010' (2014) 122 *Climate Change* 229, 229.

48 [1988] SLT 329, 334.

49 317 Md 72 (1989), 107–8.

50 [1985] Ch 270, 288 (Megarry V-C).

The theory of ‘universal owner’ (‘UO’), while not yet considered in any case law, is also arguably relevant to the foregoing issue. Introduced by Robert Monks and Nell Minow<sup>51</sup> and elaborated by James Hawley and others,<sup>52</sup> the UO theory suggests that because large institutional investors own ‘universal’ portfolios with stakes in all economic sectors, they should ‘have no interest in abetting behaviour by any one company that yields a short-term boost while threatening harm to the economic system as a whole’.<sup>53</sup> Behaving as a UO implies being vigilant against any ‘externality’ of an individual company because it will lead to a costly ‘internality’ for an investor’s overall portfolio. The UO theory thus posits that these investors will benefit from being active shareholders and promoting sustainable development practices in their companies.<sup>54</sup>

But while the UO theory supports a more environmentally responsible understanding of fiduciary responsibility in the context of large institutional funds, it has been described by some commentators as a ‘premature’ theory because it neither accurately reflects how investors currently behave nor realistically models how they should.<sup>55</sup> Even where a UO can address the environmental externalities of individual companies, the economy as a whole does not internalise all such impacts. Markets lack an internal mechanism to constrain the economy’s total resource use or pollution load within the biosphere’s limits,<sup>56</sup> because some impacts are too remote temporally or spatially for markets to recognise.<sup>57</sup> Also, ubiquitous market and regulatory failures to control environmental externalities may provide a countervailing business case for financiers to support unsustainable development in the carbon economy.

With regard to university endowment funds, which are bearing the brunt of the fossil fuels divestment campaign, analysis of what constitutes their ‘best interests’ is coloured by the university’s social mission and its community of students, staff and donors. Some universities are taking the initiative, such as the Australian National University, which in 2014 divested from seven major resource companies because of climate change and other environmental concerns.<sup>58</sup> In May 2016, La Trobe University’s Council declared that its University would divest ‘fully’ from fossil fuels over the next five years.<sup>59</sup> But

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51 See Robert A G Monks and Nell Minow, *Corporate Governance* (Blackwell, 1995).

52 See James P Hawley and Andrew T Williams, *The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic* (University of Pennsylvania Press, 2000).

53 Stephen Davis, Jon Lukomnik and David Pitt-Watson, *The New Capitalists: How Citizen Investors are Reshaping the Corporate Agenda* (Harvard Business School Press, 2006) 18.

54 See Tessa Hebb, *No Small Change: Pension Funds and Corporate Engagement* (Cornell University Press, 2008).

55 Benjamin J Richardson and Maziar Peihani, ‘Universal Investors and Socially Responsible Finance: A Critique of a Premature Theory’ (2015) 30 *Banking & Finance Law Review* 405.

56 Herman Daly, ‘Allocation, Distribution and Scale: Towards an Economics that is Efficient, Just and Sustainable’ (1992) 6 *Ecological Economics* 185, 189–90.

57 See generally Ivo Mulder, *Biodiversity, the Next Challenge for Financial Institutions?* (World Conservation Union (IUCN), 2007).

58 Australian National University, *University to Divest Holdings in Seven Companies* (3 October 2014) <<http://www.anu.edu.au/news/all-news/university-to-divest-holdings-in-seven-companies>>.

59 La Trobe University, ‘La Trobe Signals Fossil Fuel Divestment’ (Media Release, 25 May 2016) <<http://www.latrobe.edu.au/news/articles/2016/release/la-trobe-signals-fossil-fuel-divestment>>.

many others, such as the University of British Columbia, continue to resist divestment.<sup>60</sup> A university is governed by its board of trustees, who are legally obliged under their enabling legislation to act in the best interests of the university.<sup>61</sup> Their legal responsibility encompasses all the activities of the board in supervising the university's affairs, not merely oversight of endowment funds. A university's best interests are much wider than its financial performance, and encompass its reputation for research and teaching, and its standing in the wider community such as for its environmental policies and practices. Consequently, a broader, more socially compassionate interpretation of 'best interests' is arguably appropriate for university endowment funds. Divestment from fossil fuels might be justified in this manner, especially for universities committed to scholarship and education about the need for action on climate change. These considerations would also apply to some philanthropic endowment funds, whose investments should be aligned with the values of the funds.

### 3 A 'Tie Breaker'

The second situation where fossil fuels divesting may be legally permissible is where two or more investments are judged to be of comparable financial merit: in this case, trustees could give preference to ethical considerations as the 'tie breaker'. In *Harries v Church Commissioners for England* ('Bishop of Oxford'), involving a clash between the Church's investment goals and its Christian values, the judge ruled that trustees choosing between two investments of equal suitability according to conventional principles of prudent investment might account for the ethical considerations as the deciding factor.<sup>62</sup> The *City of Baltimore* case, which acknowledged the permissibility of SRI when its financial repercussions are trivial, also supports this view.<sup>63</sup>

The tie breaker principle, however, is difficult to implement given that investments tend to be managed collectively in a portfolio rather than narrowly asset-by-asset. In other words, rarely would a large investment portfolio comprising thousands of assets be managed by comparing one specific company against another. Furthermore, of course, only with the benefit of hindsight can one know the relative performance of alternate investments. Nonetheless, with a growing body of research suggesting that SRI, including climate-conscious investing, is financially comparable to conventional investing,<sup>64</sup> the tie breaker principle should become more relevant to validating investment strategies that exclude major carbon polluters.

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60 See UBCC350, *Divestment – Divest UBC* <<http://www.ubcc350.org/divestment-at-ubc/>>.

61 For instance, in the case of the University of British Columbia, see *University Act*, RSBC 1996, c 468, s 19.1.

62 [1992] 1 WLR 1241, 1247 (Nicholls V-C).

63 317 Md 72 (1989), 107 (Eldridge J) (1989).

64 Lucy Cormack, 'Fossil Fuel-Free Super Funds Pay Off for Investors', *The Sydney Morning Herald* (online), 10 April 2015 <<http://www.smh.com.au/environment/climate-change/fossil-fuel-free-super-funds-pay-off-for-investors-20150409-1mhpui.html>>; Rupert Jones, 'Thinking Ethical Pays Off as Good Guys Come Out on Top', *The Guardian* (online), 17 October 2015 <<https://www.theguardian.com/money/2015/oct/17/ethical-funds-green-investments-coal-oil-gas>>.

#### 4 Trust Deed Mandate

Divesting may be legally defensible, and indeed even mandatory, by virtue of the terms of the trust deed or equivalent constitutional instrument of a fund. If a deed expressly requires SRI, the trustees must comply unless there are conflicting, overriding legal duties (eg, government regulations of a superannuation fund). Such a mandate would most likely appear in an endowment fund established by a charity, and the mandate may even be implied. Where a trust endowment fund has several stated purposes, such as to obtain financial returns while fulfilling a charitable purpose, conflicts may arise. As illustrated by the *Bishop of Oxford* case, the Court observed (in upholding the pre-eminence of the financial goals), '[i]n most cases the best interests of the charity require that the trustees' choice of investments should be made solely on the basis of well-established investment criteria'.<sup>65</sup> But that view, nearly a quarter-century old, may be legally outdated. In Great Britain, the *Charities (Protection and Social Investment) Act 2016* (UK) introduced an explicit legal authorisation for charities to engage in SRI,<sup>66</sup> and the Charity Commission, which supervises British charities pursuant to the *Charities Act 2011* (UK), advised that a charity could choose investments that do not necessarily seek to maximise financial returns if the preferred investments better advance the organisation's philanthropic goals.<sup>67</sup>

Outside of the charity sector and private trusts, a specific mandate for SRI including fossil fuels divestment is most likely to be found among mutual funds. The investment prospectus issued by a mutual fund provides a statement of its investment values and criteria, which are legally binding on the fund managers. Many mutual funds cater to social investors, including some that purport to be fossil free or climate friendly.<sup>68</sup> Green Century Funds claims to be the world's first mutual fund that is entirely fossil fuels free.<sup>69</sup> No fund, however, can be entirely fossil fuels free given the ubiquity of carbon energy in our economy. 'Fossil fuels free', instead, usually means exclusion of *major* producers or consumers of carbon fuels.

#### 5 Consent of Beneficiaries

The law may allow fiduciaries to divest from fossil fuels when beneficiaries consent. The seminal Freshfields report, commissioned by the United Nations to assess aspects of the legal context of SRI, advised that: 'a decision-maker may integrate ESG considerations into an investment decision to give effect to the

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65 [1992] 1 WLR 1241, 1246 (Nicholls V-C).

66 *Charities (Protection and Social Investment) Act 2016* (UK) c 4, s 15(1), inserting *Charities Act 2011* (UK) c 25, ss 292A–292C.

67 Charity Commission (UK), 'Charities and Investment Matters: A Guide for Trustees' (Guidance, 1 August 2016) [3.3] <<https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-a-guide-for-trustees>>.

68 See *Fossil Free Funds* <<https://fossilfreefunds.org>>.

69 Green Century Funds, *Why Choose Green Century* <<http://greencentury.com/why-choose-green-century/#ffinvesting>>.

views of the beneficiaries in relation to matters beyond financial return'.<sup>70</sup> Thus, if members of a pension fund petitioned the fund's trustees to act on their concerns about climate change, that might indicate 'consent' to divest. But while this conclusion might seem to dovetail with the fiduciary duty of loyalty, it suffers from several difficulties.<sup>71</sup>

First, it is at odds with the generally passive role that beneficiaries assume in fund governance as a matter of practice and legal precedent. Beneficiaries are legally entitled to know about the administration of the trust assets, but traditionally they have not enjoyed rights to be consulted or to instruct trustees.<sup>72</sup> A trustee is not an *agent* of beneficiaries: trustees need only to act in their 'best interests' without necessarily being obliged to consult or ascertain what those best interests are. Although pension fund legislation increasingly provides for beneficiary representation on the boards of trustees, as notably in Australia,<sup>73</sup> such representation itself may not be sufficient because of a second impediment – namely that beneficiaries are not usually of one mind. In the *Bishop of Oxford* case, discussed above, it was held that:

trustees should not make investment decisions on the basis of preferring one view of whether on moral grounds [a]n investment conflicts with the objects of the charity over another. This is so even when one view is more widely supported than the other.<sup>74</sup>

While some legal commentators reject the assumption that complete unanimity of beneficiaries is necessary in order for trustees to act on their 'consent',<sup>75</sup> the law does require that any differences among beneficiaries be handled impartially. While rigid equality is not decreed, this duty forbids trustees to have 'personal favoritism ... [and] nor is it permissible for a trustee to ignore the interests of some beneficiaries merely as a result of oversight or neglect'.<sup>76</sup> Fulfilment of the duty of impartiality would oblige trustees to ensure that any investment decision does not disadvantage some beneficiaries relative to others.

Fossil fuels divesting, like many SRI issues, is controversial, and it is unlikely that beneficiaries of any single fund would agree on its merits. If a majority consented to divestment, and such action would not cause any significant harm to the opposing beneficiaries, then conceivably divestment might be legally acceptable. Support for this conclusion comes from Charles Scanlan, a British expert on pensions trusts law, who argues that:

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70 United Nations Environment Program Finance Initiative and Freshfields Bruckhaus Deringer, 'A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment' (Report, October 2005) 12.

71 See Benjamin J Richardson, 'From Fiduciary Duties to Fiduciary Relationships for Socially Responsible Investing: Responding to the Will of Beneficiaries' (2011) 1 *Journal of Sustainable Finance and Investment* 5.

72 Ontario Law Reform Commission, *Report on the Law of Trusts*, Report (1984) 74.

73 The *Superannuation Industry (Supervision) Act 1993* (Cth) pt 9 mandates 50 per cent member representation on trustee boards of employer-sponsored funds that have at least five members.

74 [1992] 1 WLR 1241, 1247–8 (Nicholls V-C).

75 Patricia Lane, 'Ethical Investment: Towards the Best Interest of Everyone' (1987) 45 *The Advocate* 171, 176.

76 American Law Institute, above n 39, § 79 cmt (b).

[o]n the assumption that the scheme suffers no financial harm ... there is no trust law requirement to obtain the views of all beneficiaries; If the trustees can confer a non-financial benefit on a significant number of their beneficiaries, that should be sufficient justification.<sup>77</sup>

Interestingly, the duty of impartiality might also be used creatively to focus on the intergenerational responsibilities of trustees towards both current contributing fund members and fund retirees; as the temporal focus shifts to the long-term across different cohorts of beneficiaries, it might be argued that the duty of impartiality provides leverage for trustees to consider long term environmental impacts such as climate change. The American case of *Withers v Teachers' Retirement System of City of New York*<sup>78</sup> recognised this intergenerational equity dimension, in effect mandating trustees to consider the long-term consequences of their investment decisions on future retirees. On this ground, trustees might justify boycotting fossil fuel stocks to meet the needs of future beneficiaries in a more climate conscious society, even if this reduced financial returns for current retirees of the pension plan. Nonetheless, however we might characterise the legal context for obtaining beneficiaries' consent and dealing with them even-handedly, in practice, trustees do not ordinarily consult with beneficiaries. Some research on UK pension funds suggests that beneficiaries' views carry little weight in fund administration,<sup>79</sup> including in the consideration of SRI issues.<sup>80</sup>

## 6 Social Custom

Without explicit consent from beneficiaries, a fiduciary might look to broader societal values for guidance on any SRI position. The Freshfields report suggests that trustees could rely on social customs as a proxy for the values of the beneficiaries, such as to exclude 'investments that are linked to clear breaches of widely recognised norms, such as international conventions on human rights, labour conditions, tackling corruption and environmental protection'.<sup>81</sup> Social customs could be considered a proxy for beneficiaries' values, suggests James Gifford (former Executive Director of the PRI), because '[g]iven the ubiquity of pension fund membership, especially in the developed world, it can also be

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77 Charles Scanlan, 'Socially Responsible Investment by Pension Schemes' in Charles Scanlan (ed), *Socially Responsible Investment: A Guide for Pension Schemes and Charities* (Key Haven Publications, 2005) 75, 98.

78 447 F Supp 1248 (SD NY, 1978), affirmed by *Withers v Teacher's Retirement System of City of New York*, 595 F 2d 1210 (2<sup>nd</sup> Cir, 1979).

79 Gregory S Alexander, 'Pensions and Passivity' (1993) 56(1) *Law and Contemporary Problems* 111, 113.

80 Emiko Caerlewy-Smith, Gordon L Clark and John C Marshall, 'Agitation, Resistance, and Reconciliation with Respect to Socially Responsible Investment: The Attitudes of UK Pension Trustees and Oxford Undergraduates' (2006) 38 *Environment and Planning* 1585, 1586; Chris Gribben and Matthew Gitsham, 'Will UK Pension Funds Become More Responsible: A Survey of Trustees' (Report, UK Social Investment Forum, 2006) 14.

81 United Nations Environment Program Finance Initiative and Freshfields Bruckhaus Deringer, above n 70, 96.

argued that the interests of members of funds are broadly consistent with those of the society in which the members live'.<sup>82</sup>

This approach is illustrated by the Norwegian Government Pension Fund – Global ('NGPF-G'), a sovereign wealth fund whose legislative SRI mandate is based on international norms relating to human rights, environmental protection and other values that the Norwegian government respects.<sup>83</sup> Numerous international treaties govern issues of interest to social investors, including environmental protection. Some are widely ratified and thus putatively reflect a near-consensus of international opinion. But others are less helpful because of significant dissenting opinion or because their standards are too vague to guide investors in contentious cases. Climate change, while the subject of much division internationally in terms of the magnitude, timing and responsibility for cutting greenhouse gas emissions, at least has widespread international recognition as a global concern as evident in the number of parties to the principal treaties and agreements, such as 196 parties to the UN Framework Convention on Climate Change,<sup>84</sup> and broad support for the 2015 Paris Agreement.<sup>85</sup>

Still, in the absence of any judicial authority or legislative direction, it might be risky for a trust fund to divest from fossil fuels purely on the basis of some supposed international or national 'consensus', especially if the beneficiaries of the fund itself were of divided opinion. This risk is evident in the aforementioned Norwegian fund itself. In 2013 the Norwegian National Contact Point – an entity that oversees implementation of the Organization for Economic Cooperation and Development's Guidelines for Multinational Enterprises<sup>86</sup> – upheld a complaint against the fund for its investment in a Korean company's steel project in India.<sup>87</sup> The company, POSCO, acquired extensive agricultural lands for its environmentally controversial development, and allegedly violated local regulations. While this incident did not involve climate change issues, it addresses the question of social custom and how sovereign wealth funds respond to social concerns.

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82 James Gifford, 'Measuring the Social, Environmental and Ethical Performance of Pension Funds' (2004) 53 *Journal of Australian Political Economy* 139, 140.

83 Norwegian Ministry of Finance, 'Guidelines for Observation and Exclusion from the Government Pension Fund Global' (Guidelines, 9 February 2016) sections 2–3 <[https://www.regjeringen.no/contentassets/7c9a364d2d1c474f8220965065695a4a/guidelines\\_observation\\_exclusion2016.pdf](https://www.regjeringen.no/contentassets/7c9a364d2d1c474f8220965065695a4a/guidelines_observation_exclusion2016.pdf)>.

84 *United Nations Framework Convention on Climate Change*, opened for signature 4 June 1992, 1771 UNTS 107 (entered into force 21 March 1994).

85 Conference of the Parties, United Nations Framework Convention on Climate Change, *Adoption of the Paris Agreement*, 21<sup>st</sup> sess, UN Doc FCCC/CP/2015/L.9/Rev.1 (12 December 2015) annex.

86 Organisation for Economic Co-operation and Development, *Guidelines for Multinational Enterprises* <<http://www.oecd.org/corporate/mne>>.

87 The Norwegian National Contact Point for the OECD Guidelines for Multinational Enterprises, 'Final Statement: Complaint from Lok Shakti Abhiyan, Korean Transnational Corporations Watch, Fair Green and Global Alliance and Forum for Environment and Development vs POSCO (South Korea), ABP/APG (Netherlands) and NBIM (Norway)' (Final Statement, 27 May 2013) 6.

### C Judicial Standing to Dispute Investment Decisions

That fiduciary and trusts law may allow fossil fuels divestment does not in itself mean that one can *oblige* a financial institution to divest.<sup>88</sup> For a lawsuit to be brought against the financial trustees there must be a grievance relating to a performance failure, such as a failure to divest from companies that has led to adverse consequences for the fund. Even if no adverse financial consequences arose, a lawsuit could also ensue if trustees failed to respect the terms of the trust deed, ignored beneficiaries' demands or breached relevant legislative standards.

Not only must a specific grievance or performance failure exist to underpin a cause of action, someone must have standing to bring that action. Apart from the circumstances surrounding any specific regulatory regime, the four most likely candidates for standing are as follows.

1. First, standing accrues to persons with a legally recognised interest in the fund's assets, such as a beneficiary of a pension or superannuation plan. Such persons have their own money at stake, which fiduciary and contract law will protect.
2. The Attorney-General has standing to enforce charitable purpose trusts, such as university and philanthropic endowment funds, without a specific class of beneficiaries.
3. Thirdly, a donor to a charitable fund may have standing to challenge its investment decisions, especially if the donation is subject to restrictions on its investment or expenditure.<sup>89</sup>
4. Further, a member of the board of trustees has standing. The famous *Cowan v Scargill* case itself involved a dispute between rival trustees appointed by the employer and trade union over whether the pension fund should practice SRI.<sup>90</sup>

Conversely, standing is unlikely to accrue to an ordinary member of the public without any direct financial interest. Nor would standing accrue to individuals or groups that we might informally consider to be 'stakeholders', such as academics and students interested in the investments of their university's endowment fund, or employees or supporters of a community charity fund, as they do not enjoy personal legal rights to the endowed money in the manner that a beneficiary of a pension plan does.<sup>91</sup>

Of relevance, in 2015 a US court dismissed a fossil fuels divestment lawsuit brought by the student-run Harvard Climate Justice Coalition against the president and fellows of Harvard College and others for alleged 'mismanagement of charitable funds' and 'intentional investment in abnormally dangerous

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88 George C Christie, 'Legal Aspects of Changing University Investment Strategies' (1980) 58 *North Carolina Law Review* 189, 207–9.

89 See, eg, the *Robertson v Princeton University* lawsuit, settled out of court: Princeton University, *Robertson Lawsuit Overview* <<http://www.princeton.edu/robertson/about>>.

90 [1985] Ch 270.

91 On the other hand, students and staff may legally be able to challenge how the funds are spent: see *Sylvia Nasar v Trustees of Columbia University in the City of New York* (NY Sup Ct, No 150132/13, 10 February 2013).

activities'. The plaintiffs argued that Harvard's investment in fossil fuels breached '[Harvard's] fiduciary and charitable duties as a public charity and nonprofit corporation'. In March 2015, the Superior Court granted Harvard's motion to dismiss the case, with the presiding judge noting that the: '[p]laintiffs' status as Harvard students ... does not endow them with personal rights specific to them that would give them standing to charge Harvard with mismanagement of its charitable assets'.<sup>92</sup> Another relevant precedent from the US is the 1978 lawsuit filed by students from the University of Oregon and Portland State University who sought to force withdrawal of Oregon Board of Higher Education endowment funds invested in corporations active in South Africa.<sup>93</sup> But the substantive legal issues were never tested in court; in finding that the students lacked standing, the Oregon Court of Appeals observed:

[T]hey do not allege any legally recognized injury, and neither agreement with plaintiffs' opposition to apartheid nor the desirability of encouraging students to become concerned with social and moral wrongs and to seek to right them can turn the alleged 'injuries' into legally recognized ones.<sup>94</sup>

In regard to public sector financial institutions – which this article considers shortly – there may be other scope to challenge investment decisions, such as through judicial review especially where open standing is available to any member of the public. The pioneering decision of a Dutch court in 2015 to order its government to cut greenhouse gas emissions more ambitiously in order to meet international mitigation goals came about from a challenge by civil society activists (Urgenda); this important precedent may one day prove to be valuable in informing lawsuits against governments that invest heavily in fossil fuels.<sup>95</sup>

#### IV FINANCIAL CORPORATIONS

As with stock market investors, some banks are taking an interest in SRI. While many lenders incorporate environmental risk appraisal into their due diligence procedures,<sup>96</sup> a small minority have gone beyond 'defensive' banking to actively finance sustainable development.<sup>97</sup> The banking industry also drafted the Equator Principles in 2003 to provide a voluntary code for responsible global project financing.<sup>98</sup> Recalcitrant banks have come under increasing pressure from

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92 See Theodore R Delwiche and Mariel A Klein, 'Judge Dismisses Divestment Lawsuit', *The Harvard Crimson* (online), 23 March 2015 <<http://www.thecrimson.com/article/2015/3/24/judge-dismisses-divestment-lawsuit/>>.

93 *Associated Students of University of Oregon v Oregon Investment Council*, 82 Or App 145 (1986).

94 *Ibid* 150.

95 Arthur Neslen, 'Dutch Government Ordered to Cut Carbon Emissions in Landmark Ruling', *The Guardian* (online), 24 June 2015 <<https://www.theguardian.com/environment/2015/jun/24/dutch-government-ordered-cut-carbon-emissions-landmark-ruling>>.

96 See generally Karen Wendt (ed), *Responsible Investment Banking: Risk Management Frameworks, Sustainable Financial Innovation and Softlaw Standards* (Springer, 2015).

97 See Jan Jaap Bouma, Marcel Jeucken and Leon Klinkers (eds), *Sustainable Banking: the Greening of Finance* (Greenleaf Publishing, 2001); Olaf Weber and Sven Remer (eds), *Social Banks and the Future of Sustainable Finance* (Routledge, 2011).

98 *Equator Principles* <<http://www.equator-principles.com>>.

NGOs to shun fossil fuel projects. In Australia, banks have been targeted to boycott coal mining, a campaign that has had some effect: in 2015 the National Australia Bank shunned the proposed Adani coal mine in Queensland.<sup>99</sup> Environmentalists also succeeded in 2008 in persuading the Australia and New Zealand Bank to withdraw its support for a proposed pulp mill in Tasmania, a move that killed off the proposal.<sup>100</sup> Important empirical research by Megan Bowman on global banks reveals that they are increasingly sensitive to their reputation on climate change and seek to engage with their clients on such issues.<sup>101</sup>

Banks are one of several types of financial institutions that take a corporate form; others are insurers and some mutual fund businesses. All are subject to industry-specific regulations that generally aim to protect consumers and ensure financiers are adequately capitalized to buffer against market risks. Rarely is any legal obligation imposed on banks to promote SRI. An interesting American precedent is the *Community Reinvestment Act of 1977*;<sup>102</sup> it obliges banks to alleviate the financial plight of the local communities in which they are chartered, by ensuring public access to credit and low-cost banking services, especially to low-income and ethnic minority communities.<sup>103</sup> Nor, on the other hand, does financial market regulation ban SRI. Therefore, the question of whether fossil fuel divesting is lawful may hinge on the underlying corporate governance framework.

Modern corporate law in the Anglophile jurisdictions is not prescriptive about how a company should be managed, in terms of its economic activities or its environmental goals. Corporate law does not preclude a company from being managed for high environmental performance such as being fossil fuel free. The law also allows a company's shareholders to adopt articles of association to enshrine a mission (for example, an environmental mission), which would be legally binding on the company. Even without it, company law itself does not oblige a company to be governed by an unadulterated profit-making ethos. The fiduciary responsibility of corporate bosses is to promote their company's success, as a distinct legal entity, rather than the interests of its shareholders. American corporate law is sometimes viewed as congruent with the popular

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99 Amanda Saunders and Ben Potter, 'National Australia Bank Rules Out Funding Adani's Carmichael Coal Mine', *The Sydney Morning Herald* (online), 3 September 2015

<<http://www.smh.com.au/business/mining-and-resources/national-australia-bank-rules-out-funding-adanis-carmichael-coal-mine-20150902-gjdsfl.html>>.

100 Marian Wilkinson and Ben Cubby, 'ANZ Exit from Pulp Mill Project Confirmed', *The Age* (online), 28 May 2008 <<http://www.theage.com.au/articles/2008/05/27/1211654037422.html>>; Benjamin J Richardson, 'Can Socially Responsible Investment Provide a Means of Environmental Regulation?' (2009) 35(2) *Monash University Law Review* 262.

101 Megan Bowman, *Banking on Climate Change: How Finance Actors and Transnational Regulatory Regimes are Responding* (Kluwer Law International, 2015).

102 12 USC §§ 2901–5 (1977).

103 James T Campen, 'Banks, Communities and Public Policy' in Gary A Dymski, Gerald Epstein and Robert Pollin (eds), *Transforming the U.S. Financial System: Equity and Efficiency for the 21<sup>st</sup> Century* (ME Sharpe, 1993), 221–49.

sentiment that the interests of a company and its shareholders coincide.<sup>104</sup> However, there is no legally enforceable duty to maximise profits, and US courts have explicitly consented to companies sacrificing profits for philanthropic and humanitarian purposes.<sup>105</sup> Australian corporate law recognises that shareholders' interests are relevant to determining the interests of the company, but it is still a legal personality in its own right.<sup>106</sup> In recent years, Canadian courts<sup>107</sup> and British legislation<sup>108</sup> have led the way among Anglophile jurisdictions in developing a more socially responsible model of corporate governance, a trend some commentators label 'enlightened shareholder value' that focuses on long-term business success.<sup>109</sup>

Also relevant to this analysis is the business judgment rule, which provides a defence against civil liability claims against managers and directors who make decisions in good faith and on an informed basis that they believed was in the best interests of their company.<sup>110</sup> The resulting judicial deference to business acumen means that courts will not readily overturn any impugned business decision unless there is persuasive evidence of bad faith or procedural lapses, for instance. Consequently, companies can lawfully take climate positive measures such as to be 'carbon neutral' or 'fossil fuel free' if their managers reasonably believe that such measures will enhance their company's reputation and business success. More difficult to legally defend, however, would be a stance against fossil fuels based on the perceived long-term financial advantages that may not necessarily accrue and may even entail short-term economic pain for the company. This temporal mismatching between the costs of environmentally positive actions and their future benefits would require companies to undertake some research to validate the projected net gains over time.

Notwithstanding these discretions, company law may also impede environmental performance because the discretion to be social-minded is also the discretion to act otherwise. Self-interested behaviour usually prevails because of the market's competitive pressures, especially for public-listed companies with shareholders.<sup>111</sup> As social investors become more numerous in the market, they may be able to use their shareholder rights to exert positive environmental

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104 In the widely quoted 1919 case of *Dodge v Ford Motor Co*, the Supreme Court of Michigan held that 'a business corporation is organized and carried on primarily for the profit of the stockholders': 170 NW 668, 684 (Ostrander CJ) (Mich, 1919).

105 Lynn A Stout, 'Why We Should Stop Teaching *Dodge v Ford*' (2008) 3 *Virginia Law & Business Review* 163, 170–1.

106 The High Court of Australia in *Ngurli v McCann* framed the fiduciary responsibility of directors as to the 'the company as a whole', which the Court defined as including its shareholders: (1953) 90 CLR 425, 438–40.

107 See, eg, *Peoples Department Stores (Trustee of) v Wise* [2004] 3 SCR 461.

108 *Companies Act 2006* (UK) c 46, s 172.

109 Cynthia A Williams and John M Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 *Cornell International Law Journal* 493.

110 See, eg, *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1. See also Lyman P Q Johnson, 'Corporate Officers and the Business Judgment Rule' (2005) 60 *Business Lawyer* 439.

111 Beate Sjøfjell et al, 'Shareholder Primacy: The Main Barrier to Sustainable Companies', in Beate Sjøfjell and Benjamin J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, 2015) 79, 120–5.

change within financial corporations. Climate change has increasingly become an issue raised by shareholders, who are filing resolutions that seek changes to fossil fuel companies' policies and practices.<sup>112</sup> However, shareholder alliances are not easily arranged in a big company with thousands of members having diverse values, and corporate law contains mechanisms that limit the voice of shareholders, such as rendering shareholder resolutions not legally binding, requiring high voting majorities for such resolutions to pass, or limiting the capacity of shareholders to coordinate challenges to corporate management.

Apart from any legislative requirements, some distinctions between banks, insurers and mutual fund companies can be made with regard to the application of fiduciary law on their scope to address climate change issues.

In most countries, the core banking activities of deposit taking and lending are not fiduciary in nature, since these relationships are primarily understood as contractual dealings.<sup>113</sup> Once money is deposited, it simply becomes a debt due by the bank to the account holder.<sup>114</sup> A bank owes no fiduciary responsibility to the depositor, and may thus reuse and lend money as the bank wishes, such as to support a coal mining client. In the bank–borrower relationship, where the roles of debtor and creditor are reversed, it is similarly a contractual rather than fiduciary relationship.<sup>115</sup> Absent other legal constraints, banks may thus allocate funds regardless of any ethical preferences expressed by their depositors. But fiduciary principles can apply when a bank provides expert financial advice that is relied upon by a naive client.<sup>116</sup> Although not all jurisdictions conceive of a fiduciary duty of care that connotes positive responsibilities towards beneficiaries, a separate duty of care in regulation or the common law may to some extent fulfil this purpose (although the triggers of liability and remedies can differ). If a bank recommends to a client a course of action, the bank is potentially liable for all the foreseeable adverse consequences of the client relying on its advice.<sup>117</sup> As climate change concerns will likely intensify, it is conceivable that eventually banks will need to actively consider climate change financial risks and consequences when advising clients in many business contexts.

Insurance companies are also increasingly relevant to climate change action, both as insurers of assets vulnerable to damage by global warming as well as investors in other companies in the market. In 2006, UNEP FI established an Insurance Working Group (now known as the Insurance Commission) to assess and promote ESG issues in insurance business. The Commission drafted the Principles for Sustainable Insurance, a voluntary code that aims to provide tools for insurers to manage environmental risks.<sup>118</sup> In 2007, the sector issued the

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112 Jackie Cook, 'Political Action through Environmental Shareholder Resolution Filing: Applicability to Canadian Oil Sands?' (2012) 2 *Journal of Sustainable Finance & Investment* 26.

113 See generally John Glover, 'Banks and Fiduciary Relationships' (1995) 7(1) *Bond Law Review* 50.

114 *Foley v Hill* (1848) 2 HL Cas 28, 36; 9 ER 1002, 1005 (Lord Cottenham LC).

115 See Cecil J Hunt II, 'The Price of Trust: An Examination of Fiduciary Duty and the Lender-Borrower Relationship' (1994) 29 *Wake Forest Law Review* 719.

116 See, eg, *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390.

117 Glover, above n 113, 61.

118 *UNEP Finance Initiative: Principles for Sustainable Insurance* <<http://www.unepfi.org/psi>>.

ClimateWise Principles to help companies report how they incorporate climate change issues into the management of their business, including their investment portfolios.<sup>119</sup> So far, however, most insurers have viewed any commitment to environmental responsibility as largely confined to the direct ecological footprint of their physical operations rather than the indirect effects of their investments.<sup>120</sup> An independent review of implementation of the ClimateWise Principles in 2011 identified major failings by signatories in achieving ‘Principle 4’ (‘to incorporate climate change into our investment decisions’).<sup>121</sup>

The legal framework governing insurers around the world does not reflect such voluntary standards. Insurers may take the form of a mutual or stock company, but most have the latter structure because of economic efficiency, tax and fund-raising advantages.<sup>122</sup> A mix of contract law, fiduciary law and prudential regulation governs the investment activities of insurers.<sup>123</sup> The companies legislation under which insurers incorporate may also restrict their activities; for example, Canada’s *Insurance Companies Act* limits an insurer to ‘the business of providing financial services’, a mandate that might conceivably restrict some forms of SRI.<sup>124</sup> Regulation of insurers’ investment activities draws on both quantitative portfolio regulation and prudent investment standards so as to ensure that insurers will quarantine sufficient reserves to cover their liabilities and maintain healthy solvency margins.<sup>125</sup> American courts have recognised that some functions of insurance businesses are trustee-like and have thus imposed a fiduciary duty on the management of insurance companies when insurers offer pension plans and savings products.<sup>126</sup> Thus, some of the foregoing analysis on fiduciary law may be relevant in this context.

Investment companies are another institution that utilises the corporate structure. They often manage mutual funds that allow individuals to buy shares in pooled investment schemes, and they provide asset management services to other financial entities such as pension funds. There are no legal restrictions on a mutual fund offering boutique investment portfolios that cater to environmentally-conscious investors, and some now focus explicitly on climate change such as the Global Warming Prevention Equity Fund and Nomura Global Climate Change Fund.

The manager of a mutual fund owes fiduciary and contractual responsibilities to shareholders to follow the fund’s investment prospectus, even if the prospectus

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119 *Cambridge Institute for Sustainability Leadership: ClimateWise* <<http://www.climatewise.org.uk>>.

120 See, eg, Standard Life’s analysis of its carbon footprint: Standard Life, ‘Annual Report and Accounts 2010’ (Report, 2011) 45.

121 PriceWaterhouseCoopers, ‘ClimateWise Principles: The Fourth Independent Review’ (Report, ClimateWise, 2011) 10.

122 See Henry Hansmann, ‘The Organization of Insurance Companies: Mutual versus Stock’ (1985) 1 *Journal of Law, Economics & Organization* 125.

123 See generally Centre for Co-operation with the Economies in Transition and Organisation for Economic Co-operation and Development, *Policy Issues in Insurance – Investment, Taxation, and Insolvency* (OECD, 1996).

124 SC 1991, c 47, s 440(1).

125 See Susan Randall, ‘Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners’ (1999) 26 *Florida State University Law Review* 625.

126 *John Hancock Mutual Life Insurance v Harris Trust and Savings Bank*, 510 US 86 (1993).

prioritises ethical considerations over financial returns.<sup>127</sup> A prospectus may be altered, but normally only with approval of the fund members. Appropriate disclosure, as required by securities regulations, provides further protection to fund managers on the assumption that once relevant information about a fund is made public, investors assume the financial risks based on their assessment of that information. Rarely, legislation may be passed to explicitly validate SRI practices. America's *Sudan Accountability and Divestment Act of 2007*<sup>128</sup> shields fund managers who divest or avoid companies operating in Sudan in the targeted sectors of oil, mineral extraction, power production or production of weapons, so long as the practice is disclosed in periodic reports.

While mutual fund investors commonly enjoy legal rights to participate in fund governance, including voting on major changes to a fund's constitution, the principal legal technique used to align fund governance with investors' interests is enhanced disclosure obligations. They aim to ensure that fund members receive sufficient information to make rational decisions, thereby facilitating market efficiency. The prospectus is the main form of disclosure to investors,<sup>129</sup> and it may contain several pieces of information to help inform social investors about the suitability of the fund for their ethical preferences, including its fundamental investment philosophy (eg, ethical, industry sector or geographic scope) and investment risks. Disclosure standards across national jurisdictions are broadly similar, although some contain additional measures of particular value to SRI. Notably, Canadian and US law requires mutual funds to disclose their shareholding proxy voting policies and voting records.<sup>130</sup> Australia has gone the furthest to legislate disclosure standards for SRI-related information. Since 2001, all retail and superannuation funds are governed by Product Disclosure Statement ('PDS') requirements that oblige the fund provider to explain the extent to which social and environmental considerations are taken into account in its investment decisions.<sup>131</sup> These measures are buttressed by the Australian Securities and Investments Commission's ('ASIC') regulatory guidelines<sup>132</sup> that aim to facilitate the 'quantity, format and accuracy of SRI disclosure'.<sup>133</sup> If a fund claims to invest responsibly, the ASIC expects its PDS to explain the criteria for

127 Charles Zhen Qu, 'Australia's Managed Investment Schemes: The Nature of Relationships among Scheme Participants' (2004) 12 *Asia Pacific Law Review* 69, 84–5.

128 50 USCA § 1701 Note, 15 USCA § 80a-13 (2007).

129 Robert A Robertson, 'In Search of the Perfect Mutual Fund Prospectus' (1999) 54 *Business Lawyer* 461, 461–2.

130 Securities and Exchange Commission (US), 'Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies' (Final Rule No 33-8188, 31 January 2003); Ontario Securities Commission, 'Investment Fund Continuous Disclosure and Companion Policy' (National Instrument No 81-106, 2005) ch 5 <[http://www.osc.gov.on.ca/documents/en/Securities-Category8/rule\\_20050603\\_81-106\\_if-cont-disc.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category8/rule_20050603_81-106_if-cont-disc.pdf)>.

131 *Corporations Act 2001* (Cth) s 1013D(1).

132 Australian Securities and Investment Commission, *Section 1013DA Disclosure Guidelines*, Regulatory Guide 65, November 2011; Australian Securities and Investment Commission, *Disclosure: Product Disclosure Statements (and Other Disclosure Obligations)*, Regulatory Guide 168, October 2011.

133 Alana George, Nick Edgerton and Tom Berry, 'Mainstreaming Socially Responsible Investment (SRI): A Role for Government? Policy Recommendations from the Investment Community' (Report, Institute for Sustainable Futures, University of Technology, Sydney, 2005) 11.

measuring investment standards, a general description of whether adherence to the methodology is monitored and an explanation of actions taken when an investment no longer adheres to the stated investment policy.<sup>134</sup>

Despite the generally increasing rigour of disclosure standards worldwide, their efficacy in aligning the behaviour of financial fiduciaries with their investors remains highly debatable. The challenges pertain not only to general policy disclosures but also the reporting on specific environmental and social performance metrics. The problems also extend beyond the quality of information provided by financial institutions to the companies they invest in, as such businesses tend to have their own environmental and financial disclosure obligations.<sup>135</sup> These reporting standards are typically limited by the need to tie information to the financial position of the company and do not take account of very long-term risks and performance. Furthermore, the underlying accounting standards, such as the International Financial Reporting Standards, which are widely used for securities reporting, are not well adapted to capturing social and environmental information of a qualitative nature.<sup>136</sup>

In sum, climate conscious investors choosing mutual funds that shun fossil fuels industries cannot be assured that disclosed prospectuses and other details about the funds' strategies fully reflect their actual practices. Already, some ostensible SRI funds have been accused of continuing financial ties to fossil fuels producers.<sup>137</sup> Disturbingly, the Natural Capital Institute's study of American mutual funds in 2004 found 'the screening methodologies and exceptions employed by most SRI funds allow practically any publicly-held corporation to be considered as an SRI portfolio company'.<sup>138</sup> While of course legal liabilities might ensue for such malfeasance, the passive culture of retail investing, in which investors usually take their money elsewhere rather than devote time and resources to confront misguided fund managers, discounts the likelihood of such action being sufficiently prevalent to discipline the mutual fund industry.<sup>139</sup>

## V SOVEREIGN WEALTH FUNDS

Governments are also in the spotlight regarding fossil fuels financing, and sovereign wealth funds ('SWF') are the largest and most visible public sector funds under such scrutiny. A SWF is a state-owned investment vehicle

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134 Australian Securities and Investment Commission, *Section 1013DA Disclosure Guidelines*, Regulatory Guide 65, November 2011, regs 65.32–65.45.

135 See, eg, Nathan Lemphers, 'Full Disclosure: Environmental Liabilities in Canada's Oilsands' (Perspective for Investors Report, Pembina Institute, 2011).

136 See *IFRS* <<http://www.ifrs.org/Pages/default.aspx>>.

137 Richard Valdmanis, 'Green Investors Take Note: Climate-Focused Mutual Funds Dabble in Oil', *Reuters* (online), 1 December 2015 <<http://www.reuters.com/article/climatechange-summit-investing-idUSL8N13M42J20151201>>.

138 Paul Hawken and Natural Capital Institute, 'Socially Responsible Investing' (Natural Capital Institute, October 2004) 18–19 <<http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/report-harkin.pdf>>.

139 See generally Robert C Pozen, *The Mutual Fund Business* (MIT Press, 1998).

established commonly from balance of payments surpluses, the proceeds of asset privatizations or resource export receipts.<sup>140</sup> About 60 SWFs exist worldwide with assets of some US\$7.5 trillion as of early 2016.<sup>141</sup> Such concentration of wealth has made SWFs, an institutional phenomenon dating from the mid-1950s, influential actors in the global economy and thus potentially a force for SRI. Since 2000, the SWFs of Norway, New Zealand ('NZ') and France have become subject to legislative direction to invest ethically. The SWFs of some other nations, including Canada and Australia, have also adopted SRI policies despite the lack of an explicit legislative mandate.<sup>142</sup> Climate change has become an issue that some of these SWFs are beginning to consider.

The NGPF-G is both the world's largest SWF and has the strongest legal mandate for SRI.<sup>143</sup> Its track record of practising SRI is also due to the NGPF-G's unique institutional feature – an independent Council on Ethics that scrutinizes investments and recommends divestments to the Norwegian Ministry of Finance that makes the final decision. The legislative regulations require, on the advice of the Council, exclusion of companies that produce tobacco or weapons that violate fundamental humanitarian principles, or sell weapons or military material to pariah states.<sup>144</sup> The Guidelines also allow for exclusion of companies associated with specified impacts, one of which is 'severe environmental damage'.<sup>145</sup> Within these categories, which already pitch a high threshold for offending conduct, the Council aims 'to target [the] worst case[s]'.<sup>146</sup> Consequently, some unethical behaviour will not be challenged by the NGPF-G. It has demonstrated in practice that it is prepared to divest from the worst offenders, despite any financial repercussions for itself. The Ministry of Finance has acknowledged that 'the Fund will not invest in companies that are in gross breach of fundamental ethical norms, regardless of the effect this will have on returns'.<sup>147</sup>

Climate change has recently become an additional focus for divestment by the NGPF-G. In May 2015 the Norwegian parliament agreed by special resolution to direct the fund to sell off its investments in 122 coal mining companies worldwide.<sup>148</sup> It was a bold move for an SWF that originated as a vehicle to invest Norway's North Sea oil riches. It was that incongruity that

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140 See generally *SWFI* <<http://www.swfinstitute.org>>.

141 *SWFI, Fund Rankings* <<http://www.swfinstitute.org/fund-rankings>>.

142 Benjamin J Richardson and Angela Lee, 'Social Investing without Legal Imprimatur: The Latent Possibilities for SWFs' in Fabio Bassan (ed), *Research Handbook on Sovereign Wealth Funds and International Investment Law* (Edward Elgar, 2015) 389.

143 See generally Norwegian Ministry of Finance, 'Guidelines for Observation and Exclusion from the Government Pension Fund Global' (Guidelines, 9 February 2016).

144 *Ibid* s 2(1)–(2).

145 *Ibid* s 3(c).

146 Gro Nystuen, Andreas Follesdal and Ola Mestad, 'Introduction' in Gro Nystuen, Andreas Follesdal and Ola Mestad (eds), *Human Rights Corporate Complicity and Disinvestment* (Cambridge University Press, 2011) 1, 9.

147 Norwegian Ministry of Finance, 'On the Management of the Government Pension Fund in 2008' (Report No 20 to the Storting, 2009) 13.

148 Damian Carrington, 'Norway Confirms \$900bn Sovereign Wealth Fund's Major Coal Divestment', *The Guardian* (online), 5 June 2015 <<https://www.theguardian.com/environment/2015/jun/05/norways-pension-fund-to-divest-8bn-from-coal-a-new-analysis-shows>>.

probably explains why such a decision was not taken earlier. Instead, in 2008 the NGPF-G administrators released an ‘expectations’ document on how companies should manage risks relating to climate change.<sup>149</sup> The expectations included having

strategies for managing both physical and economic climate effects, to measure its emissions and set targets for reducing them, to explore and exploit opportunities to develop new products and services that will help the transition to a low-carbon economy, and to develop a strategy for dealing with climate change risk in the supply chain.<sup>150</sup>

Prior to the 2015 coal divestment decision, the NGPF-G saw corporate engagement as the best means to address companies that did not meet such ‘expectations’.<sup>151</sup>

Fossil fuels divestment has not yet been accepted by other SWFs such as the New Zealand Superannuation Fund (‘NZSF’). It was established pursuant to the *New Zealand Superannuation and Retirement Income Act 2001* (NZ). The Act’s SRI mandate obliges the NZSF Guardians to ‘invest the Fund on a prudent, commercial basis ... in a manner consistent with ... avoiding prejudice to New Zealand’s reputation as a responsible member of the world community’.<sup>152</sup> The legislation also obliges the Guardians who administer the NZSF to prepare a statement of ethical investment standards.<sup>153</sup> The Act does not define this terminology nor provide guidance on how to reconcile any conflicts between financial and ethical goals.

Despite growing public pressure on the NZSF to divest from fossil fuels,<sup>154</sup> the Guardians have interpreted their SRI mandate quite conservatively. They favour addressing social and environmental issues through corporate engagement, with divestment applied only in limited cases, such as against whaling, the manufacture of tobacco, cluster mines or anti-personnel mines, and the production and testing of nuclear explosives.<sup>155</sup> Apart from tobacco, these are not significant economic sectors. The Guardians acknowledge climate change as a growing SRI issue, but prefer to address it through polite corporate engagement.<sup>156</sup> The Guardians see their participation in the Carbon Disclosure Project (a global tool for investors to collaboratively solicit climate-relevant disclosures from companies) as important in engaging with NZ companies in order to learn about how they are responding to climate change emissions and risks.<sup>157</sup>

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149 Norges Bank Investment Management, *NBIM Investor Expectations: Climate Change Management* (Norges Bank, 2008).

150 As summarised by the Norwegian Ministry of Finance: Norwegian Ministry of Finance, ‘On the Management of the Government Pension Fund in 2009’ (Report No 10 to the Storting, 2010) 126.

151 *Ibid* 125.

152 *New Zealand Superannuation and Retirement Income Act 2001* (NZ) s 58(2)(c).

153 *New Zealand Superannuation and Retirement Income Act 2001* (NZ) s 61(d).

154 See Fossil Free, *Fossil Free NZ* <<http://gofossilfree.org/nz>>.

155 Anne-Maree O’Conner, David Rae and Rishab Sethi, ‘‘How We Invest’’ White Paper: Why We Believe Responsible Investing Pays Off’ (Report, NZ Super Fund, November 2015) 4.

156 Guardians of New Zealand Superannuation, ‘Responsible Investment Framework’ (New Zealand Super Fund, June 2016) 12.

157 New Zealand Super Fund, ‘New Zealand Superannuation Annual Report 2015’ (2015) 69.

Of SWFs without a clear legislative mandate for SRI, Australia's Future Fund illustrates some of the practices. Established under the *Future Fund Act 2006* (Cth), the Australian government has issued investment directions to the Future Fund trustees that include that they 'must act in a way that ... is unlikely to cause any diminution of the Australian Government's reputation in ... financial markets'.<sup>158</sup> The Fund's investment policy has evolved to ostensibly give weight to social and environmental considerations. The 2015 policy declares that '[t]he Board believes that effective management of material financial and reputational risks and opportunities related to ... [ESG] issues will, over the long term, support its requirement to maximise returns earned on the Funds'.<sup>159</sup> The Future Fund has boycotted some companies in order to respect Australia's obligations under the Convention on Cluster Munitions and the Anti-Personnel Mines Convention,<sup>160</sup> and it has also eschewed tobacco businesses<sup>161</sup> to fulfil expectations under the World Health Organization Framework Convention on Tobacco Control. But the Future Fund has largely eschewed interest in climate change, and indeed has been criticised by the Australian Greens for heavily investing in coal.<sup>162</sup>

There is little scope for any private person to legally challenge any of the foregoing SWFs' investment decisions including any decision to retain ties to fossil fuel businesses. The substantive merits of any investment decision, such as assessment of financial risks and returns, are not amenable to judicial scrutiny, but procedural failures and errors of law might be. For instance, the NZSF is subject to judicial review under the *Crown Entities Act 2004* (NZ)<sup>163</sup> for acts that are ultra vires or for an improper purpose.<sup>164</sup> However, reviewability of NZSF decisions would depend on whether a court views the imputed decision as an exercise of a public or commercial function (the NZSF's investment decisions might be construed as commercial decisions that are not justiciable except in regard to allegations of bad faith or corruption, or if the rights of a private individual were jeopardized).<sup>165</sup> The matter has never been tested in court so far. A similar conclusion about the scope for judicial review of the activities of the Norwegian and Australian SWFs applies. The discretionary and expert nature of

158 Peter Howard Costello and Nicholas Hugh Minchin, *Future Fund Investment Mandate Directions 2006*, 3 May 2006, cl 8(b).

159 Future Fund Board of Guardians, 'Statement of Investment Policies' (December 2015) 31 <<http://www.futurefund.gov.au/-/media/Files/FutureFund/04---Investment-Policies/01---Fund-Board-of-Guardian-Statement-of-Investment-Policies.pdf?la=en>>.

160 In 2012, Australia enacted the *Criminal Code Amendment (Cluster Munitions Prohibition) Act 2012* (Cth), which includes measures to ensure consistency between Australian law and the *Convention on Cluster Munitions*, opened for signature 30 May 2008, 48 ILM (2009) 357 (entered into force 1 August 2010).

161 Future Fund, 'Future Fund Excludes Tobacco Producers' (Media Release, 28 February 2013).

162 Rachel Alembakis, 'Greens Call on Future Fund to Divest from Coal Companies', *The Sustainability Report* (online), 7 June 2013 <<http://www.thesustainabilityreport.com.au/greens-call-on-future-fund-to-divest-from-coal-companies/>>.

163 See *Crown Entities Act 2004* (NZ) s 4(1).

164 *Crown Entities Act 2004* (NZ) s 19(1).

165 Jenny Cassie and Dean Knight, 'The Scope of Judicial Review: Who and What May be Reviewed' (2009) *NZLS Intensive: Administrative Law* 63, 89.

decision-making by the entities that administer the NGPF-G or Future Fund would effectively insulate from judicial scrutiny these SWFs' investment choices.

A further obstacle to any legal challenge is having standing to bring proceedings. Neither the NZSF Guardians nor the managers of Australia's Future Fund owe fiduciary or contractual duties to any putative beneficiary, as no individual citizen has any personal entitlement to either fund's assets. While the NZSF and other SWFs manage public funds in order to meet future contingencies and liabilities such as social welfare programs, the funds are not repositories of money traceable to specific individuals as is the case with a superannuation plan. On the other hand, courts in these jurisdictions have increasingly taken a broad view of standing for public interest organisations wishing to challenge administrative decisions that relate to their mandate.<sup>166</sup> In the seminal *Alta* case, the Norwegian Supreme Court affirmed the right of public interest environmental organisations to challenge administrative actions and compliance with legislation.<sup>167</sup> Such standing might be useful for legal challenges that relate to any SWFs' procedural failures or ultra vires conduct, but standing itself does not alleviate the difficulty of challenging the substantive merits of any investment decision that involve matters of commercial judgement that courts would be loath to interfere with.

## VI CONCLUSIONS

As the global campaign for divesting from fossil fuel industries intensifies, it is important to ascertain its legality. Misunderstandings about the legality of divesting can impede its uptake and impact. This article contends that such divesting is lawful in many situations. For an individual managing her own money, she may divest or invest as she wishes, either by participating directly in the market or through one of the boutique mutual funds that cater to social investors. The legal complexities of divesting begin with institutional funds that invest on behalf of many beneficiaries.

The legal difficulties of divesting are typically least onerous for financial corporations, such as banks and insurers. Banks may decline to lend to fossil fuel industries or to actively support renewable energy companies. Likewise, insurance companies may make climate change mitigation a priority in their investments. Neither banks nor insurance companies owe fiduciary responsibilities to their customers (except in limited circumstances) that might constrain their freedom to divest or invest. Prudential regulation of the banking and insurance industries poses some discipline against risky financial practices, but divesting is unlikely to be caught by such stipulations. Investment companies that manage mutual funds similarly enjoy the freedom to devise portfolios for

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166 See, eg, *Environmental Defence Society v South Pacific Aluminium Ltd* [No 3] [1981] 1 NZLR 216.

167 *Norsk Retstidende*, 1980, 569 (a challenge to a large hydropower project).

environmentally-minded investors including portfolios that eliminate fossil fuel industries.

The obstacles to divesting intensify for trust funds such as pension plans and endowment funds. The former, which are one of the world's largest pools of capital, are subject to fiduciary and trust law standards that restrict SRI-driven divestment unless trustees can show that it is in beneficiaries' best interests (mainly financial) or if one of the other legal excuses identified in this article apply. Endowment funds, without beneficiaries, may divest from fossil fuels where this would be aligned with their mission, as verified by the fund's trust deed. University endowment funds have additional considerations associated with their public mission and community of stakeholders.

The biggest legal obstacle to fossil fuels divesting is not so much that it cannot be done, but the limited scope to force unwilling trustees, bank managers or other financial executives to act. The discretionary and expert nature of much financial decision-making renders its judgments not easily amenable to legal challenge. For financial corporations, the business judgement rule substantially shields corporate managers' business decisions from judicial scrutiny. Financial trustees also enjoy some latitude under trusts law so long as the correct procedures are followed, due diligence is done and there is no bias or bad faith. In other words, any lawsuit would struggle to surmount the discretionary ambit of financial and corporate decision making. Furthermore, an aggrieved person needs *locus standi*. Customers of banks and insurance companies will ordinarily lack it. While beneficiaries of a pension plan have legal rights enforceable against trustees, it is improbable at this stage of the law's evolution that they would succeed in a lawsuit premised on a supposed duty of trustees to divest from fossil fuels. While the law conceivably obliges trustees to consider the financial risks of fossil fuel industry investments, the law also gives trustees plenty of options such as simply to dilute those risks through complementary investment in green companies or to 'engage' with fossil fuel business in the hope that they adopt ameliorating strategies such as to adopt carbon capture technology.

Despite such obstacles, the divesting movement may eventually succeed politically by raising public awareness about the disastrous environmental and economic consequences of continued reliance on carbon fuels, and in that regard it may help hasten urgently needed law reform that benefits SRI directly or indirectly. New legislation would be useful in several areas, including: to alter the investment mandates of SWFs to include a duty to consider climate change risks and impacts; to modify the prudential investment duties codified in pension, banking and insurance industry regulation to require consideration of financial risks associated with climate change; and to oblige all companies including financial institutions to report on their greenhouse gas emissions and climate policies. Ultimately, the most powerful legal instrument to engender change would be a carbon pricing mechanism, in the form of a tax or emissions trading scheme, which would undermine any business case for continued investment in fossil fuels. Proper analysis of these issues and potential law reforms is beyond the scope of this article, which focuses on current legal potentialities in the

Anglophile jurisdictions. But we should note that while the divestment movement arose due to the lack of government leadership on climate change, ultimately it may need to refocus on the role of governments in order to leverage change in the market.