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CANADA:

COUNTRY SUMMARY ON CLIMATE CHANGE FINANCIAL RISK

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1. Introduction

a) Context - Climate change as a material financial risk

Climate change represents a significant risk in financial and other markets; it could substantially affect the valuation of many publicly listed companies and place some investment portfolios at risk.² As 195 countries agreed in December 2015 in the first fully-global climate change agreement (“COP 21”), there is an urgent need to reduce annual emissions of greenhouse gases (GHG) by 2020 to survive as a planet.³ In Canada, while there is leadership by some governments, businesses and pension funds, many others lag in identifying and addressing climate change financial risk.⁴

Canadian fiduciaries face the challenge that Canada’s fossil fuel sector generates 7.7% of Canada’s GDP,⁵ but 21.7% of Alberta’s GDP; 17.9% of Saskatchewan’s; and 19.7% of Newfoundland and Labrador’s.⁶ Canada exports approximately \$85 billion in value of crude oil, refined petroleum products and natural gas annually.⁷ Oil production in Canada increased by over 50% in the past decade.⁸ Canada’s predicted 1.26 million barrel/day increase in production by 2040 mainly comes from oil sands production.⁹ Consumption is an important part of the challenge.¹⁰ The oil and gas sector is the largest GHG emitter in Canada, accounting for 26% of total GHG emissions, followed closely by the transportation sector, which emits 24% of total emissions. The oil sands alone account for 9.3% of Canada’s total GHG emissions.¹¹

The impact of climate change on Canadian cities is not yet as visible as it is in the far north of our country, far away from population centres; yet Canada has a higher rate of warming than most

¹ For a comprehensive discussion, see the working papers that formed the basis for this country study: Janis Sarra, Peter Allard School of Law, UBC, “Fiduciary Obligations in Business and Investment: Implications of Climate Change”, October 2017; and Cynthia Williams and Jordan Routliff, Osgoode Hall Law School, York University, “Disclosure of Information Concerning Climate Change: Liability Risks and Opportunities”, October 2017. Our sincere thank you to the Ivey Foundation for funding support for this research.

² World Economic Forum, “The Global Risks Report 2017”, <http://reports.weforum.org/global-risks-2017/>.

³ United Nations Framework Convention on Climate Change, Conference of the Parties (“COP21”), December 2015.

⁴ Howard Covington and Raj Thamotheram, “The Case for Forceful Stewardship”, 2015, SSRN-id2551478.

⁵ Natural Resources Canada, “Energy Factbook 2016-2017”, https://www.nrcan.gc.ca/sites/www.nrcan.gc.ca/files/energy/pdf/EnergyFactBook_2016_17_En.pdf, at 5.

⁶ *Ibid.* at 6.

⁷ *Ibid.*

⁸ L McKeown *et al.*, “Canada’s shifting sands: Oil production, distribution and implications, 2005 to 2014”, Statistics Canada (12 July 2016), <http://www.statcan.gc.ca/pub/16-002-x/2016002/article/14629-eng.pdf>, at 1.

⁹ US Energy Information Association, *International Energy Outlook 2017*, September 2017, www.eia.gov/ieo at 40, 44.

¹⁰ Government of Canada, Pan-Canadian Framework on Clean Growth and Climate Change, 9 December 2016, <https://www.canada.ca/en/services/environment/weather/climatechange/pan-canadian-framework.html>.

¹¹ EIA, *Energy Fact Book 2016-2017*, *supra* note 5 at 35. Janis Sarra and Sally Aitken, “A Greener Future”, in P Tortell, M Young and P Nemetz, eds, *Reflections of Canada* (Vancouver, UBC, 2017) at 24-32.

other regions of the world.¹² Since Canada’s economy is heavily dependent on the very resources that generate some of the most egregious GHG emissions, our capital markets are directly implicated in both the risk-generating activity and the potential to mitigate the risks.

Pension funds, which safeguard the financial security of our aging population, will potentially lose significant value of their investments if Canada does not shift the existing fossil fuel trajectory of our economy very soon.¹³ That shift includes both decarbonizing efforts and technological improvement in fossil fuel extraction and production.

There are mismatched timelines between capital markets’ need for profit, directors’ and officers’ obligations to act in the best interests of the company, and Canada’s need for long-term sustainability of its economy.¹⁴ Bank of England Governor Mark Carney has called climate risk a “tragedy of the horizon”, in that the most serious consequences of today’s emissions will eventuate beyond the time-frame of current business and regulatory cycles. He has observed that: “the catastrophic impacts of climate change will be felt beyond the traditional horizons of most actors – imposing a cost on future generations that the current generation has no direct incentive to fix.”¹⁵ Given that challenge, he encouraged the Financial Stability Board (“FSB”) to establish “an industry-led group, a Climate Disclosure Task Force, to design and deliver a voluntary standard for disclosure” of climate-related information.¹⁶

The FSB did establish the Task Force on Climate-Related Financial Disclosures (“TCFD”), which has reported that climate-related risks fall into two major categories: (1) risks related to the transition to a lower-carbon economy and (2) risks related to the physical impacts of climate change.¹⁷ It suggests that transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change; and such risks pose varying levels of financial and reputational risk to organizations. Policy aimed at constraining actions that contribute to the adverse effects of climate change, or aimed at promoting adaptation to climate change, include: “implementing carbon-pricing mechanisms to reduce GHG emissions, shifting energy use toward lower emission sources, adopting energy-efficiency solutions, . . .and promoting more sustainable land-use practices.”¹⁸

Canada has yet to expressly adopt climate-related disclosure requirements in its securities legislation. However, arguably, materiality requirements already require such disclosures, given the importance of climate-related financial risk to most businesses in Canada. This moment in time presents an important opportunity to shift the trajectory of our efforts to address climate change risk.

¹² Government of Canada, Impacts of Climate Change, 27 November 2015,

<http://climatechange.gc.ca/default.asp?lang=En&n=036D9756-1>

¹³ Janis Sarra, “The Anthropocene at the Time of Trump”, 2017.

¹⁴ *Ibid.*

¹⁵ Mark Carney, “Breaking the Tragedy of the Horizon- climate change and financial stability”, Bank of England (29 September 2015), <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx#> at 3 [“Carney”].

¹⁶ *Ibid.* at 14.

¹⁷ Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017), <https://www.fsb-tcfd.org/publications/final-recommendations-report/> at 5 [“TCFD Final Report”].

¹⁸ *Ibid.*

b) Brief overview of relevant fiduciary precepts – duties of trust/loyalty and competence

Corporate and pension laws, as currently framed in Canada, create a fiduciary obligation in respect of climate change. In fulfilling their duty to act in the best interests of companies, directors and officers have an obligation to identify and address climate-related financial risk.¹⁹ Pension and other investment fiduciaries, in fulfilling their obligations to beneficiaries, have an obligation to identify and address climate-related financial risk.²⁰ There are both statutory provisions and a highly developed jurisprudence on fiduciary obligations in the business context in Canada. While the legislation governing corporate directors and officers, and that governing pension funds and other institutional investors, have different parameters, one point of intersection is the scope of fiduciary obligation, and more specifically, we argue, that obligation in respect of climate-related risk.

Generally, a fiduciary relationship is “a relationship in which one person is under a duty to act for the benefit of another person on matters within the scope of the relationship.”²¹ A fiduciary obligation “arises in a relationship in which the fiduciary has a discretion or power to exercise, the fiduciary can unilaterally exercise this discretion or power, and the beneficiary is vulnerable to, or at the mercy of, the fiduciary.”²² In terms of individuals and firms who manage other people’s money, fiduciary obligation requires them to act in the interests of beneficiaries, rather than serving their own interests, including a duty of loyalty and a duty of prudence.²³ The duty of loyalty requires fiduciaries to act in good faith in the interests of their beneficiaries, impartially balance the conflicting interests of different beneficiaries, avoid conflicts of interest, and includes a duty to not act for the benefit of themselves or a third party.²⁴ The prudential obligation requires fiduciaries to act with the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.²⁵

The Supreme Court of Canada has held that there are certain common threads running through fiduciary duties that arise from relationships marked by discretionary power and trust, such as loyalty and “the avoidance of a conflict of duty and interest, and a duty not to profit at the expense of the beneficiary”.²⁶

c) Relationship between statutory and common law duties

Prior to modern corporations statutes, directors were found to be in a fiduciary relationship with the corporation and, therefore, required to exercise care in making management decisions

¹⁹ Sarra, *supra* note 1 at 5.

²⁰ *ibid*

²¹ *Black’s Law Dictionary*, 10th ed (St Paul, Minn: Thomson Reuters, 2009). For a discussion see R Yalden, J Sarra, M Gillen, M Khimji, P Paton, M Condon, G Campo, B Bryan, C Liao, and M Deturbide, *Business Organizations: Practice, Theory and Emerging Challenges* (Toronto: Emond Montgomery, 2017) [“Yalden *et al*”].

²² *Lac Minerals Ltd v International Corona Resources Ltd*, [1989] 2 SCR 574 [“*Lac Minerals*”].

²³ Ronald B Davis, *Democratizing Pension Funds, Corporate Governance and Accountability* (Vancouver: UBC Press, 2008) at 54 [“Davis”].

²⁴ Sarra, *supra* note 1 at 6.

²⁵ See for example, the Ontario *Pension Benefits Act*, RSO 1990, c P 8 [OPBA], as amended, s 22(1).

²⁶ *ibid*.

with respect to the corporation.²⁷ Statutory law in Canada complements the common law. Statutes of incorporation in Canada have codified fiduciary duty provisions of directors and officers, which operate in tandem with common law obligations. Directors and officers of companies incorporated under such statutes have a duty to act in the best interests of the corporation.²⁸ The *Canada Business Corporations Act (CBCA)* and its sister corporations statutes in the provinces and territories codify and enhance the common law duties of loyalty and care of directors and officers. The corporate statutory duty of loyalty requires that the directors and officers of a corporation “act honestly and in good faith with a view to the best interests of the corporation.”²⁹ The statutory duty of care requires that the directors and officers “exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.”³⁰ The Supreme Court of Canada has held that it is the first of these duties that is the “statutory fiduciary duty”.³¹

Pension benefits legislation and trustee legislation in Canada also build on the common law. Provincially enacted, the language varies from province to provinces, but in all cases, pension trustees and investment managers of pension funds are fiduciaries. The prudential obligation requires fiduciaries to act with the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.³²

2. Acting in good faith in best interests and the company and to promote success of the company

a) Trust/loyalty duties framework

The Supreme Court of Canada has held that the statutory fiduciary duty, also known as the duty of loyalty, requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation.³³ The Court has held that considerable power over the deployment and management of financial, human and material resources is vested in the directors and officers of corporations. In deciding to invest in, lend to or otherwise deal with a corporation, shareholders and creditors transfer control over their assets to the corporation, and hence to the directors and officers, in the expectation that the directors and officers will use the corporation’s resources to make reasonable business decisions that are to the corporation’s advantage.³⁴ Directors and officers must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation.³⁵ They must serve the corporation selflessly, honestly and loyally.³⁶

²⁷ *Lac Minerals, supra*, note 22.

²⁸ For a detailed discussion, see Sarra, *supra* note 1.

²⁹ *CBCA*, s 122(1)(a); *ABCA*, s 122(1)(a); *BCBCA*, s 142(1)(a); *MCA*, s 117(1)(a); *NBBCA*, s 79(1)(a); *NLCA*, s 203(1)(a); *NTBCA*, s 123(1)(a); *NuBCA*, s 123(1)(a); *OBCA*, s 134(1)(a); *QBCA*, s 119; *SBCA*, s 117(1)(a); *YBCA*, s 124(1)(a).

³⁰ *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 461 [“*Peoples Department Stores*”].

³¹ *Ibid* at 476-477, citing s 122(1), *CBCA*.

³² See for example, the *OPBA*, *supra* note 25, s 22(1).

³³ *Peoples Department Stores, supra* note 30 at 476-477.

³⁴ *Ibid* at 477-478.

³⁵ *Ibid*.

³⁶ *Ibid*.

In considering the specific substance of the fiduciary duty based on the relationship of directors to corporations, the Supreme Court of Canada held that “best interests of the corporation” should be read not simply as the “best interests of the shareholders”; that from an economic perspective, the best interests of the corporation means the maximization of the value of the corporation, but that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the company’s best interests.³⁷ In executing its duty of loyalty to the corporation, the board of directors is required to reflect on the interests of the corporation both as an economic actor and as a “good corporate citizen”.³⁸

Canadian pension fund trustees have a fiduciary obligation to pension beneficiaries to act prudently in their best interests in making investment decisions regarding fund portfolios. Pension plan trustees’ duties are assessed based on the express language in the pension plan, and the relevant pension and trust legislation.³⁹ For example, for a defined benefit pension plan, the objective is to build a life income for the future retiree. Pension plans have an obligation to make investment decisions that create sustainable pension funds, addressing intergenerational pressures such as the need to fund pensions in the short to medium term, and the need to look ahead to future generations of beneficiaries.⁴⁰

b) Application of trust/loyalty duties laws in climate risk context

The statutory obligation that directors act honestly and in good faith, and be diligent in supervising and managing the corporation’s affairs, necessarily means that they must engage with climate change risk. Depending on the firm’s economic activities, the risk may be minor or highly significant, but directors and officers have an obligation to make the inquiries, to devise strategies to address risks, and to have an ongoing monitoring and adjusting plan to ensure the strategy continues to be responsive to the risk.⁴¹ The Supreme Court of Canada has expressly approved the ability of directors to take account of the interests of diverse stakeholders.⁴² Directors’ decisions must be reasonable business decisions in light of all the circumstances about which they knew or ought to have known.⁴³ Directors are given broad authority to address climate change risk, and provided that decisions taken are within a range of reasonableness, the courts will defer to their business judgment.⁴⁴

Canadian environmental law jurisprudence may assist in thinking about what due diligence in respect of addressing climate change might look like when stakeholders bring actions in respect of climate-related financial risk. Questions that the courts might pose, could include:

³⁷ *Ibid* at 481.

³⁸ *Ibid* at para 66.

³⁹ *Burke v Hudson’s Bay Co*, [2010] 2 SCR 273 at para 41; *Nolan v Kerry (Canada) Inc*, [2009] 2 SCR 678 at para 187.

⁴⁰ *Davis*, *supra* note 23.

⁴¹ *Sarra*, *supra* note 1 at 16.

⁴² *Peoples Department Stores*, *supra* note 30 at para 34. The Court further held that in determining whether directors are acting with a view to the best interests of the corporation, it may be legitimate, given all the circumstances of a given case, for the board of directors to consider the interests of shareholders, employees, suppliers, creditors, consumers, governments, and the environment, at para 42.

⁴³ *Ibid* at para 67.

⁴⁴ *Ibid* at paras 64 and 65.

- Did the directors and officers undertake to identify potential transition risks and physical risks from climate change and climate change policies?
- Did the directors and officers develop an ongoing process or program for monitoring and identifying new climate-related risks, and have mechanisms in place to respond rapidly to changes in the risk profile?
- Did directors and officers put appropriate strategies in place to manage climate-related risks?
- Did the directors and officers establish a program or put appropriate strategies in place to manage the risks identified, such as reduction of greenhouse gas emissions, climate mitigation and adaptation?
- Was there supervision or inspection of employees carrying out the mitigation or adaptation activities?
- Did each director ensure that the corporate officers had been instructed to set up a system, sufficient within the terms and practices of the specific industry, of ensuring compliance with the climate risk identification, mitigation and adaptation program?
- Did the directors ensure that the officers of the corporation reported back periodically to the board of directors on the operation of the system?
- Did the directors ensure that the officers had been instructed to report any substantial non-compliance to the board of directors in a timely manner?
- Is there a system of ongoing climate-related risk audit?
- Are there remedial and contingency plans in place for acute events?
- Are there training programs in place, sufficient authority to act, and other indicia of pro-active climate risk identification, mitigation and adaptation program?⁴⁵

Pension fund fiduciaries must act in the best interests of pension fund beneficiaries in accordance with the terms of the trust.⁴⁶ This fiduciary obligation is eminent in both statutory and common law, requiring positive actions on the part of the fiduciaries. In determining asset allocation between short-term and long-term investments, the duty of care precludes short-term investments that prejudice long-term investments, as the fund must be sustained over the long-term, and thus, trustees must take account of systemic risks.⁴⁷ Climate change is one such risk. The duty of impartiality requires trustees and fund managers to balance intergenerational

⁴⁵ Sarra, *supra* note 1 at 41-42.

⁴⁶ *Galambos v Perez*, [2009] 3 SCR 247 at para 69. See also Paul Miller, "A Theory of Fiduciary Liability" (2011) 56 *McGill LJ* 235 at 270.

⁴⁷ James Hawley, Keith Johnson and Ed Waitzer, "Reclaiming Fiduciary Duty Balance" (2011) 4 *Rotman International Journal of Pension Management* 2 at 13.

interests in their investment decisions, in that the time horizon for older workers is much different than for workers just entering the workforce.⁴⁸

c) Trust and loyalty conclusion

In Canada, therefore, the law is clear that directors owe their duty of loyalty to the corporation. The Supreme Court of Canada has also confirmed that in considering what is in the best interests of the corporation, directors can consider the interests of multiple stakeholders.⁴⁹ Canadian jurisprudence in respect of directors' fiduciary obligations makes clear that the duty can include obligations in respect of climate change risk.

The law is equally clear that pension trustees, pension investment managers and similar fiduciaries have a duty to address climate-related financial risk. Internationally, institutional investors have increased their attention to climate risk management.⁵⁰ In Canada, pension funds in particular have begun to engage with companies in their portfolios in respect of climate risk. Pension funds and other institutional investors will potentially lose significant value of their investments if they do not act as prudent investors by recognizing climate change financial risk. The financial services sector in Canada accounts for approximately 6% of Canada's gross domestic product,⁵¹ and thus these institutional investors can be a significant force in the move towards a lower carbon economy.

There are duties of both care and loyalty with respect to trustees' fiduciary obligation. Where institutional investors are fiduciaries, they could be held accountable for failing in their obligations if they do not address these issues. As noted above, a fiduciary's duties to beneficiaries are twofold: a duty to act prudently (duty of care) and a duty of loyalty.⁵² It is the prudential obligation that necessitates fiduciaries paying attention to climate change risk, for the same reasons that directors and officers of corporations must.

3. Competence - due care and diligence

a) Due care and diligence framework

The statutory duty of care in corporate law requires that the directors and officers "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."⁵³ The Supreme Court of Canada has held that the duty of care imposes a legal obligation on directors and officers to be diligent in supervising and managing the corporation's

⁴⁸ Davis, *supra* note 23.

⁴⁹ Yalden *et al*, *supra* note 21 at 51.

⁵⁰ See for example, the FSB Task Force on Climate-Related Disclosure, <https://www.fsb-tcfd.org/>.

⁵¹ Principles for Responsible Investment, *Fiduciary Duty in the 21st Century*, https://www.unpri.org/download_report/6131, 8 September 2015 [*"Fiduciary Duty in the 21st Century"*] at 38.

⁵² *Hodgkinson v Simms*, [1994] 3 SCR 377 at 419.

⁵³ *Peoples Department Stores*, *supra* note 30.

affairs.⁵⁴ That directors must satisfy a duty of care is a long-standing principle of the common law, although the duty of care has been reinforced by statute to become “more demanding”.⁵⁵

The Supreme Court held that unlike the statutory fiduciary obligation, 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.⁵⁶ Thus, the identity of the beneficiary of the duty of care is much more open-ended.⁵⁷ The Supreme Court held that the statutory duty of care requires more of directors and officers than the traditional common law duty of care. The standard by which to assess their conduct is objective; thus, the factual aspects of the circumstances surrounding the actions of the director or officer are important to assessing whether directors met their duty of care.⁵⁸

The Supreme Court of Canada further held that the contextual approach dictated by s.122(1)(b) of the *CBCA* not only emphasizes the primary facts, but also permits prevailing socio-economic conditions to be taken into consideration.⁵⁹ Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made, and the courts look to see that the directors made a *reasonable* decision, *not a perfect* decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board, even though subsequent events may have cast doubt on the board’s determination.⁶⁰ In order for a plaintiff to succeed in challenging a business decision, he or she has to establish that the directors acted (i) in breach of the duty of care, and (ii) in a way that caused injury to the plaintiff. Directors and officers will not be held to be in breach of the duty of care if they act prudently and on a reasonably informed basis.⁶¹ The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known.⁶²

In most circumstances, the court’s analysis of whether directors and officers have met their duty of care involves an inquiry into the process undertaken by the directors or board of directors in making the decision and the procedures they have in place to identify and address problems, not an inquiry into the substance of the decision where the complaint is not directly related to a specified statutory violation. The Supreme Court has held that courts should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.⁶³

The Supreme Court of Canada has recognized that directors and officers need to look to the long-term interests of the corporation. As long as the decision was a reasonable one at the time, courts will defer to directors’ decisions. That means that where directors and officers are duly

⁵⁴ *Ibid* at 476-477.

⁵⁵ *Ibid* at 489.

⁵⁶ *Ibid* at 489.

⁵⁷ *Ibid*.

⁵⁸ *Ibid*.

⁵⁹ *Ibid* at 492.

⁶⁰ *Ibid* at 492.

⁶¹ *Ibid* at 493.

⁶² *Ibid* at 493.

⁶³ *Ibid* at 493.

diligent in trying to identify climate-related financial and other risks, and take action to mitigate and adapt, they will not face personal liability risk. Acting prudently and on a reasonably informed basis is what is required. At the same time, failure to consider climate change risk does leave directors and officers open to actions against the corporation and in some cases, the directors and officers personally.

Important for the Canadian context is the interplay of the *Civil Code of Québec (Civil Code)* and corporations law, since directors' and officers' obligations fall under both common law and civil law in Québec. In Québec, directors and officers can be found to have violated a duty of care under both corporate law and the *Civil Code*.

b) Application of due care and diligence duties laws in climate risk context

Directors and Officers of Companies

Addressing climate risk is the responsibility of directors and officers in determining the best interests of the corporation. In addition to this fiduciary obligation, the duty of care requires directors and officers to exercise the care, diligence and skill that a reasonably prudent person would exercise in the circumstances; and arguably, this duty requires directors and officers to identify and development a strategy to supervise and manage the transition that will address the specific risks posed by climate change.

The crucial question of what are the best interests of the corporation in respect of climate change risk requires directors and officers to directly engage with developments in knowledge regarding the physical and transition risks and how that information may impact their corporation. As discussed above, the Supreme Court of Canada has accepted that it may be legitimate to consider the interests of numerous types of stakeholders and the environment when determining how to act in the corporation's best interest in respect of climate change. Directors and officers that engage good governance practices already take account of socio-economic conditions and the diverse and sometimes conflicting interests of all the stakeholders with an interest in the company. Ronald Davis has observed that "the range of options on corporate management's desk rarely involves the following decision pairs - profit, only if socially irresponsible versus no profit, only if socially responsible" and that providing one takes into account all consequences that can reasonably be expected to occur over the foreseeable future, pension fiduciaries have broad authority to act in the interests of their beneficiaries.⁶⁴

In Canada, the scope of fiduciary obligation in the business context goes beyond mere survival of the corporate entity. The Supreme Court of Canada has recognized that directors and officers need to look to the long-term interests of the corporation. In *BCE Inc v 1976 Debentureholders*, it held that directors and officers must treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.⁶⁵ The Supreme Court held that directors should resolve conflicts among stakeholders or between them and the corporation "in accordance with their fiduciary duty to act in the best interests of the

⁶⁴ Davis, *supra* note 23 at 175.

⁶⁵ *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 39, [2008] 3 SCR 560 ["BCE"] at paras 80, 81.

corporation, viewed as a good corporate citizen”.⁶⁶ Thus, a director’s fiduciary duty implicates considerations of what “good” corporate citizenship requires in the context of climate change. Arguably, climate change risk poses a challenge made complex by the growing degree of interdependence and interconnectedness that have come to define our world, where domestic and sectoral regulation no longer provide adequate instruments to deal with public stewardship challenges.⁶⁷ Directors’ responses to these challenges should accord with their duty to conform to good corporate citizenship.

The COP 21 agreement recognizes that deep reductions in global emissions through both climate adaption and remediation are required and urgent.⁶⁸ Both the risks posed by climate change and recent governmental commitment to its remediation create reasonable expectations by citizens that legal and other processes will advance these public policy objectives.⁶⁹ Reasonable expectations have been used to achieve objectives that are remarkably consistent, requiring the fair treatment of others and upholding the integrity of legal or regulatory regimes by closing the gaps and loopholes that allow avoiding the obligations associated with these regimes.⁷⁰ A focus on systemic risks acknowledges interdependencies and requires that decision-makers act with reference to others in society and to the principles that inform “reasonable expectations”

Directors and officers should understand that their fiduciary duty requires that they have undertaken efforts to identify any relevant risks to their business from climate change and climate change policies; that they have put appropriate strategies in place to manage these risks; that they have overseen and monitored the actions of the individuals charged with managing these risks; and have mechanisms in place to respond rapidly to changes in the risk profile.⁷¹ Considering whether climate change poses a risk to the business requires directors to take account of the business sector, sources of energy, direct carbon emissions, benefits and risks of investing to support a lower carbon infrastructure, best environmental practices in terms of regulatory compliance, and integration of asset climate risk and resiliency in the firm’s investment decision making.⁷²

Given the broad mandate of directors and officers under their statutory fiduciary obligation and their duty of care, specific decisions made to address climate change are unlikely to give rise to personal liability. It is the failure to act that is likely to attract liability, given the reasonable expectations of stakeholders, either through derivative actions on behalf of the company or personal actions against directors and officers. Courts will examine directors’ decisions balancing competing interests, but once a decision is found to be reasonable, it will be upheld.⁷³ Measuring fulfillment of directors’ duties against reasonable expectations serves not only as an

⁶⁶ *Ibid* at paras 81, 111.

⁶⁷ Edward Waitzer and Douglas Sarro, “Fiduciary Society Unleashed: The Road Ahead for the Financial Sector” (2014). *Osgoode Legal Studies Research Paper Series*. 10. <http://digitalcommons.osgoode.yorku.ca/olsrps/10> [“Waitzer and Sarro”].

⁶⁸ Janis Sarra and Edward Waitzer, “Climate Change – A Case Study/Tipping Point for Rebalancing Interests in Insolvency Law?”, in Janis P Sarra and Barbara E Romaine, eds, *Annual Review of Insolvency Law 2016* (Toronto: Carswell, 2017). The agreement is due to enter into force in 2020.

⁶⁹ *Ibid*.

⁷⁰ *Ibid*.

⁷¹ Sarra, *supra* note 1 at 18.

⁷² *Ibid*.

⁷³ *Ibid* at 19.

accountability check, but it may also provide evidence that directors have met their statutory and common law obligations, and thus provide a defence against shareholder and other claims of breach of those obligations.

As long as the decision was a reasonable one at the time, courts will defer to directors' decisions. That means that where directors and officers are duly diligent in trying to identify climate-related financial and other risks, and take action to mitigate and adapt, they will not face personal liability risk. Acting prudently and on a reasonably informed basis is what is required. At the same time, failure to consider climate change risk does leave directors and officers open to actions against the corporation and in some cases, the directors and officers personally.

Pension Funds, Investment Management Firms and Other Fiduciaries

Pension trustees and other fiduciaries must address the full range of considerations relevant to both risk and return. Pension fund fiduciaries must make their investment strategy decisions based on a time frame commensurate with the pension plan's liabilities.⁷⁴ While there is always a risk of loss, trustees are to make decisions in a manner that avoids undue loss. Prudential obligations require the fiduciary to undertake a careful and thorough evaluation of climate change risk prior to making decisions, and to act on information generated by that process, including a rationale for their decisions.⁷⁵ Materiality is important in assessing the likelihood of the risk materializing and the downside financial risk if it does. Pension trustees and other fiduciaries must evaluate the market and regulatory risks that are likely to depress market prices or restrain fossil fuel production and consumption, for instance, adjusting their investment strategies appropriately.⁷⁶ Pension fund trustee's fiduciary duty is to provide oversight of those fiduciaries making investment decisions, with the objective of trying to ensure that there are funds to pay the promised pension benefits owing to members currently and in the future. Pension fund trustees' fiduciary duty requires them to take into account any risks, within their portfolios, of climate change, as well as investment opportunities.⁷⁷ Non-financial risks can ultimately become financial risks, so a broad range of these factors must be taken into account.

Pension fiduciaries must also comply with trustee legislation, which is complementary to their obligations under pension standards legislation. For example, the Ontario *Trustee Act* requires that "in investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments."⁷⁸ A trustee may invest trust property in any form of property in which a prudent investor might invest. Trustees are to diversify the investment of trust property to an extent that is appropriate to the requirements of the trust and general economic and investment market conditions.⁷⁹ In Ontario, the *Pension Benefits Act* has been amended to require pension funds to disclose information about whether environmental, social and governance (ESG) factors are incorporated into the plan's investment

⁷⁴ Davis, *supra* note 23.

⁷⁵ Sarra, *supra* note 1 at 60.

⁷⁶ Damian Carrington and Caelainn Barr, "Coal crash: how pension funds face huge risk from climate change" The Guardian, 15 June 2015, www.theguardian.com/environment/2015/jun/15/coal-crash-how-pension-funds-face-huge-risk-from-climate-change.

⁷⁷ Sarra, *supra* note 1 at 61.

⁷⁸ Ontario *Trustee Act*, RSO 1990, c T 23, as amended, s 27(1).

⁷⁹ *Ibid*, s 27(6).

policies and procedures and, if so, how those factors are incorporated.⁸⁰ It is a “disclose and explain” approach. Pension funds do not necessarily need to consider these ESG factors, which would include climate change financial risk, but they do need to disclose whether they consider ESG factors, and if so how.

Public statements by several pension funds and their investment managers illustrate how they consider climate change to be a material financial risk. An example is the Canada Pension Plan Investment Board (“CPPIB”), an investment management organization that invests the funds of the Canada Pension Plan on behalf of its 20 million contributors and beneficiaries.⁸¹ CPPIB states that it has a responsibility to take climate change into account in ensuring it is making sound investments over the long term.⁸² As a long-term investor, CPPIB reports that it is investing for multiple generations of beneficiaries, today and well into the future. It is positioning its portfolio to perform well through the transition to a low-carbon economy. CPPIB states that it seeks to create change from the inside of companies by engaging with numerous Canadian and global companies that are high emitters of greenhouse gas emissions.

Another example is the British Columbia Investment Management Corporation (“bcIMC”), which provides investment management services, with \$123.6 billion in assets under management.⁸³ bcIMC considers assessing investment risk, including that related to climate change, to be integral to fulfilling its fiduciary duty.⁸⁴ It reports: “in discharging our fiduciary obligation of working in our clients’ best financial interests to generate returns, bcIMC aims to manage the long-term risks and opportunities that ESG matters present”.⁸⁵ Where it considers appropriate, bcIMC uses its influence as a shareholder to encourage companies to manage emissions reduction and resource efficiency.

c) Duty of care: conclusion

Directors and officers should understand that their fiduciary duty requires that they have undertaken efforts to identify any relevant risks to their business from climate change and climate change policies; that they have put appropriate strategies in place to manage these risks; and that they have overseen and monitored the actions of the individuals charged with managing these risks; and have mechanisms in place to respond rapidly to changes in the risk profile. Considering whether climate change poses a risk to the business requires directors to take account of the business sector, sources of energy, direct carbon emissions, benefits and risks of investing to support a lower carbon infrastructure, best environmental practices in terms of regulatory compliance, and integrating asset climate risk and resiliency in the firm’s investment decision making.

⁸⁰ O Reg 235/14, s. 8. *Pension Benefits Act*, RRO 1990, Reg 909.

⁸¹ Canada Pension Plan Investment Board (“CPPIB”), “Who We Are”, <http://www.cppib.com/en/who-we-are/our-mandate/>.

⁸² CPPIB, “Our approach to climate change”, 2017, <http://www.cppib.com/en/public-media/headlines/2017/cppibs-approach-climate-change/>.

⁸³ British Columbia Investment Management Corporation (“bcIMC”), Responsible Investing Newsletter: Climate Change, April 2016 at 1, <http://read.uberflip.com/i/664765-rin-april-2016>.

⁸⁴ bcIMC, “Responsible Investing Fact Sheet”, 2017, <http://www.bcimc.com/publications/pdf/2017RIFactsheet.pdf>.

⁸⁵ bcIMC, “2016 ESG Engagement: Public Equities Priorities and Process”, at 6, <http://www.bcimc.com>.

4. Duty of disclosure

a) Disclosure and reporting requirements

Climate change presents both risks and opportunities to equity portfolios. There are clear benefits to investing in companies that prioritize energy efficiency and reduction of GHG emissions, and that develop sustainable business models.

Global Standards for Best Practice

The TCFD has developed voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. A work in progress, it considers the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures across industries. One of its goals is to “help companies understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors’ needs.”⁸⁶ The TCFD concluded that assessing climate change risk is complex, partly because there are no uniform risk assessment tools or disclosure standards, and because the interaction of climate science, financial markets, and regulatory frameworks is complex in determining downside risks of particular strategies.⁸⁷ However, there is global consensus in the scientific community that there is an urgent need for mitigation and adaptation, which can be a guidepost for fiduciaries.

In June 2017 the TCFD released three key documents that serve as building blocks to describe and support implementation of the Task Force’s recommendations: Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures; Annex: Implementing the Recommendations of the TCFD, which provides detail to help companies implement the recommendations and is a “living” document that will be refined as companies gain more experience preparing climate-related financial disclosures; and Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities, which provides a further level of detail that can be helpful for companies in considering scenario analysis.⁸⁸

Shareholder action on climate change can help to minimize risk and ensure that portfolio companies are working towards cost-effective and innovative climate solutions. For example, in 2016, the Canadian Shareholder Association for Research and Education (“SHARE”) engaged with 28 companies across a range of sectors on the importance of measuring, disclosing and

⁸⁶ Financial Stability Board, Introduction to the Task Force on Climate-related Financial Disclosures, <https://www.fsb-tcf.org/about/#>.

⁸⁷ TCFD *Final Report*, *supra* note 17.

⁸⁸ Technical Supplement, The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities (December 2016), <https://www.fsb-tcf.org/wp-content/uploads/2016/11/TCFD-Technical-Supplement-A4-14-Dec-2016.pdf>

reducing their climate risks.⁸⁹ SHARE reports that in 2016, 18 of these companies reported to the CDP Climate Change survey;⁹⁰ nine companies reduced their GHG emissions; five companies substantially expanded disclosure on key climate performance indicators;⁹¹ and two companies set new company-wide targets to reduce GHG emissions. Through its proxy voting service, SHARE executed votes in favour of 34 shareholder proposals on climate change-related matters in 2016.⁹²

There is growing opinion that companies should also expressly report on their strategies to address how they are meeting their climate risk mitigation responsibilities.⁹³ There are a growing number of shareholder resolutions calling for enhanced disclosure regarding climate change risk and management. Transparency requirements draw fiduciaries' attention to climate risk and serve as a normative influence on fiduciaries to take action. Institutional investors with three trillion dollars under management have launched the Carbon Asset Risk project, calling on the world's top non-renewable energy companies to assess the risks of climate change to their businesses.⁹⁴ Institutional investors globally are beginning to protect their portfolios from the risks of global warming and climate change.

Canadian securities regulators lag international developments in disclosure on climate change risk, although in 2017 they are studying the issue. Canadian securities regulators should adopt the recommendations of the TCFD, which provide a framework for disclosure of climate-related financial risks by corporations, financial enterprises, investors, and asset managers.⁹⁵ SHARE has been coordinating a group of large Canadian pension plans to ask Canadian securities regulators to adopt new requirements for large issuers to advocate for an update to company disclosure obligations and guidance to address climate-change-related concerns.⁹⁶ An enhanced framework for disclosure is critically important, but it is not sufficient measure by itself to address the challenges regarding climate finance. There needs to be a deeper discussion about the role of financial markets in addressing climate risk, and the allocation of responsibility as between public and private interests.

Current Disclosure Requirements

The requirements set out in provincial securities legislation are the primary source of disclosure obligations in Canada. These requirements are reinforced by nationally harmonized standards set out in National Instruments issued by the Canadian Securities Administrators (CSA), which is

⁸⁹ Shareholder Association for Research and Education ("SHARE"), Annual Report 2016 at 7, http://share.ca/documents/annual_reports/annual_activity_report_2016.pdf

⁹⁰ CDP Climate Change Survey, which requests information on climate risks and low carbon opportunities from the world's largest companies on behalf of 827 institutional investor signatories with a combined US\$100 trillion in assets, <https://www.cdp.net/en/climate>. CDP, "Out of the starting blocks, Tracking progress on corporate climate action", 2016. Only 49 of 200 companies surveyed in Canada answered the CDP Survey; <https://www.cdp.net/en/research/global-reports/tracking-climate-progress-2016>.

⁹¹ SHARE Annual Report 2016, *supra* note 89 at 8.

⁹² *Ibid* at 8.

⁹³ Covington and Thamotheram, *supra* note 4.

⁹⁴ Aaron Pickering, "Investors ask fossil fuel companies to assess how business plans fare in low carbon future", Ceres, <http://www.Ceres.org/press/press-releases/investors-ask-fossil-fuel-companies-to-assess-howbusiness-plans-fare-in-low-carbon-future>. TFCF Final Report, *supra* note 17.

⁹⁵ TFCF Final Report, *supra* note 17.

⁹⁶ SHARE Annual Report 2016, *supra* note 89.

an organization established by the 10 provinces and 3 territories to harmonize capital market regulations.⁹⁷ General disclosure obligations are primarily provided by National Instrument (NI) 41-101 General Prospectus Standards (NI 41-101) for primary market transactions, and NI 51-102 Continuous Disclosure Obligations (NI 51-102), for secondary market transactions and continuing disclosure. According to those instruments, issuers' disclosures must generally provide "full, true, and plain disclosure of all material facts"; issuers must also notify security holders of any material changes to their business and operations.

Three changes in the market motivated the CSA in 2010 to issue specific guidance on environmental reporting in Staff Notice 51-533: "increasing impacts on issuers of environmental matters; the changing environmental regulatory landscape; and increasing investor interest in environmental matters."⁹⁸ A staff notice is a less formal communication from the CSA than is a National Instrument, often, as here, to provide guidance on "emerging regulatory problems that have not yet become the subject of a policy or a rule."⁹⁹ The Staff Notice was published in an effort to "assist issuers in assessing which information must be disclosed on material environmental matters, such as risks related to weather patterns or environmental legislation".¹⁰⁰ In specific, CSA Notice 51-333 was drafted to provide guidance on definitions and principles concerning the following areas of disclosure:

- Material Information (that is, the materiality of environmental information);
- environmental risks and related matters;
- environmental risk oversight and management;
- forward-looking information requirements as they relate to environmental goals and targets; and
- impact of adoption of International Financial Reporting Standards (IFRS) on disclosure of environmental liabilities.¹⁰¹

Since the release of Notice 51-333, regulators have continued to refine and update environmental disclosure obligations. On June 9, 2016, by way of OSC Notice 11-775 *Notice of Statement of Priorities for Financial Year to End March 31, 2017*, the Ontario Securities Commission (OSC) stated that "commenters have suggested that the OSC find ways to work with" the TCFD and "consider how the OSC can encourage adoption of the Task Force's recommendations."¹⁰² In response, OSC emphasized that "companies already have an obligation to disclose material environmental and governance information," but then committed to "assessing whether additional disclosure may be required," which will include "monitoring and

⁹⁷ See <https://www.securities-administrators.ca/aboutcsa.aspx?id=77>.

⁹⁸ Canadian Securities Administrators, *Staff Notice 51-333, Environmental Reporting Guidance*, October 27, 2010, available at http://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20101027_51-333_environmental-reporting.pdf.

⁹⁹ Mary Condon, Anita Anand, Janis Sarra and Sarah Bradley, *Securities Law in Canada, 3d ed.* (Toronto: Emond Montgomery, 2017), at 29 ["Condon et al"].

¹⁰⁰ *News Release: Canadian Securities Regulators Publish Additional Guidance on Environmental Disclosure, CSA* (27 October 2010), online: <http://www.securities-administrators.ca/aboutcsa.aspx?id=928>.

¹⁰¹ Staff Notice 51-333, *supra* note 98, at 6.

¹⁰² OSC Notice 11-775 *Notice of Statement of Priorities for Financial Year to End March 31, 2017*, June 9, 2016, 39 OSCB 5157, http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20160609_11-775_sop-end-2017.htm.

commenting” on the disclosure recommendations put forth by the TCFD.¹⁰³ That commitment was echoed in the OSC’s latest *Statement of Priorities* (released on June 30, 2017).¹⁰⁴

On March 21, 2017, the CSA announced a “project to review the disclosure of risks and financial impacts associated with climate change”.¹⁰⁵ As part of this project, the CSA committed to gathering information on climate change disclosure in Canada and abroad.¹⁰⁶ The CSA has been engaged in consultation and in gathering information throughout the spring and summer of 2017, and plans to publish a report detailing its review. To date, no further public announcements about the results of this review have been made.

Evaluation

Well-meaning and well-counseled issuers have good, general, principles-based guidance on the disclosure of environmental issues in securities documents and financial statements. What is lacking, however, is specific, clear, and comprehensive guidance on the disclosure of specific climate-related information. There are obvious overlaps between the general environmental disclosure provisions emphasized in 51-333 and some of the aspects of the TCFD Framework. In our view, disclosure in a single document as part of required filings according to the TCFD Framework would give investors a clearer, more consistent, and more easily comparable picture of how companies are thinking about, and managing, their current and future challenges from the changing climate and regulatory efforts to mitigate those changes.

Our view is significantly informed by a recent study undertaken by Chartered Professional Accountants of Canada (CPA Canada), a national organization with over 210,000 members in Canada and abroad.¹⁰⁷ CPA Canada has recognized since 2008 that climate change has “significant implications for disclosures by public companies, both as a result of regulatory obligations and due to increased shareholder interest”.¹⁰⁸ As part of its on-going policy work in this area, CPA Canada studied the climate-change disclosure practices of “75 listed companies, representing approximately 78% of the market capitalization of the S&P/TSX Composite Index across 10 major industries.”¹⁰⁹ The study found that the majority (79%) of issuers were making some climate-related disclosure, but the disclosure was generally inadequate: there were inconsistent uses of terminology; the information was not comparable within or between industries, 81% of issuers failed to provide specific disclosure about board or senior management oversight of climate-related risks, the majority of issuers failed to provide financial

¹⁰³ *Ibid.*

¹⁰⁴ Notice of Statement of Priorities for Financial Year to End March 31, 2018, OSC Notice 11-777, (2017) 40 OSCB 5449.

¹⁰⁵ News Release: Canadian Securities Regulators Announce Climate Change Disclosure Review Project, CSA (21 March 2017), online: <https://www.securities-administrators.ca/aboutcsa.aspx?id=1567>.

¹⁰⁶ *Ibid.*

¹⁰⁷ See CPA Canada, *State of Play: Study of Climate-Related Disclosures by Canadian Public Companies*, 2017, at 14, available at <https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/sustainability-environmental-and-social-reporting/publications/climate-related-disclosure-study> (hereinafter “CPA Study”). Data on CPA’s membership can be found in About Chartered Professional Accountants of Canada, available at <https://www.cpacanada.ca/en/the-cpa-profession/about-cpa-canada>.

¹⁰⁸ CPA Canada, *Executive Briefing Climate Change and Related Disclosures* (March 2008) at 3, <https://www.cpacanada.ca/-/media/site/business-and-accounting-resources/docs/executive-briefing--climate-change-and-related-disclosures.pdf> [“Executive Briefing Climate Change Disclosures”].

¹⁰⁹ See CPA Study, *supra* note 107, at 14.

metrics or targets for their strategies regarding climate-change risks, and so on.¹¹⁰ Only one-quarter of issuers discussed their strategies in light of the transition to a low-carbon economy¹¹¹ envisioned by both the Paris Agreement and Canada’s Pan-Canadian Framework. When compared to the specific disclosure in the TCFD Framework about the governance, strategy, risk management, and metrics and targets companies are using to evaluate and manage the risks and opportunities of the transition to a low-carbon economy, we argue that there are obvious gaps between what information investors are being provided with today, and what information they would be provided with if the TCFD Framework is incorporated into a National Instrument in Canada.

5. Establishing Liability

a) Evidentiary requirements

The evidentiary requirements necessary to establish liability will depend on the particular cause of action being alleged, but the kinds of liabilities being discussed in this paper are for the most part statutory or civil liabilities. If there is a prosecution under s 122 of the Ontario *Securities Act* or its equivalent in other provincial securities legislation, then it is the criminal burden of beyond a reasonable doubt. If it is an administration hearing before a tribunal of a securities commission or a civil action in the courts, it is the civil standard of establishing the alleged conduct on a balance of probabilities.

This paper has emphasized three potential sources of legal liability: officers’ and directors’ statutory duties of loyalty (fiduciary duty) and care; and companies’ disclosure obligations pursuant to securities regulations. Given the strength of the potential defences discussed immediately below, it is our conclusion that litigation and liability are more likely in the Canadian context pursuant to companies’ disclosure obligations. One important caveat, though: to the extent that directors make decisions to continue oil, gas, and coal infrastructure investment in a context where those investments are likely to become “stranded assets,” fiduciary liability is also possible.

b) Possible defences

Directors and Officers of Companies

The Supreme Court of Canada recognizes a “business judgment rule” in Canada, which serves as a type of defence to particular decisions or conduct of directors and officers. The business judgment rule accords deference to a business decision, so long as it lies within a range of reasonable alternatives.¹¹² The deference reflects the reality that directors, who are mandated to manage the corporation's business and affairs, are often better suited to determine what is in

¹¹⁰ *Ibid.*, at 2, Executive Summary.

¹¹¹ *Ibid.*

¹¹² *BCE*, *supra* note 65.

the best interests of the corporation than the courts are, including decisions on the appropriate balance among stakeholders' interests.¹¹³

With respect to climate-related financial risk, the court will look to see that the directors made a reasonable decision, not a perfect decision. Provided that the decision made and action taken to monitor, mitigate and/or adapt with respect to climate risk is within a range of reasonableness, the courts will not substitute their opinion for that of the directors, even though subsequent events may have cast doubt on the directors' decision.¹¹⁴

Courts are entitled to consider the content of the directors' decision and the extent of the information on which it was based, and to measure these considerations against the facts as they existed at the time the impugned decision was made. Therefore, although corporate board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination.¹¹⁵ Given rapidly developing technical and best practice information on climate-related financial risk, which allows directors and officers more information on scale of risk, materiality, probability, etc, directors will need to demonstrate how they exercised their duties of loyalty and care in respect of climate-related risk that they ought reasonably to have known exists.

Under Canadian environmental law, directors are to take all reasonable care by establishing a proper system to prevent commission of the environmental offence and by taking reasonable steps to ensure the effective operation of the system, including a system that requires officers to report periodically to the board on the operation of the system and that ensures that officers are promptly addressing environmental concerns brought to their attention.¹¹⁶

The careful attention that the court pays to the specific requirements under environmental protection legislation, including the obligations of directors and officers and the availability of defences, is quite different than advancing a more general fiduciary obligation for directors and officers to identify and address climate change risk. There may, however, be an interplay between these various obligations, where the failure to address climate change intersects with emissions or other statutory violations. When corporations are financially healthy, they indemnify their directors, but where they are in financial distress and there is no value in the corporation's assets to cover the claims, stakeholders may look to the directors and officers personally.

Pension Fiduciaries

Given mounting evidence of the financial, health and other risks of climate change, today pension trustees and other fiduciaries could be found in breach of their fiduciary obligations if they do not take into account climate-related financial risks. Arguably, some of the current investments in fossil fuels are weighted in favour of current beneficiaries and not all

¹¹³ *Ibid.*

¹¹⁴ *Peoples Department Stores, supra* note 30 at paras 64 and 65.

¹¹⁵ *UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc*, [2002] OJ No 2412, 214 DLR (4th) 496 (Ont SCJ), additional reasons at 2002 CarswellOnt 3579 (Ont SCJ [Commercial List]), affd [2004] OJ No 636 (Ont CA) at para 152.

¹¹⁶ *R v Bata Industries Ltd*, [1992] OJ No 236, 9 OR (3d) 329 (Ont Prov Div), remedy var'd on appeal, [1993] OJ No 1679, 14 OR (3d) 354 (Ont Gen Div), var'd [1995] OJ No 2691, 25 OR (3d) 321 (Ont CA).

beneficiaries because the huge financial risks only 15 years out must be considered.¹¹⁷ In fulfilling their fiduciary obligation, pension fiduciaries need to consider how their decisions impact on risk and return to the pension fund, and ultimately beneficiaries,¹¹⁸ in terms of the expected shifts to low carbon technologies, the risk of stranded assets, and diminished returns from companies failing or market prices plummeting. If they are diligent in these decisions, they are unlikely to be held personally liable.

All factors relevant to risk and return should be considered by fiduciaries in investment decisions, and it may be a breach of fiduciary duties *not to take into account* climate-related risk considerations that are relevant, and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good ESG performance and good financial performance exists.¹¹⁹ Climate change risk involves both material financial and non-financial risks, both relevant to fiduciaries.

c) Personal liability and availability of D&O insurance

While there appear to be no Canadian judgments expressly addressing climate change liability, corporations and their officers have long been held accountable for emissions exceeding statutory limits under environmental legislation. Environmental liability under both statute and common law in Canada is an area in which there has been a growth in the responsibility assigned to corporate directors and officers.¹²⁰ There are more than 30 statutes in Canada that afford protection to the environment and most, if not all, impose liability on directors for breach of the statute.¹²¹ These statutes are generally referred to as “public welfare” legislation, aimed at preventing potentially adverse effects through the enforcement of minimum standards of care and conduct of corporations and their directors and officers.¹²² Directors and officers face potential personal liability under these statutes in addition to the corporation’s liability. The potential liability varies depending on the type and severity of the conduct giving rise to the environmental condition or damage. Directors and officers may face fines and/or terms of imprisonment, and even liability for clean-up costs.¹²³

When a company is financially sound, the company affords strong protection to directors and officers under both director and officer (“D&O”) errors and omissions insurance and indemnification of directors against personal liability using the corporation’s assets. However, if a company starts to fail financially, D&O insurance renewal is almost impossible to purchase and there are no longer any unencumbered assets to meet the claims against directors and officers personally.

Pension fiduciaries also have D&O errors and omission insurance. In equity, trustees are entitled to recover from the trust assets all expenses reasonably incurred in the administration of the

¹¹⁷ Sarra, *supra* note 1 at 57.

¹¹⁸ *Cowan v Scargill* [1985] Ch 270, [1984] 3 WLR 501.

¹¹⁹ UNEP Finance Initiative (UNEP FI), “A Legal Framework for the Integration of Environmental, Social, and Governance Issues into Institutional Investment” (London: Freshfields Bruckhaus Deringer LLP, 2005)

¹²⁰ Janis P Sarra and Ronald B Davis, *Director and Officer Liability*, 3rd ed (Toronto, LexisNexis, 2015).

¹²¹ *Ibid.*

¹²² *Ibid.*

¹²³ *Ibid.*

trust. Trustee statutes contain a provision to same effect. That would not indemnify trustee where allegations of wrong doing are found by the court.¹²⁴ To date, there are no cases in Canada that test the scope of any indemnification of pension fiduciaries regarding failure to identify and address climate-related financial risk.

d) Plausible scenarios for how liability risk might emerge

A number of plausible scenarios for how liability risk might emerge involve litigation or liability pursuant to a company's disclosure obligations. Two potential kinds of claims seem particularly plausible in Canada if companies (1) fail to discuss financially material transition risks; or (2) materially misstate the value of a company's assets in light of "stranded assets" and unburnable carbon. An example of the first type of claim, failing to discuss material transition risk accurately, occurred recently when Greenpeace challenged Kinder Morgan, Canada, Ltd's prospectus being prepared to use to distribute its securities during an IPO announced on May 10, 2017.¹²⁵ The basis of the challenge was Kinder Morgan's use of what Greenpeace alleged were overly optimistic projections for the future use of oil, relying exclusively on the International Energy Agency's (IEA) *New Policies Scenario* forecast that was most favourable to the company, in which demand for oil continues to grow because aggressive climate policies are not adopted in the future.¹²⁶ Greenpeace alleged that the inclusion of a single climate change scenario, which ignored other IEA scenarios that forecasted decreased demand for oil if governments took actions to achieve the Paris COP 21 Agreement goal of keeping warming well below 2° Celsius, was materially misleading.¹²⁷

The second type of problem, materially misstating the value of a company's assets in light of regulatory developments, seems a plausible risk in particular to oil, gas, or coal companies, and related industries. Carbon Tracker, United Nations Principles for Responsible Investment, and leading public institutional investors recently published a study of the value of "stranded assets", those "unburnable" assets that must stay in the ground if the goal of keeping global temperature increases to 2°C or less is to be met. Evaluating the stated economic value of the assets in the ground of 69 oil and gas companies, the report concluded that "across the oil and gas industry \$2.3 trillion of upstream projects – roughly a third of business as usual projects to 2025 – are inconsistent with global commitments to limit climate change to a maximum 2°C."¹²⁸ In that report, the capital expenditures currently underway or publicly announced by those 69 oil and gas companies were analyzed to determine what percentage of those expenditures will be "stranded" if global efforts to limit temperature increases to 2°C are successful. A number of Canadian oil and gas companies are at risk: 50-60% of Imperial Oil, Vermillion and Encana's expenditures will become stranded, according to the analysis, and 40-50% of Husky's and

¹²⁴ M Gillen and F Woodman, eds, *The Law of Trusts, A Contextual Approach* (Toronto: Emond Montgomery, 2008).

¹²⁵ *Ibid* at 1; see also *Alberta Securities Act*, SA 2000, c S4, s 113(1) [ASA] and *Ontario Securities Act*, RSO 1990, c S5, s 56(1) [OSA].

¹²⁶ *Ibid* at 7; in particular, Greenpeace Canada argued that, "by failing to reference either the *450 Scenario* or the *66% Scenario*, [Kinder Morgan 's] Prospectus [failed] to present the IEA's alternative market forecasts", thereby misrepresenting significant risk to the Company's business model."

¹²⁷ *Ibid* at 8.

¹²⁸ Carbon Tracker Initiative *et al*, "Two Degrees of Separation: Transition Risk for Oil and Gas in a Low Carbon World", 2017, available at <http://www.carbontracker.org/report/2-degrees-of-separation-transition-risk-for-oil-and-gas-in-a-low-carbon-world/>.

Suncor's expenditures will also become stranded.¹²⁹ Beyond securities litigation, officers and directors making decisions now to invest in infrastructure likely to become stranded may be susceptible to claims of failing to fulfill their statutory duty of care.

7. Procedural considerations

a) Standing and derivative actions

The derivative action under Canadian corporate law is aimed at enforcing a right of the corporation itself.¹³⁰ The complainant seeks leave of the court to bring an action on behalf of the corporation against directors. It is a remedy designed to hold directors accountable for conduct that harms the corporation itself. A derivative action can be sought for alleged violations of the statutory fiduciary duty, the duty of care, or under oppression remedy provisions. The remedy sought must be for the benefit of the corporation as a whole. The derivative action is a possible avenue for shareholders and possibly others to seek a remedy against directors personally for failure to act. Complainants must meet the threshold criteria as a complainant and persuade the court to exercise its discretion to allow the claim to proceed. In addition to giving notice of the claim to the directors and providing a reasonable period for them to take up the claim, a complainant must demonstrate to the satisfaction of the court that the claim is being brought in good faith and that it has a reasonable prospect of success, in order to be granted leave to proceed with the claim.¹³¹

In thinking about potential derivative action claims regarding climate-related risk, directors and officers will be most vulnerable to claims from shareholders, as they have a direct financial interest in corporate officers managing these risks. A derivative action is aimed at benefiting the corporation itself and the entire body of shareholders and others with legitimate interests in how the corporation is being managed. However, one could anticipate an NGO located in a "one company" or "one industry" community in which directors failed to consider climate change risk seeking to commence a derivative action. The NGO would have to establish a legitimate interest in the corporation's future sustainability, such as that its survival affects the economic security of the community. One-industry steel and mining towns in Northern Ontario come to mind as an example.

One benefit for potential complainants and a hurdle for getting approval of a derivative action is that the court can order that the corporation fund the litigation where the complainant makes a case it should.¹³² Where the court authorizes the derivative action, the claimant is often not risking its own resources in pursuing the claim against the directors personally. To this end, the rigorous tests in the statute and the high thresholds set by the court ensure that the resources of a corporation are not unnecessarily depleted by pursuit of the action, while still allowing potentially meritorious cases to proceed.¹³³ An NGO would have to persuade the court that it met this threshold in order to found a derivative action.

¹²⁹ *Ibid* at 7. These percentages for potentially stranded assets are comparable to some of the oil majors: Exxon is analyzed to risk 40-50% of its current and announced capex; Chevron 30-40%, and Royal Dutch Shell 30-40%.

¹³⁰ *BCE*, *supra* note 645 at para 45.

¹³¹ For example, s 239, *CBCA*.

¹³² For example, s 240, *CBCA*.

¹³³ For a discussion, see Sarra, *supra* note 1 at 29.

Directors therefore have incentives not to engage in conduct contrary to the interests of the corporation, which arguably entails not ignoring climate change financial risk. The court's high-threshold tests for commencing an action means that creditors cannot inappropriately use corporate resources to pursue litigation. The availability of the remedy may enhance governance decisions, since institutional shareholders are unlikely to tolerate conduct by directors that results in corporate resources financing litigation.

b) Remedies

The oppression remedy under Canadian corporate law focuses on harm to the legal and equitable interests of stakeholders when directors act oppressively or unfairly prejudicially.¹³⁴ An extraordinarily broad set of remedies is available, although there are limits to who can bring a complaint and from what harms they can seek relief. Oppression remedies offer another potential mechanism for the courts to assess the reasonable expectations of certain stakeholders in respect of directors' decisions or lack thereof regarding climate change risk.¹³⁵ The oppression remedy under corporate law statutes creates an equitable remedy that "seeks to ensure fairness – what is just and equitable".¹³⁶

A complainant must first "identify the expectations that he or she claims have been violated by the conduct at issue and establish that the expectations were reasonably held".¹³⁷ Second, the complainant must show that these reasonable expectations were violated by corporate conduct that was oppressive, or unfairly prejudicial to, or that unfairly disregarded the interests of "any security holder, creditor, director or officer", pursuant to the statutory provisions.¹³⁸ The scope of the remedy is broad, but it must be tailored to remedy only the oppressive conduct. Remedies include orders restraining conduct, replacing directors, setting aside transactions, and compensating aggrieved persons.¹³⁹ The oppression remedy seeks to apply a measure of corrective justice and should go no further than necessary to correct the injustice or unfairness between the parties.¹⁴⁰

Applying these standards to conduct in respect of climate change risk, if directors act in a manner that is unfairly prejudicial, they could be held personally liable. An example would be a decision to continue investing in fossil fuels when directors and officers ought reasonably to have known that the consequences would be firm failures and growing numbers of stranded assets. "Unfair prejudice" does not require a culpable state of mind, the court will assess whether the decision or failure to act had unfair consequences. The third threshold, "unfair disregard" of interests, extends the remedy to where directors have ignored an interest as being of no importance, contrary to the stakeholders' reasonable expectations. Directors and officers are arguably at risk of personal liability if a complainant had a reasonable expectation that they would address climate change risk, and the directors and officers disregarded their interests.

¹³⁴ *Wilson v Alharayeri*, 2017 SCC 39 ["Wilson"]. See also *BCE*, *supra* note 65 at para 45 (SCC).

¹³⁵ For a discussion, see Sarra, *supra* note 1 at 19.

¹³⁶ *BCE*, *supra* note 65 at para 81; *Wilson*, *ibid* at para 23.

¹³⁷ *BCE*, *ibid* at para 70; *Wilson*, *ibid* at para 24.

¹³⁸ *Wilson*, *ibid* at para 24.

¹³⁹ Section 241(3), *CBCA*.

¹⁴⁰ *Wilson*, *supra* note 134, at para 27.

It is most likely that security holders would bring claims seeking an oppression remedy for the directors and officers failing to identify climate-related risk and to develop mitigation and adaptation strategies. They have standing as of right, and can more easily establish their reasonable expectations that the directors and officers would address threats to the sustainability of the company and thus to their financial interests.

If the best interests of the corporation are defined in terms of decisions that advance the potential long-term operational, financial and environmental sustainability of an enterprise, including climate adaptation and mitigation measures, arguably both the public interest and the interests of a broader number of stakeholders could become factors in shifting current approaches.¹⁴¹ Assessed on the reasonable expectations of the complainant, the remedy could be utilized to enforce directors' obligations to make decisions that are aimed at financial sustainability and addressing climate or other systemic risks. While claimants seeking oppression remedies would have to establish they come within the definition of complainant, once that threshold is met, the court has broad authority within the proceeding to craft a remedy to address the risk or the harm caused. On the other hand, for claimants seeking to assert that climate mitigation strategies are oppressive because of reductions to their immediate returns are liable to be thwarted by the "reasonable corporate citizen" view of the corporation's best interests as the lens through which the reasonableness of expectations will be evaluated.

8. Conclusion

a) Assessment of materiality of liability risk

Materiality underpins much of the transparency requirements of Canadian securities law.¹⁴² Materiality is also a tool with which to measure proper exercise of fiduciary obligations. If the risks to the business are material, whether direct risk to the business through physical risks, transition costs or material financial risk in terms of market prices, financial performance, etc, directors and officers should have identified material risk to the best interests of the company, devised a strategy to address the challenges, and monitor its implementation on a continuing basis, whether the company is privately held or publicly traded. Non-financial material issues, which may be important to stakeholders, are also relevant, and directors and officers should be managing these issues effectively, even if they do not pose a significant threat to the viability of the business. They need to be able to establish for corporate stakeholders the ongoing steps they are taking.

Materiality of climate-related financial risk depends on probability/magnitude, timing, scale, etc.¹⁴³ In some instances, material changes are contingent or uncertain, although directors and officers of the corporation may have some information regarding the possibility of such a change. The probability/magnitude test is a method sometimes used by Canadian securities regulators to analyze when contingent events become sufficiently crystallized that they are

¹⁴¹ Waitzer and Sarro, *supra* note 67.

¹⁴² Condon *et al*, *supra* note 99 at 282-312, 434-477.

¹⁴³ *Ibid*.

required to be disclosed as material changes.¹⁴⁴ It requires an assessment of the probability that an event will occur, having regard to all the known or ascertainable facts. It also requires some assessment of the magnitude or significance of the change, in terms of whether the information would be viewed by reasonable investors as important information for making a decision to buy, sell, or continue to hold their securities.¹⁴⁵

The TCFD has recognized that most information included in financial filings is subject to a materiality assessment.¹⁴⁶ However, it observes that because climate-related risk is a risk that affects nearly all industries, many investors believe it requires special attention. For example, it reports that in assessing organizations' financial and operating results, investors want insight into the governance and risk management context in which such results are achieved.¹⁴⁷ It recommends that organizations provide climate-related financial disclosures in their mainstream public annual financial filings, noting that in most G20 jurisdictions, public companies have a legal obligation to disclose material information in their financial filings, including material climate-related information.¹⁴⁸ The TCFD recommends that organizations should describe their processes for prioritizing climate-related risks, including how materiality determinations are made within their organizations.¹⁴⁹ Essentially, the materiality requirement is that investors and other stakeholders should be able to see major trends and significant events related to climate change that affect or have the potential to affect the company's financial condition and/or its ability to achieve its business plan or strategy.

b) Concluding remarks

Climate-related financial risk exists, and will continue to grow as Canada transitions to a low carbon economy. Directors and officers, pension trustees and other fiduciaries have a fiduciary obligation to identify the risks, and where they exist, to develop strategies in the best interests of the company, pension fund or investment fund to reduce the risk. Duly diligent efforts by these fiduciaries will not be second-guessed by the courts, and thus, the best strategy is to avoid liability risk by acting now.

There are also significant opportunities for Canadian business in the transition to a low carbon economy. Efforts to mitigate and adapt to climate change produce new opportunities for organizations through resource efficiency and cost savings,¹⁵⁰ investing in technological innovation, the adoption of low-emission energy sources,¹⁵¹ the development of new low-

¹⁴⁴ *YBM Magnex International Inc* (2003), 26 OSCB 5285.

¹⁴⁵ *Condon et al, supra* note 99; it is important to note that provincial securities laws have slightly different definitions of material fact and material change, something that Canadian securities regulators have sought to harmonize through national instruments.

¹⁴⁶ TCFD *Final Report, supra* note 17.

¹⁴⁷ *Ibid.*

¹⁴⁸ *Ibid.*

¹⁴⁹ *Ibid* at 21.

¹⁵⁰ UNEP and Copenhagen Centre for Energy Efficiency, *Best Practices and Case Studies for Industrial Energy Efficiency Improvement*, February 2016; Environmental Protection Agency Victoria (EPA Victoria), "Resource Efficiency Case Studies: Lower your Impact", 2013, <http://www.epa.vic.gov.au/business-and-industry/lower-your-impact/resource-efficiency/case-studies>.

¹⁵¹ International Energy Agency, "Global energy investment down 8% in 2015 with flows signalling move towards cleaner energy", 14 September 2016. <https://www.ceres.org/resources/reports/power-forward-3>.

emission products and services, access to new markets as sectors shift to a lower-carbon economy,¹⁵² and building resilience along the supply chain. Good governance would suggest that directors and other fiduciaries address these upside potential opportunities to offset transition risks and costs. Climate-related opportunities will vary depending on the region, market, and industry in which an organization operates.

It may take time for an appellate court judgment to alert directors and officers of the extent of their fiduciary and other obligations in respect of climate change related financial risk. Canada and its provincial and territorial governments could help clarify the scope of obligations by either expressly legislating that companies address climate change financial risk or expressly requiring directors and officers to identify material climate related risks and develop strategies to manage them. At a minimum, they should legislate the relevant disclosure requirements recommended by the TCFD. While directors, officers, pension trustees and other fiduciaries have an obligation to identify and address climate change risk under their existing duties, the federal government could offer guidance in the scope of their obligations.

¹⁵² G20 Green Finance Study Group. G20 Green Finance Synthesis Report. 5 September 2016, http://unepinquiry.org/wp-content/uploads/2016/09/Synthesis_Report_Full_EN.pdf.