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Climate Change-Related Risks: A New Liability Risk for Corporate Directors and Officers?

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Environmental liability for directors and officers is well established. Federal and provincial statutes in Canada impose statutory duties on directors and officers to take all reasonable care to prevent the corporation from contravening environmental legislation.[1] Directors and officers have also been held civilly liable under causes of action such as negligence, nuisance, and strict liability for environmental harms.[2]

Director and officer liability for climate change-related risks is less clear. Even in the middle of the Covid-19 pandemic, concerns remain about climate change. Investors continue to closely track climate change disclosure and associated corporate governance practices.[3] Inadequate disclosure of climate change risk, coupled with a lack of good governance, could be the basis for a new wave of liability for corporate directors and officers.

D&O LIABILITY IN THE ENVIRONMENTAL CONTEXT

In the regulatory context, directors' and officers' environmental liability is baked into environmental legislation. For example, under the *Environmental Protection Act* ("EPA"), directors and officers who fail to take all reasonable care to prevent the corporation from discharging contaminants in contravention of the EPA are guilty of an offence.[4] The EPA also authorizes the issuance of regulatory orders to address harm caused by environmental contamination.[5] Where a person owns or owned, or has or had

1 See e.g. *Environmental Protection Act*, RSO 1990, c E 19, s 194 [EPA]; *Ontario Water Resources Act*, RSO 1990, c O 40, s 116; *Canadian Environmental Protection Act, 1999*, SC 1999, c 33, s 280.1.

2 See e.g. *Midwest Properties Ltd v Thordarson*, 2015 ONCA 819.

3 Principles for Responsible Investment, "What are the Principles for Responsible Investment?", online: https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment.

4 EPA, *supra* note 1, s 194(2).

5 *Ibid*, s 18.

management or control of an undertaking or property, he or she may be subject to such an order. Corporate directors and officers are presumed to have management and control of the corporation.[6] As such, directors and officers may be named in orders issued by regulators such as the Ontario Ministry of Environment, Conservation and Parks to address environmental contamination.

Courts have upheld regulatory orders issued to directors and officers in a number of cases. For example, in *Baker v Ministry of the Environment*,[7] Northstar Aerospace Inc. was ordered to remediate contamination caused by its operations. Following Northstar's bankruptcy, the Ministry of the Environment and Climate Change (as it then was) issued an order to the former directors of Northstar to continue with the remedial work. The directors brought a motion to stay the order. The Divisional Court denied the motion, holding that the directors were responsible for continuing the remediation work.[8] The directors eventually reached a $4.75M settlement with the Ministry to be released from the order.

In the civil context, courts have held directors and officers liable for environmental contamination under various causes of action. For example, in *Midwest Properties Ltd v Thordarson*,[9] the Ontario Court of Appeal held the company and its director liable for petroleum hydrocarbon contamination that had migrated onto a neighbour's property. In *Midwest*, liability was grounded in nuisance, negligence, and the statutory cause of action under s. 99(2) of the EPA. The Court of Appeal ordered the company and its director to pay remediation costs as well as punitive damages.

POTENTIAL WAVE OF D&O LIABILITY FOR CLIMATE CHANGE RISKS

With ongoing public concern about climate change, directors and officers could face a new wave of climate change-related liability. Such liability could arise where directors and/or officers fail to take all reasonable care to address or mitigate climate change-related risks relating to corporate activities. Climate change risks include physical risks (e.g. extreme weather events or shifts in climate patterns) and transitional risks (e.g. changes in markets, regulations, policies, and technologies related to a shift towards a low-carbon economy).[10] Investors concerned about these risks are increasingly looking at two factors in making investment decisions: (1) corporate disclosure and (2) good corporate governance.

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6 *Caltex Petroleum Inc v Ontario (Ministry of Environment and Energy)*, 1995 OEAB No 75 at 7–8, aff'd 1998 OJ No 825 (Div Ct).
7 2013 ONSC 4142.
8 *Ibid*.
9 *Supra* note 2.
10 Canadian Securities Administrators, CSA Staff Notice 51-358: Reporting of Climate Change-related Risks (1 August 2019) at 10–11, online: https://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20190801_51-358_reporting-of-climate-change-related-risks.pdf.

Corporate Disclosure of Climate Change-Related Risks

Given the potential risks and liabilities associated with climate change, investors:

- are increasingly focused on the adequacy of corporate disclosure respecting climate change-related risks[11]
- are seeking improved disclosure on material risks, opportunities, financial impacts, and corporate governance processes related to climate change,[12] and
- may seek to hold corporations and their directors and officers accountable if such disclosures are inadequate.

For example, in a Unites States case, *Ramirez v Exxon Mobil Corp*,[13] an investor filed a securities fraud class action against Exxon Mobil Corp. and three of Exxon's officers in the Federal Court for the Northern District of Texas. The claim alleged that Exxon's public statements during the period from February to October 2016 were materially false and misleading. The class action further alleged that[14]

- Exxon had failed to disclose climate change-related risk
- Exxon used an inaccurate price of carbon to calculate the value of certain oil and gas prospects, and
- as a result of Exxon's disclosures, the common stock price was artificially inflated.

Exxon brought a motion asking the Federal Court to dismiss the class action. Exxon argued that its disclosure was not false or misleading and that the claim did not adequately plead fraudulent intent or loss causation.[15] The Federal Court allowed the claim to proceed against Exxon.[16] Exxon brought a subsequent motion asking the Court to reconsider, which was also dismissed.[17] The case is ongoing and could have important implications for directors and officers, particularly if the plaintiffs are successful.

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11 *Ibid* at 1.
12 *Ibid*.
13 N.D. Tex, Docket number: 3:16-cv-3111.
14 Climate Chase Chart, "Ramirez v. Exxon Mobil Corp", http://climatecasechart.com/case/ramirez-v-exxon-mobil-corp/?cn-reloaded=1.
15 *Ibid*.
16 *Ibid*.
17 *Ibid*.

Apart from potential civil liability, large-scale investors can inflict damage by deciding to pull their investments where they feel corporations have not adequately addressed climate change-related risks. For example, ahead of Rio Tinto's annual meeting, some investors tabled a shareholder motion to improve the mining company's "weak" climate goals.[18] Rio Tinto had announced that its indirect emissions from the generation of purchased energy consumed by a company, such as electricity, would be 15% lower by 2030 than 2018 levels.[19] Proxy investor Institutional Shareholder Services ("ISS") recommended that shareholders support the resolution that asks Rio Tinto to also tackle emissions generated by customers through the use of its products. ISS noted that shareholders "have a long-term interest in assessing whether Rio Tinto is adequately assessing and acting on its climate risk and opportunities".[20]

In August 2019, the Canadian Securities Administrators released Staff Notice 51-358 to provide guidance to corporations about climate change-related risk reporting.[21] For information about this guidance, see our article "A Changing Climate around Reporting: Canadian Securities Regulator Provides Guidance on Reporting Climate Change-Related Risks".

Lenders and other organizations are also relying on internationally accepted standards such as the IFC Performance Standards,[22] the Equator Principles,[23] and the Task Force on Climate-Related Financial Disclosure ("TCFD") recommendations.[24] These standards provide guidance on the development of climate-related disclosures. For example, the TCFD recommendations provide that disclosure should include four themes:

1 governance: the organization's governance around climate-related risks and opportunities

2 strategy: the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy and financial planning

3 risk management: the process used by the organization to identify, assess and manage climate-related risks, and

[18] Cecilia Jamasmie, "Rio Tinto's top investors face off over emissions cut plan" (5 May 2020), https://www.mining.com/rio-tintos-top-investors-face-off-over-emissions-cut-plan/.
[19] *Ibid*.
[20] *Ibid*.
[21] Canadian Securities Administrators, *supra* note 10.
[22] International Finance Corporation, "Performance Standards on Environmental and Social Sustainability" (1 January 2012), online: https://www.ifc.org/wps/wcm/connect/24e6bfc3-5de3-444d-be9b-226188c95454/PS_English_2012_Full-Document.pdf?MOD=AJPERES&CVID=jkV-X6h.
[23] Equator Principles, online: https://equator-principles.com/about/352/.
[24] Recommendations of the Task Force on Climate-Related Financial Disclosures: Final Report, online: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf.

4 metrics and targets: the metrics and targets used to assess and manage relevant climate-related risks and opportunities.[25]

Financial institutions are collaborating to address challenges related to risk identification, scenario analysis, data sources, and standardization of disclosure practice. One financial institution representative has commented that they are starting to see that companies with stronger environmental, social and governance ("ESG") factors are weathering the Covid-19 crisis better than companies that have weaker ESG.[26]

Climate change-related risks can be difficult to assess and quantify. Given that Ontario's *Securities Act*[27] creates a statutory right of action for purchasers of securities in the secondary market for misrepresentations contained in an issuer's continuous disclosure documents and oral public statements,[28] entities may be reluctant to provide forward-looking information. However, the *Securities Act* also contains a "safe harbour" provision – a defence to civil liability for misrepresentations in forward-looking information. A person or company will not be liable if they can prove certain circumstances were present, including that:

1 the document or statement contained reasonable cautionary language and a statement of the material factors that were relied on, and

2 the person or company had a reasonable basis for making the forecasts and projections.[29]

Good Governance

Investors are also concerned with corporate governance. Directors have a duty of care and must exercise the care, diligence, and skill of a reasonably prudent person in comparable circumstances.[30] Directors also have a fiduciary duty to act in the best interests of the corporation.[31] The *Canada Business Corporation Act* ("CBCA") sets out factors that directors and officers may consider when exercising this duty. In 2019, the CBCA was amended to add the environment and the long-term interests of the

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[25] *Ibid* at v.
[26] Rebekah Church, Senior Advisor, Sustainability and Climate Change, Legal & Regulatory Compliance, BMO Financial Group, at the Ontario Bar Association's panel on Climate Change and Corporate Social Responsibility (28 April 2020).
[27] RSO 1990, c S5.
[28] *Ibid*, s 138.3.
[29] *Ibid*, s 138.4(9).
[30] *Canada Business Corporations Act*, RSC 1985, c C-44, s 122(1)(b) [CBCA]; *Business Corporations Act*, RSO 1990, c B16, s 134(1)(b); *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at paras 36–37.
[31] CBCA, *supra* note 30, s 122(1)(a), *Business Corporations Act*, *supra* note 30, s 134(1)(a).

corporation as factors to consider.[32] Diligent directors will want to consider and assess the risks that climate change pose to their business to ensure compliance with their fiduciary duties.

Corporate commitment and investment can also impact good governance. For example, when speaking about what is needed to "get sustainability going", former CEO of Coca-Cola Enterprises John Brock stated, "[i]f you have the personal commitment but aren't willing to invest the time, money, and resources, it's not going to happen. And if you don't have the personal commitment, even if you invest the time, money and resources, it won't happen."[33]

Ensuring good governance may require directors to look to established frameworks for best practices, such as the Principles for Responsible Investment[34] or the United Nations' Guiding Principles on Business and Human Rights.[35] These principles may influence the fiduciary duties that directors and officers owe to their shareholders.

Bearing in mind these Principles, boards of directors should consider five key questions in assessing best practices relating to climate change:

1. Does the board have a climate plan to identify and manage climate change-related risks?

2. Does the board have effective oversight of its climate strategy, including identifying climate-related risks that are emerging?

3. Has the board identified strategic opportunities to address climate-related risks over the short, medium, and long-term?

4. Who in the company is responsible for climate-related risk and implementing the company's climate strategy?

5. Is the board reviewing and approving the disclosure of the company's efforts to manage climate change?[36]

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32 CBCA, *supra* note 30, s 122(1.1).
33 CB Bhattacharya, "Taking Ownership of a Sustainable Future", McKinsey Quarterly (May 2020) at 4.
34 Principles for Responsible Investment, online: https://www.unpri.org/pri/about-the-pri.
35 United Nations Human Rights, Office of the High Commissioner, "Guiding Principles of Business and Human Rights (2011), online: https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.
36 Janis Sarra and Cynthia A Williams, "Good Governance: Understanding the New Realities" (3 February 2020).

While courts have yet to hold directors and officers personally liable for inadequate disclosure of climate change-related risks, cases such as the U.S. *Exxon* case suggest that such liability may be emerging. It will become increasingly important for directors and officers to establish and prove their diligence around climate change-related risks. As a result, directors and officers will want to review their climate change-related disclosure obligations, develop and implement a plan to address these obligations, and regularly evaluate the efficacy of their company's climate strategy.

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