

# The Ability of Directors to Consider ESG Factors in Board Decision Making

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Currently the Companies Act provides that a director of a company must act in good faith in what the director believes to be the best interests of the company. This is a subjective test – what matters is what the director actually believes – although the courts have indicated that such belief must be reasonably held. There is no statement of factors that a director may or may not take into account when forming this belief.

As originally proposed the amendment bill provided for the addition of the following:

‘To avoid doubt, a director of a company may, when determining the best interests of the company, take into account recognised environmental, social and governance factors, such as:

- recognising the principles of the Treaty of Waitangi (Te Tiriti o Waitangi):
- reducing adverse environmental impacts:
- upholding high standards of ethical behaviour:
- following fair and equitable employment practices:
- recognising the interests of the wider community.’

The above wording has been criticised on various grounds, including:

- Directors can already take into account ESG matters when considering the best interests of the company, so the changes are not necessary.
- Listing specific factors that may be taken into account suggests that some factors may carry more weight than others.
- It is not appropriate to refer to Te Tiriti as this governs relations between the Crown and Maori not between private entities.
- The wording is too vague and light touch.
- Consideration of these factors should not be optional.
- It would be better to have a full review of directors’ duties rather than to deal with this change in isolation.

The Select Committee considering the bill split along party lines and was unable to agree whether or not the bill should be passed. However the Committee did agree that if the bill was to be passed, it should not be passed in the above form. Instead the Committee proposed that the amendment should take the form of a simple acknowledgement as follows:

‘To avoid doubt, in considering the best interests of a company for the purposes of this section, a director may consider matters other than the maximisation of profit.’

This more limited amendment has been criticised for being unnecessary (on the grounds it merely states what is already the law) whilst still increasing uncertainty for directors.

So does the Select Committee's proposed change have any merit?

It is worthwhile noting that debate around the bill appears to have largely accepted that directors may already consider ESG factors under the current law and that this is desirable.

It is also of note that an express ability to consider factors of this nature is becoming more common in other jurisdictions. For example, in the UK under the UK Companies Act 2006, a director is required to act in a way that he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so the directors must have regard to various listed factors, including the impact of the company's operations on the community and the environment.

In our view although the amendment as proposed in the original bill was flawed, the change now proposed is of some, although admittedly limited, value.

Although it is now generally accepted that directors can already take into account ESG factors, this was not the case when the Companies Act 1993 was originally passed. Amending the Act to acknowledge that wider factors may be taken into account reflects the shift in societal attitudes from when the Act was first enacted and removes any residual doubt.

Further even if the change merely reflects the current law this is not reflected in the current wording of the Companies Act. The legislation should be clear on such a fundamental issue.

The acknowledgement also helps bring our legislation more in line with developments in other jurisdictions.

It is easier to criticise the revised bill for not going far enough. However in our view a more fundamental change to the directors' duties provisions in the Companies Act (including any step to make the consideration of such wider factors compulsory) deserves a fuller review.

Given that there is unlikely to be the parliamentary will or time for such a review in the short to medium term, the bill as reported back seems at least a step in the right direction.