

# HANSELL LLP

## **PUTTING CLIMATE CHANGE RISK ON THE BOARDROOM TABLE**

Climate change has been identified by the scientific community and accepted by world leaders as an existential threat. Governments and regulators in Canada and internationally have been engaged for many years in responding to the risks posed by climate change. The implications of climate change for the economy and individual businesses have been an important area of focus.

We have been asked whether directors of Canadian corporations are obliged to address climate change risk. The answer is clearly yes. Canadian courts have accepted climate change and the risks it presents as self-evident and uncontroversial, as has the investment community. It would be nearly impossible for a director to dismiss climate change risk out of hand.

The obligation of directors to consider the implications of climate change risk is grounded in the duties each director owes to the corporation he or she serves. In managing or overseeing the management of risk, directors must meet the objective standard of what a reasonably prudent person would do in comparable circumstances. Among other things, directors must put aside their own preconceptions about the reality or imminence of climate change risk. They may not demure to management and simply wait for presentations to be made to them. Directors must put climate change on the board agenda. They must require reports and recommendations from management and external sources as necessary, and be satisfied that the corporation is addressing climate change risk appropriately.

Directors must act with a view to the best interests of the corporation. This can be complex in application. The issues may be long term or short term and must be evaluated in the context of a shifting landscape. While the corporation is responding to climate change risk, so too are the corporation's customers, suppliers, employees and investors. Directors may take the interests of the corporation's stakeholders into account, but those interests may be different from one another. It falls to the directors to determine whose interests should prevail, but a judicial determination of this nature in the context of climate change risk is largely untested.

The governance tools necessary to deal with risk are well developed and readily adaptable to deal with climate change risk. Many Canadian boards are deeply engaged in climate change risk and provide exemplary leadership for other boards, both in Canada and abroad. Others must now begin their engagement with these complex issues.

## PART I - CONTEXT FOR THE BOARD

Climate change and the risks it poses have been well researched, documented and publicized. Certain of the most significant initiatives and commentary are discussed below.

### 1. International Context

#### (a) The Science

The United Nations established the International Panel on Climate Change ("IPCC") in 1988 to "provide the world with a clear scientific view on the state of knowledge in climate change and its potential environmental and socio-economic impacts."<sup>1</sup> Reflecting the consensus of more than 800 scientists, the IPCC reported that human activities have caused approximately 1.0°C of global warming above pre-industrial levels, and that global warming will reach 1.5°C as early as 2030 if it continues to increase at the current rate.<sup>2</sup> It has further reported that continued emission of greenhouse gases ("GHG") will cause further global warming, and that warming above 2°C, relative to the pre-industrial levels, "could lead to catastrophic economic and social consequences."<sup>3</sup>

#### (b) International Response

The IPCC's First Assessment Report, published in 1990, played a key part in the creation of the United Nations Framework Convention on Climate Change ("UNFCCC") in 1994.<sup>4</sup> The objective of the UNFCCC is the "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic human-induced interference with the climate system."<sup>5</sup> The Convention set non-binding limits on GHG emissions for individual countries, but contained no enforcement mechanisms. At their first conference in 1995, the parties to the UNFCCC agreed that a protocol to the convention was necessary to strengthen the commitments of the parties and to set quantified emission reduction objectives.<sup>6</sup> The Kyoto Protocol, adopted in 1997, established legally binding obligations for industrialized countries to reduce their overall

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<sup>1</sup> Justine Sullivan, "[The Intergovernmental Panel on Climate Change: 30 Years of Informing Global Climate Action](#)", *United Nations Foundation* (13 March 2018).

<sup>2</sup> Intergovernmental Panel on Climate Change, [Special Report: Global warming of 1.5°C – An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty](#), (2018) at A.1, B.4, B.5.

<sup>3</sup> Task Force on Climate Related Financial Disclosures, [Recommendation of the Task Force on Climate-related Financial Disclosures](#), (June 2017) at 1, referencing Intergovernmental Panel on Climate Change, *Fifth Assessment Report*, Cambridge University Press (2014).

<sup>4</sup> United Nations Treaty Collection, "[United Nations Framework Convention on Climate Change](#)", (accessed: 24 June 2020): The UNFCCC was opened for signature at the United Nations Conference on Environment and Development, known as the Rio de Janeiro Earth Summit, held from 4 to 14 June, 1992, where it was signed by 154 states and entered into force on March 21, 1994.

<sup>5</sup> United Nations Treaty Collection, [United Nations Framework Convention on Climate Change](#), (May 1992) at Article 2.

<sup>6</sup> Joanna Depledge, [Technical Paper: Tracing the Origins of the Kyoto Protocol](#), (November 2000) at 6.

GHG emissions by at least 5 per cent below 1990 levels by 2012 based on individualized emissions targets.<sup>7</sup>

In 2015, the 196 parties to the UNFCCC adopted the Paris Agreement. Under the agreement, all countries agreed to work to limit the increase in the global average temperature to well below 2°C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change.<sup>8</sup>

(c) Implications for Financial Stability

Former Bank of England Governor, Mark Carney, pulled the science of climate change into a business reality for many in a much quoted speech in 2015.<sup>9</sup> Governor Carney (then also the Chair of the Financial Stability Board (the "FSB")), outlined the three broad channels through which climate change can affect financial stability:

- physical risks (the impact on the value of financial assets arising from climate and weather-related events, such as floods and storms that damage property or disrupt trade);
- liability risks (the impact if parties who have suffered loss or damage from the effects of climate change seek compensation from those they hold responsible); and
- transition risks (financial risks which could result from the process of adjustment towards a lower-carbon economy which could prompt a reassessment of the value of a large range of assets as costs and opportunities become apparent).

Recognizing the implications of climate change, the G20 Finance Ministers and Central Bank Governors tasked the Financial Stability Board with a review of how the financial sector could better take account of climate change-related issues.<sup>10</sup> The FSB established the Task Force on Climate-related Financial Disclosures ("TCFD"), chaired by Michael Bloomberg. In its 2017 report, the TCFD stated (among other things) that one of the most significant risks that organizations face today relates to climate change, noting that the large-scale and long-term nature of the problem makes it uniquely challenging, especially in the context of economic decision making.<sup>11</sup>

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<sup>7</sup> United Nations Treaty Collection, [Kyoto Protocol to the United Nations Framework Convention on Climate Change](#), (December 1997) at Article 3.

<sup>8</sup> United Nations Treaty Collection, [Paris Agreement](#), (December 2015) at Article 2.

<sup>9</sup> Mark Carney (Governor of the Bank of England and Chairman of the Financial Stability Board), ["Breaking the Tragedy of the Horizon – climate change and financial stability"](#) (Speech at Lloyd's of London, 29 September 2015).

<sup>10</sup> Task Force on Climate Related Financial Disclosures, [Recommendation of the Task Force on Climate-related Financial Disclosures](#), (June 2017) at 1.

<sup>11</sup> *Ibid.*, at ii.

The TCFD's recommendations specifically deal with the governance of climate change risk and the role of the board:

- companies should disclose how they govern climate change risk, carbon emissions, emissions intensity, and their metrics and targets; and
- companies should disclose the board's role in climate change risk management.

The TCFD continues to promote and monitor the adoption of its recommendations with a view towards climate-related risks (and opportunities) becoming a natural part of companies' risk management and strategic planning processes.<sup>12</sup> In September 2018, the TCFD released its first status report to the FSB noting that more than 500 firms, with a combined market capitalisation of over \$7.9 trillion USD, supported its recommendations (as compared to just over 100 firms that supported the recommendations when they were first released in June 2017).<sup>13</sup> For its second status report in June 2019, the TCFD reviewed the reports of over 1,000 companies over a three-year period and conducted a survey on companies' efforts to implement its recommendations.<sup>14</sup> While the percentage of companies disclosing climate-related financial information had increased, the review and survey results indicated that:

- too few companies are disclosing decision-useful climate-related financial information and the level of disclosure remains insufficient for investors;
- companies need to provide more clarity around the potential financial impact of climate-related issues on their business; and
- companies that use scenarios analysis to assess the resilience of their strategies do not disclose information on the resilience of their strategies.<sup>15</sup>

The TCFD's next status report to the FSB is expected in September 2020.

## **2. Impact of Climate Change for Canada**

### **2.1 The Science**

The Government of Canada reported in 2019 that Canada had in the past warmed at double the magnitude of global warming – with northern Canada warming by more than double the global rate.<sup>16</sup> This was projected to continue. As climate change intensifies, snow, sea ice and glacier coverage will decrease, resulting in rising sea levels and increased coastal flooding, and coastal erosion. Overall precipitation levels are expected to increase across most of the country and during all seasons, with increased flooding, except for parts of southern Canada. Heat waves are likely to increase in frequency and severity, resulting in higher risks of forest fires and many more wildlife species being at risk. Human health impacts include:

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<sup>12</sup> Task Force on Climate-related Financial Disclosures, [2018 Status Report](#), (September 2018) at iv.

<sup>13</sup> *Ibid.*

<sup>14</sup> Task Force on Climate-related Financial Disclosures, [2019 Status Report](#), (June 2019) at iv.

<sup>15</sup> *Ibid.*

<sup>16</sup> Government of Canada, [Canada's Changing Climate Report – Headline Statements](#), (2019).

- increased risk of deaths from dehydration and heat stroke, and injuries from intense local weather changes;
- greater risk of respiratory and cardiovascular problems and certain types of cancers with rising temperatures rise and exacerbated air pollution; and
- risk of water-, food-, vector- and rodent-borne diseases may increase (vulnerable populations such as children and the elderly expected to be the most affected).

## 2.2 Implications for the Canadian Economy

The Canadian government has also reported on the economic impacts of climate change including:

- challenges for agriculture, forestry, tourism and recreation industries as a result of changing weather patterns;
- additional economic stress on health and social support systems; and
- damage to infrastructure such as roads and bridges caused by extreme weather events, thawing permafrost and rising sea levels.<sup>17</sup>

The Bank of Canada has acknowledged that "climate change itself and actions to address it will have material and pervasive effects on Canada's economy and financial system"<sup>18</sup> and has reported that it is incorporating climate change risk into its analysis of the Canadian economy and financial system.<sup>19</sup>

In 2018 the federal government created the Expert Panel on Sustainable Finance to consider how climate change and finance issues should be addressed in Canada. The Expert Panel (chaired by the now Governor of the Bank of Canada, Tiff Macklem), spent more than a year studying and consulting on the climate change issue from a Canadian perspective. The Expert Panel's Final Report,<sup>20</sup> released on June 14, 2019, made fifteen recommendations "focused on spurring the essential market activities, behaviours and structures needed to bring sustainable finance into the mainstream."<sup>21</sup> Among other things, the Expert Panel recommended the development of a Canadian approach to implementing the recommendations of the TCFD.<sup>22</sup>

The Expert Panel also recommended that the federal government clarify that fiduciary duty in the context of climate change does not preclude the consideration of relevant climate change factors.<sup>23</sup>

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<sup>17</sup> Government of Canada, "[Greenhouse gas emissions: drivers and impacts](#)" (updated 9 June 2020).

<sup>18</sup> Timothy Lane (Deputy Governor of the Bank of Canada), "[Thermometer rising- climate change and Canada's economic future](#)" (Remarks delivered at the Finance and Sustainability Initiative, Montreal, Quebec, 2 March 2017).

<sup>19</sup> Bank of Canada, "[Financial System Review – 2019](#)", (9 May 2019).

<sup>20</sup> Government of Canada, Expert Panel on Sustainable Finance, "[Final Report of the Expert Panel on Sustainable Finance: Mobilizing Finance for Sustainable Growth](#)" (14 June 2019).

<sup>21</sup> *Ibid*, at iv.

<sup>22</sup> *Ibid*, at 14-18.

<sup>23</sup> *Ibid*, at 20.

More specifically, it recommended that the Minister of Finance issue a statement that consideration of climate factors is within the remit of fiduciary duty.<sup>24</sup> The Expert Panel also recommended that the government establish climate-related disclosure legislation for federally-regulated pension plans, and encouraged provincial regulators to consider similar requirements. In addition, the Expert Panel also recommended that the federal government, provinces, and relevant regulators work together to clarify the materiality of climate-related financial disclosures.<sup>25</sup>

### 3. What Canadian Courts Have Said

Canadian courts consider climate change risk as uncontroversial and beyond reasonable dispute.<sup>26</sup> They have taken judicial notice of the existence of climate change and its impact. In other words, courts have accepted the existence of climate change risk without the need for litigants to prove the point. In the recent reference cases regarding the constitutionality of the Canadian federal government's legislation to regulate GHGs, the appellate courts in Alberta, Ontario and Saskatchewan each acknowledged the risk presented by climate change.<sup>27</sup> The Alberta Court of Appeal, for example, stated: "The dangers of climate change are undoubted as are the risks flowing from failure to meet the essential challenge."<sup>28</sup> The Court of Appeal for Ontario stated that anthropogenic climate change poses an existential threat to human civilization.<sup>29</sup> In another matter, the Federal Court held that the *Renewable Fuels Regulations*<sup>30</sup> were not *ultra vires* the federal government. In its decision, the Federal Court accepted that "[t]he evil of global climate change and the apprehension of harm resulting from the enabling of climate change through the combustion of fossil fuels has been widely discussed and debated by leaders on the international stage. Contrary to [the applicant]'s submission, this is a real, measured evil, and the harm has been well documented."<sup>31</sup> In yet another matter, *Reference re Environmental Management Act (British*

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<sup>24</sup> *Ibid*, at 20-21.

<sup>25</sup> *Ibid*, at 19-20.

<sup>26</sup> Brenda Powell and Josephine Yam, "[Judicial Notice of Climate Change](#)", (Paper delivered at the Symposium on Environment in the Courtroom: Evidentiary Issues in Environmental Prosecutions and Hearings, University of Calgary, 6-7 March 2015).

<sup>27</sup> In [Reference re Greenhouse Gas Pollution Pricing Act](#), 2019 ONCA 544, and [Reference re Greenhouse Gas Pollution Pricing Act](#), 2019 SKCA 40, the Courts of Appeal for Ontario and for Saskatchewan found the federal legislation regulating GHGs to be within the jurisdiction of the federal government. In [Reference re Greenhouse Gas Pollution Pricing Act](#), 2020 ABCA 74, the Court of Appeal of Alberta found the same legislation to be *ultra vires* the federal government and therefore unconstitutional. A hearing before the Supreme Court of Canada on all three cases is forthcoming (see: Supreme Court of Canada, "[SCC Case Information – Docket – 38663](#)" (accessed 18 June 2020)). Note that the Supreme Court of Canada has previously held environmental legislation to be *ultra vires* the province, where it restricted the possession and control of oil transported through the province ([Reference re Environmental Management Act \(British Columbia\)](#), 2020 SCC 1, aff'g [2019 BCCA 181](#)).

<sup>28</sup> [Reference re Greenhouse Gas Pollution Pricing Act](#), 2020 ABCA 74 at para 1.

<sup>29</sup> [Reference re Greenhouse Gas Pollution Pricing Act](#), 2019 ONCA 544 at para 104.

<sup>30</sup> [Renewable Fuels Regulations](#), SOR/2010-189. The Federal Court found that the regulations were not *ultra vires* the federal government.

<sup>31</sup> [Synkrude Canada Ltd. v Canada \(Attorney General\)](#), 2014 FC 776 at para 83, aff'd, [2016 FCA 160](#).

*Columbia*), the Court of Appeal for British Columbia considered provincial legislation restricting the transportation of oil between provinces. The Court of Appeal noted at the outset of its reasons that "[t]he protection of the environment is one of the driving challenges of our time. No part of the world is now untouched by the need for such protection; no government may ignore it; no industry may claim immunity from its constraints."<sup>32</sup>

#### **4. Institutional Investors**

The risks presented by climate change for the economy and for individual businesses have been broadly acknowledged. Canadian institutional investors have noted that climate change is not a distant threat, but a current investment risk that can impact long-term investment values.<sup>33</sup> This section provides some context about the institutional shareholders in Canada and the way in which they influence the management and governance of climate change risk in the organizations in which they invest.

##### **4.1 Institutional Investors and Proxy Advisors in Canada**

Institutional investors include pension funds, custodians, banks and fund managers who invest funds belonging to others. As discussed below, institutional investors make their views on these issues known through their public statements (including proxy voting guidelines) and through their dealings with individual organizations. The Canadian Coalition for Good Governance ("CCGG") represents the interests of institutional investors. Its research, policies and engagement initiatives on behalf of its members have significant influence in the Canadian capital markets.

Proxy advisory firms (Institutional Shareholder Services ("ISS") and Glass Lewis in Canada) provide a variety of services to institutional investor clients. Among other things, they analyze proxy materials and provide voting recommendations on matters put before the shareholders in organizations in which their clients invest. Some institutional investors adopt the proxy voting guidelines developed by the proxy advisor (sometimes with modifications) and routinely vote in accordance with the proxy advisor's guidelines and recommendations. Other institutional investors make their voting decisions based on their own proxy voting guidelines and analysis, but use the analysis and recommendations of the proxy advisors as a resource. Like institutional investors, proxy advisors publish their proxy voting guidelines, giving issuers a line of sight into how the actions or inactions of the issuer will affect shareholder support for the organization and its directors.

##### **4.2 The Significance of Climate Change for Investors**

Climate change is sometimes addressed by institutional investors under the topic of ESG (Environmental, Social and Governance) which are generally non-financial factors that can have a material impact on an organization's performance and long term prospects. In many other cases, institutional investors refer to climate change risk specifically. Investors also refer to responsible

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<sup>32</sup> *Reference re Environmental Management Act (British Columbia)*, [2019 BCCA 181](#), at para 1, aff'd [2020 SCC 1](#).

<sup>33</sup> Caisse de dépôt et placement du Québec, *Climate Change* (accessed 19 March 2020); CPP Investment Board, *2019 Report on Sustainable Investing*, (6 November 2019) at 38.

or sustainable investing. It is important to distinguish these concepts from the concept corporate social responsibility.

Corporate social responsibility (or CSR) is used by some to mean an organization's commitment to being a responsible corporate citizen regardless of the profit motive. Others reconcile responsible corporate citizenship and profitability – the corporation's regard for the environment and respect for human rights benefits the communities in which the corporation operates, but also gives the corporation the ability to continue to operate in those communities. In either case, the focus is on what the corporation is doing to the environment and the communities in which it operates.

There are of course many investors for whom a corporation's sense of social responsibility is an important factor. The discussion in this paper, in particular with respect to the views of institutional investors, however, relates not to what organizations do to the earth, but rather what the earth is doing to the organization. Recognizing that climate change presents well documented risks, investors want to know how the organizations in which they invest are managing these risks.

### **4.3 How Institutional Investors Express Their Views on Climate Change Risk**

Investors give action to their view on climate change risk in a variety of ways, as discussed below.

#### **4.3.1 Investment Decisions**

Institutional investors consider ESG issues, including climate change risk in making investment decisions.<sup>34</sup> Some explicitly factor climate change risk into every investment decision, while others consider broadly ESG factors that are likely to have an impact on long-term risk and return. The way in which an organization handles and discloses climate change risks can influence investor decisions and, accordingly, can affect the organization's cost of capital.

#### **4.3.2 Ongoing Engagement**

Institutional investors engage companies in which they invest on climate change issues. These engagements include discussions about investees' strategy and governance of climate-related risks and related disclosure practices.<sup>35</sup>

#### **4.3.3 Recommended Framework**

As discussed below, a number of frameworks have been developed over the last number of decades to help organizations deal with climate change risk. There has been uncertainty among public issuers about which framework they should adopt – and in particular, which framework would be

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<sup>34</sup> CPP Investment Board, [2019 Report on Sustainable Investing](#), (6 November 2019) at 6; Ontario Teachers' Pension Plan, [2018 Climate Change Report](#), at 1; OMERS, [Sustainable Investing Policy](#), (effective 1 January 2020); Alberta Investment Management Corporation, [Responsible Investment Report 2018-2019](#), (1 October 2019) at 7; Caisse de dépôt et placement du Québec, [Climate Change](#) (accessed 19 March 2020); British Columbia Investment Management Corporation, [2019 ESG Annual Report](#), at 5, 9; Public Sector Pension Investment Board, [2019 Responsible Investment Report](#), at 15.

<sup>35</sup> See: Alberta Investment Management Corporation, [Responsible Investment Report 2018-2019](#), (1 October 2019) at 30; CPP Investment Board, [2019 Report on Sustainable Investing](#), (6 November 2019) at 39.



most acceptable to institutional investors. Now, many institutional investors encourage issuers to adopt the TCFD disclosure framework.<sup>36</sup> The CCGG has also endorsed the TCFD framework.

#### 4.3.4 Shareholder Proposals

Shareholders have the right to express their views and, in some cases, influence corporate behavior, through the shareholder proposal mechanism. This allows shareholders to put issues on the agenda of shareholder meetings (subject to some restrictions).<sup>37</sup>

Climate change has been the subject of shareholder proposals for many years. Shareholder proposals address climate change in numerous ways, including: seeking corporate disclosure in line with the TCFD framework; seeking disclosure of how a company intends to meet the targets established by the Paris Agreement; seeking analysis of climate change risk (and disclosure of the analysis); and seeking adoption of targets for the reduction of GHGs.

The number of shareholder proposals dealing with climate change risk has increased significantly over the last decade. In 2003, proposals calling for increased disclosure on greenhouse gas emissions were submitted at three TSX-listed companies' annual shareholder meetings.<sup>38</sup> Between 2018 and 2020 to date, 25 shareholder proposals addressing climate change-related issues were submitted at TSX-listed companies' annual meetings. Of these proposals, eight (32%) have proceeded to a vote and 17 (68%) were withdrawn by the proponent following discussions with the company. Of the eight proposals submitted to a vote, four (50%) received majority support from shareholders.<sup>39</sup>

Canada's large institutional investors have provided specific guidance regarding their support for shareholder proposals dealing with climate change.<sup>40</sup> CPPIB encourages companies to implement the recommendations of the TCFD and supports shareholder proposals that do so. CPPIB also supports proposals that request the review of environmental factors that are likely to enhance long-term corporate performance or mitigate environmental risk.<sup>41</sup> While examining shareholder proposals on a case by case basis, OMERS has stated that it generally supports proposals that

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<sup>36</sup> See: British Columbia Investment Management Corporation, [ESG Engagement in Public Markets: Our Priorities, Objectives & Processes](#), (2019) at 5; Caisse de dépôt et placement du Québec, [2018 Stewardship Investing](#), at 15, Alberta Investment Management Corporation, [Proxy Voting Guidelines & Corporate Governance Principles](#), (January 2020), at 15; CPP Investment Board, [Proxy Voting Principles and Guidelines](#), (13 February 2020), at 27.

<sup>37</sup> [Canada Business Corporations Act](#), RSC 1985, c. c-44, s 137.

<sup>38</sup> The proposals were submitted at Imperial Oil Ltd., IPSCO Inc., and Petro-Canada. These proposals were identified using SHARE's [shareholder proposal database](#).

<sup>39</sup> These proposals were identified through our internal data collection. The successful proposals were at iA Financial Corp. Inc. in 2020 (two proposals), Ovintiv Inc. in 2020, and TC Energy Corp. in 2018.

<sup>40</sup> See: CPP Investment Board, [Proxy Voting Principles and Guidelines](#), (13 February 2020) at 27; OMERS, [Proxy Voting Guidelines](#), (accessed 19 March 2020); Alberta Investment Management Corporation, [Proxy Voting Guidelines & Corporate Governance Principles](#), (January 2020) at 15; Public Sector Pension Investment Board, [Proxy Voting Guidelines](#), (November 2017) at 40.

<sup>41</sup> CPP Investment Board, [Proxy Voting Principles and Guidelines](#), (13 February 2020) at 27.

encourage ESG disclosure to assist investors in assessing how corporate decisions contribute or detract from investment performance.<sup>42</sup>

Proxy advisors have also called for enhanced environmental disclosure, and, in certain circumstances, for more prescriptive proposals. ISS assesses how a climate change-related shareholder proposal may enhance or protect shareholder value in either the short term or long term.<sup>43</sup> Proposals are considered on a case-by-case basis and ISS may consider a wide range of factors in determining a voting recommendation. Glass Lewis (depending on a company's specific circumstances) may support proposals calling for disclosure regarding climate change emissions strategies, compliance with disclosure regimes such as TCFD, or proposals calling for the adoption of an emissions reduction goal.<sup>44</sup>

#### 4.3.5 Accountability of Directors

Institutional investors consider material climate change as a board level responsibility. As such, an organization's handling of climate change risk can inform the director election votes of some institutional investors.<sup>45</sup> The Ontario Teachers' Pension Plan ("OTPP") has called out the accountability of the board of directors with respect to climate change risk, noting, that where a company's climate change risks are material, it is the responsibility of the whole board to oversee these risks.<sup>46</sup> Some institutional investors have explicitly committed to voting against directors of companies that fail to address climate change risk. OTPP states: "We will take a case by case approach when assessing a board's approach to overseeing climate change risk and, depending on circumstances, will consider not supporting individual director(s), chair(s), or committee(s) when we determine that a board has not taken appropriate action to effectively oversee a company's relevant climate change related risks."<sup>47</sup> The British Columbia Investment Management Corporation states that it will vote against the "chair or all returning members of the relevant committee who, in [its] view, have not effectively performed this critical function [environmental and social risk management] and corporate performance has been unsatisfactory."<sup>48</sup>

Glass Lewis considers environmental and social risk oversight as part of its voting guidelines for the election of directors, and "may consider recommending that shareholders vote against members of the board who are responsible for oversight of environmental and social risks" where the company "has not properly managed or mitigated environmental or social risks to the detriment of

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<sup>42</sup> OMERS, [Proxy Voting Guidelines](#), (accessed 11 June 2020).

<sup>43</sup> Institutional Shareholder Services, [Proxy Voting Guidelines for TSX-Listed Companies](#), (2019) at 45.

<sup>44</sup> Glass Lewis, [2020 Guidelines – Shareholder Initiatives](#), (2019) at 18-19.

<sup>45</sup> This is the case internationally, as well as in Canada. For example, BlackRock has announced that it will vote against directors of companies who are not managing climate change risks, while State Street will vote against directors of companies under some circumstances. See: BlackRock Inc., [A Fundamental Reshaping of Finance](#), Letter from Larry Fink to CEOs (January 2020) and State Street Global Advisors, [CEO's Letter on our 2020 Proxy Voting Agenda](#), Letter from Cyrus Taraporevala to Board Members (28 January 2020).

<sup>46</sup> Ontario Teachers' Pension Plan, [2020 Corporate Governance Principles and Proxy Voting Guidelines](#), at 25.

<sup>47</sup> *Ibid.*

<sup>48</sup> British Columbia Investment Management Corporation, [Proxy Voting Guidelines](#), (2019) at 9.

shareholder value, or when such mismanagement has threatened shareholder value."<sup>49</sup> While ISS does not explicitly include environmental concerns as part of its baseline proxy voting advisory service, its sustainability guidelines provide that it may recommend shareholders vote withhold "for directors individually, on a committee, or potentially the entire board" including where the board oversaw "[m]aterial failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company, including failure to adequately manage or mitigate environmental, social and governance (ESG) risks" or where ISS identifies "[a] lack of sustainability reporting in the company's public documents and/or website in conjunction with a failure to adequately manage or mitigate ESG risks."<sup>50</sup>

## **PART II - CLIMATE CHANGE RISK MANAGEMENT**

Having established that climate change and the risks it poses to business are widely known and accepted, we turn to the legal standard for directors in connection with these risks. The directors' duty of care and the case law interpreting that standard make it clear that corporate directors must be engaged in the management of climate change risk.

### **5. The Board's Oversight of Risk**

In most commercial enterprises, the board oversees risk management, rather than managing risk directly. We discuss below what oversight means, the importance of risk management and the legal standard that directors must meet in discharging their duty of oversight with respect to risk management.

#### **5.1 What Oversight Means**

Corporate law charges directors with the responsibility for managing or supervising the management of the business and affairs of the corporation. While the board may delegate much of its authority to management, that delegation does not absolve directors from responsibility. Directors retain responsibility for the business through their duty to oversee management's discharge of the authority delegated to it.

In discharging this duty of oversight, directors are entitled to rely, in good faith, on management. "Good faith reliance" means, among other things, that the directors have no reason to doubt that management is being forthright and candid with them. They must, however, be satisfied that they have the information they need to perform their oversight responsibilities. This includes having reporting systems in place that will allow them to monitor management performance and will alert them to issues that may require closer board scrutiny.

An Ontario court provided the following guidance in respect of the director's oversight function in the context of the organization's compliance with environmental laws:

- The directors are responsible for reviewing the environmental compliance reports provided by the officers of the corporation, but are justified in placing *reasonable* reliance on reports provided to them by corporate officers, consultants, counsel or other informed parties.

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<sup>49</sup> Glass Lewis, [2020 Guidelines – Shareholder Initiatives](#), (2019) at 20.

<sup>50</sup> Institutional Shareholder Services, [Sustainability Proxy Voting Guidelines](#), (21 January 2020) at 8.

- The directors should substantiate that the officers are promptly addressing environmental concerns brought to their attention by government agencies or other concerned parties, including shareholders.
- The directors should be aware of the standards of their industry, and other industries which deal with similar environmental pollutants or risks.
- The directors should immediately and personally react when they have noticed the system has failed.<sup>51</sup>

## 5.2 Importance of Risk Management

Managing the business of a corporation necessarily involves dealing with the risks facing the business of the corporation. It is common practice for the board to delegate responsibility for risk to management. Management identifies risks and develops risk management strategies, often within an enterprise-wide risk management framework. Management may report to one or more board committees on various aspects of the risks facing the corporation as well as to the board as a whole.

Courts and regulators have been prepared to scrutinize an organization's approach to risk management. In the 1992 decision of the Ontario Securities Commission in the Standard Trustco matter, the Commission was critical of the directors for the way in which they monitored risk. The decision refers to the board's failure to recognize the increased risk involved in certain business activities. It also mentions the board's failure to recognize that the financial information they were receiving suggested that management was not following the company's accrual policy or its policy of obtaining appraisals.

*The directors were also aware or should have been aware that some of the mortgage lending activities in which the company was involved, such as participation lending, involved more risk than single family mortgages and that they did not have a long track record in such lending.* Also, the directors should have seen from the OSFI package that the arrears were increasing rather dramatically; in OSFI's view the loan loss provision was substantially understated; a number of the appraisals on mortgaged properties were old *which suggested that management was not always following the company's policy of obtaining appraisals* on properties in respect of which legal proceedings had been taken; and in several cases the balance outstanding was in excess of what was shown as the estimated value *which suggested that management might not be following the company's accrual policy.*<sup>52</sup>

In the context of the 2008 financial crisis, an Ontario court traced a bank's potential breach of its disclosure obligations to a poor risk management strategy. The court stated:

This raises the question of why this risk was not anticipated when CIBC acquired its subprime portfolio and why appropriate risk management strategies – including appropriate hedges – were not put in place at that time. *It also raises the question of whether appropriate risk management strategies should have addressed the challenges of valuation and disclosure that would be encountered during the 'worse case' scenario.* The evidence suggests that CIBC was left struggling to respond to these challenges as the tidal wave of the subprime crisis was breaking on the beaches. *Even once-in-a-century tsunamis can be anticipated. The degree of damage they can inflict make it all the more critical to anticipate and prepare for them. Had*

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<sup>51</sup> *R v Bata Industries Ltd.*, 1992 CarswellOnt 211 at para 147, 9 OR (3d) 329 (Ont Ct J (Prov Div)). [Emphasis added.]

<sup>52</sup> *Standard Trustco Ltd., Re*, 1992 CarswellOnt 140, 15 OSCB 4322 (OSC).

*CIBC anticipated the tail risk, it could have prepared itself to respond to the issues it would face in the heat of the crisis.*<sup>53</sup> [Emphasis added]

There are several points to note in this passage as having application to the management of climate change risk. The court referred to the evaluation of 'worse case' scenarios as part of an appropriate risk management strategy. It also noted that organizations should anticipate and prepare for material events that may not be imminent or frequently occurring (such as a once-in-a-century tsunami). In addition, it points to the failure of the organization to put appropriate risk management strategies in place when it acquired a new line of business (in this case, a subprime portfolio).

## **6. Director's Duty of Care - How Would a Reasonably Prudent Person Oversee Climate Change Risk?**

In exercising their powers and discharging their responsibilities, every director must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. This is the duty of care as set out in most Canadian corporate statutes. The duty of care sets an objective standard of performance of each director. This is different from the director's fiduciary duty (discussed below), which is concerned with the subjective motivations of the director.<sup>54</sup> Even directors who are skeptical about the climate change risk alarms being sounded by international organizations and governments must be informed by more than their personal views on the risks facing the corporation.

In this section, we look at the three elements of the duty of care in the context of climate change risk. The duty of care requires each director to exercise *care, diligence and skill*, but to what standard? That question is answered by the next phrase in the test – a director must exercise the care, diligence and skill *that a reasonably prudent person would exercise*. The third element of the test takes into account the context in which a director is required to act – he or she must do what a reasonably prudent person would do *in comparable circumstances*.

### **6.1 Care, Diligence and Skill**

"Care, diligence and skill" deals with the means and methods that the director uses to fulfill his or her responsibility. The words care, diligence and skill have not been defined by the courts in cases dealing with the director's duty of care and, accordingly, we ascribe the ordinary meaning to each of these words. In describing the standard of performance of corporate directors, the Supreme Court said simply, directors must "be diligent in supervising and managing the corporation's affairs."<sup>55</sup>

The concepts of care and diligence speak to the time and effort that a director devotes in order to make an informed business judgment. Directors who are being careful and diligent ask themselves whether they are considering the appropriate issues and whether they have the information they need in order to make the necessary decisions. They consider the information they receive

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<sup>53</sup> [Green v Canadian Imperial Bank of Commerce](#), 2012 ONSC 3637 at para 421, var'd on other grounds [2014 ONCA 90](#), appeal ref'd [2015 SCC 60](#). [Emphasis added.]

<sup>54</sup> [Peoples Department Stores Inc. \(Trustee of\) v Wise](#), 2004 SCC 68 at para 63.

<sup>55</sup> *Ibid*, at para 32.

critically. They attend and engage in board and committee discussions, and question management, outside advisors and board committee reports until they are satisfied with the responses they receive. The courts have faulted directors for not seeking sufficient information upon which to ground a reasonable judgment. On the other hand, the courts have found a board chair blameless when a reporting system he had put in place failed to alert him to a problem, because the court found that the board chair could not have known that the reporting system was not reliable.<sup>56</sup>

The concept of skill speaks to the expertise and experience of the individual director. Every director brings a different set of skills to the table, an important consideration in developing the composition of any board. Depending on the nature of the business, an organization may need financial, operating, legal, human resources, logistics and communications skills (to name just a few) at the board level. It may also require expertise in particular markets or experience with organizations in different phases of growth. It is nearly impossible to find a director who has all of the skills that a corporation needs at the board level for the entire time the director is on the board. The legal standard cannot require a director to apply skills that he or she does not have, but it can require a director to apply the skills that he or she does have to the work of the board.

## **6.2 The Reasonably Prudent Person**

What degree of "care, diligence and skill" must directors exercise? The statutes provide that they must exercise the care, diligence and skill that "a reasonably prudent person" would exercise in comparable circumstances. The words "reasonably prudent" mean that directors will not be held to a standard of infallibility and need not be extraordinarily conservative or cautious in their judgement. The standard of a "reasonably prudent person" accepts that risk is an unavoidable element of running a business and outcomes will not always be positive. The standard expected of a director is reasonableness, not perfection.

## **6.3 In Comparable Circumstances**

What a reasonably prudent person would do is modified by the phrase "in comparable circumstances". This phrase does not relate to the competence of the director, but rather to the context in which the director was acting.<sup>57</sup> Directors must make reasonable business decisions in light of all of the circumstances about which the directors knew or ought to have known.<sup>58</sup>

The Supreme Court of Canada has referred to the phrase "in comparable circumstances" as establishing a "contextual approach" allowing directors to take into account prevailing socio-economic conditions, as well as the primary facts. The well-publicized socio-economic implications of climate change risk support the argument that a reasonably prudent person in circumstances comparable to those facing directors today would address the climate change risk facing the corporation and its business. Evidence of the risk has been known and accepted for many years. Information about how the risk might affect the corporation is increasingly available or obtainable in most cases.

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<sup>56</sup> *R v Bata Industries Ltd.*, 1992 CarswellOnt 211 at para 157, 9 OR (3d) 329 (Ont Ct J (Prov Div)).

<sup>57</sup> *Peoples Department Stores Inc. (Trustee of) v Wise*, 2004 SCC 68 at para 62.

<sup>58</sup> *Ibid*, at para 67.

## 7. Certain Duty of Care Issues

### 7.1 Are Some Directors Subject to a Higher Standard than Others?

Even though directors make decisions collectively, as a board, the duty of care is owed by each individual director. Accordingly, it is possible for one director to have discharged his or her duty appropriately and for another director not to have done so. In an extreme example, one might expect that a director who never reads the board materials or engages in board discussions would find it difficult to make the case that he or she is exercising the care, diligence or skill that a reasonably prudent person would exercise. A director who is thorough, thoughtful and engaged would better be able to prove that he or she satisfied the duty of care.

The concern is sometimes expressed that directors with particular expertise will be held to a higher standard than their board colleagues. As discussed above, there is one statutory duty of care which applies to all directors. A reasonably prudent person would apply the skill he or she has in the role as a director, as the duty of care requires. Accordingly, a CPA would bring greater financial expertise to the work of the board than someone with no financial training and would be expected to use that expertise as a director. As boards consider identifying new directors who understand climate change risk, they should of course also expect that directors recruited for that skill set will apply their expertise to the work of the board.

Another concern sometimes expressed is that directors who sit on committees are subject to a higher standard than those who do not sit on those committees. If there is an issue with the financial statements, will members of the audit committee be subject to a higher standard than those who are not on the audit committee? Again, there is a single duty of care that applies to all directors. Members of the audit committee may have more insight into the financial statements than other board members because of the time they spend reviewing those statements and discussing them with management, the internal auditor and the external auditor. However, a reasonably prudent person in comparable circumstances would use the information he or she receives as a member of the audit committee in exercising the powers and discharging the responsibilities of a director. Similarly, directors to whom particular responsibility for climate change risk is delegated are expected to incorporate the additional information they receive on the topic into their work on the board.

### 7.2 To Whom is the Duty of Care Owed?

While a director's fiduciary duty is owed solely to the corporation, the corporate statutes do not specify the beneficiary of a director's duty of care. The fiduciary duty and duty of care are set out as follows in the *Canada Business Corporations Act* and most other Canadian corporate statutes:

122 (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

(a) act honestly and in good faith with *a view to the best interests of the corporation*; and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. [Emphasis added]

The fiduciary duty (set out in section 122(1)(a)) refers to the best interests of the corporation. There is no question that directors owe their duty of care to the corporation. Importantly, the duty of care

(set out in section 122(1)(b)) does not refer to the corporation at all. This leaves open the possibility that directors may owe a duty of care to someone other than the corporation.

The Supreme Court of Canada has found that creditors are also obvious beneficiaries of the directors' duty of care.

Indeed, unlike the statement of the fiduciary duty in s. 122(1)(a) of the CBCA, which specifies that directors and officers must act with a view to the best interests of the corporation, the statement of the duty of care in s. 122(1)(b) of the CBCA does not specifically refer to an identifiable party as the beneficiary of the duty. Instead, it provides that "[e]very director and officer of a corporation in exercising his powers and discharging his duties shall ... exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." *Thus, the identity of the beneficiary of the duty of care is much more open-ended, and it appears obvious that it must include creditors.*<sup>59</sup> [Emphasis added]

In a subsequent decision, the Supreme Court referred to the persons to whom directors could potentially owe a duty of care as "other stakeholders" more broadly.

A second remedy lies against the directors in a civil action for breach of duty of care. As noted, s. 122(1)(b) of the CBCA requires directors and officers of a corporation to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". *This duty, unlike the s. 122(1)(a) fiduciary duty, is not owed solely to the corporation, and thus may be the basis for liability to other stakeholders in accordance with principles governing the law of tort and extracontractual liability: Peoples Department Stores. Section 122(1)(b) does not provide an independent foundation for claims.* However, applying the principles of *The Queen in right of Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205, courts may take this statutory provision into account as to the standard of behaviour that should reasonably be expected.<sup>60</sup> [Emphasis added]

The principles of tort and extracontractual liability in the passage above require the stakeholder to make the case that the directors owed the stakeholder a duty, that the duty was breached and that the stakeholder suffered damage as a result. A claim of this nature would raise important legal and policy issues. Based on the two decisions of the Supreme Court discussed above, a stakeholder who was able to make out such a claim could look to the director's statutory duty of care as the standard by which the actions of each director should be measured.

## **8. Director's Fiduciary Duty and Consideration of the Interests of the Corporation's Stakeholders**

Directors must act honestly and in good faith, with a view to the best interest of the corporation (the fiduciary duty). The Supreme Court of Canada has been clear that directors must take the long-term interests of the corporation into account. "The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation."<sup>61</sup>

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<sup>59</sup> *Ibid*, at para 57.

<sup>60</sup> [\*BCE Inc. v 1976 Debentureholders\*](#), 2008 SCC 69 at para 44.

<sup>61</sup> *Ibid*, at para 38.



While the best interests of the corporation may be co-extensive with the best interests of the stakeholders, the directors owe their fiduciary duty to the corporation, and not to any stakeholders, including shareholders. The director's duty is to act in the best interests of the corporation.

However, within the concept of the "best interest of the corporation", it is well established that in discharging their fiduciary duty to the corporation, directors may also consider the interests of the corporation's stakeholders. When the corporation's stakeholders have competing interests, it is up to the board to determine whose interest will be prioritized, provided that any action taken does not compromise the interests of the corporation. The federal corporate statute specifically permits directors to consider the environment when considering the best interests of the corporation.

## **9. How Courts Assess the Decisions Made by Directors – The Business Judgment Rule**

Courts will defer to the reasonable business judgment of disinterested directors who have followed an appropriate process. This is referred to as the business judgment rule.

Importantly, the courts have held that although the board's decisions will not be subject to microscopic examination by the courts, they will be subject to examination. A court will consider the context of directors' decisions and the extent of the information on which they were based and will measure this against the facts as they existed at the time. If a decision cannot be attributed to a rational business purpose, if directors have made an unintelligent or unadvised judgment, or if they have otherwise been unduly passive, the courts will not defer to the judgment of the directors. Boards must engage in a reasoned analysis before making decisions. Doing so requires directors to inform themselves about the material facts relating to those decisions and, where circumstances warrant, make inquiries to evaluate and seek advice about the information presented to them.

## **PART III - BOARD OVERSIGHT OF DISCLOSURE**

The disclosure requirements for Canadian public companies are discussed below, as are the frameworks that have been developed to help companies with their disclosure.

### **10. Importance of Climate Change Risk Disclosure**

Scientific information and economic analysis published by international organizations about the impact of climate change are often at a macro level. The risks and opportunities that climate change present for individual businesses must be identified by each business. This is of course critical for management and the board to be able to manage those risks and take advantage of those opportunities. It is also important information for the corporation's financial stakeholders.

The TCFD noted that "while climate change affects nearly all economic sectors, the level and type of exposure and the impact of climate-related risks differs by sector, industry, geography and organization[.]"<sup>62</sup> If investors are misinformed or unaware of climate change risks and opportunities, "investors and others are likely to collectively misprice assets and systematically misallocate capital, threatening financial stability and profit."<sup>63</sup>

### **11. Disclosure Issues**

The global issue of climate change can crystalize at the level of individual corporations in their climate change related disclosure. Public issuers, in particular, are being prompted to examine climate change issues as they represent material risks for the corporation. Disclosure can thus impact both what a corporation discloses externally and how it operates internally. These disclosures also have important legal consequences, including potential liability.

#### **11.1 Global Disclosure Initiatives**

There are number of global initiatives promoting voluntary sustainability reporting that provide guidance to directors and officers. Several of those initiatives are discussed below.

In 1997, the Coalition for Environmentally Responsible Economies and the United Nations Environment Program launched the Global Reporting Initiative ("GRI") to develop reporting guidelines for the "triple bottom line" accounting for economic, environmental and social performance. The goal was to establish sustainability reporting as rigorous as financial reporting. As a result, there was a growth in voluntary corporate sustainability reports through the 1990s.

The International Integrated Reporting Council ("IIRC"), a global coalition of regulators, investors, companies, and others, established the International Integrated Reporting Framework, which is designed to communicate how a company's strategy, governance, performance and prospects, taking into consideration its external environment, lead to the creation of value over the short, medium and long-term.

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<sup>62</sup> Task Force on Climate Related Financial Disclosures, [\*Recommendation of the Task Force on Climate-related Financial Disclosures\*](#), (June 2017) at 8, referencing Sustainability Accounting Standards Board research.

<sup>63</sup> UNEP Finance Initiative, [\*Changing Course: A Comprehensive Investor Guide to Scenario-Based Methods for Climate Risk Assessment, in Response to the TCFD\*](#), (May 2019) at 17.

The Sustainability Accounting Standards Board ("SASB"), a non-profit organization that provides accounting standards for use by publicly-listed corporations in the U.S. SASB developed sustainability accounting metrics or indicators – both qualitative and quantitative – that express a fair representation or "account for" company performance on material sustainability topics, and ensure that reasonable investors have access to the "total mix" of information in their decision-making process.<sup>64</sup>

In 2017, the TCFD's Final Report set out a framework around four thematic areas that are core elements of how organizations operate: governance, strategy, risk management, and metrics and targets. The Final Report also sets out how its recommendations aligns with other frameworks that an organization may have adopted or may be considering adopting.

The International Business Council of the World Economic Forum in January 2020 released a draft consultation framework for disclosure of ESG issues, which draws from and attempts to consolidate existing standards and disclosure frameworks (GRI, SASB, TCFD, among others).

## 11.2 Public Company Disclosure Requirements

Public companies have disclosure obligations that include disclosing the risks facing the corporation. An Ontario court noted that "[a]n issuer is required to provide a balanced discussion of its results of operations and financial condition 'including, without limitation, such considerations as liquidity and capital resources – openly reporting bad news as well as good news.' [...] [A]n investor is entitled to know what specific risks are presently threatening the company."<sup>65</sup>

Canadian securities regulators issued guidance more than a decade ago stating that disclosure in respect of climate change and environmental issues is an aspect of issuers' existing disclosure obligations. In 2019 they acknowledged that "[c]limate change-related risks are a mainstream business issue"<sup>66</sup> and directed board and management to "take appropriate steps to understand and assess the materiality of these risks to their business."<sup>67</sup>

Canadian securities regulators have been reviewing the way in which issuers disclose climate change risk. In 2017, the Alberta Securities Commission agreed to review a complaint submitted by Greenpeace seeking to prevent a public offering by alleging that Kinder Morgan Canada Ltd. ("Kinder Morgan") failed to provide full, true, and plain disclosure of all material facts in a preliminary prospectus. The complaint alleged that Kinder Morgan misled investors by failing to fully disclose climate change risks. Greenpeace made a subsequent complaint about Kinder Morgan's annual report, grounding its complaint in an evaluation of the disclosure against the TCFD framework. The results of these complaints have not been disclosed, but it is worth noting their existence.

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<sup>64</sup> BlackRock expects to see companies in which it invests make climate change risk disclosures in line with SASB and TCFD frameworks.

<sup>65</sup> [Green v Canadian Imperial Bank of Commerce](#), 2012 ONSC 3637 at para 32, var'd on other grounds [2014 ONCA 90](#), appeal ref'd [2015 SCC 60](#).

<sup>66</sup> CSA Staff Notice 51-358, [Reporting of Climate Change-related Risks](#), (1 August 2019) at 2.

<sup>67</sup> *Ibid*, at 3.

In the U.S., the Securities and Exchange Commission ("SEC") has published guidance for public companies on disclosure related to climate change. Like the Canadian Securities Administrators, the SEC guidance confirmed that climate change risks are to be considered and disclosed as part of public companies' existing disclosure obligations. The SEC has continued to signal its focus on climate change in the context of disclosure.

### **11.3 Other Regulated Industries**

Other regulators, including the Office of the Superintendent of Financial Institutions ("OSFI") are also addressing the risk that climate change poses for the organizations they regulate. OSFI has noted that financial assets most affected by the transition to policies aimed at reducing carbon emissions are:

- investments directly impacted by measures reducing carbon use, such as oil and gas and utilities, and
- investments where changes are influenced by the higher cost of using fossil fuels, such as transportation and industrial production.

OSFI is requiring all insurers to quantify their exposure and develop strategic approaches for making the transition to fewer carbon-linked assets.

### **11.4 Potential Liability Relating to Disclosure**

As is the case for any disclosure, misrepresentations about climate change risk can expose the corporation, its officers and its directors to both regulatory and civil liability. In respect of potential civil liability, an important factor for directors is that investors need not be aware of a misrepresentation about climate change to seek damages based on it; securities law deems them to have relied on the misrepresentations.

Directors should also be aware that their decisions about disclosure are not protected by the business judgment rule. The Supreme Court of Canada considered a claim by shareholders that Danier Leather Inc. had made a misrepresentation in a financial forecast included in a prospectus. At the outset of its analysis, the Court described the purpose of the disclosure obligation, being to ensure that investors are provided with relevant information about companies to inform their investment decisions. The Court considered the nature of the disclosure requirements and concluded that, "while forecasting is a matter of business judgment, disclosure is a matter of legal obligation. The Business Judgment Rule is a concept well-developed in the context of business decisions but should not be used to qualify or undermine the duty of disclosure."<sup>68</sup>

In another instance, the Ontario Superior Court of Justice stated that if the bank "...failed to equip itself with the appropriate tools to assess and control the risks associated with its subprime investments and to accurately value those investments in the collapsing market of the Class Period, its ability to make appropriate judgments about the disclosure of its positions would necessarily

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<sup>68</sup> [\*Kerr v Danier Leather Inc.\*, 2007 SCC 44 at para 54.](#)

be impaired."<sup>69</sup> While this decision did not determine liability, it is significant that the Court held that the claims based on disclosure breaches, anchored in operational failures to adequately assess and manage a risk, had a reasonable possibility of success.

The issue of liability for climate related disclosure has also been dealt with by U.S. courts. In 2019, the Supreme Court of the State of New York considered a claim by the Attorney General of the State of New York against ExxonMobil alleging that the company had materially misrepresented and omitted information from its public disclosure about how it managed the risks of climate change and increasing regulations. Essentially, ExxonMobil was accused of disclosing different values in respect of the risk posed by climate change regulation from those used for its internal decision making. The judge found that the Attorney General "failed to prove by a preponderance of the evidence that ExxonMobil made any material misrepresentations that 'would have been viewed by a reasonable investor as having significantly altered the 'total mix' of information made available."<sup>70</sup> While this judge dismissed the claim against ExxonMobil, the finding that it was not material leaves open the possibility that such a claim could succeed with other factual underpinnings, where the disclosure was material.

In another complaint dated October 24, 2019, filed in the Massachusetts Superior Court, the Attorney General for the Commonwealth of Massachusetts filed a lawsuit against ExxonMobil under the State's Consumer Protection Act, alleging that the company systematically and intentionally misled investors and consumers about material climate change risks to its business and the impact its fossil fuel products have on climate change. That case continues to work its way through the courts.

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<sup>69</sup> [Green v Canadian Imperial Bank of Commerce](#), 2012 ONSC 3637 at para 463, var'd on other grounds [2014 ONCA 90](#), appeal ref'd [2015 SCC 60](#).

<sup>70</sup> [People of the State of New York v Exxon Mobil Corporation](#), index no 452044/2018 at 3 (NY SC).

## **PART IV - BOARD GOVERNANCE OF CLIMATE CHANGE RISK**

How a board deals with climate change risk is not prescribed in detail, but rather, is a question of the governance adopted by the organization and its board. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. There is no universal approach to climate change risk management. Boards, like courts, will need to take a contextual approach to devise the structures and systems that are appropriate for their corporation.

### **12. Putting Climate Change Risk on the Boardroom Table**

Who should put the issue of climate change risk on the board agenda? In many cases, management is already reporting to the board on the risks that climate change poses for the organization and the board is actively engaged in the issue. In other cases, management is dealing with climate change risk, but has not elevated it to a board level issue. In some cases, management may not yet be addressing climate change risk (or not addressing it adequately).

Since there can be little doubt that directors are aware of climate change risk, they must inform themselves of the risk that climate change poses to the corporation and how that risk is being managed. If this information is not already included in management reports to the board, the board should direct management to deliver the necessary information to them.

This is not to say that action on climate change is necessarily imperative for every corporation. SASB, working with industry representatives, has identified material climate change risk in 72 of 79 industries. In our view, boards have a positive obligation to consider the issue in all instances, however. A director may conclude that the corporation need take no action with respect to climate change, but the director must base that conclusion on a careful and diligent review of the relevant factors. Following that review, the director's business judgement may be that climate change does not pose any material risk to the corporation. If the actions of the board are challenged, a court will examine whether that business judgement was reasonable.

### **13. Governance Tools**

The board and individual directors have an important role to play in setting the tone in the corporation. There are a number of ways for directors to do this. Enhancing the skills of the board with respect to the climate change risks relevant to the corporation is an important first step. This can take the form of seminars developed for the board, led by management and outside experts. Beyond the scheduled programs, directors should receive detailed briefings on the relevant issues as they arise in order to build the board's understanding of the issues. Making room in the board agenda for regular reports from management on climate change risk is an important part of the board's oversight of risk, but also sends a clear message to management that climate change risk is a priority. The board might consider conducting an internal assessment or inventory to see how the corporation is currently engaging with climate change as an issue.

The board should consider the resources that the corporation has to address the risks posed by climate change. Directors should be satisfied that the corporation has the expertise to assess

climate change risk or that management is retaining consultants to supplement corporate knowledge.

Each of the board's committees should consider climate change risk in the context of their mandates. Audit committees will need to consider how climate change risk impacts financial reporting and may also be responsible for overseeing other forms of climate change risk reporting. Compensation committees may consider aligning management objectives and incentives with the corporation's progress in addressing climate change risk. The governance committee may look at the governance of climate change risk in the organization as well as the corporation's approach to climate change risk disclosure. The disclosure of climate change issues can help to focus the board's attention on the matter and prompt the board to consider ways to include climate change as an issue subject to its oversight. The board may also consider the role climate change should play in its engagement with stakeholders, as well as being aware of what others in their industry are doing on the issues.

The board as a whole should integrate climate change risk into its work plan. Strategy, in particular long-term strategy, is perhaps the most important and obvious area of focus. As the board oversees the strategic planning process, it will be important to consider how climate change risks (both transition risks and physical risks) could challenge the corporation's success in executing its strategy. Consideration of the opportunities that climate change presents is also relevant.

Finally, directors should be alert to compliance issues. Governments will continue to take steps to meet their international obligations and to otherwise mitigate the risks posed by climate change. This may create new cost and compliance challenges. For some corporations, it may also present opportunities.

A great deal of guidance has been published on the governance of ESG matters, including climate change risk. The CCGG, for instance, has published *The Directors' E&S Guidebook* which provides practical guidance for boards in dealing with environmental and social issues.

## **PART V - IN SUMMARY**

### **14. Conclusions**

Based on the analysis in this paper, we emphasize the following:

- The fact of climate change and the risks that it poses for the planet have been well researched, documented and publicized.
- The implications of climate change for the global economy, for financial stability and for individual businesses have been called out by governments, central bankers, expert panels, investors and by many corporations.
- Directors have a clear responsibility to be informed about the risks that climate change poses for the business of the corporation they serve and to be satisfied that those risks are being appropriately managed.
- The director's fiduciary duty is not an obstacle in dealing with climate change risk. Directors have the authority to consider the interests of the corporation's stakeholders.
- For public companies, disclosure about the risks that climate change poses for the organization is important. Directors do not need interpreters to understand what kind of disclosure investors require. Investors are open and engaged with organizations about their disclosure needs. In Canada, many institutional investors and the CCGG have endorsed the TCFD framework.

### **15. Recommendations for Directors**

Directors should recognize that the courts, regulators and investors accept that climate change poses real risks. They expect that management teams and boards are alert to those risks and opportunities and are reflecting their assessment of that risk in their strategic thinking and risk management practices. Directors must put aside any preconceptions they may have about the reality or imminence of the risk. They may not be demure to management or simply wait for management to identify and bring the issue forward. Rather, they must put climate change on the board agenda as more than just a discussion point or an education session. They must then receive reports and recommendations from management and reports from external sources as necessary, to be satisfied that the corporation is addressing climate change risk appropriately. Among other things, directors should:

- Keep abreast of what the science is saying and how it affects the organization's business.
- Talk to management about how it is currently dealing with climate change risk. In many cases, management has the issue well in hand, but has not elevated it to the board level. Directors should work with management to bring the issues and strategies to the board with the appropriate level of detail.
- Listen to investors. They devote enormous resources to understanding the risks associated with climate change and have informed views about the governance and management of those risks.



- Hear from your investor relations professionals about what investors are saying about your industry and your organization in respect of climate change risk and what they recommend to communicate the organization's message effectively.
- Focus on your disclosure, both to meet the needs of the investment community and to satisfy legal requirements.
- Integrate climate change risk into the work of the board beyond formal risk management and compliance.

Above all, understand that it remains the responsibility of the board to be satisfied that it is properly informed about the climate change risks facing the organization and the way in which those risks are being managed.

June 2020

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### **About the Firm**

Hansell LLP is a team of lawyers and other professionals grounded in corporate and securities law. We are governance experts with extensive experience in corporate transactions, commercial litigation, regulatory enforcement and compliance. We have acted for the full range of corporate and market stakeholders.

Hansell LLP is part of the Hansell McLaughlin Advisory Group. Hansell McLaughlin has senior level expertise in law, governance, government and regulatory affairs and strategic communications, complemented by expertise in data science and analytics. Our integrated thinking results in strategies and solutions that reflect the complexity of the challenges facing our clients.

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