

LEGAL DEVELOPMENTS IN DIRECTORS' DUTIES AND ESG

What Every Hong Kong Company
Director Should Know

November 2022



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Foreword

Directors' duties have developed over many years and are constantly evolving. Traditionally, directors' duties under Hong Kong law are only owed to shareholders collectively as a whole. In line with global developments and emerging trends, the short-term view of profitability for shareholders is giving way to a longer-term or sustainable view of profitability, taking into account the interests of relevant stakeholders. In parallel, enforcement of directors' duties permissible by the company concerned, subject to limited exceptions, has given way to more expansive statutory rights under the Companies Ordinance. Directors and governance professionals should understand the developments in Hong Kong. This paper highlights developments in the area of directors' duties to take into account environmental, social and governance (ESG) developments for sustainable business operations.

The Institute is grateful for the contributions of Mr Ben McQuhae and his team to this paper, with input from Ms Gillian Meller FCG HKFCG(PE), Institute Immediate Past President, Mrs April Chan FCG HKFCG, Institute Past President and Chairman, Technical Consultation Panel and Mr Mohan Datwani FCG HKFCG(PE), Institute Deputy Chief Executive. The Institute as thought leader of governance-related best practices will provide, from time-to-time, practical sharing to address applicable legal and regulatory requirements to promote 'better governance for a better future'.

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Part 1 – Executive Summary

Directors’ Duties and ESG under Hong Kong Law

This paper will offer a referential view of developments in respect of directors’ duties and ESG, with the caveat that specific facts require specific legal advice. In summary:

1. Under Hong Kong law, directors of Hong Kong companies are required to have regard to ESG risks and opportunities (referred to as **ESG considerations**) in the discharge of their duties.
2. Directors’ duties have evolved over many years. They comprise relatively well-understood legal principles that guide conduct but which need to be considered in the context of specific fact patterns to determine whether, in any given situation, there has been a proper discharge. Hong Kong directors owe fiduciary duties (such as utmost good faith, proper purposes, conflicts of interest, and independent judgment) and a statutory duty to exercise reasonable care, skill and diligence. The absence of express judicial authority or statutory provision (i.e. specifically requiring directors to take into account ESG considerations in discharging their duties) does not mean ESG is unconnected to the proper discharge of their duties.
3. ESG is now embedded in Hong Kong’s policy objectives and regulatory landscape. Directors of regulated entities must comply with the ESG rules and requirements of the Stock Exchange of Hong Kong (**SEHK**), the Securities and Futures Commission (**SFC**) and the Hong Kong Monetary Authority (**HKMA**), as may be applicable. Most of these new rules and requirements expressly allocate ESG responsibilities to directors, such as the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (**Listing Rules**) which now require that all listed companies embed ESG in their governance structures. Importantly, directors have overall responsibility for ESG strategy and reporting.
4. While the ESG legal and regulatory landscape in Hong Kong is still developing and evolving, we have identified three main touchpoints where ESG intersects with directors’ duties:
 - All directors must pay due regard to ESG considerations when discharging their fiduciary duties and duty to exercise reasonable care, skill and diligence. The scope of directors’ duties concerning ESG considerations can be inferred from existing legal principles.
 - Directors of listed and regulated entities must comply and procure that the company complies with the ESG regulations imposed by Hong Kong’s regulators. Hong Kong case law supports the proposition that a breach of the Listing Rules can amount to a breach of a director’s duty to exercise reasonable care, skill and diligence.
 - Directors may also be subject to ESG

obligations under Hong Kong laws that address certain elements of ESG, for example, ordinances requiring disclosures or relating to environmental protection. A breach of law can amount to a breach of duty.

5. ESG has become an important topic for Hong Kong companies and their directors. Still, there is currently no precedent to inform as to the exact standards expected of directors for properly discharging their duties in respect of ESG considerations. We offer the following commentary to illustrate how ESG considerations can intersect with directors' duties:^{1,2}

- Directors are obligated at all times to act in the best interests of the company as a whole and to exercise reasonable care, skill and diligence in the performance of their functions. To the extent that ESG issues intersect with and affect the company's interests, directors must consider such issues appropriately in discharging their duties to the company. ESG issues that intersect with and affect the interests of the company refer to, at a minimum, ESG issues that pose a risk to the company's financial performance and/or present a business opportunity to the company.
- To discharge the duty to exercise reasonable care, skill and diligence and the continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business, directors must keep themselves adequately informed. They need at least to have access to information via internal or external sources about ESG considerations affecting, or potentially affecting, the company, the likely consequences for the company and how the company is currently monitoring and managing such considerations.
- To discharge the duty to exercise independent judgment in respect of ESG considerations, directors must ensure that they are adequately informed about ESG matters generally. The information will enable them to make a good faith determination whether any particular ESG considerations affect the interests of the company and to allow them to properly consider, assess and exercise oversight in respect of ESG considerations. Also, to exercise independent judgment, directors must critically evaluate any management and board committee report and/or independent expert advice received, and the business implications of relevant ESG considerations.
- The Listing Rules require directors of listed companies to be responsible for the company's ESG reporting. Directors must ensure that ESG representations contained in disclosures made by the company are appropriate, true, accurate and not misleading and avoid any misstatements, critical omissions and greenwashing. Directors should be mindful of the surge in regulatory actions targeting greenwashing globally (we are not aware of any yet in Hong Kong) and the growing trend of regulators policing ESG disclosures, and manage greenwashing and ESG litigation risk accordingly.
- Schedule 5 of the Companies Ordinance requires all directors to include in the business review section of the annual directors' report, which outlines the state of the company's business operations "*to the extent necessary for an understanding of the development, performance or position of the company's business:*"
 - *A discussion of their environmental policies and performance;*

1 This is not intended to be an exhaustive list of ESG-related obligations to which directors are subject, but rather a practical guide to help companies and their boards identify touch points.

2 This summary does not cover the ESG-related regulations published by the HKMA or the SFC. Directors of Hong Kong companies subject to such regulations would also have to bear them in mind in discharging their duties.

- *A discussion of their compliance with relevant laws and regulations that have a significant impact on them; and*
 - *An account of their key relationships with employees, customers, suppliers, and others that have a significant impact on them and on which their success depends*.³
- Directors must ensure that the company's financial statements and the accompanying directors' report properly reflect relevant and material ESG considerations where appropriate, in order to provide a "true and fair" view of the company's financial position, performance and prospects as required under section 380 of the Companies Ordinance.
6. Directors should be mindful that the range and breadth of ESG-related obligations will certainly expand as the ESG policy and regulatory landscape evolves, including through the adoption in Hong Kong of sustainability reporting standards developed by the International Sustainability Standards Board (ISSB) (which builds upon the TCFD⁴ framework).
 7. There is no distinction between executive, and non-executive directors (including independent non-executive directors) insofar as directors' duties are concerned. To discharge their duty to exercise independent judgment, non-executive directors should take a proactive role in engaging with and understanding how the executive directors are identifying, assessing, prioritising, monitoring and managing ESG considerations before making their own reasonable assessment of whether to endorse executive directors' decisions.
 8. The standard of care expected when exercising reasonable care, skill, and diligence is a dual objective/ subjective standard. The subjective element means that directors appointed for their special knowledge, skill or experience in ESG matters are subject to a higher standard of care commensurate with their qualifications. The objective element requires assessing what a reasonable director would do in a given situation. Due to the constantly evolving ESG landscape, directors should be mindful of shifting expectations regarding what is reasonably expected of a reasonable director when assessing ESG considerations. There are obvious risks where a company allocates to an existing director responsibility for ESG and/or a title that implies such responsibility where the director has inadequate knowledge and access to capacity building and external advice.
 9. Directors must manage ESG considerations and adequately discharge their duties through a robust ESG governance structure and internal reporting framework. Directors have some discretion to make commercial decisions (for example, to determine whether any particular ESG considerations are material). However, they must demonstrate they are making decisions based on credible assumptions and a robust decision-making process and that they have applied an appropriate degree of diligence to pursue the company's interests in good faith.

3 Since 2015, this disclosure requirement has also been incorporated into the Listing Rules as a mandatory disclosure requirement for all companies listed on the SEHK under paragraph 28(2)(d) of Appendix 16 and paragraph 12 of Appendix 27.

4 The G20 Financial Stability Board Taskforce on Climate-related Financial Disclosures.



Part 2 – Detailed analysis

Directors' Duties in respect of ESG Considerations under Hong Kong Law

Section A: Introduction

1. This analysis considers the extent to which directors of a Hong Kong-incorporated company are required, in the discharge of their duties under Hong Kong law, to have regard to ESG risks and opportunities (referred to throughout as **ESG considerations**)⁵. This analysis covers directors' obligations in respect of ESG considerations generally and the enhanced obligations of listed company⁶ **directors**. In this analysis, the term director refers to a director of a solvent Hong Kong-incorporated company.
2. **Section B** summarises the general law on directors' duties under Hong Kong Law.

Section C discusses the ESG regulatory landscape in Hong Kong.

Section D considers directors' duties and ESG considerations under Hong Kong law and regulations.

Section E surveys directors' duties and ESG considerations under the laws of other jurisdictions, which may indicate the law's direction of travel on this topic and the legal position in Hong Kong in the foreseeable future.

Section B: General Law on Directors' Duties under Hong Kong Law

3. This section summarises certain key duties⁷ that directors owe under Hong Kong law.
4. Under the general laws of Hong Kong, duties owed by directors can be classified into three broad categories:
 - (1) Fiduciary duties;
 - (2) Duty to exercise reasonable care, skill and diligence; and
 - (3) Disclosure obligations.
5. As part of their fiduciary duties,⁸ directors owe to

⁵ Please see "Legal Opinion on Directors' Duties and Disclosure Obligations under Hong Kong Law in the Context of Climate Change Risks and Considerations" which serves a useful reference on the climate change as an ESG issue.

⁶ In this analysis, the term **listed company** refers to a Hong Kong-incorporated company listed on SEHK.

⁷ The directors' duties considered in Section B are those we consider most relevant and most likely to touch on ESG considerations in the absence of confirmatory precedent or regulatory guidance. Section B is not intended to be an exhaustive account of all duties which directors.

⁸ Numerous directors' duties fall within the scope of fiduciary duties. In paragraph 5 of this analysis, we have adopted what we consider to be the most commonly used headings of fiduciary duties.

the company:

- (1) A duty to act in utmost good faith. They must exercise their powers for the benefit and in the best interests of the company as a whole;⁹
 - (2) A duty to make decisions only for proper purposes and having considered relevant matters;¹⁰
 - (3) A duty to avoid situations in which the director's interests may conflict with the company's. They must not obtain any undisclosed profit through their position as a director;¹¹ and
 - (4) A duty not to delegate powers except with proper authorisation¹² and an overriding duty to exercise independent judgment (which includes a duty not to merely rely on the judgment of other directors but to act independently)¹³ and to properly supervise the exercise of powers by delegates¹⁴. The extent of the duty of supervision and whether it has been discharged depends on the facts of each case. These include the director's role in the management of the company.¹⁵ As such, it is important to note that directors must continue to acquire and maintain sufficient knowledge and understanding of the company's business to discharge their duties properly.
6. Directors also owe a duty to the company to exercise reasonable care, skill and diligence under section 465 of the Companies Ordinance (Cap.622 of the Laws of Hong Kong) (**Companies Ordinance**), which has codified and replaced the previous common law position:

- (1) The standard of care expected of directors is a dual objective/ subjective standard. Section 465(2) expressly provides that reasonable care, skill and diligence means "*the care, skill and diligence that would be exercised by a reasonably diligent person with: (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and (b) the general knowledge, skill and experience that the director has*"; and
 - (2) In considering whether a director has breached their duty of care, skill and diligence, the common law rules for causation, foreseeability and remoteness generally apply.¹⁶ In contrast, questions of foreseeability and remoteness do not arise when considering whether there is a breach of fiduciary duty.
7. Directors of companies listed on the SEHK owe the same fiduciary duties and duty of care, skill and diligence as are owed by all directors under the general laws of Hong Kong.¹⁷ The Listing Rules also require directors of listed companies to, amongst other things:
- (1) Ensure compliance with the Listing Rules (which includes all of the ESG-related disclosure obligations under the Listing Rules);¹⁸ and
 - (2) Take an active interest in the issuer's affairs, obtain a general understanding of its business and follow up on anything untoward that comes to their attention.¹⁹

9 *Re Smith and Fawcett Ltd* [1942] Ch 304 per Lord Greene MR at 306; *Re Tysan Holdings Ltd* [2013] 4 HKC 425 per Mimmie Chan J at para 38.

10 *Passport Special Opportunities Master Fund LP & Another v eSun Holdings Ltd & Others* [2011] 4 HKC 62.

11 *North-West Transportation Co Ltd v James Hughes Beatty* (1887) 12 App Cas 589 at 594; *Chung Pui Tak v Tam Chi Leung Nolan* [2021] HKCFI 242 per DHCJ Leung at paras 106-107.

12 *Re Leeds Banking Co, Howard's Case (1866) LR 1 Ch App 561; Miu Hon Kit & Others v The Stock Exchange of Hong Kong Limited* [2020] HKCFI 675 per Chow J at paras 69-77.

13 *Securities and Futures Commission v Wong Yuen Yee* [2019] HKCU 3787.

14 *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 (CA, Eng); *Miu Hon Kit*, supra n.12.

15 *Re Copyright Ltd* [2004] 2 HKLRD 113 per Kwan J at para 34; *Miu Hon Kit*, supra n.12.

16 *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681 per Ribeiro PJ at paras 73-83.

17 Main Board Listing Rules 3.08.

18 Main Board Listing Rules 3.16.

19 *Ibid.*

8. Directors may also be subject to disclosure obligations under Hong Kong law. Specifically in relation to ESG matters of the company, Schedule 5 of the Companies Ordinance mandates all directors to include in the business review section of the annual directors' report, which outlines the state of the company's business operations²⁰, "to the extent necessary for an understanding of the development, performance or position of the company's business:
- A discussion of their environmental policies and performance;
 - A discussion of their compliance with relevant laws and regulations that have a significant impact on them; and
 - An account of their key relationships with employees, customers, suppliers, and others that have a significant impact on them and on which their success depends".²¹
9. Recognising the obvious challenges in determining whether there has been a breach of a director's fiduciary duties or the duty of care, skill and diligence in relation to commercial decision-making, Hong Kong courts take into account what is known as the business judgment rule.²² According to the business judgment rule, Hong Kong courts are slow to interfere with directors' business judgment and decisions as long as they exercise their powers in good faith and not for irrelevant purposes.²³ Although the business judgment rule provides directors with a certain amount of flexibility in how they apply their judgment, directors should take steps to apprise themselves beforehand of relevant information in relation to the company's business.²⁴ A court is also unlikely to apply the business

judgment rule where it can be shown that no reasonable director could have rationally concluded that the course of action taken by the director was in the company's interests.²⁵ We are of the view that whereas the business judgment rule may be relied on where directors make informed judgment calls, it is unlikely to be applied where directors make uninformed decisions or fail to consider a relevant issue.

Section C: The ESG Regulatory Landscape in Hong Kong

10. The ESG regulatory landscape in Hong Kong, as in other jurisdictions, has evolved rapidly.
11. In Hong Kong, ESG regulations have been introduced by the three regulators, the SEHK, SFC and HKMA, each with respect to entities that come under their respective regulatory remit – the SEHK for listed companies, SFC for fund managers and HKMA for authorised institutions:
- (1) In 2020, the SEHK introduced revisions to the ESG disclosure regime under the Listing Rules.²⁶ The current ESG disclosure regime, contained in Appendix 27 of the Main Board Listing Rules, requires directors to express that the directors have overall responsibility for the company's ESG strategy and reporting. The Listing Rules now impose mandatory disclosure requirements relating to the company's ESG governance structure and reporting and "comply or explain" disclosure provisions in respect of certain specified ESG issues. In 2022, the SEHK introduced revisions to the Corporate Governance Code under the Listing Rules (Appendix 14 of the Main Board Listing Rules). There is now an explicit link between

20 Sections 388 and 389 of the Companies Ordinance.

21 Since 2015, this disclosure requirement has also been incorporated into the Listing Rules as a mandatory disclosure requirement for all companies listed on the SEHK under paragraph 28(2)(d) of Appendix 16 and paragraph 12 of Appendix 27.

22 Also known as the principle of judicial non-interference or the principle of judicial non-interference with bona fide management decisions.

23 *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance Oil) Co NL* (1968) 121 CLR 483 at 493; *Wong Luen Hang & Another v Chan Yuk Lung & Others* unrep. CACV 112/2012 (30.10.2013) per Yuen JA at para 26.

24 *Sanju Environmental Protection (Hong Kong) Limited v Wang Lishan and Ors* [2021] HKCFI 1503 per Linda Chan J at paras 36-37.

25 *Re Gresham Life Assurance Society, ex p Penney* (1872) LR 8 Ch App 446; *Gaiman v National Association for Mental Health* [1971] Ch 317.

26 This analysis focuses on the Main Board Listing Rules, and we note that the GEM Listing Rules have the same ESG disclosure regime.

ESG and corporate governance, requiring directors, as part of their annual review of the listed company's risk management and internal controls systems, to consider the effectiveness of their ESG governance structure.

(2) On 20 August 2022, amendments to the Fund Manager Code of Conduct (**FMCC**) in respect of the management and disclosure of climate-related risks by fund managers came into effect. These amendments were introduced by the SFC in an August 2021 circular setting out expected standards for fund managers to integrate climate-related risks into the fund manager's governance, investment and risk management processes and to make appropriate disclosures of such policies and procedures (**SFC Circular**).²⁷ Among the requirements set out in the SFC Circular, the board or board committees of the fund manager are expected to oversee the incorporation of climate-related considerations into the fund manager's investment and risk management processes and progress against goals for addressing climate-related issues. The SFC has stated publicly (including in a consultation paper issued in October 2020²⁸) that climate-related risks are only the initial focus of the SFC's strategy on ESG in relation to fund managers and that the scope will expand to cover ESG risks. The SFC has also introduced regulations to impose disclosure obligations on fund managers regarding ESG funds.²⁹

(3) In December 2021, the HKMA introduced a new module to its Supervisory Policy Manual on climate risk management to provide high-level guidance to authorised institutions on incorporating climate considerations into their governance, strategy, risk management and disclosure policies and procedures.³⁰ Board oversight was also a key feature of the guidance provided. In the same

month, the HKMA issued a circular to authorised institutions to share some sound practices supporting the transition to carbon neutrality.³¹ In June 2022, the HKMA announced its two-year plan to integrate climate risk into its banking supervisory processes.³²

12. Some important inferences may be drawn from the SEHK's current ESG disclosure regime under the Listing Rules:

(1) By imposing responsibility on the board for the company's ESG strategy and reporting, directors cannot discharge this responsibility without giving specific and thorough consideration to ESG considerations which should cover each ESG issue set out under the "comply or explain" disclosure provisions.

(2) The specificity of the disclosure requirements under the current ESG disclosure regime effectively requires directors of listed companies to develop and implement a proper ESG strategy to manage material ESG considerations.

(3) The mandatory requirement to disclose the listed company's approach in assessing "materiality" effectively requires boards of listed companies to put in place policies and procedures to enable them to identify, assess, prioritise, monitor and manage relevant ESG considerations to the company.

13. The ESG regulatory landscape in Hong Kong is still developing and will continue to evolve. On 17 December 2020, the Green and Sustainable Finance Cross-Agency Steering Group announced a green and sustainable finance strategy for Hong Kong, which includes plans to mandate TCFD³³

27 SFC, "Circular to licensed corporations Management and disclosure of climate-related risks by fund managers", 20 August 2021.

28 SFC, "Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers", October 2020.

29 SFC, "Circular to management companies of SFC-authorized unit trusts and mutual funds - ESG funds", June 2021.

30 HKMA, "Supervisory Policy Manual: GS-1 Climate Risk Management", December 2021.

31 HKMA, "Circular on Sound practices supporting the transition to carbon neutrality", December 2021.

32 HKMA, "Circular on Embedding climate risk in banking supervision", June 2022.

33 The G20 Financial Stability Board Taskforce on Climate-related Financial Disclosures.

disclosures across "relevant sectors" (which appears to include financial institutions including banks, asset managers, insurance companies and pension trustees) no later than 2025 and to adopt the Common Ground Taxonomy.³⁴ On 21 June 2022, it announced that the SFC and the Hong Kong Exchanges and Clearing Limited (HKEX) are evaluating readiness for implementing sustainability reporting standards developed by the ISSB for listed companies.³⁵ In the Agenda for Green and Sustainable Finance published by the SFC in August 2022, the SFC emphasised the important role of regulators in supporting capital allocation that considers material climate and sustainability-related risks. This is against the background of local, regional and global initiatives and sets out further steps that the SFC intends to take to support the transition towards a greener economy. Two main focus areas include corporate disclosures and monitoring the implementation of and enhancing existing measures. We are of the view that these and other developments in the ESG regulatory landscape and regulators' stances will influence and shape the scope of directors' duties in relation to ESG considerations under Hong Kong law.

Section D: Directors' Duties and ESG Considerations under Hong Kong Law and Regulations

14. There is currently no express common law authority or statutory provision under Hong Kong law obliging directors, in the discharge their duties (fiduciary or otherwise), to consider ESG considerations.
15. However, that is not to say that directors are not under any legal obligation to have regard to ESG considerations under Hong Kong law. In our view, there are three principal touchpoints where ESG considerations logically intersect with directors'

duties:

- (1) Directors are required to pay due regard to ESG considerations when discharging their fiduciary duties and duty to exercise reasonable care, skill and diligence. The scope of directors' ESG-related obligations can be inferred from existing legal principles in relation to directors' duties.
- (2) As noted in Section C above, ESG regulations introduced by Hong Kong's regulators increasingly require board oversight of ESG matters. Directors of regulated entities will need to comply or procure the company's compliance with the ESG obligations under the applicable regulations or risk disciplinary sanctions from the relevant regulator.

- We are of the view that directors of listed companies are obligated both under existing legal principles in relation to directors' duties (per paragraph 15(1) above) and the Listing Rules to pay due regard to ESG considerations in managing the company's affairs.
- The ESG obligations imposed on directors under relevant ESG regulations will likely influence and shape the scope of directors' duties in respect of ESG considerations. In light of the current and anticipated future regulatory environment, it will become increasingly complex, if at all possible, for a director of a regulated entity to act reasonably if they fail to reasonably consider and/or manage relevant and material ESG risks affecting the company. We note there is already Hong Kong case law to support the proposition that a breach of the Listing Rules can potentially amount to a breach of a director's duty to exercise reasonable

³⁴ HKMA, "Cross-Agency Steering Group Launches its Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future", 17 December 2020; and HKMA, "Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future", 17 December 2020.

³⁵ HKMA, "Cross-Agency Steering Group announces launch of information and data repositories and other progress in advancing Hong Kong's green and sustainable finance development", 21 June 2022.

care, skill and diligence.³⁶

- Although we are unaware of any Hong Kong authority to support the proposition that a breach of the FMCC can potentially amount to a breach of a director's duties, as a breach of the Listing Rules can, we consider this a logical assumption to make.

(3) Directors may also be subject to obligations under certain legislations under Hong Kong law that touches on specific elements of ESG to the extent that such legislation is relevant to the company's business.

16. As noted in paragraph 15(1) above, we are of the view that directors are required to pay due regard to ESG considerations when discharging their duties under Hong Kong law. However, we recognise this statement is of limited practical use without further guidance. We are sympathetic to the fact that ESG has quickly become an important topic for Hong Kong companies and their directors. However, there is, as yet, no precedent in Hong Kong (or, as far as we can tell, in any other persuasive jurisdiction) to inform as to the standards expected of directors for the proper discharge of their duties in respect of ESG considerations. We offer the following examples to illustrate our view on the likely scope of ESG-related obligations to which directors are subject as inferred by legal principles under Hong Kong law and regulations^{37,38}:

(1) As noted in Section B above, directors are

obligated at all times to act in the best interests of the company as a whole^{39,40}, and to exercise reasonable care, skill and diligence in the performance of their functions⁴¹. To the extent that ESG issues intersect with and affect the company's interests, directors would need to consider such issues appropriately in discharging their duties to the company. ESG issues that intersect with and affect the interests of the company refer to, at a minimum, ESG issues that pose a risk to the company's financial performance and/or those that present a business opportunity to the company.

(2) To discharge the duty to exercise reasonable care, skill and diligence⁴² and the continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business⁴³, we are of the view that directors are required to be adequately informed (or at least have access to information via internal or external sources) about the ESG considerations affecting, or potentially affecting, the company, their likely consequences for the company and how the company is currently monitoring and managing such ESG considerations. To satisfy the requirement to be adequately informed, a director would need to proactively make inquiries to obtain the necessary information or seek appropriately qualified and independent expert advice where necessary. A failure to be sufficiently informed could amount to a breach of the duty to exercise reasonable care, skill and diligence.

36 For example, see *Re Styland Holdings Ltd (No 2)* [2012] 2 HKLRD 325.

37 This is not intended to be an exhaustive list of ESG-related obligations to which directors are subject, but rather a practical guide to help companies and their boards interpret the rules today.

38 This analysis does not cover the ESG-related regulations published by the HKMA or the "Circular to management companies of SFC-authorized unit trusts and mutual funds - ESG funds" published by the SFC. Directors of Hong Kong companies subject to such regulations would also have to bear them in mind in discharging their duties.

39 See paragraph 5(1) of this analysis.

40 Under Hong Kong law, the interests of the company refer to the interests of present and future members of the company as a whole; directors may also take into account the general interests of the company's employees in considering the interests of the company, provided that such interests ultimately advances the interests of the members. (Halsbury's Laws of Hong Kong (August 2022), at para. [95.0669]) Please note that statutory provisions have been introduced in jurisdictions such as the EU, UK and Canada. These permit directors to also consider the interests of stakeholders and environmental impact in directors' pursuit of the best interests of the company (please refer to paragraph 21(1) of this analysis).

41 See paragraph 6 of this analysis.

42 See paragraph 6 of this analysis.

43 See paragraph 5(4) of this analysis.

(3) To be able to discharge their duty to exercise independent judgment⁴⁴ in respect of ESG considerations, it logically follows that directors should ensure that they are adequately informed about ESG matters generally. Such knowledge will enable them to make a good faith determination whether any particular ESG considerations affect the interests of the company and allow them to consider, assess and exercise oversight over ESG considerations properly. Being inadequately informed and/or failing to ask the right questions could form the basis of a breach by a director of the duty to exercise independent judgment, as well as the duty to exercise reasonable care, skill and diligence, as noted above.

(4) Also, as part of a director's duty to exercise independent judgment⁴⁵, directors are expected to critically evaluate any management / board committee report and/or independent expert advice received in respect of ESG considerations and the implications for the business. Where a director fails to consider, or through wilful neglect accepts, the conclusions made by relevant delegates or experts without independent review or consideration of the findings or advice received, this could likely lead to a breach of the director's duties.⁴⁶

(5) As noted in paragraph 15(1) above, the scope of directors' duties in relation to ESG considerations is partly shaped by the directors' duty to exercise reasonable care, skill and diligence. In this regard, a dual objective/subjective standard of care applies. Applying the objective element of this duty to a factual situation would require an assessment of what a reasonable director would do in that situation

to determine the expected conduct of a director. The constantly evolving ESG landscape (including, without limitation, regulatory, policy, competitive, technological, climate science, etc.) may affect what is reasonably expected of a reasonable director when assessing ESG considerations, as well as the foreseeability of any resulting losses from a breach of directors' duty. Directors should be mindful that the range and breadth of ESG-related obligations will undoubtedly expand, including through the adoption in Hong Kong of ISSB (which builds upon the TCFD framework).

(6) As noted in Sections B and C above, directors are subject to various ESG reporting obligations under Hong Kong laws and regulations. The Listing Rules require directors of listed companies to be responsible for the company's ESG reporting. With the rise in litigation cases and regulatory actions targeting greenwashing globally⁴⁷ (although we are not aware of any yet in Hong Kong) and the growing trend of regulators policing ESG disclosures⁴⁸, Hong Kong directors should be aware of and manage greenwashing and ESG litigation risk. In this context, we are of the view that directors should ensure that any ESG representations made in disclosures by the company are appropriate, true, accurate and not misleading and avoid any misstatements, critical omissions and greenwashing. Directors should also ensure that the company's financial statements and the accompanying directors' reports adequately and accurately reflect ESG risks and/or opportunities. These statements should provide a "true and fair" view of the company's financial position, performance and prospects as required under section 380 of the

44 See paragraph 5(4) of this analysis.

45 See paragraph 5(4) of this analysis.

46 Commonwealth Climate and Law Initiative, "Directors' Liability and Climate Risk: Comparative Paper – Australia, Canada, South Africa, and the United Kingdom", October 2019.

47 For instance, there have been recent claims in other jurisdictions against corporate directors, trustees, and other fiduciaries for failure to disclose climate transition risks, such as *O'Donnell v Commonwealth*, VID482/2020 (Federal Court of Australia), *Massachusetts v ExxonMobil*, 1984CV03333 (Mass. Super. Ct.), *Ramirez v Exxon Mobil Corp.*, 3:16-cv-3111 (N.D. Tex. Ct.) *New York v ExxonMobil*, 452044/2018 (N.Y. Sup. Ct.).

48 For instance, the US Securities and Exchange Commission set up its Climate and ESG Task Force in March 2021, where one of its missions is to seek out material ESG misstatements and disclosure gaps proactively.

Companies Ordinance.

17. There is no distinction between executive and non-executive directors insofar as directors' duties are concerned.⁴⁹ Non-executive directors should not, and are under a duty not to, merely rely on the judgment of the executive directors. To discharge their duty to exercise independent judgment, non-executive directors should take a proactive role in engaging with and understanding how the executive directors are assessing, monitoring and managing ESG considerations before making their own reasonable assessment of whether they would endorse executive directors' decisions.
18. Noting the subjective element of a director's duty to exercise reasonable care, skill and diligence, directors appointed to the board due to their special knowledge, skill or experience in ESG matters are subject to a higher standard of care commensurate with the director's qualifications. There are risks for a company that allocates to an existing board member responsibility for the company's ESG strategy, policies and procedures and/or a title that implies such responsibility, where the director has inadequate knowledge and access to capacity building and external advice.
19. Applying the business judgment rule illustrates the relative importance of the decision-making process over the resulting decision in evaluating whether a director has properly discharged their duties.⁵⁰ Whereas directors may exercise discretion in determining whether any particular ESG considerations are material, they must first engage in a proper decision-making process. Directors must demonstrate that decisions were made based on credible assumptions and a robust decision-making process and that they have applied appropriate diligence to pursue the company's interests in good faith.

Section E: Directors' Duties and ESG Considerations under the Laws of Other Jurisdictions

20. The law in other persuasive jurisdictions with respect to ESG considerations is substantively similar to Hong Kong.
21. Set out below are some additional ESG-related obligations imposed on directors in other jurisdictions which may potentially inform the evolution of the legal position in Hong Kong:
 - (1) Some jurisdictions have introduced express statutory provisions that either permit or obligate directors to consider ESG matters and stakeholder interests in discharging their fiduciary duties to the company. Examples include:
 - (a) Section 172 of the UK Companies Act 2006 imposes a clear affirmative duty on directors to consider a number of factors when discharging the duty to act in utmost good faith to promote the company's success. These factors include, among other things, the interests of employees, the impact of company operations on the community and environment, the need to foster the company's business relationships with suppliers, customers and others, and the importance of maintaining a reputation for high standards of business conduct. It should be noted that when developing the Companies Ordinance, which took effect in 2014, the Hong Kong government decided not to follow the UK's approach in codifying a more comprehensive range of directors' duties following public consultation,⁵¹ despite taking reference from and mirroring the UK Companies Act 2006 in many other

⁴⁹ *China Metal Recycling (Holdings) Ltd (in compulsory liquidation) and Another v Chun Chi Wai and Others* [2021] HKCU 747, where Liu J adopted Foster J's judgment in *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498.

⁵⁰ LaVoy, K., "A Board's Guide to Oversight of ESG", 22 July 2022, Harvard Law School Forum on Corporate Governance.

⁵¹ Financial Services and the Treasury Bureau, "Second Public Consultation on Companies Ordinance Rewrite", April 2008, at Chapter 3; Financial Services and the Treasury Bureau, "Rewrite of the Companies Ordinance: Consultation Conclusions on Company Names, Directors' Duties, Corporate Directorship and Registration of Charges", December 2008, at paragraphs 16-24.

respects. During the Cap. 622 consultation period the business community in Hong Kong expressed “*strong reservation*” against following the UK in widening directors’ duties, expressing the view that the concept of “*enlightened shareholder value*” was not yet widely accepted in Hong Kong. With sustainability and ESG now firmly embedded in Hong Kong’s policy objectives and regulatory landscape, and an increasingly important topic for Hong Kong companies and their directors, we believe that widening directors’ duties is inevitable.

- (b) In Canada, directors are permitted under section 122(1.1) of the Canada Business Corporations Act to have regard for the environment and stakeholders, such as employees and consumers, in their pursuit of the company’s best interests. This is framed as part of the requirement for directors to reflect on the interests of the corporation as an economic actor and a “good corporate citizen”.
- (c) Article 25 of the European Union’s proposed Corporate Sustainability Due Diligence Directive imposes a duty of care on directors to “*take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term*” when fulfilling their duty to act in the best interest of the company.

- (2) In the US, the seminal case of *Caremark*⁵² established that directors can be held liable under the duty of loyalty for a failure of oversight if (a) directors “*failed to implement any reporting or information system or controls*” or (b) despite such a system or

controls, the directors “*consciously failed to monitor or oversee its operations, thus disabling themselves from being informed of risks or problems requiring their attention*”. Consequently, as a part of directors’ fiduciary duties, the board of directors have a duty to make a good faith effort to implement an oversight system and related system of controls and monitor the corporation’s operational viability, legal compliance, and financial performance, failure of which may lead to liabilities.⁵³ Commentators consider that it is conceivable that the failure of directors to implement information systems and controls that allow board consideration of material ESG risks affecting the company or ignoring elements of ESG risk may lead to an inference that directors have deliberately shielded themselves from their oversight responsibilities.⁵⁴

- (3) Article 26 of the European Union’s proposed Corporate Sustainability Due Diligence Directive imposes an obligation on directors to put in place and oversee processes and policies for conducting human rights and environmental due diligence of company operations and give due consideration to relevant input from stakeholders and civil society organisations. A reporting mechanism is to be implemented at the board level. Directors must also adapt the company’s corporate strategy to consider the actual and potential adverse impacts identified under the due diligence exercises, and the remedial measures taken.
- (4) In the UK case of *ClientEarth v Board of Directors of Shell (2022)*, ClientEarth initiated an action against the Board of Directors of Shell for breach of directors’ duties under sections 172 and 174 of the Companies Act 2006 due to the Board of Directors’ failure to properly manage climate risks to Shell. According to

52 *In re Caremark Int’l Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

53 *Marchand v Barnhill*, 212 A.3d 805 (Del. 2019).

54 LaVoy, *supra* n.50.



ClientEarth, the Board of Directors has failed to adopt and implement a climate strategy that aligns with the Paris Agreement's climate

targets. The case is still in its early stages, and we will have to wait to see how this argument plays out.

Conclusions

22. Whether listed or not, directors of Hong Kong-incorporated companies are required to have regard to ESG risks and opportunities in the discharge of their duties. With sustainability and ESG now firmly embedded in Hong Kong's policy objectives and regulatory landscape, we believe that widening directors' duties for all Hong Kong listed companies, irrespective of place of incorporation, under the Listing Rules is inevitable.
23. As advisors to boards on governance related matters, governance professionals need to be well-equipped to ensure regular board consideration of ESG risks and their implications to the company's business. Directors might find it helpful to seek advice from governance professionals, including company secretaries, to ensure that consideration of ESG risks and implications is a regular agenda

- item. Boards and governance professionals are reminded to seek duly qualified assistance in respect of ESG matters where necessary.
24. The global ESG regulatory landscape continues to evolve and expand across jurisdictions. To enable directors to properly and continually discharge their ESG-related obligations in Hong Kong, directors would be well advised to keep ahead by staying informed of the direction of travel, such as via public statements by Hong Kong's regulators and policymakers and developments in other key jurisdictions. There is a great deal of publicly available information to inform directors. Our Institute will seek to provide helpful precedent or practical guidance on best practices and how to comply on ESG concerns.

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With over 70 years of history and as the Hong Kong/China Division of The Chartered Governance Institute (CGI), the Institute's reach and professional recognition extend to all of CGI's nine divisions, with more than 40,000 members and students worldwide. The Institute is one of the fastest growing divisions of CGI, with a current membership of over 6,800, 300 graduates and 3,000 students with significant representations within listed companies and other cross-industry governance functions.

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Core focus areas include ESG regulations and greenwashing, sustainable finance, green fintech, energy, carbon markets, climate change & decarbonisation, supply chain and impact funds. The firm advises clients, including listed corporates and regulated financial institutions, on a range of ESG-related legal and regulatory issues and helps clients explore opportunities to create value through ESG compliance and best practices. The firm delivers its unique law + ESG service jointly with Venturis (www.venturis.eco), a multidisciplinary sustainability strategy consulting firm.

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