Future Facing Disputes

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Risk, Resilience and Reputation

Climate risk – shareholder and investor activism

In a world where climate-related risk climbs ever higher on the global agenda, shareholder activism around the issue is gaining unprecedented traction. Businesses must engage now to remain ahead of the game, or will risk significant legal, reputational and financial consequences.

In this paper we look in more detail at what shareholder activism is and what it means for senior managers and their businesses.

For more on the topic, see our two recent insight papers: *Emergence of Climate Change Litigation* (early 2020), and *Enforcing the Ethical Charter* (July 2020), where we explored the rise in climate related litigation and how shareholder action can uphold the Environmental, Social and Governance criteria contained in the Ethical Charter.

Shareholder activism and climate change

Climate risks are risks to business, governments, communities, and the wider economy, which arise specifically from the effects or anticipated effects of climate change. From a business perspective, these manifest as (i) **Physical risks** (such as supply chain disruption from major weather events), (ii) **Transitional risks** (such as costs associated with poor preparation for regulatory changes such as increased reporting requirements), and (iii) **Liability risk** (such as legal action from stakeholders for climate damage that a business has caused). We discussed this risk in our earlier paper, the *Emergence of Climate Change Litigation*.

Activist shareholders, whether they have a social, financial, climate-related or other agenda, generally seek to effect a positive change. In some instances, groups or individuals may even purchase shares in a company with the specific intention of using their newly acquired rights to try to bring about change.

Shareholder litigation strategies are increasingly being used to hold companies to account for climate-related issues; including challenging the way that senior managers address (or fail to address) climate change as a business financial risk. With organised groups such as Climate Action 100+ making engagement in shareholder action very easy, and mounting media interest in the challenges, we cannot understate how significant this issue is going to become for businesses.

How are shareholders applying pressure?

There are a number of legal avenues available to activist shareholders, who can take action on their own behalves and on behalf of the company in which they hold shares. Here, we look at how shareholder action has been used in the UK, and internationally, to apply pressure on boards to adopt more climate-friendly business practices.

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Members' power to require circulation of resolutions for AGMs

In May 2020, activist shareholders coordinated by ***Share***Action filed a resolution asking Barclays to phase out the provision of financial services not aligned with the goals of the Paris Agreement. Although not passed, the move prompted Barclays to commit to decarbonising lending by 2050. This demonstrates the power of shareholder resolutions to influence company behaviour, even where they are not technically successful. In a similar move a year earlier, Climate Action 100+ filed a resolution asking BP to expand climate-related disclosures in its reporting. The resolution passed in May 2019 with over 99% voting in favour.

Civil claims against management

In the UK, a senior manager owes various duties to their company, including a duty to promote the company's success. Where a company director fails to do this, shareholders may be able to bring a claim against them on the company's behalf. This is increasingly being used in the context of failure to address climate-related risks.

In the Australian case of *McVeigh v Retail Employees Superannuation Trust*, a superannuation fund implemented a net-zero by 2050 goal following a challenge by one of its beneficiaries for failing to disclose information on how climate change would impact the success of the trust and what its trustees were doing about it. As well as demonstrating the power of individual stakeholders to influence corporation behaviour, it also demonstrated the weight that courts are giving to these issues. While the matter did not ultimately go to trial, the judge described it as raising "*a socially significant issue about the role of superannuation trusts and trustees in the current public controversy about climate change*" and being "*of a public interest nature*". In the recent landmark settlement, the pension fund also agreed to incorporate climate change financial risks in its investments and implement a net-zero by 2050 carbon footprint goal; a move which will likely send ripples through the sector. Trustees and others in fiduciary positions should take note that these sorts of actions are not being viewed as without merit, and that courts are willing to consider them.

Environmental law NGO, ClientEarth, bought a share interest in Polish utility company, Enea SA (**Enea**), specifically so it could bring an action against the company, and succeeded in having Enea's decision authorising construction of a €1.2 billion coal-fired power plant declared invalid. While not ultimately ruled on by the court, ClientEarth argued that construction of the plant would harm Enea's economic interests due to climate related risk factors, including the increasing price of carbon, competition from cheaper renewable energy sources and decreased EU subsidies for coal power. Further, *ClientEarth* submitted that the project would *"risk breaching board members' fiduciary duties of due diligence and to act in the best interests of the company and its shareholders*".

In the US, ExxonMobil's shareholders brought a class action for the board's failure to provide adequate climate risk disclosure after stock prices fell by 13% in one year. They alleged a "*longstanding fraudulent scheme*" to overvalue the company and deceive investors into thinking the board were managing climate risk effectively, when this was not the case. While eventually dismissed, the lengthy three-and-a-half-year process garnered significant media attention and highlights yet another important business risk associated with climate change: reputational damage.

As these three cases show, shareholder activism is impactful, and it is here to stay. In the next three to five years we expect these actions will have become par for the course in shaping board decisions.

What next?

As can be seen from the examples above, boards of directors and other managers are being pushed on their climate risk strategy by activist shareholders, and companies and investment funds are susceptible regardless of sector or jurisdiction. Public and political will for transparency and positive action on green issues is growing.

Increasing scrutiny of actual and perceived lack of affirmative action to fight climate change should be expected. In 2020, BlackRock Inc chairman, Larry Fink, announced that the world's largest asset manager would be asking the companies it invests in to provide detailed climate disclosures including their operating plan in a low emission economy. Most recently, in December 2020, Blackrock also vowed to back more shareholder resolutions on climate and social issues at annual meetings, going forwards.

Group Litigation Orders mean that the UK may also see a rise in the kind of collective redress sought in the ExxonMobil case, with defendant companies being pursued by large numbers of claimants at once in high profile cases.

Businesses must devote the necessary resources to understanding the full environmental impact of their wider business strategies – from the carbon footprint of input resources and end of product life emissions in supply chains, to company environmental policies on investments. Taking this meaningful action now will not only help to avoid the sorts of disputes discussed here, but future-proof businesses for the Green Recovery.

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