

## GREEN BOARDROOMS?

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*Corporate and securities law tools are increasingly being used to address climate change. Disclosure of climate-related business risks and shareholder proposals and engagement have grown in the United States and globally, as have broader efforts to use these tools to address environmental and social issues. Emerging fiduciary duty suits in other jurisdictions claim that corporate boards have failed to monitor and manage climate-related risks adequately. However, legal scholarship has failed to assess whether these efforts are actually changing corporate behavior. This Article draws on original interviews with corporate leaders and investors in the United States and Australia to assess the effectiveness of corporate and securities law tools in addressing climate change. It finds that while disclosures and shareholder proposals related to climate change have been extensive, they have not yet changed corporate behavior much, if at all. The Article therefore proposes a multi-pronged approach to increase the future effectiveness of disclosure, shareholder proposals and engagement, and fiduciary duty suits. This study offers new insights to*

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*the old debate over how corporations can and should be used to address societal problems.*

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## I. INTRODUCTION

In 2017, the shareholders of three major fossil fuel companies, including ExxonMobil, approved proposals requiring that the companies produce detailed reports concerning climate change and their businesses.<sup>1</sup> Shareholders called for these analyses to incorporate the potential impact on the companies of the Paris Climate Agreement's

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<sup>1</sup> Cydney Posner, *Are Shareholder Proposals on Climate Change Becoming a Thing?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 21, 2017), <https://corpgov.law.harvard.edu/2017/06/21/are-shareholder-proposals-on-climate-change-becoming-a-thing/> (discussing these three resolutions).

goal of limiting global warming to well-below 2-degrees Celsius.<sup>2</sup> In 2018, the Sustainability Accounting Standards Board published a set of standards to guide voluntary reporting on a wide range of topics, including climate change, with guidance particularized to the needs of 77 different industries.<sup>3</sup>

These are two examples among many of initiatives being undertaken in the United States and around the world to use securities and corporate law tools – disclosure, shareholder proposals and engagement, and fiduciary duty litigation – to pressure corporations to respond more quickly to the challenges of climate change in their business plans and investments.<sup>4</sup> Companies increasingly provide sustainability disclosures in their annual reporting and on their website, though the quality of the information varies.<sup>5</sup> The number of shareholder proposals on climate change, and votes in support of them, continue to grow.<sup>6</sup> And lawsuits asserting fraud in disclosure or a

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<sup>2</sup> The 2015 Paris Agreement, C.N.92.2016.TREATIES-XXVII.7.d, Article 2(1)(a) calls on parties to hold global average temperature rises to “well below” 2 degrees Celsius above pre-industrial levels and to pursue efforts to contain temperature rises to no more than 1.5 degrees Celsius. *Id.*

<sup>3</sup> SASB, Current Standards, <https://www.sasb.org/standards-overview/download-current-standards/>. The Board is one of many organizations that has emerged to create voluntary sustainability disclosure standards. *See infra* notes 106 through 110 and accompanying text.

<sup>4</sup> Disclosure involves companies providing information about climate change risks and activities. Shareholder proposals involve someone who has a share in the company bringing an proposal to be voted on by shareholders demanding that the company be responsive to climate change. Fiduciary duty suits argue that companies have a fiduciary duty to address the risks of climate change. For an analysis of these tools, see Hari M. Osofsky, Jacqueline Peel, Brett McDonnell & Anita Foerster, *Energy Re-Investment*, 94 IND. L.J. 595 (2019).

<sup>5</sup> JIM COBURN & JACKIE COOK, CERES, COOL REPOSE: THE SEC & CORPORATE CLIMATE CHANGE REPORTING 11-12 (2014); IRRC Institute, *State of Integrated and Sustainability Reporting 2018* 33.

<sup>6</sup> Conference Board, *In 2020, Companies Will Continue to Face Pressure to Diversify Their Boards, Address Pay Gaps, and Expand Political Contribution Disclosure*, Dec. 17, 2019, <https://www.prnewswire.com/news-releases/in-2020-companies-will-continue-to-face-pressure-to-diversify-their-boards-address-pay-gaps-and-expand-political-contribution-disclosure-300976064.html>.

failure to monitor and manage climate change-related risks<sup>7</sup> adequately have begun to emerge globally.<sup>8</sup>

These tools are not only being used to address climate change. That topic is just one of a number of environmental and social issues<sup>9</sup> that new disclosure frameworks and shareholder proposals are targeting. Other common issues include gender pay equity, workplace diversity, and political and lobbying expenditures by corporations.<sup>10</sup> The initiatives addressing these issues form a new phase in a cycle of corporate governance debates raising fundamental questions of corporate law:<sup>11</sup> In whose interests should corporations be governed? How can we ensure that corporations best advance the public good?<sup>12</sup> However, amid all this activity and debate, the critical question remains of whether this new activism is actually changing corporate behavior.

This Article analyzes whether corporate and securities law can impact corporate behavior with respect to climate change, drawing on original interviews with corporate managers, investors, regulators, and

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<sup>7</sup> We use the term “climate change-related risks” or “climate risk” in this Article to refer to the two principal categories of risk that climate change may pose for businesses that have been identified by the Taskforce on Climate-Related Financial Disclosures (TCFD): *physical* risks, i.e., risks posed by climate change to the assets, operations and supply chains of a company and *transition* risks, i.e., risks associated with the transition to a low-carbon economy which can include risks due to new regulatory requirements, potential litigation, technology change or reputational or brand damage. See TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES 5-6 (JUNE 2017). Our focus in the Article is primarily on transition risk as we are concerned with how companies are responding to the challenge of transitioning business practices for a low-carbon economy.

<sup>8</sup> See *supra* note 276 and accompanying text.

<sup>9</sup> Along with governance issues, these sorts of issues are frequently referred to as ESG matters. We will also frequently use the term “sustainability” to cover the range of environmental and social topics currently being addressed in corporate governance circles.

<sup>10</sup> Marc Treviño, *2019 Proxy Season Review: Part 1—Rule 14a-8 Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 26, 2019), <https://corpgov.law.harvard.edu/2019/07/26/2019-proxy-season-review-part-1-rule-14a-8-shareholder-proposals/>.

<sup>11</sup> C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 15 U. KAN. L. REV. 77 (2002); Brett McDonnell, *The Corrosion Critique of Benefit Corporations*, 6-9, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3450747](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450747).

<sup>12</sup> See Part II.A.

other relevant stakeholders in the United States and Australia.<sup>13</sup> Through the interviews, we sought a deeper understanding of how different actors perceive climate-related uses of securities law tools, and how companies are responding. This included an effort to understand how, if at all, voluntary disclosure and shareholder proposals and engagement have succeeded so far at getting companies to address climate change-related risks.<sup>14</sup>

Our findings indicate these corporate and financial law initiatives have not yet had a significant impact on underlying corporate behavior in ways which substantively affect the allocation of resources and capital to address climate change.<sup>15</sup> However, those interviewed generally accept that even under corporate law models focused on enhancing long-term shareholder value (rather than considering other key stakeholders and the general public), companies will need to pay greater attention to policy issues such as climate change that are likely to have serious effects on financial performance.<sup>16</sup> Importantly, compared to the situation just five years ago, many more companies and investors in both countries now understand climate change to pose financial risks for businesses.<sup>17</sup>

Based on these findings, the Article proposes pathways for enhancing the effectiveness of corporate and financial law tools.<sup>18</sup> Australia provides a particularly helpful comparative example for the United States in developing these strategies because of its legal, socio-political, and economic similarities. Drawing from the interviews and evolving use of the tools in practice, the Article considers how they could be used more effectively. In doing so, it recognizes the ongoing debate in corporate law about whether corporations should focus only on enhancing value for their shareholders or also consider other stakeholders and the general public.<sup>19</sup> The Article argues that even if a model focused on enhancing long-term shareholder value is not ideally suited to addressing problems like climate change, working within its structure – while exploring longer-term reform – is most likely to be

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<sup>13</sup> A total of 38 interviews were undertaken, 14 with stakeholders in the United States and 24 with stakeholders in Australia. Additional details of different groups of participants in the interviews is below, *see infra* notes 95 through 96 and accompanying text. A separate online appendix provides further information on the interview methodology and analysis.

<sup>14</sup> *Id.*

<sup>15</sup> *See infra* Parts III-V.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *See infra* Part VI.

<sup>19</sup> *Id.*

effective in our deadlocked political environment.<sup>20</sup> For each tool, we outline what truly deep reform to create stakeholder-focused corporations might look like, but also suggest more modest reforms within the prevailing long-term shareholder value paradigm that have better prospects of success while nudging corporations in a more stakeholder-focused direction.

In the case of disclosure, a stakeholder focus would suggest comprehensive new mandatory disclosure rules,<sup>21</sup> along the lines of what has emerged in the European Union (EU),<sup>22</sup> while more modest reform would entail the Securities and Exchange Commission (SEC) mandating more specific disclosure of items related to climate change where they have a material impact on financial results and adopting one of the new private standards for disclosure so that there is greater uniformity.<sup>23</sup>

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<sup>20</sup> *Id.*

<sup>21</sup> See Lipton, *infra*, note 119. See also Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, FACULTY SCHOLARSHIP AT PENN LAW, [https://scholarship.law.upenn.edu/faculty\\_scholarship/1998/](https://scholarship.law.upenn.edu/faculty_scholarship/1998/) (April 2019); Cynthia A. Williams & Jill E. Fisch, *Petition to SEC for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, Oct. 9, 2018, <https://corpgov.law.harvard.edu/2018/10/09/petition-to-sec-for-rulemaking-on-environmental-social-and-governance-esg-disclosure/>.

<sup>22</sup> The EU's Non-Financial Reporting Directive (2014/95/EU) requires large undertakings across the EU to include a non-financial statement in the management report containing information on environmental, social and employee, human rights and bribery and anti-corruption related issues. In June 2017, the European Commission published non-binding guidelines on non-financial reporting to help companies to provide high quality disclosure of environmental, social and governance-related information. European Commission, Commission Guidelines on Non-Financial Reporting, [https://ec.europa.eu/info/publications/non-financial-reporting-guidelines\\_en](https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en). Further, in June 2019, the European Commission published non-binding guidelines specifically on reporting climate-related information. The guidelines were developed as part of the European Commission's 2018 Action Plan on Financing Sustainable Growth, which aims to foster sustainable investment, manage financial risks associated with climate change and other environmental and social problems, and encourage transparent and long-term focused financial activity. The guidelines supplement the existing 2014 Directive and non-binding guidelines, and they integrate the recommendations of the TCFD.

<sup>23</sup> See *supra* note 3 and accompanying text. The SEC could require issuers to either comply with those standards or explain why they are not material for their business. Climate change disclosure should include analysis of how

Regarding shareholder actions and engagement, a stakeholder focus would empower persons with environmental expertise at the board level or through advisory councils, while modest reform would bring SEC treatment of proposals concerning greenhouse gas emissions and Department of Labor guidance on the duty of retirement plan fiduciaries back to its approach during the Obama years. We also recommend a variety of types of shareholder proposals that climate change activists may want to pursue, some of which are already being tried in the U.S. and Australia but could be expanded, and others of which are new suggestions based on our interview findings.<sup>24</sup>

With respect to fiduciary duty, we note the immense obstacles that a breach of duty climate change suit faces under governing law, but also draw attention to the emergence of such suits in other countries and comment on their potential application in a U.S. context. Australia provides a pertinent comparison here with authoritative legal opinions,<sup>25</sup> endorsed by Australian national regulators,<sup>26</sup> predicting that litigation against directors for failure to consider climate-related risk “is likely to be only a matter of time.”<sup>27</sup>

The Article proceeds as follows. Part II provides conceptual framing for the rest of the Article by situating the use of corporate and financial law to address climate change within debates in both corporate and environmental law over the role of corporations. It also

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world governments responding to a 2 degree Celsius or lower scenario as required by the Paris Agreement would affect the disclosing company. *See infra* Part VI.

<sup>24</sup> Useful proposals include limits on lobbying and political spending, requiring at least one director with relevant environmental expertise, and requiring a more elaborate and formalized process for consulting with environmental, community, and other stakeholder groups on climate change, as well as other sustainability issues. *See infra* Part IV.B.

<sup>25</sup> *See* NOEL HUTLEY SC & SEBASTIAN HARTFORD-DAVIS, CLIMATE CHANGE AND DIRECTOR’S DUTIES: MEMORANDUM OF OPINION (2016), <https://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf>; NOEL HUTLEY SC & SEBASTIAN HARTFORD-DAVIS, CLIMATE CHANGE AND DIRECTOR’S DUTIES: SUPPLEMENTARY MEMORANDUM OF OPINION (2019), [https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016\\_pdf.pdf](https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016_pdf.pdf).

<sup>26</sup> *See, e.g.,* John Price, Comm’r, Austl. Sec. & Inv. Comm’n, *Keynote Address – Centre for Policy Development: Financing a Sustainable Economy* (June 18, 2018).

<sup>27</sup> NOEL HUTLEY SC & SEBASTIAN HARTFORD-DAVIS, CLIMATE CHANGE AND DIRECTOR’S DUTIES: MEMORANDUM OF OPINION (2016), *supra* note 25, para. 51.

introduces the value of comparing the United States and Australia in this context. Parts III through V review legal and institutional developments and present our interview results and comparisons with Australia for each tool, with Part III covering disclosure, IV covering engagement, and V covering fiduciary duty. Part VI provides suggestions for reforms. Part VII concludes.

## II. THE ROLE OF CORPORATE AND SECURITIES LAW IN ADDRESSING CLIMATE CHANGE

In the past decade or so, the shape of corporate governance for U.S. public corporations has altered dramatically, with initiatives surrounding climate change playing a central role. Environmental, Social, and Governance (ESG) activism has exploded as a major part of shareholder formal and informal engagement.<sup>28</sup> Multiple disclosure initiatives, focused on climate change in particular and sustainability more generally, have expanded, with sustainability reports becoming a standard part of corporate disclosure.<sup>29</sup>

These developments can be situated within a long-running and evolving debate over the nature and purpose of business corporations. They also reflect growing social and political recognition of the urgency of addressing climate change. The developments described here are taking a particular form within the United States, but are occurring at public companies around the world as well, with close parallels in similarly-situated carbon economies such as Australia.

This Part frames the rest of the Article by providing background on debates within corporate governance and environmentalist circles concerning the relationship between climate change and corporations. Section A describes the evolving debate over the nature and purpose of U.S. corporations. Section B explores why environmentalists concerned about climate change have turned to using these securities and corporate law tools and their varying views of them. Section C discusses features of company law and governance in Australia, and discusses some benefits from comparing emerging practices in these two similarly-situated countries.

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<sup>28</sup> Tamas Barko, Martijn Cremers, & Luc Renneboog, *Shareholder Engagement on Environmental, Social, and Governance Performance*, paper available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2977219](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977219).

<sup>29</sup> Hans B. Christensen, Luzi Hail, & Christian Leuz, *Adoption of CSR and Sustainability Reporting Standards: Economic Analysis and Review*, paper available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3439179](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439179).



### A. *The Corporate Governance Debate*

The proper purpose of corporations, especially public corporations, and the related question of to whom the fiduciary duties of corporate directors and officers do and should run, have been a source of several cycles of public and scholarly debate over the past century. The *locus classicus* of this debate is an exchange between Adolf Berle and Merrick Dodd in the Harvard Law Review in the early nineteen-thirties. Berle, a major New Deal figure and co-author of the book which first analyzed the separation of ownership and control in public corporations, argued that directors and officers have a duty to protect the interests of shareholders.<sup>30</sup> Dodd countered that their duty runs to the corporation more broadly, including the interests of other stakeholders and the public in general.<sup>31</sup>

The managerialist ideology of the fifties seemed to reflect a victory for Dodd's view, as Berle recognized.<sup>32</sup> But in the seventies and eighties, Berle's shareholder conception became dominant. This was driven by the rise of corporate raiders who launched hostile takeovers of poorly run businesses. A wave of economists and legal scholars argued that a focus on shareholder value would maximize the general welfare, at least within properly functioning markets constrained by laws that countered major external effects.<sup>33</sup> Milton Friedman made the case most famously in a short and elegant essay in the New York Times.<sup>34</sup> Some scholars, though, criticized this view, asserting the broader stakeholder vision of Dodd, and many states adopted corporate constituency statutes that allowed directors and officers to consider the

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<sup>30</sup> A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

<sup>31</sup> E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

<sup>32</sup> ADOLF A. BERLE, JR., *POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY* (1959).

<sup>33</sup> FRANK EASTERBROOK & DANIEL FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 36-39 (1991); Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021, 2031 (1993); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550 (2003).

<sup>34</sup> Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, NEW YORK TIMES MAGAZINE (Sept. 13, 1970).

interests of a variety of stakeholders, including employees, creditors, customers, the environment, and the community.<sup>35</sup>

In the last two decades or so, two different sorts of shareholder activism have embodied the tension between the shareholder and stakeholder positions. On the one hand, a group of equity funds have followed a strategy of identifying poorly-performing companies, buying up a substantial share position in them, and then pressuring management to take actions that the activists believe will increase returns to shareholders.<sup>36</sup> On the other hand is the growth of the type of ESG activism discussed here, which addresses environmental and social concerns.

Many proponents of ESG proposals and disclosure do not take a firm position on the stakeholder side of the debate. Instead, they argue that a focus on long-term shareholder value is consistent with, and indeed requires, aggressive consideration of a variety of stakeholder interests. Typical of this attempt to reconcile shareholders and stakeholders through a focus on the long run are recent annual letters from Larry Fink, the CEO of BlackRock, one of the Big Three family of mutual funds that has come to play a huge role in the ownership of public corporations. In his most recent letter to CEOs, Fink specifically focused on climate change:

Our investment conviction is that sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors. And with the impact of sustainability on investment returns increasing, we believe that sustainable investing is the strongest foundation for client portfolios going forward.<sup>37</sup>

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<sup>35</sup> Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); LYNN A. STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012); LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT* (2001); KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* (2010); David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L. REV. 1013 (2013).

<sup>36</sup> See Lucian A. Bebchuk, Alon Brav, & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545 (2016).

<sup>37</sup> Blackrock, *A Fundamental Reshaping of Finance*, <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>.

Fink is far from alone in this view. A large number of both investors and companies have publicly taken similar positions. For an example of the view expressed from the company side, consider this statement from the Sustainability Report of Prologis, the highest-rated U.S. corporation on the Global 100 Most Sustainable Companies list:<sup>38</sup>

Our ESG program is good business—benefiting our customers, investors, communities and employees. Good ESG practices support our corporate commitment to enduring excellence and advance our longstanding focus on exemplary customer service.<sup>39</sup>

Why might a long-term focus help reconcile shareholder with stakeholder interests? Several sorts of arguments are made in the context of climate change. For many companies, climate change already is imposing costs that require action, and for others it presents new business opportunities. Another reason companies may need to focus on climate change now is the threat of potentially much stronger regulation in the relatively near future. Particularly for companies in energy and related fields, which must make long-term investment decisions, the profitability of those investments may shift dramatically with potential new regulations.<sup>40</sup>

Reputational concerns may also drive companies to consider stakeholder interests.<sup>41</sup> Reputation becomes more important the more weight decisionmakers give to the future profitability of the business. Many consumers increasingly choose what companies to patronize, or not patronize, based in part on their sense of how well those companies conform to their personal values.<sup>42</sup> Reputation with potential

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<sup>38</sup> Corporate Knights, 2019 Global 100 Results, <https://www.corporateknights.com/reports/2019-global-100/2019-global-100-results-15481153/>.

<sup>39</sup> Prologis, A Culture of Resistance (2017), [https://prologis.getbynder.com/m/10c8bf7b4af3adf1/original/Prologis\\_2017\\_SustainabilityReport\\_180530\\_FINAL.pdf](https://prologis.getbynder.com/m/10c8bf7b4af3adf1/original/Prologis_2017_SustainabilityReport_180530_FINAL.pdf).

<sup>40</sup> Madison Condon, *Externalities and the Common Owner*, forthcoming, WASH. L. REV., available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3378783](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378783).

<sup>41</sup> Claire A. Hill, *Caremark as Soft Law*, 90 TEMP. L. REV. 681 (2018); Claire A. Hill, *Marshalling Reputation to Minimize Problematic Business Conduct*, 99 B.U. L. REV. 1193 (2019).

<sup>42</sup> LAWRENCE B. GLICKMAN, BUYING POWER: A HISTORY OF CONSUMER ACTIVISM IN AMERICA (2009); EMILY HUDDART KENNEDY, MAURIE J. COHEN & NAOMI T. KROGMAN (eds), PUTTING SUSTAINABILITY INTO PRACTICE:

employees also matters to many businesses, and highly-skilled employees may increasingly care about climate change.<sup>43</sup> However, even if all of the concerns above are correct, one must also make a case for why managers are not already fully taking them into account and hence why shareholder activism or litigation could help, e.g. by addressing agency costs or market imperfections.

Engagement with stakeholders may also have informational benefits. Scientists and other environmentalists who are deeply engaged in and knowledgeable about the issue of climate change may be able to help companies evaluate potential effects from climate change. Employees and customers may have helpful ideas about how a company can reform its operations. Local community leaders and organizations may help businesses become aware of environmental impacts they are having in the places where they are located.

A further effect, beyond a long-term focus on the returns of individual companies, may reconcile shareholder and stakeholder interests. Many institutional investors, the owners of most shares of public companies, are highly diversified in their share ownership. They thus care about the effect that the behavior of one company may have on the long-term profits of their other portfolio companies. Even if a utility company may generate greater profits by building more fossil fuel plants, if the resulting greenhouse gas (GHG) emissions hurt the profits of other companies more, a diversified investor will not want to see those plants built. This portfolio effect helps internalize major externalities such as GHG emissions.<sup>44</sup>

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APPLICATIONS AND ADVANCES IN RESEARCH ON SUSTAINABLE CONSUMPTION (2015).

<sup>43</sup> See, e.g., BlackRock, Purpose and Profit, <https://www.blackrock.com/corporate/investor-relations/2019-larry-fink-ceo-letter> (“Attracting and retaining the best talent increasingly requires a clear expression of purpose. With unemployment improving across the globe, workers, not just shareholders, can and will have a greater say in defining a company’s purpose, priorities, and even the specifics of its business. Over the past year, we have seen some of the world’s most skilled employees stage walkouts and participate in contentious town halls, expressing their perspective on the importance of corporate purpose. This phenomenon will only grow as millennials and even younger generations occupy increasingly senior positions in business. In a recent survey by Deloitte, millennial workers were asked what the primary purpose of businesses should be – 63 percent more of them said ‘improving society’ than said ‘generating profit.’”)

<sup>44</sup> Condon, *supra* note 40. A new nonprofit has been formed to advocate that investors with diversified portfolios should take this effect into account, allowing them to advocate planet-friendly policies. The Shareholder Commons, <https://theshareholdercommons.com/about/#our-story>.

For these reasons among others, the prevalent long-term value mantra may go a long way to reconciling the interests of shareholders with other stakeholders, including the interests of all persons in reducing the impact of climate change. However, this consensus is challenged from opposing directions.

On one side are shareholder proponents who believe that ESG activism has gone too far, and that much of the time following what ESG believers propose would harm shareholder interests.<sup>45</sup> These proponents can accept that good business reasons may justify addressing climate risks, but deny that shareholders or courts can improve upon the judgment of managers. This may be because ESG proponents know much less about what is going on within a business than its directors and officers. Some shareholder proponents also worry that some ESG proponents may be using the long-term mantra to hide the true motivation of their agenda, namely to co-opt the mechanisms of corporate governance to reduce climate change even if doing so damages the companies involved. These shareholder proponents go back to the gospel of Milton:<sup>46</sup> if GHG emissions are imposing major external effects on the world, the proper response is with legislation to stop it, such as a carbon tax or a cap-and-trade program.

A related criticism is that internal power remains focused on shareholders, who are the sole constituents who elect the board and have the power to sue over fiduciary duty violations. Director and officer compensation also remain focused on shareholder value, and the prospects of officers are naturally tied to the economic success of their business. All that means that we should expect directors and officers to remain tied to the interests of shareholders. Most other constituencies have both no power and also very limited knowledge about the operations of most businesses. Insofar as businesses spotlight the interests of others, we should expect it to be mostly for show.<sup>47</sup>

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<sup>45</sup> Some have taken to direct counter-action against climate change shareholder action, *see* Burn More Coal, <https://burnmorecoal.com/>; *see also* Stephen M. Bainbridge, *Corporate Purpose in a Populist Era*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3237107](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3237107).

<sup>46</sup> *See* Friedman, *supra* note 34.

<sup>47</sup> The Chief Justice of the Delaware Supreme Court, Leo Strine, has argued that this concentration of corporate power on shareholders alone is the main reason why we should expect the duty of directors to run to shareholders. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761 (2015); Strine, *Our Continuing Struggle with the Idea That For-Profit Corporations*

A different critique comes from the side of stakeholder proponents. These agree with the Friedmanite critique that corporations as currently constituted are unfit to become much more aggressive in addressing climate change. However, these stakeholder-side critics are skeptical that legislative or regulatory responses will be forthcoming at the scale and on a timeline that is adequate to the challenge. Governments are captured by the very shareholder-centered companies that are causing the problem, and even if they had the will, they lack the resources necessary to enforce rules adequately were they able to enact them. Addressing climate change thus requires an enormous voluntary mobilization by businesses, but current corporations will not mobilize nearly actively enough. Corporations must therefore themselves be reformed, in their purposes, duties, and power structure, so as to represent stakeholder interests adequately, including our shared interest in addressing climate change.<sup>48</sup>

Thus, three basic positions have emerged regarding the role that non-shareholder-focused interests, including the public interest in averting climate change, should play in corporate decisionmaking. All positions aim ultimately at improving social welfare, but they disagree as to what role corporations should play in doing so. The shareholder wealth maximization position that has dominated in the United States draws on the Smithian invisible hand idea:<sup>49</sup> Within functioning markets, firm profit maximization should maximize social welfare, with legal intervention as needed to address externalities that may make prices inadequate signals of true social costs.<sup>50</sup> The stakeholder position holds that markets and legal interventions are not enough, and that we need corporations to consciously pursue the general good, not just

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*Seek Profit*, 47 WAKE FOREST L. REV. 135 (2012). Note, Strine's personal opinions do not necessarily coincide with this existing legal structure. He has advocated various reforms to increase protection for employees in corporate governance. See Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing Between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3461924](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924).

<sup>48</sup> BEATE SJAFJELL & BENJAMIN J. RICHARDSON, eds., *COMPANY LAW AND SUSTAINABILITY: LEGAL BARRIERS AND OPPORTUNITIES* (2015).

<sup>49</sup> ADAM SMITH, *The Wealth of Nations* (1776).

<sup>50</sup> Friedman, *supra* note 34.

profits.<sup>51</sup> The long-term shareholder position tries to reconcile the two extremes.<sup>52</sup>

### *B. The Environmental Debate*

Just as a triad of positions have emerged among corporate governance scholars regarding the proper role of companies in addressing issues of broad public interest like climate change, so we have seen a similar variation of opinion arise among environmental scholars and activists. Environmental scholars and activists approach the issue not from the perspective of corporate governance but rather from what strategies and laws are most effective to deal with the looming climate crisis. The Paris Climate Agreement, concluded in 2015, sets out a clear, science-based goal for what is necessary to prevent dangerous climate change: holding global average temperature rises to well below 2 degrees Celsius over pre-industrial levels and pursuing efforts to keep temperature rises to no more than 1.5 degrees Celsius.<sup>53</sup> The premier climate science body globally – the Intergovernmental Panel on Climate Change (IPCC) – advised in a 2018 report that achieving this goal requires “rapid and far-reaching transitions” across all economic sectors.<sup>54</sup>

For some environmental scholars and activists, corporations – particularly fossil fuel corporations – are an obstacle to achieving this goal, rather than a part of the solution. For example, some of the key leaders of the “climate justice” movement, which has gained considerable momentum in recent years, aim to reduce emissions through targeting major corporate emitters of GHGs. Writing in 1999, the non-governmental organization (NGO), Corporate Watch, described the ultimate aim of the then nascent climate justice movement as “holding fossil fuel corporations accountable for the central role they play in contributing to global warming.”<sup>55</sup> In the early 2000s, U.S. lawsuits such as *Kivalina* and *Comer* featured plaintiffs (unsuccessfully) seeking to attribute legal responsibility for climate

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<sup>51</sup> Sjaafjell & Richardson, *supra* note 48.

<sup>52</sup> Fink, *supra* note 37.

<sup>53</sup> See The 2015 Paris Agreement, *supra* note 2, Article 2(1)(a).

<sup>54</sup> GLOBAL WARMING OF 1.5°C. AN IPCC SPECIAL REPORT ON THE IMPACTS OF GLOBAL WARMING OF 1.5°C ABOVE PRE-INDUSTRIAL LEVELS AND RELATED GLOBAL GREENHOUSE GAS EMISSION PATHWAYS, IN THE CONTEXT OF STRENGTHENING THE GLOBAL RESPONSE TO THE THREAT OF CLIMATE CHANGE, SUSTAINABLE DEVELOPMENT, AND EFFORTS TO ERADICATE POVERTY 15 (V. Masson-Delmotte et al. eds., 2018), p. 15.

<sup>55</sup> CorpWatch, *What is Climate Justice?* (Nov. 1, 1999), <https://corpwatch.org/article/what-climate-justice>.

change harms to major oil companies.<sup>56</sup> More recently, there has been another eruption of climate justice lawsuits brought against both governments and companies, in the United States and in other countries.<sup>57</sup>

Those in the climate justice movement with this perspective have pursued a variety of legal and campaigning strategies in their efforts to pursue accountability for climate-related damage, ranging from large-scale protests and disruptive actions to legislative advocacy and litigation.<sup>58</sup> In addition to direct action against fossil fuel companies, some advocates and organizations, such as 350.org, have encouraged institutional investors like universities, pension funds, churches and other large charities to divest their shareholdings in fossil fuel companies.<sup>59</sup> The movement has also accused companies, particularly in the fossil fuel industry, of seeking to undermine the findings of climate science and to block progressive regulatory efforts to advance

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<sup>56</sup> *Native Village of Kivalina v. ExxonMobil Corp*, 696 F.3d 849 (9th Cir. 2012); *Comer v. Murphy Oil USA*, 607 F.3d 1049 (5th Cir. 2010).

<sup>57</sup> Geetanjali Ganguly, Joana Setzer & Veerle Heyvaert, *If at First You Don't Succeed: Suing Corporations for Climate Change*, 38 OXF. J. LEG. STUD. 841, 843 (2018).

<sup>58</sup> See environmental movements such as Extinction Rebellion and Fridays for Future. See also the 2015 Urgenda case, upheld on appeal to the Hague Court of Appeal and the Supreme Court of the Netherlands. The court found that the Dutch state had breached its duty of care by failing to adopt sufficiently ambitious reduction targets: *Urgenda Foundation v. The State of the Netherlands (Ministry of Infrastructure and the Environment)*, *Rechtbank Den Haag* [Hague District Court] 24 June 2015, C/09/456689 HA ZA 13-1396 (English translation) at [4.83]-[4.86]. This finding was upheld by the Court and Appeal and Supreme Court of the Netherlands on the basis of the state's violation of rights protected by the European Convention on Human Rights by which the Netherlands is bound. See *Netherlands v Urgenda*, *Hoge Raad der Nederlanden* [Supreme Court of the Netherlands], 20 December 2019, No. 19/00135 (in Dutch). In the United States, the plaintiffs in the Juliana case assert that the Federal government violated their constitutional and public trust rights by burning fossil fuels. In 2016 Judge Aiken denied motions to dismiss the action, finding that there is a fundamental right to a climate system capable of sustaining human life. This decision has been appealed: *Juliana v. United States*, 217 F. Supp. 3d 1224, 1250 (D. Or. 2016), appeal docketed, No. 18-36082 (9th Cir. Dec. 26, 2018).

<sup>59</sup> See 350.org. See also Neil Gunningham, *Building Norms from the Grassroots Up: Divestment, Expressive Politics, and Climate Change*, 39 LAW & POL'Y. 372 (2017).



climate policy.<sup>60</sup> Although some of these advocates simply target fossil fuels, others argue more broadly that unrestrained capitalism – represented by profit-driven corporate interests – is to blame for the majority of GHG pollution.<sup>61</sup>

A second set of environmental scholars and advocates – agreeing with the need to reduce corporate greenhouse gas emissions – have focused on the need for corporate and financial law to be reformed to give needed weight to the critical value of sustainability. These scholars generally identify with the stakeholder approach in the corporate governance literature, and focus on reforms to companies, as well as laws and principles governing investment, that could incentivize a greater focus on ESG issues.<sup>62</sup> This may include reforms to corporate disclosure requirements to mandate disclosure of environmental risks such as climate change,<sup>63</sup> all the way up to the introduction of new corporate forms that allow a primary ESG-related objective beyond the usual focus on shareholder profit.<sup>64</sup>

Like the convergence between shareholder and stakeholder approaches described above, we also see the emergence of what might be termed a “pragmatic middle” position on the role of companies in

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<sup>60</sup> NAOMI ORESKES & ERIK M. CONWAY, *MERCHANTS OF DOUBT: HOW A HANDFUL OF SCIENTISTS OBSCURED THE TRUTH ON ISSUES FROM TOBACCO SMOKE TO GLOBAL WARMING* (2010); Gunningham, *supra* note 59, at 381.

<sup>61</sup> Richard Heede, *Tracing anthropogenic carbon dioxide and methane emissions to fossil fuel and cement producers, 1854–2010*, 122 *CLIM. CHANGE* 229 (2014); Peter Frumhoff, Richard Heede & Naomi Oreskes, *The climate responsibilities of industrial carbon producers*, 132 *CLIM. CHANGE* 157 (2015).

<sup>62</sup> Sjafjell & Richardson, *supra* note 48; ELISA MORGERA, *CORPORATE ACCOUNTABILITY IN INTERNATIONAL ENVIRONMENTAL LAW* (2009).

<sup>63</sup> *See, e.g.*, Anita Foerster, Jacqueline Peel, Hari Osofsky & Brett McDonnell, *Keeping Good Company in the Transition to a Low Carbon Economy? An Evaluation of Climate Risk Disclosure Practices in Australia*, 35 *COMPANY & SEC. L. J.* 154 (2017); Cary Di Lernia, *Strange Bedfellows? Climate Change, Carbon Risk, and the Regulation of Corporate Disclosure*, 36 *COMPANY & SEC. L. J.* 221 (2018); Natalie Nowiski, *Rising above the Storm: Climate Risk Disclosure and Its Current and Future Relevance to the Energy Sector*, 39 *ENERGY L.J.* 1 (2018).

<sup>64</sup> Brett McDonnell, *From Duty and Disclosure to Power and Participation in Social Enterprise*, 70 *ALA. L. REV.* 77 (2018); Brett H. McDonnell, *Benefit Corporations and Public Markets: First Experiments and Next Steps*, 40 *SEATTLE U. L. REV.* 717 (2017); Dana Brakman Reiser, *Benefit Corporations – A Sustainable Form of Organization*, 46 *WAKE FOREST L. REV.* 591 (2011).

addressing climate change in environmental scholarship and practice.<sup>65</sup> Those adopting this approach seek to persuade corporations, as they are currently configured, to do more to address climate change on the basis that this can also serve corporate interests where climate change poses material business risks. For example, Professor Sarah Light's recent article on *The Law of the Corporation as Environmental Law* argues that we should embrace corporate law requirements as part of the "environmental toolkit," using these nontraditional levers to encourage company action to address pressing environmental issues, including climate change.<sup>66</sup> Authors such as Professors Michael Vandenberg and Jonathan Gilligan in their book, *Beyond Politics: The Private Governance Response to Climate Change*, take an even more robust stance, arguing that private sector action on climate change provides a promising alternative to waiting for governments to make progress on the issue.<sup>67</sup>

Those working to advance this approach have a variety of perspectives on corporations and on the appropriate strategy for deploying tools from this "environmental toolkit." This pragmatic middle position is sometimes held in conjunction with some variation on the first two positions, with these efforts treated as crucial complementary strategies given current partisan political dynamics.<sup>68</sup> For instance, some environmental groups embracing this middle-ground position do so through an engagement-focused strategy conducted in the shadow of the threat of litigation if companies do not step up their game on climate change. A leading example is the U.K.-based environmental NGO, ClientEarth, whose corporate and financial law program includes efforts both to educate companies about climate business risk and also to develop shareholder lawsuits against companies which fail to monitor and manage these risks adequately.<sup>69</sup>

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<sup>65</sup> The authors have articulated this view in previous work *see, e.g.*, Hari M. Osofsky & Jacqueline Peel, *Energy Partisanship*, 65 EMORY L.J. 695 (2016); Osofsky, Peel, McDonnell & Foerster, *supra* note 4. *See also* SARAH BARKER, DIRECTORS' LIABILITY AND CLIMATE RISK: AUSTRALIA – COUNTRY PAPER (COMMONWEALTH CLIMATE LAW INITIATIVE, APRIL 2018); Sarah Barker, Mark Baker-Jones, Emilie Barton & Emma Fagan, *Climate change and the fiduciary duties of pension fund trustees – lessons from the Australian law*, 6 J. SUSTAIN. FIN. & INV. 211 (2016).

<sup>66</sup> Sarah E. Light, *The Law of the Corporation as Environmental Law*, 71 STAN. L. REV. 137 (2019).

<sup>67</sup> MICHAEL P. VANDENBERGH & JONATHAN M. GILLIGAN, *BEYOND POLITICS: THE PRIVATE GOVERNANCE RESPONSE TO CLIMATE CHANGE* (2017).

<sup>68</sup> Osofsky & Peel, *supra* note 65, at 794.

<sup>69</sup> ClientEarth, *Company Reporting*, <https://www.clientearth.org/company-reporting/> (last visited Jan. 8, 2020).

In addition, the “pragmatic middle” position is a nuanced one because corporations and investors vary significantly in how they approach the problem of climate change and interact with the environmental community. Even within the fossil fuel industry, companies have positioned themselves differently with respect to how the energy transition needed interacts with their bottom line. This variation is particularly strong among oil and gas companies, many of which market natural gas as a transitional fuel and have invested significantly in renewable energy.<sup>70</sup> Some fossil fuel companies have been actively involved in corporate climate change efforts, including sending representatives to the international climate change negotiations, opposing the Trump Administration’s withdrawal from the Paris Agreement.<sup>71</sup>

The negotiations for the Paris Agreement and response to President Trump’s withdrawal exemplify this complexity. Those negotiations featured an unprecedented level of engagement with business interests, including some fossil fuel companies and investors in them.<sup>72</sup> Many of these companies and investors, including energy companies, opposed President Trump’s Paris Agreement withdrawal, and have committed – together with other stakeholders – to action as part of the We Are Still

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<sup>70</sup> Analysts have highlighted that European oil and gas companies are outpacing their U.S. rivals, *see e.g.*, Ron Bousso, *Big Oil spent 1 percent on green energy in 2018*, REUTERS (Nov. 12, 2018), <https://www.reuters.com/article/us-oil-renewables/big-oil-spent-1-percent-on-green-energy-in-2018-idUSKCN1NH004>; Timothy Abington & Kelly Gilblom, *Shell Leads Big Oil in the Race to Invest in Clean Energy*, BLOOMBERG (Sept. 4, 2019), <https://www.bloomberg.com/news/articles/2019-09-04/shell-leads-big-oil-in-the-race-to-invest-in-clean-energy-tech>.

<sup>71</sup> *See e.g.*, *Thousands of big energy reps at UN climate talks: monitor*, FRANCE24 (June 21, 2019), <https://www.france24.com/en/20190621-thousands-big-energy-reps-un-climate-talks-monitor>; Rebecca Elliott & Bradley Olson, *Oil Companies, Pushed to Address Climate, Disagree on How*, THE WALL STREET JOURNAL (Sept. 22, 2019), <https://www.wsj.com/articles/oil-companies-pushed-to-address-climate-disagree-on-how-11569144602>; Alanna Petroff, *Big business wants Trump to stick with Paris climate accord*, CNN (May 30, 2017), <https://money.cnn.com/2017/05/29/news/trump-paris-climate-change-business/>.

<sup>72</sup> Ilario D’Amato, Marc Bolland, CEO, M&S: COP21 a “Turning Point” Thanks to Business Engagement and Demand, THE CLIMATE GROUP (Dec. 6, 2015), [www.theclimategroup.org/what-we-do/news-and-blogs/cop21-a-turning-point-thanks-to-business-engagement-and-demand-marc-bolland-ceo-mands](http://www.theclimategroup.org/what-we-do/news-and-blogs/cop21-a-turning-point-thanks-to-business-engagement-and-demand-marc-bolland-ceo-mands) [<https://perma.cc/GJ57-J78Q>].

In initiative.<sup>73</sup> Additional, parallel private sector initiatives, such as the We Mean Business Coalition<sup>74</sup> and the G20 Taskforce on Climate-related Financial Disclosures (TCFD),<sup>75</sup> have continued to gain momentum following the Paris Agreement. Both prominently feature corporate and investor stakeholders seeking to embed the management of climate change-related business risks as a matter of standard practice for companies.<sup>76</sup>

These initiatives are complemented by efforts of shareholder advocacy and investor groups in the United States and other countries that advocate for corporate leadership on sustainability issues, often based on a program of shareholder activism and engagement with companies. A prominent U.S. example is Ceres, which describes its purpose as follows:

Ceres is a sustainability nonprofit organization working with the most influential investors and companies to build leadership and drive solutions throughout the economy. Through powerful networks and advocacy, Ceres tackles the world's biggest sustainability challenges, including climate change, water scarcity and pollution, and inequitable workplaces.<sup>77</sup>

Those working in this middle-ground space thus include a wide array of actors, from environmental organizations and individual advocates, to corporations and investors, and non-profit organizations working specifically on these issues.

Accordingly, we see three – at times interrelated – positions developing in the environmental community on the role that companies should play in averting dangerous climate change. All positions aim ultimately at achieving climate change mitigation goals, such as the Paris Agreement's 2 degrees target, and advocate for the need for

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<sup>73</sup> We Are Still In, Businesses and Investors, <https://www.wearestillin.com/businesses-investors>; Richard Luscombe, *Top US Firms Including Walmart and Ford Oppose Trump on Climate Change*, THE GUARDIAN, Dec. 1, 2017.

<sup>74</sup> We Mean Business Coalition, <https://www.wemeanbusinesscoalition.org/about/>.

<sup>75</sup> Task Force on Climate-related Financial Disclosures, <https://www.fsb-tcfd.org/about/>.

<sup>76</sup> See, e.g., TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (JUNE 2017).

<sup>77</sup> Ceres, [ceres.org/about-us](https://ceres.org/about-us).

corporate behavioral change, but they disagree as to how to position corporations in that effort. The first position treats corporations as actors – and for some taking this position, bad actors – who need to be held accountable, including through litigation, for their major role in harming the global climate system. The other positions see a role for corporations as part of the solution to climate change. According to the second position, this will require an agenda of law and corporate governance reform to align corporate interests more closely with broader environmental stakeholder interests. Under the third position, a middle ground approach using existing law is preferable, at least in the short-term, as a way of encouraging corporate action to address climate change, based on the threats it poses to business' financial bottom-lines.

None of these positions are necessarily in conflict with one another, other than at the extremes, such as between those who oppose entirely working with corporations and those who are engaging corporations in developing solutions to climate change. Many advocates support a multi-pronged approach, which might include corporate accountability litigation, legal reform, and collaborative work with corporations. After exploring current practices in Parts III through V, we will explore what such an inclusive multi-pronged approach might look like in Part VI.

### *C. The Value of a Comparative Conceptual Approach*

Because climate change is a transnational and international problem, the Article takes a comparative approach, with a particular focus on Australia, in its assessment and recommendations so that the United States can benefit from what has been tried in other places. Other countries have also faced the challenge of how to address the role of private sector companies in addressing public interest issues, such as climate change. The different positioning of viewpoints across the corporate governance and environmental communities described above is replicated in the scholarship and practice of a number of other developed countries.<sup>78</sup> Some countries, particularly in Europe, are developing far-reaching corporate law reforms that carve out a central

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<sup>78</sup> See, e.g., Beate Sjaafjell, *Why Law Matters: Corporate Social Irresponsibility and the Futility of Voluntary Climate Change Mitigation*, 8 EUR. CO. LAW 56 (2011); Lisa Benjamin & Stelios Andreadakis, *Corporate Governance and Climate Change: Smoothing Temporal Dissonance to a Phased Approach*, 40 BUS. L. REV. 146 (2019); Janet Dine, *Corporate Regulation, Climate Change and Corporate Law: Challenges and Balance in an International and Global World*, 26 EUR. BUS. L. REV. 173 (2015); Benjamin J. Richardson, *Putting Ethics into Environmental Law: Fiduciary Duties for Ethical Investment*, 46 OSGOODE HALL L.J. 243 (2008).

role for ESG considerations in corporate governance.<sup>79</sup> However, in others no firm position has been reached on corporate governance and climate change, paralleling the U.S. approach. In this respect, Australia provides a useful comparator to the United States for three key reasons.

First, like the United States, Australia has a carbon-driven economy. It is highly dependent on fossil-fuel exports as a principal source of income,<sup>80</sup> and has electricity-generation and transportation systems dominated by fossil fuel energy sources.<sup>81</sup> Moreover, of the top 300 companies listed on the Australian Stock Exchange (ASX), over half have high exposure to climate risk.<sup>82</sup> These factors make regulation

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<sup>79</sup> See *supra* note 22 and European Commission, *Action Plan: Financing Sustainable Growth*, COM (2018) – Action 10 and more broadly, European Commission, *Green Finance*, [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/green-finance\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/green-finance_en) (last visited Jan. 9, 2020). See also discussion in Part III(A) of the French Energy and Ecology Transition law, introduced in 2015, which requires listed companies to report on financial risks linked to the effects of climate change and the measures that the company takes to reduce such effects by implementing a low-carbon strategy in all components of its business. French Energy Transition Law, <https://www.unepfi.org/fileadmin/documents/PRI-FrenchEnergyTransitionLaw.pdf>;

<sup>80</sup> Australia's mining sector accounted for 35% of Australia's GDP growth in 2018-19. Resource and energy commodity exports more broadly are forecast to earn \$281 billion in 2019-20: OFFICE OF THE CHIEF ECONOMIST, RESOURCES AND ENERGY QUARTERLY (DEC. 2019). See also Australia Institute analysis that Australia is the world's third largest fossil fuel exporter: TOM SWANN, HIGH CARBON FROM A LAND DOWN UNDER QUANTIFYING CO<sub>2</sub> FROM AUSTRALIA'S FOSSIL FUEL MINING AND EXPORTS (JULY 2019).

<sup>81</sup> In 2017-18, fossil fuels (coal, oil and gas) accounted for 94% of Australia's primary energy mix. Fossil fuels contributed to 81% of total electricity generation in 2018, with coal accounting for 60% of total generation and gas-fired generation representing 19% of total generation. Further, transport constituted the largest consumer of energy, with road and air transport accounting for 71% and 20% of energy consumption respectively: DEPARTMENT OF THE ENVIRONMENT AND ENERGY, AUSTRALIA ENERGY UPDATED 2019 (SEPT. 2019).

<sup>82</sup> MARKET FORCES, OUT OF LINE, OUT OF TIME (Mar. 2019), at 2, available at <https://www.marketforces.org.au/wp-content/uploads/2019/03/Out-of-line-out-of-time-WEB.pdf>. For energy and electricity-generation companies, climate risk is primarily transitional risk associated with the potential for increasing regulation of carbon emissions and the risk of stranded assets. However, Australian companies also have significant exposure to physical climate risk, given the country's hot, dry climate and particular vulnerability to climate change-fuelled extreme weather events like heatwaves, wildfires

to address climate change a central issue of economic importance and corporate concern in Australia, as in the United States.

Second, Australia offers a socio-political and cultural context that is perhaps the most closely aligned with the United States of any country worldwide. This is particularly so when it comes to the issue of climate change, which has produced strong partisan divides and national legislative paralysis similar to that seen in the United States.<sup>83</sup> Australia briefly experimented with a carbon tax in the early 2010s<sup>84</sup> which was effective in lowering energy-related GHG emissions,<sup>85</sup> but this was repealed by an incoming conservative government.<sup>86</sup> In the aftermath, national climate regulatory proposals have stalled,<sup>87</sup> leading environmental activists to focus on other avenues for achieving progress, including through changes in corporate behavior.

Finally, Australia shares a similar corporate and securities law framework to the United States, based in the Anglo-American corporate law tradition.<sup>88</sup> Although relevant laws on disclosure, shareholder proposals and directors duties are by no means identical,<sup>89</sup>

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and flooding. See Narelle Hooper, *3 major areas of concern for climate risk in Australia*, COMPANY DIRECTOR, May 1, 2019, at <https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/may/climate-risk>.

<sup>83</sup> Hari M. Osofsky & Jacqueline Peel, *The Grass is Not Always Greener: Congressional Dysfunction, Executive Action, and Climate Change in Comparative Perspective*, 91 CHI. KENT L. REV. 139 (2016).

<sup>84</sup> *Clean Energy Act 2011* (Cth).

<sup>85</sup> For analysis on the efficacy of the carbon tax see Marianna O’Gorman & Frank Jotzo, *Impact of the carbon price on Australia’s electricity demand, supply and emissions* (Crawford School of Public Policy, Aust. Nat’l. U., Working Paper No. 1411, July 2014). For a broader review of Australia’s climate change law over time see Ilona Millar & Sophie Whitehead, *Climate Change Law in Australia – A History and the Current State of Play*, 92 AUST. L. J. 756 (2018).

<sup>86</sup> *Clean Energy Legislation (Carbon Tax Repeal) Act 2014* (Cth).

<sup>87</sup> AUSTRALIAN PANEL OF EXPERTS ON ENVIRONMENTAL LAW, CLIMATE LAW 11 (Technical Paper 5, 2017).

<sup>88</sup> JOHN FARRAR, CORPORATE GOVERNANCE: THEORIES, PRINCIPLES AND PRACTICE 5 (3rd. 2008).

<sup>89</sup> A key distinction of note is that the concept of “fiduciary duties” in Australia differs from that in the United States, though there are duties owed by directors who are fiduciaries. However, not all such duties are fiduciary duties. In the case of the duty of care, it is a common law duty and an equitable duty: see ROBERT AUSTIN & IAN RAMSAY, *FORD, AUSTIN & RAMSAY’S PRINCIPLES OF CORPORATIONS LAW* (2019), paras [8.010.3], [8.320]. A similar position applies in other common law countries, which generally treat loyalty as the

the general structure of laws and the dominance of the shareholder wealth-maximization view are shared by both the United States and Australia.<sup>90</sup> This means that efforts to use corporate law tools to shape corporate behavior on climate change in Australia, as well as stakeholders' perception of the effectiveness of such efforts, offer lessons for evolving practice in the U.S., and *vice versa*.

As we describe further in Part III below, legal requirements regarding disclosure and shareholder proposals are generally more favorable to taking forward climate change issues in the United States than in Australia, although greater access for investors to companies through informal engagement avenues may obviate the need for the more confrontational approach seen in the United States. Large institutional investors, such as sovereign wealth funds and pension funds (including Australia's substantial "superannuation" funds), have made significant investments in the top-200 Australian listed companies (ASX200),<sup>91</sup> with their concentrated shareholding giving them significant sway with companies.<sup>92</sup> In the context of fiduciary duties, the legal positions of the U.S. and Australia are reversed, with broader interpretations of relevant duties in Australia potentially easing the pathway for potential litigation there.<sup>93</sup> In addition, while the volume of shareholder proposals in Australia is dwarfed by that in the United States, interesting approaches are emerging around non-binding advisory resolutions and in more well-established investor-corporate engagement activities that particularly focus on questions such as corporate lobbying and membership of industry organizations with

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only "fiduciary duty:" see Christopher M. Bruner, *Is the Corporate Director's Duty of Care a 'Fiduciary' Duty? Does It Matter?* 48 WAKE FOREST L. REV. 1027 (2013). In this Article, we have used the term "fiduciary duties" simply for convenience in discussing relevant duties under Australian law.

<sup>90</sup> Malcolm Anderson, Meredith Jones, Shelley Marshall, Richard Mitchell & Ian Ramsay, *Shareholder Primacy and Directors' Duties: An Australian Perspective*, 8 J. CORP. L. STUD. 161 (2008); Richard Mitchell, Anthony O'Donnell, Ian Ramsay & Michelle Welsh, *Shareholder Protection in Australia: Institutional Configurations and Regulatory Evolution*, 38 MELB. U. L. REV. 68 (2014).

<sup>91</sup> JUSTIN ELLIS, UNDERSTANDING OWNERSHIP TRENDS IN AUSTRALIA: 2018 KEY INSIGHTS (2018).

<sup>92</sup> Parliament of Australia, *Chapter 5: Institutional Investors*, [https://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/Completed\\_inquiries/2004-07/corporate\\_responsibility/report/c05](https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2004-07/corporate_responsibility/report/c05) (last accessed Jan. 9, 2020).

<sup>93</sup> Barker, *supra* note 65, at 58.



anti-climate regulatory positions.<sup>94</sup> As these practices continue to evolve, they could offer examples of approaches that might also be pursued in U.S. shareholder activism.

This multi-pronged, comparative approach is not a panacea. No one has yet found a politically realistic way to address climate change at the pace that is needed to prevent major impacts, and corporate and financial law cannot address this problem without other significant environmental and energy law initiatives. Nonetheless, the Parts that follow provide an in-depth assessment, grounded in original interview-based research, of current views on the impact of these efforts to date, which provides a basis for assessing how to make future strategies more effective.

### III. DISCLOSURE

The following three Parts provide our review of current developments in disclosure, shareholder proposals and engagement, and fiduciary duty based on our interview findings and in a comparative U.S.-Australian context. Each Part examines current developments and then discusses existing practices, drawing on qualitative interviews conducted with several dozen stakeholders in the U.S. and Australia.<sup>95</sup> Interviewees included mostly persons who work for corporations and investors, although they also included regulators, advocacy groups, and service providers. In the United States, interview participants encompassed the following groups:

- Listed companies (5 interviews), drawn from the industry sectors of utilities, financial, food, retail, and materials. Interviews were undertaken with a corporate director, an in-house counsel with a securities law focus, and sustainability staff.
- Asset owners (3 interviews), including a public employee pension fund, a union pension fund, and a charitable foundation.
- Asset managers (4 interviews), including two investment funds with a focus on socially responsible investing and two with a focus on index funds.

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<sup>94</sup> The Australasian Centre for Corporate Responsibility (ACCR) maintains details of resolutions, see <https://accr.org.au/shareholder-action/current-resolutions/>. See also ACCR, *Overview of Resolutions*, <https://accr.org.au/shareholder-action/resolution-voting-history/>.

<sup>95</sup> Interviews were conducted in the U.S. with a total of 14 persons from August to November of 2018, and in Australia with a total of 24 persons from February to August of 2018.

- Investor and company service providers (2 interviews).
- Investor associations (1 interview).

In Australia, interviews covered similar groups, including:

- Corporate and financial sector regulators (2 interviews).
- Civil society advocacy groups engaging with corporate law tools to influence company decision-making on energy transition (2 interviews).
- Investor groups or associations (2 interviews).
- Investor service providers providing ESG analysis, proxy voting, engagement and representation services (2 interviews).
- Listed ASX50 companies (7 interviews), drawn from the industry sectors of energy, utilities and materials. Interviews were undertaken with various company officers including company secretaries, investment relations and sustainability staff.
- Asset owners, with predominantly industry superfunds (7 interviews). Interviews were conducted with in-house ESG and investment analysts.
- Asset managers (2 interviews), with fund managers associated with the asset owners interviewed for the research. Interviews were conducted with in-house ESG and investment analysts.<sup>96</sup>

This Part focuses on disclosure, which is one of the main securities law tools being used to promote a faster energy transition. In a previous Article, we discussed several pathways by which disclosure could do so.<sup>97</sup> Disclosure could provoke disinvestment from companies with higher GHG emissions profiles to those with lower ones profiles by revealing risks of the former and opportunities of the latter. It could affect involvement in companies by consumers and employees. Disclosure could also promote shifting of resources within companies by affecting the focus of and information available to corporate decisionmakers.<sup>98</sup>

U.S. companies whose shares trade publicly must engage in a variety of required periodic disclosure, such as annual reports on Form

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<sup>96</sup> In this Article we include insights from the Australian interviews mainly as a comparison to the U.S. findings. For a fuller analysis of the results of the Australian interviews see Jacqueline Peel, Anita Foerster, Brett McDonnell & Hari M. Osofsky, *Governing the Energy Transition: the Role of Corporate Law Tools*, 36(5) ENVIRONMENTAL & PLANNING L.J. 459 (2019).

<sup>97</sup> Osofsky *et al.*, *supra* note 4.

<sup>98</sup> *Id.*

10-K and quarterly reports on Form 10-Q.<sup>99</sup> There are no specific requirements concerning climate change-related disclosure, but a variety of required disclosures may be implicated where climate change threatens to have a material impact on the financial performance of a company. Companies may also choose to disclose beyond what the securities law requires in other documents, and many now do so for many sustainability matters. This Section reviews developments in mandatory and voluntary disclosure surrounding climate change and presents results from our interviews concerning the effects of these developments.<sup>100</sup>

#### *A. Legal and Institutional Developments*

In 2010, the SEC issued guidance on applying various reporting requirements to risks connected to climate change.<sup>101</sup> It included examples covering both risks that the effects of climate change may have on company assets and operations (so-called physical risks) and legal, market, and reputational risks associated with how a company responds, or fails to respond, to emerging rules and best practices that attempt to reduce GHG emissions (so called non-physical or transition risks).<sup>102</sup>

Early analysis of mandated reports following the 2010 SEC guidance suggested that disclosure concerning climate change did increase, but the disclosure by many companies remained brief and

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<sup>99</sup> See Securities Exchange Act of 1934, Pub. L. 73–291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a–78qq (2012)); 17 C.F.R. § 229.601 (2002).

<sup>100</sup> In addition to the effects discussed below, one way that climate activists can use disclosure is through enforcement actions. Most prominently, various state attorneys general have investigated the reporting practices of ExxonMobil, and in 2016 a shareholder class action was brought against that company. See Justin Gillis & Clifford Krauss, *ExxonMobil Investigated for Possible Climate Change Lies by New York Attorney General*, N.Y. TIMES (Nov. 5, 2015), <http://www.nytimes.com/2015/11/06/science/exxon-mobil-under-investigation-in-new-york-over-climate-statements.html>; Ivan Penn, *California to Investigate Whether Exxon Mobil Lied About Climate-Change Risks*, L.A. TIMES (Jan. 20, 2016, 3:00 AM), <http://www.latimes.com/business/la-fi-exxon-global-warming-20160120-story.html>.

<sup>101</sup> Commission Guidance Regarding Disclosure Related to Climate Change Release, Exchange Act, 75 Fed. Reg. 6290 (Feb. 8, 2010) (to be codified at 17 C.F.R. pts. 211, 231, 241).

<sup>102</sup> *Id.*

lacking in substance.<sup>103</sup> A more recent analysis finds that in 2018, 50% of S&P 500 companies address sustainability in their annual reports or 10-Ks.<sup>104</sup> Thirty-eight percent discussed sustainability issues in their annual proxy statements, typically in a summary at the beginning of the filing.<sup>105</sup>

Companies may also choose to report matters beyond what the securities laws require. The demand from both shareholders and other stakeholders for information related to climate change and other sorts of sustainability concerns, combined with the lack of detailed rules from the SEC, has led to a growth of a number of efforts to create voluntary disclosure standards. There are a variety of organizations competing to provide frameworks for disclosure concerning climate change. The CDP (formerly Carbon Disclosure Project) focuses specifically on greenhouse gas emissions<sup>106</sup> and the TCFD also focuses on climate change issues.<sup>107</sup> In contrast, the GRI,<sup>108</sup> SASB,<sup>109</sup> and IIRC<sup>110</sup> cover a wide range of sustainability topics. Some frameworks like the TCFD follow a standards-based approach while others like the CDP and SASB include more specific rules. In addition to organizations like these which publish publicly-available frameworks that companies may use in their reporting, other organizations gather information privately and use that information to issue ratings concerning performance along a variety of metrics, including metrics related to the environment and climate change. Leading examples include MSCI<sup>111</sup> and Sustainalytics.<sup>112</sup> In the United States, none of these competing approaches has yet achieved clear market dominance.<sup>113</sup>

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<sup>103</sup> JIM COBURN & JACKIE COOK, CERES, COOL REPOSE: THE SEC & CORPORATE CLIMATE CHANGE REPORTING 11-12 (2014)

<sup>104</sup> IIRC Institute, *State of Integrated and Sustainability Reporting 2018* 33.

<sup>105</sup> *Id.*

<sup>106</sup> <https://www.cdp.net/en>.

<sup>107</sup> Final Report, *Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), available at <https://www.fsb-tcfd.org/publications/final-recommendations-report/>.

<sup>108</sup> *G4 Sustainability Reporting Guidelines*, available at <https://www2.globalreporting.org/standards/g4/Pages/default.aspx>.

<sup>109</sup> *SASB Conceptual Framework*, available at <https://www.sasb.org/wp-content/uploads/2019/05/SASB-Conceptual-Framework.pdf>.

<sup>110</sup> *The International IR Framework*, available at <https://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>.

<sup>111</sup> <https://www.msci.com/our-purpose>.

<sup>112</sup> <https://www.sustainalytics.com/about-us/>.

<sup>113</sup> IIRC Institute, *supra* note 104, at 16-24.

Voluntary reporting in regular sustainability reports is much more widespread and extensive. A study of reporting in 2018 found that 92% of S&P 500 countries offered sustainability information on their websites.<sup>114</sup> About 78% of these companies issued sustainability reports.<sup>115</sup> Ninety-five percent offered environmental performance metrics, and 67% set quantified environmental goals.<sup>116</sup> Only a minority of the reports, 38%, obtained any external assurance concerning their reports.<sup>117</sup>

The literature on disclosure under the securities law in general, and specifically on disclosure related to environmental issues, has identified various benefits and costs of such disclosure. Disclosure helps both investors and other stakeholders, such as customers and employees, decide whether or not to associate with the disclosing company.<sup>118</sup> Disclosure can reduce informational asymmetries between the company and various stakeholders, reducing moral hazard and adverse selection issues.<sup>119</sup> The process of gathering and evaluating information to be disclosed can also change and improve internal decisionmaking.<sup>120</sup> However, there are direct monetary costs involved in gathering information. The process of gathering information will also divert the time and attention of directors, officers, and employees. Another concern is information overload.<sup>121</sup>

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<sup>114</sup> *Id.* 27.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 29.

<sup>117</sup> *Id.*

<sup>118</sup> See *supra* note 97 and accompanying text.

<sup>119</sup> Ann M. Lipton, *Not Everything is about Investors: The Case for Mandatory Stakeholder Disclosure*, forthcoming, , forthcoming, YALE J. REG, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3439179](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439179) at 9-10; Cynthia A. Williams, *The Securities Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999); Hans B. Christensen, Luzi Hail, & Christian Leuz, *Adoption of CSR and Sustainability Reporting Standards: Economic Analysis and Review*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3439179](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439179) at 35, 48-49.

<sup>120</sup> Lipton, *supra* note 119, at 10; Hillary A. Sale, *Disclosure's Purpose*, 107 GEORGETOWN L.J. 1045, 1047 (2019).

<sup>121</sup> Virginia Harper Ho, *Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform from the Regulation S-K Concept Release*, forthcoming, VILLANOVA L. REV., available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3452457](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452457).

Given the availability of voluntary disclosure, are there market imperfections that justify making some disclosure required?<sup>122</sup> Mandatory rules can standardize disclosure, making comparison across firms easier for investors and others.<sup>123</sup> Required sustainability disclosure could also encourage the reduction of externalities in company behavior (e.g., emission of GHGs).<sup>124</sup> However, beyond the obvious direct costs of gathering and disclosing information, if the disclosure rules are not well-designed, they may focus companies on low-value matters.<sup>125</sup> The limited evidence on mandatory sustainability disclosure suggests that reporting regulation may increase costs, but it also may reduce harmful activities targeted by the regulation.<sup>126</sup>

Some jurisdictions have recently adopted rules requiring disclosure of various sustainability matters, including climate change. In 2015, France implemented a significant law requiring disclosure specifically focused on climate change. The law requires listed companies to disclose financial risks related to climate change, the measures adopted to reduce them, and the consequences of climate change for their activities.<sup>127</sup> The European Union is in the process of enacting rules concerning disclosure of sustainability risks.<sup>128</sup> As part of a broad release seeking public comment on a wide range of disclosure issues, the SEC in 2016 sought guidance on the need for more detailed rules on ESG issues, including climate change.<sup>129</sup> So far, the SEC has not proposed any new rules. The Concept Release received a large number of comments.<sup>130</sup> Of those who commented, investors mostly supported more extensive and rule-like disclosure rules, while companies opposed such changes.<sup>131</sup>

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<sup>122</sup> Christensen *et al. supra* note 119, at 18; Benjamin E. Hermalin & Michael S. Weisbach, *Information Disclosure and Corporate Governance*, 67 J. Fin. 195 (2012); Christian Leuz & Peter D. Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, available at <http://dx.doi.org/10.2139/ssrn.1105398>.

<sup>123</sup> Christensen *et al., supra* note 119, at 18.

<sup>124</sup> Christensen *et al., supra* note 119, at 19.

<sup>125</sup> *Id.* at 20.

<sup>126</sup> *Id.* at 59-72.

<sup>127</sup> <https://www.unepfi.org/fileadmin/documents/PRI-FrenchEnergyTransitionLaw.pdf>.

<sup>128</sup> <https://www.lexology.com/library/detail.aspx?g=61d5698f-bf73-451c-9c49-bdc6b342442b>.

<sup>129</sup> Business and Financial Disclosure Required by Regulation S-K: Concept Release, 81 Fed. Reg 23916 (Apr. 22, 2016).

<sup>130</sup> Ho, *supra* note 121, at 19.

<sup>131</sup> *Id.* at 37.

As we have seen, one way that disclosure may promote energy transition is through causing shareholders and other stakeholders to reassess whom they choose to patronize.<sup>132</sup> Reflecting the shareholder primacy approach discussed in Part II,<sup>133</sup> the dominant though disputable<sup>134</sup> view is that federal securities law mandates disclosure solely for the benefit of investors, and that the disclosure should focus on the financial risks associated with an investment. Disclosure around sustainability issues such as climate change is then justified to the extent that such matters may have a material effect on financial returns.<sup>135</sup> That is clearly the position the SEC took in its 2010 guidance on climate change related disclosure<sup>136</sup>

Whether or not current securities law is understood as legally focused only on investors, it is not just investors who use that disclosure – investors, employees, and other stakeholders also use it. Information that may not be material to financial results may be material to the interests of other stakeholders. Regulation that focuses only on financial risks and returns will not force companies to reveal all of the information that matters to other stakeholders.<sup>137</sup>

The literature reveals much concern about the quality of current disclosure. The lack of mandatory rules allows companies to selectively pick and choose what they want to disclose, emphasizing positive developments, and making it hard to compare developments across companies.<sup>138</sup> The IRRC Institute's survey of S&P 500 company reporting found that most companies pick and choose among various frameworks, customizing a unique style, and only a minority obtain any external assurance.<sup>139</sup>

Investors are also unhappy with current disclosure. A recent survey of institutional investors found that many believe that current disclosures are imprecise and not sufficiently informative. They also believe that there should be more standardization.<sup>140</sup> An analysis of

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<sup>132</sup> See *supra* note 97 and accompanying text.

<sup>133</sup> See *supra* notes 30 through 35 and accompanying text.

<sup>134</sup> Sale, *supra* note 120.

<sup>135</sup> Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, forthcoming, GEORGETOWN L.J.

<sup>136</sup> See *supra* note 101.

<sup>137</sup> Lipton, *supra* note 119; Ann M. Lipton, *What We Talk about When We Talk about Disclosure: The Need for an Honest Conversation*.

<sup>138</sup> Fisch, *supra* note 135.

<sup>139</sup> IRRC Institute, *supra* note 104, at 29-32.

<sup>140</sup> Emirhan Ilhan *et al.*, *Institutional Investors Views and Preferences on Climate Disclosure*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3437178](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3437178).

public comment letters to the SEC's 2016 questions on the current state of disclosure showed that most responding investors said that current disclosure leads to too little disclosure and too much boilerplate.<sup>141</sup>

The lack of standardization is thus a serious concern. This is a widely-recognized justification for mandatory disclosure regulation in the general literature on securities law.<sup>142</sup> But private coordination may be able to set effective standards without the need for governmental regulation, and private standard-setting may be more likely to agree upon efficient standards than government agencies.<sup>143</sup> Perhaps, for instance, the recent announcement by BlackRock's CEO<sup>144</sup> that they are pushing their portfolio companies to use SASB and TCFD will help focus disclosure on those two standards.

### *B. U.S. Interview Findings*

Our U.S. interview participants were employed by a variety of types of entities, including operating companies, investors, asset managers, law firms, and advocacy organizations.<sup>145</sup> We asked them several open-ended questions concerning disclosure related to climate change. These included whether there is agreement on the importance of climate change disclosure and what it should look like, how disclosure affects investment and engagement decisions by investors and asset managers, how disclosure practices could be improved, and whether and how disclosure affects risk management and operating decisions by the disclosing companies. We describe here some of the patterns that emerged in the participants' answers that help elaborate what is happening in practice with disclosure, and the extent to which it is (or is not) shaping corporate behavior regarding climate change.

Participants confirmed that there has been a major increase in climate change disclosure in recent years. However, their overall view was that the quality of this disclosure is mixed. While larger companies and those in industries more exposed to climate change risks are more likely to make detailed and helpful disclosure, many companies cherry-pick positive information, or they make vague or boilerplate statements.

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<sup>141</sup> Ho, *supra* note 121, at 34.

<sup>142</sup> FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* xx (1991).

<sup>143</sup> Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CALIF. L. REV. 479, 517-18 (1998).

<sup>144</sup> See Fink, *supra* note 37.

<sup>145</sup> See *supra* notes 95 through 96 and accompanying text.



One participant, who advises companies on disclosure and engagement, commented: “It’s gone from nothing to a policy-and-platitudes type of disclosure.”<sup>146</sup> Another, who works as a securities lawyer at a law firm, responded that: “most companies do nothing,”<sup>147</sup> but noted that, for those who do report, disclosure can vary from “lofty goals and statements as opposed to some others that really give graphs, give data, give hard information.”<sup>148</sup> An employee of an investment firm with a focus on responsible investment noted that disclosure is “a relatively new area” for small and mid-cap companies, with “a huge amount of work to be done” to effect improvements.<sup>149</sup> This participant thought that overall “we’re on the right path,”<sup>150</sup> whereas others voiced a need for more standardization to improve quality: “the next step is to put more data around it, and more meat on the bones so that the people who consume this information can see exactly what you’re talking about, what the risks are.”<sup>151</sup>

A factor underlying the current variability in disclosure practice appears to be proliferating available models, with participants noting the presence of competing standards. One participant, who is an employee at an asset manager, commented on the lack of consensus, noting: “It’s actually worse than that. Everybody wants to set the standard. The proliferation of sustainability codes is getting to be absurd.”<sup>152</sup> This position was reflected in the interview results as a whole, with some participants seeing no particular standard currently emerging as the leading one. Others did point to one or two standards as the current or emerging leader, but identified different standards in this regard, with CDP, TCFD, GRI, and SASB all being mentioned. As one consultant participant described it:

There’s a bunch of people currently looking at MSCI, others looking at TCFD, others thinking about SRI, SASB. So, there’s all these different organizations out there. Different organizations that are in a lot of ways competing with each other for the attention of the various stakeholders, and it contributes to a lot of confusion, but at the same time is

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<sup>146</sup> US interview reference

<sup>147</sup> US12, Dec. 6, 2018.

<sup>148</sup> *Id.*

<sup>149</sup> US8, Oct. 15, 2018.

<sup>150</sup> *Id.*

<sup>151</sup> US9, Oct. 30, 2018.

<sup>152</sup> US1, Aug. 18, 2018.

also demonstrating just how much energy and need there is in this space.”<sup>153</sup>

A frequent point made by participants was that the lack of common standards makes it harder to compare practice across companies, or even for the same company over time. A securities lawyer commented:

Right now there’s no standards, so the ability to do comparability just doesn’t exist, and when you look at data you just don’t know if this is apples to apples to anything. Because there’s no standards in the way we measured it this year, the same way we measured it last year, the way we’ll measure it next year.<sup>154</sup>

On the company side as well as for investors, the proliferation of standards is a problem, as companies face pressures to respond to varying requests for information, and must decide which, if any, standards to follow. Although companies generally opposed new SEC disclosure rules for sustainability matters in comments to the 2016 release,<sup>155</sup> the growth of standards since then may give more reason for companies to accept, or at least less strongly oppose, new rulemaking that would provide uniformity.<sup>156</sup> As one of our company-side interviews remarked, “I think clarity is a helpful thing, and so I think if the SEC were to come out with a required standard of disclosure it would be helpful, because it would simplify our work, and it would simplify the work for the investor.”<sup>157</sup>

Despite the variability and lack of comparability at present, practices in climate change disclosure are clearly evolving. In the last few years it has gone from imprecise qualitative statements, to more precise and detailed quantitative metrics, to setting specific targets to be attained. A participant on the investor side commented particularly on the emergence of disclosure using targets. According to this participant, “the best companies know why or why they cannot hit a target,” with sometimes the most useful disclosures being about “why you can’t hit a target.”<sup>158</sup>

As noted above, many argue that customers, employees, and other stakeholders are major intended audiences of sustainability disclosure,

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<sup>153</sup> US9, Oct. 30, 2018.

<sup>154</sup> US12, Dec. 6, 2018.

<sup>155</sup> See *supra* note 101 and accompanying text.

<sup>156</sup> Ho, *supra* note 121.

<sup>157</sup> US5, Sept. 27, 2018.

<sup>158</sup> US6, Oct. 5, 2018.

not just investors.<sup>159</sup> Several of our interviewees made the same point, noting diverse disclosure drivers such as “brand enhancement,”<sup>160</sup> particularly with millennial customers who may have a deep concern about climate issues.<sup>161</sup> Indeed, where disclosure has a real effect on company behavior, it may be more because of concern about the company’s reputation with other stakeholders than with shareholders. One participant, a securities lawyer, related an anecdote about a board receiving a shareholder proposal, which the board was initially reluctant to engage with, “but when they changed the narrative a little bit and thought about the value of the responsibility report and some more reporting on environmental as a way to attract millennials who are a target of their employment efforts, then they became more receptive to it.”<sup>162</sup>

In the past, climate-related disclosures have often been made in separate voluntary sustainability reports rather than in mandated securities disclosures. Several interviewees noted, however, a significant benefit of including such disclosure within financial disclosure documents mandated under securities law given that information gathered for securities law disclosure gets more attention within a corporation due to liability concerns.<sup>163</sup> As one pension fund employee participant remarked, “I think the implications will force management and the board to engage in a more meaningful way.”<sup>164</sup> Indeed, the threat of liability has induced public companies to build in extensive systems for collecting and verifying such information. There is both an internal audit system and external auditors. Top executive officers review the process and resulting information, and the board is involved below.<sup>165</sup> By contrast, a weakness of the voluntary disclosure of sustainability information is that the collection and processing of such information may be done within a sustainability office that is isolated from other operating divisions. As a consequence, these reports, “even though they get some level of review, they clearly don’t get the level of review and scrutiny as if you’re actually going to take the extra step of putting it in your proxy.”<sup>166</sup> According to a sustainability officer participant, “the best thing that could happen with

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<sup>159</sup> See *supra* notes 134 through 137 and accompanying text.

<sup>160</sup> US11, Nov. 15, 2018.

<sup>161</sup> US12, Dec. 6, 2018.

<sup>162</sup> *Id.*

<sup>163</sup> See *supra* note 100 and accompanying text.

<sup>164</sup> US10, Nov. 9, 2018.

<sup>165</sup> For some further discussion of the risk management process, see Part III.C below.

<sup>166</sup> US12, Dec. 6, 2018.

disclosure is integrated reporting, meaning not having a separate sustainability report with the GRI index and an annual report.”<sup>167</sup> This would help make such reporting standardized, central to corporate operations, and a requirement rather than a voluntary option.”<sup>168</sup> However, this was not a universal view. A lawyer within an operating company noted one of the counter-arguments in favor of separate sustainability reports as being the likelihood of more information being disclosed. This participant commented:

While I understand the movement to include things in all filings so it’s together, I think the focus of CR reports, if done well, probably give you more and better information than if you were to try and fold it into a filed document where it’s one of a number of issues. This topic in particular is an area where people want more details. Probably more details than would be considered material.<sup>169</sup>

The ultimate question about the new climate change disclosure practice is whether it is causing companies to respond to climate change risks and opportunities more quickly. In a context where climate change disclosure only started in earnest recently and is very rapidly evolving, the interview evidence shows that many factors are working to both encourage and block company change. Reflecting this, interviewees expressed different opinions about the effect of disclosure on company behavior.

No interviewee on the company side pointed to any clear way in which disclosure was causing their company to behave differently in a substantive way. The exception was the corporate sustainability officer, noted above, who spoke of several instances where concern about customer reaction caused the company to pay attention to a few matters.<sup>170</sup> Most interviewees on the company side seemed to think their companies were already heavily engaged with climate change questions, and the pressure for disclosure was simply pushing them to better communicate what they were already doing. Another sustainability officer more forcefully denied that shareholder proposals encouraging more disclosure would change corporate behavior, characterizing this as “a mistaken theory of change.”<sup>171</sup>

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<sup>167</sup> US11, Nov. 15, 2018.

<sup>168</sup> US11, Nov. 15, 2018.

<sup>169</sup> US4, Sept. 20, 2018.

<sup>170</sup> See *supra* note 160 and accompanying text.

<sup>171</sup> US5, Sept. 27, 2018.

Some on the investor side had more hope that disclosure would eventually change behavior, particularly as disclosure evolves to include more detailed metrics and targets. A pension fund employee opined: “If SASB were ever to realize its true objective of getting into the financial statement, it may not provide as good information to investors, but it will be more likely to change company behavior because it’s the kind of disclosure that ultimately has to go to the boardroom.”<sup>172</sup> The same person continued: “There is no question that there is an uptake in engagement and more companies understand the need to engage and even now at the board level. I think there is an emphasis in trying to appear responsive to investors.” A former pension fund employee expressed more impatience with relying on existing disclosure rules, stating, “the regulatory system has a much larger role to play, and our legal system, and frankly our governmental agencies.”<sup>173</sup> Overall, then, it appears based on the interviewees insights, that increasing disclosure has not yet changed company behavior significantly in the United States, but has potential to do so if pursued in a more standardized and rigorous way.

### *C. Australian Interview Findings*

In Australia, our interview participants came from a range of different entities, including ASX50 listed companies, investor groups, asset managers, regulators, superannuation funds and civil society advocacy organizations.<sup>174</sup> As with our U.S. participants, we asked them a similar set of open-ended questions concerning Australian business practices on disclosure related to climate change. We first describe here the relevant corporate legal requirements pertaining to disclosure by Australian companies before comparing the patterns that emerged in the participants’ answers to those of our U.S. participants.

As in the United States, federal corporations’ law in Australia does not mandate specific climate-related disclosures, nor any form of sustainability reporting. Instead, companies listed on the ASX must provide financial statements which present a “true and fair representation” of the company’s financial position and performance as well as disclose risks that are financially material for their businesses in a Director’s Report.<sup>175</sup> Although Australian company and securities regulators have not introduced an equivalent to the SEC’s 2010

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<sup>172</sup> US10, Nov. 9, 2018.

<sup>173</sup> US13, Dec. 12, 2018.

<sup>174</sup> See *infra* notes 95 through 96 and accompanying text.

<sup>175</sup> *Corporations Act 2001* (Cth) s 299(1A), 295-97, 307-8.

guidance,<sup>176</sup> various recent regulatory guides and statements indicate a growing expectation of disclosure of climate (and other ESG) risks where those risks are judged to be financially material for ASX-listed companies.<sup>177</sup> Influential opinions issued by leading corporate lawyers have also highlighted the liability exposure of companies that fail to disclose financially material climate business risks.<sup>178</sup> This legal theory was tested in the case of *Abrahams v Commonwealth Bank of Australia*, involving a shareholder claim against one of the country's largest banks, alleging a failure to disclose climate risks in its 2016 Annual Report.<sup>179</sup> The proceedings were withdrawn, but only following the bank's commitment to improve disclosure practices, with noticeable improvements in subsequent annual reports.<sup>180</sup>

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<sup>176</sup> A Senate Inquiry of the Federal Government recommended that Australian company and securities regulators review and/or provide guidance on the implications of carbon risk but no legislation was introduced mandating regulators to take such steps: COMMONWEALTH OF AUSTRALIA, CARBON RISK: A BURNING ISSUE (APR. 2017).

<sup>177</sup> ASIC, REGULATORY GUIDE 247: EFFECTIVE DISCLOSURE IN AN OPERATING AND FINANCIAL REVIEW 247.64, 247.66 (AUG. 2019); ASX CORPORATE GOVERNANCE COUNCIL, CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS REC 7.4 (4TH ED., FEB. 2019); AUSTRALIAN ACCOUNTING STANDARDS BOARD AND AUDITING AND ASSURANCE STANDARDS BOARD, CLIMATE-RELATED AND OTHER EMERGING RISKS DISCLOSURES: ASSESSING FINANCIAL STATEMENT MATERIALITY USING AASB PRACTICE STATEMENT 2 (DEC. 2018).

<sup>178</sup> NOEL HUTLEY SC & SEBASTIAN HARTFORD-DAVIS, CLIMATE CHANGE AND DIRECTOR'S DUTIES: MEMORANDUM OF OPINION (2016), <https://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf>; NOEL HUTLEY SC & SEBASTIAN HARTFORD-DAVIS, CLIMATE CHANGE AND DIRECTOR'S DUTIES: SUPPLEMENTARY MEMORANDUM OF OPINION (2019), [https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016\\_pdf.pdf](https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016_pdf.pdf).

<sup>179</sup> See *Abrahams v Commonwealth Bank of Austl.* [2017], FCA, VID 879/2017.

<sup>180</sup> See subsequent annual reports for Commonwealth Bank of Australia: *Annual Report 2017*, [https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/annual-reports/annual\\_report\\_2017\\_14\\_aug\\_2017.pdf](https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/annual-reports/annual_report_2017_14_aug_2017.pdf); *Annual Report 2018: Becoming a Simpler, Better Bank*, <https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/results/fy18/cba-annual-report-2018.pdf>; *2019 Annual Report*, <https://www.commbank.com.au/content/dam/commbank-assets/about-us/2019-09/cba-annual-report-2019-spreads.pdf>.

A key difference between Australian and U.S. climate risk disclosure practice is developing consensus in Australia around the framework that should guide any such climate-related financial disclosures, with the TCFD emerging as the supported standard in this regard and many leading companies formally adopting this approach.<sup>181</sup> The TCFD has been favorably referenced as a climate risk disclosure framework by the Australian corporate regulator, ASIC.<sup>182</sup> It also appears that institutional investors in Australia have played a key role in raising the profile of the TCFD by using this framework in their engagement strategies with companies. For example, the Australian Council of Superannuation Investors (ACSI), whose members manage AUD \$2.2 trillion in assets, has described the TCFD recommendations as the emerging gold standard for climate risk reporting by Australian listed companies.<sup>183</sup> The TCFD's 2019 status report indicates that, globally, 785 companies and other organizations have committed to support the TCFD.<sup>184</sup> This growing global acceptance, alongside default adoption of the TCFD framework in countries such as Australia, may be influential for U.S. practice as different disclosure standards compete there for prominence.

Our results from interviews with Australian participants showed a similar pattern to the United States of highly variable disclosure practice that is in a considerable state of flux. Overall, the investors interviewed described the disclosure practices of Australian companies as “totally inadequate,” “under-developed,” “reactive and piecemeal,” “non-strategic,” “pretty poor,” and “deeply deficient.” They expressed concerns that companies were focusing narrowly and not adequately addressing all forms of climate risk and that they were not integrating and quantifying risks into financial statements as recommended by the TCFD.<sup>185</sup> However, they also noted that climate risk disclosure was in its infancy and evolving quickly; concerns about the quality and usefulness of climate disclosures have led to a debate like that in the

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<sup>181</sup> TCFD, *supra* note 7.

<sup>182</sup> John Price, Comm’r, Austl. Sec. & Inv. Comm’n, *Keynote Address – Centre for Policy Development: Financing a Sustainable Economy* (June 18, 2018).

<sup>183</sup> AUSTRALIAN COUNCIL OF SUPERANNUATION INVESTORS, CORPORATE SUSTAINABILITY REPORTING IN AUSTRALIA 7 (JUNE 2018).

<sup>184</sup> TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, STATUS REPORT 110 (JUNE 2019).

<sup>185</sup> AUS3, Jan. 13, 2018; AUS5, Mar. 2, 2018; AUS6, Mar. 22, 2018; AUS8, Mar. 15, 2018.

United States over whether there is a need for more standardization and higher levels of regulation in this sphere.<sup>186</sup>

While there is a strong momentum towards Australian companies and regulators embracing the TCFD framework as a basis for disclosures, it is not clear that these new disclosure expectations are driving companies to respond to climate change risks and opportunities more quickly or to transition to cleaner energy practices. Early experimentation with scenario analysis by companies (a key recommendation of the TCFD) shows a tendency for even highly exposed companies to portray their business-as-usual prospects favorably, despite the associated risks, often suggesting that near-to-medium term prospects are strong for highly climate-damaging products and operations (e.g., fossil fuel exploration and development).

In interviews, investors expressed some disappointment that such climate risk-exposed companies using Paris Agreement-compliant scenario analysis – an approach recommended by the TCFD<sup>187</sup> – were still reporting no negative impact of climate change on their businesses.<sup>188</sup> Subsequent surveys of company reporting confirm these problems and suggest that there has been little improvement. For example, a Market Forces 2019 analysis of the public disclosures of 72 ASX100 companies operating in sectors facing the highest levels of climate risk found that climate risk disclosure across these companies remains “largely superficial.”<sup>189</sup> For the United States, this experience suggests that even if consensus can be reached around a particular voluntary disclosure standard over time, this still may not be enough to drive shifts in corporate behavior that support energy transition without greater standardization and specification regarding required disclosures.

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<sup>186</sup> In this regard, interview participant 9 cautioned against too much standardization and the emergence of lowest common denominator metrics: AUS9, June 18, 2018.

<sup>187</sup> On scenario analysis, *see* TCFD, *supra* note 7, 25-30 and TCFD, TECHNICAL SUPPLEMENT: THE USE OF SCENARIO ANALYSIS IN DISCLOSURE OF CLIMATE-RELATED RISKS AND OPPORTUNITIES (JUNE 2017).

<sup>188</sup> AUS4, Mar. 7, 2018; AUS8, Mar. 15, 2018; AUS22, Apr. 22, 2018.

<sup>189</sup> The Market Forces analysis highlighted that only 57% of the companies surveyed identified climate change as a material business risk; 32% detailed climate risks and opportunities in mainstream reporting; 14% disclosed detailed climate change scenario analysis; 24% disclosed an emissions reduction plan; and 22% have set an absolute emissions reduction target: MARKET FORCES, INVESTING IN THE DARK (2019).



#### IV. SHAREHOLDER PROPOSALS AND ENGAGEMENT

Growing shareholder activism and engagement on climate change-related matters specifically, and on ESG issues more generally, has a public and a private face. The public face is shareholder proposals, in which shareholders use Rule 14a-8 to include mostly advisory proposals in a company's proxy and have their fellow shareholders vote on the proposal at the annual meeting.<sup>190</sup> Shareholders need to follow only minimal procedural rules to have their proposals included, although companies may argue that the proposal should be excluded for one of thirteen specified reasons.<sup>191</sup> The number of such proposals submitted in a year has increased substantially. The votes in favor of such proposals have also increased dramatically, from the single digits to an average in the range of 25%, with many proposals in the 30% or 40% range<sup>192</sup> and some occasionally passing, most notably climate change proposals at ExxonMobil, Occidental Petroleum, and PPL.<sup>193</sup> The private face of engagement is dialogue between individual or groups of shareholders and companies in meetings, phone calls, or emails. Private engagement with a focus on environmental or social issues has increased significantly in the past decade.<sup>194</sup>

As seen in our earlier analysis, shareholder engagement aims to encourage a faster transition through inducing companies to shift internal resources to cleaner energy uses.<sup>195</sup> This Part explores developments in shareholder engagement and the impact that they are having on climate change action.

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<sup>190</sup> 17 C.F.R. 240.14a-8.

<sup>191</sup> 17 C.F.R. 240.14a-8(i); Virginia Harper Ho, *From Public Policy to Materiality: Non-Financial Reporting, Shareholder Engagement, & Rule 14a-8's Ordinary Business Exception*, 76 WASH. & LEE L. REV. 3 (2019).

<sup>192</sup> <https://www.ceres.org/shareholder-resolutions-database>

<sup>193</sup> Cydney Posner, *Are Shareholder Proposals on Climate Change Becoming a Thing?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG (June 21, 2017), <https://corpgov.law.harvard.edu/2017/06/21/are-shareholder-proposals-on-climate-change-becoming-a-thing/>.

<sup>194</sup> Barko *et al.*, *supra* note 28; Ceres, *The Role of Investors in Supporting Better Corporate ESG Performance*, available at <https://www.ceres.org/resources/reports/role-investors-supporting-better-corporate-esg-performance>; Majority Action, *Climate Change in the Boardroom: How Asset manager Voting Shaped Corporate Climate Action in 2019*, available at <https://www.majorityaction.us/asset-manager-report>.

<sup>195</sup> *See supra* note 97 and accompanying text.

### A. Legal and Institutional Developments

The growth in shareholder engagement has taken place during a transformation of the ownership of shares in U.S. public corporations. To understand that engagement, one needs to understand that context, particularly the nature of several major types of institutional investors. In 1945, over 90% of the shares of publicly-traded U.S. corporations were owned by individuals; now, about 80% of shares are owned by institutions rather than individuals.<sup>196</sup> This has the potential to transform corporate governance, overcoming the separation of ownership from control traditionally seen as the core governance issue<sup>197</sup> But whether or not it will depends on the behavior of institutional investors. After describing important types of shareowners, we discuss several important legal developments and then some empirical evidence on shareholder engagement.

Socially responsible investment funds are the most obvious candidate for investors that could engage with companies to focus on climate change and other sustainability matters. Such funds screen the companies in which they invest based on specific sustainability metrics. A quarter of all dollars under professional management are invested in such funds.<sup>198</sup> But not all such funds support ESG proposals. For instance, sustainability funds sponsored by BlackRock, JP Morgan, and Vanguard have been criticized for not supporting ESG proposals.<sup>199</sup>

Another type of investor that submits ESG proposals are some public employee and union pension funds.<sup>200</sup> Controversy surrounds pension fund activism. Critics see pension funds as serving special

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<sup>196</sup> <https://theconversation.com/these-three-firms-own-corporate-america-77072>.

<sup>197</sup> ADOLF BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

<sup>198</sup> Adam Connaker & Saadia Madsbjerg, *The State of Socially Responsible Investing*, HARV. BUS. REV. (2019), <https://hbr.org/2019/01/the-state-of-socially-responsible-investing>.

<sup>199</sup> Patrick Temple-West, *Big US Sustainable Funds Fail to Support ESG Shareholder Proposals*, Fin. Times (Sept. 7, 2019), <https://www.ft.com/content/5d342a5d-443d-3327-9502-2361f37f251c>.

<sup>200</sup> For an outstanding history and overview of pension fund activism, see DAVID WEBBER, *THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON* (2018); see also Stephen J. Choi & Jill E. Fisch, *On Beyond CALPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315 (2008); Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998).

interests that conflict with the interests of other shareholders.<sup>201</sup> Others counter that successful pension fund activism focuses on items that advance the financial interests of shareholders, which can receive the support of other shareholders, and that pension funds decrease the collective action problem shareholders face.<sup>202</sup>

A third important type of investor is big asset managers, including many index funds. Of these, the “Big Three” have become hugely important shareholders, with BlackRock and Vanguard each owning over 5% of the shares of most U.S. public corporations and often Fidelity also over that threshold. These three companies thus have pivotal voting power for close proposals. Some critics<sup>203</sup> have argued that the big passive investors face incentives that discourage them from activism,<sup>204</sup> and significant evidence supports this view.<sup>205</sup> Others dispute this criticism. Several argue that index fund managers do have

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<sup>201</sup> See e.g., Roberta Romano, *Public Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993); STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 228-32 (2008).

<sup>202</sup> See e.g. Schwab & Thomas, *supra* note 200; Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 Harv. L. Rev. 833, 885 (2005).

<sup>203</sup> Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. L. 101 (2018); Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, forthcoming, COLUM. L. REV., available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3282794](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3282794); see also, Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89 (2017).

<sup>204</sup> These include a free rider problem, conflicting interest, and an emphasis on competing through low costs. See Lund, *supra* note 203, at 119-20; Bebchuk & Hirst, *supra* note 203, at 17-45.

<sup>205</sup> The Big Three do not submit shareholder proposals, they do not privately engage with most of their portfolio companies, they vote mostly with management, and they are not plaintiffs in shareholder litigation. See Bebchuk & Hirst, *supra* note 203, at 36-55.

incentives to engage in active stewardship.<sup>206</sup> Significant evidence supports this counter-view as well.<sup>207</sup>

Thus, some funds and individuals focused on socially responsible investing and some pension funds propose most climate change proposals, while the votes of the Big Three and a few others determine their success. How one evaluates both current and future shareholder engagement depends on how one evaluates the incentives and informational capacity of those investors.<sup>208</sup>

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<sup>206</sup> They have incentives to improve market returns, economies of scale in stewardship costs, a better chance of being pivotal voters, a longer time horizon, and reputational incentives to attract investors. See Jill E. Fisch, Assaf Hamdani, & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, at 12-17, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3192069](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3192069); Edward Rock & Marcel Kahn, *Index Funds and Corporate Governance: Let Shareholders be Shareholders*, at 13-17, 28-42, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3295098](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098); Michael Barzuza, Quinn Curtis, & David Webber, *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, forthcoming, SO. CAL. L. REV., available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3439516](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439516).

<sup>207</sup> The Big Three are increasing their stewardship teams, engage in hundreds of private dialogues every year, interact with more activist investors by letting them initiate proposals then deciding how to vote. Fisch *et al. supra* note 206, at 25-29. An empirical study suggests index funds allocate resources to votes for which they are pivotal and that their ownership promotes value-creating proposals. See Fatima-Zhra Filali Adib, *Passive Aggressive: How Index Funds Vote on Corporate Governance Proposals*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3480484](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3480484). A different and in some ways opposite criticism is that the big investors are becoming too big and influential. John Coates argues that if current trends continue a group of twelve or so individuals will have practical power over most U.S. public companies, creating serious legitimacy concerns. John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3247337](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337). A counter-argument suggests that the Big Three may reduce significant social externalities, since they care about how policies adopted by any given company will affect the value of their whole portfolio, not just the adopting company. Madison Condon, *Externalities and the Common Owner*, forthcoming, WASH. L. REV., available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3378783](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378783).

<sup>208</sup> A final type of institutional investor worth noting is activist hedge funds. These identify under-performing companies, buy a significant stake in them, and then propose value-enhancing strategies, threatening a proxy fight to replace incumbent directors should the board refuse. There is much

Several legal developments have affected the ability of investors to pursue ESG proposals. Many investors and asset managers are subject to strict fiduciary duty under the Employment Retirement Income Security Act of 1974 (ERISA), which provides that fiduciaries must act “for the exclusive purpose of providing benefits to participants and their beneficiaries. . .” The Department of Labor interprets this language as requiring that fiduciaries may only consider financial returns and risks in making investment decisions.<sup>209</sup> In a series of interpretive bulletins, the Department has seesawed in how much leeway fiduciaries have to frame sustainability factors as financial risks.<sup>210</sup>

More recently, the Department’s guidance has addressed ESG activism in shareholder engagement by ERISA plans. Here too the guidance has seesawed. Under the Obama administration, the Department was relatively encouraging of engagement. Under the Trump administration, the Department issued new guidance stating that typically fiduciaries should not engage in activities that “involve a significant expenditure of funds. . .”<sup>211</sup> If a fiduciary is considering engagement on environmental or social factors, that may well require “a documented analysis of the cost of the shareholder activity compared

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controversy surrounding the social impact of activist funds. For a leading statement of the arguments in favor, see Lucian A. Bebchuk, Alon Brav, & Wei Jiang, *The Long Term Effects of Hedge Fund Activism*, 115 Colum. L. Rev. 1085 (2015); for a leading statement of the arguments against, see John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. Corp. L. 545 (2016). There is concern that activist funds increase shareholder value by diverting resources from other stakeholders. Thus, those who advocate policies promoting shareholder voice as a way to address climate change should worry that those same policies may enable activist hedge funds who could have an opposite effect.

<sup>209</sup> Osofsky *et al.*, *supra* note 4, at 658-59. It can be argued that this is an overly narrow interpretation of the exclusive purpose language, and that the interests of employees investing for their retirement should include their interests as employees as well. See Webber, *supra* note 200, at xx.

<sup>210</sup> Osofsky *et al.*, *supra* note 4, at 658-59.

<sup>211</sup> See Memorandum from John J. Canary, Dir. of Regulations & Interpretations, Dep’t of Labor, to Mabel Capolongo, Dir. of Enf’t, Emp. Benefits Sec. Admin. (Apr. 23, 2018), [hereinafter Field Assistance Bulletin No. 2018-01], <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01>.

to the expected economic benefit. . .”<sup>212</sup> The President also issued an Executive Order on promoting coal, oil, and natural gas which includes a provision directing the Department of Labor to review “existing Department of Labor guidance on the fiduciary responsibilities for proxy voting to determine whether any such guidance should be rescinded, replaced, or modified to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets.”<sup>213</sup> Thus, the Trump administration clearly intends to discourage ESG activism generally, and that focused on climate change specifically.

The other significant legal development concerns limits on the ability of shareholders to use Rule 14a-8.<sup>214</sup> Those who distrust shareholder proposals are attempting to limit which shareholders can use Rule 14a-8. Shareholders who have held at least \$2,000 in shares or 1% of the securities entitled to vote for at least one year are eligible to use Rule 14a-8.<sup>215</sup> The SEC recently proposed a restriction on Rule 14a-8 eligibility. Shareholders could use the Rule if they have held \$2,000 in securities entitled to vote for at least three years, \$15,000 for at least two years, or \$25,000 for at least one year.<sup>216</sup> These threshold levels would mostly affect individual shareholders rather than institutional investors.

Also notable is a shift in the SEC’s interpretation of the ordinary business operations exclusion. Proposals that have met the procedural requirements of Rule 14a-8 may still be excluded if they fall within one of a number of exclusions given in the Rule.<sup>217</sup> One of these bases for exclusion is if “the proposal deals with a matter relating to the company’s ordinary business operations.”<sup>218</sup> The SEC bases decisions on whether or not a proposal is excludable under the ordinary business basis on two considerations. The first is whether the matters are “so fundamental to managements’ ability to run a company on a day-to-day

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<sup>212</sup> *Id.* See Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, forthcoming, STAN. L. REV.

<sup>213</sup> Proclamation No. 13868, *Promoting Energy Infrastructure and Economic Growth*, 84 Fed. Reg. 15,495 (Apr. 10, 2019).

<sup>214</sup> See *supra* notes 190 through 193 and accompanying text.

<sup>215</sup> 17 C.F.R. § 240.14a-8(b).

<sup>216</sup> *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8*, Release No. 34-87458 (Nov. 5, 2019). The Financial CHOICE Act, passed in the House, would have imposed stricter restrictions. See <https://corpgov.law.harvard.edu/2017/06/28/the-financial-choice-act-and-the-debate-over-shareholder-proposals/>.

<sup>217</sup> 17 C.F.R. § 240.14a-8(i).

<sup>218</sup> 17 C.F.R. § 240.14a-8(i)(7).

basis that they could not, as a practical matter, be subject to direct shareholder oversight.”<sup>219</sup> However, a proposal is not excludable under that consideration if it would “raise policy issues so significant that it would be appropriate for a shareholder vote.”<sup>220</sup> The significance of climate change protects most proposals on this point. The second consideration is whether a proposal “micromanages” the company.<sup>221</sup> In several recent no-action letters, the SEC’s staff has allowed the exclusion of proposals on this ground where the proposals encourage companies to impose GHG reduction targets.<sup>222</sup> In a new Staff Legal Bulletin, the SEC explains that the key differentiator between excludable and non-excludable proposals is the “level of prescriptiveness” of the proposal.<sup>223</sup> Policy significance has not saved overly prescriptive proposals. In 2019, the SEC staff agreed with the issuers’ request to be allowed to exclude a climate change proposal 45% of the time.<sup>224</sup>

Reflecting the growth of institutional investors, in the 2019 proxy season, environmental and social proposals submitted were down somewhat from the previous year, but still almost half of all proposals voted on (323 out of 678).<sup>225</sup> Only a little under half (146) of those proposals went to a vote<sup>226</sup> – proposals are withdrawn when proponents reach a compromise with the issuer. Average support for such proposals was 28%, as compared to 10% ten years earlier.<sup>227</sup> Informal engagement through dialogues with company employees, officers, and sometimes directors has also increased.<sup>228</sup> A survey of 439 institutional investors found only 16% had not engaged in any way with companies on climate change

There is limited evidence suggesting that ESG proposals can have some effect on corporate behavior. One study looks at 847 engagements on a range of ESG matters with 660 separate companies

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<sup>219</sup> Release No. 34-40018 (May 21, 1998).

<sup>220</sup> *Id.*

<sup>221</sup> *Id.*

<sup>222</sup> *See, e.g., Devon Energy Corp.*, 2019 WL 1058333 (Mar. 4, 2019).

<sup>223</sup> *Shareholder Proposals*, Staff Legal Bulletin No. 14K, SEC, Division of Corporation Finance (Oct. 16, 2019).

<sup>224</sup> Majority Action, *supra* note 194, at 8.

<sup>225</sup> <https://corpgov.law.harvard.edu/2019/07/26/2019-proxy-season-review-part-1-rule-14a-8-shareholder-proposals/>. The comparisons are for the figures as of the middle of the two years, but most proposals are voted on by then.

<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

<sup>228</sup> Ceres, *The Role of Investors in Supporting Better Corporate ESG Performance*, at 23-25.

by a European investment management firm between 2005 and 2014.<sup>229</sup> About half of the engagements were aimed at improving disclosure, and half were aimed at company operations.<sup>230</sup> The activist considered the engagement file successfully closed 59% of the time, with success defined as the target company complying with the shareholder's request.<sup>231</sup>

A study on index fund voting on shareholder proposals found that close shareholder proposal votes that pass have a 2.04% higher one-day abnormal return than those that fail, but this is driven primarily by governance proposals.<sup>232</sup> A survey of institutional investors on climate change engagement found that in 71% of the cases the targeted firms responded to their investors, but mostly that consisted of simply acknowledging the issue – successful completion of a typical engagement is reported by only 25% of those surveyed.<sup>233</sup>

Thus, the evidence suggests that at least some shareholder engagement does succeed in both creating the desired change by the target and also may improve firm performance by some measures. But that appears to be driven largely by governance proposals, the G in ESG. Systematic evidence on the effect of climate change proposals is hard to find, which is not surprising given how recent their rise has been and how rapidly they are evolving. The interviews described in the following two sections thus provide an important way to understand better the impact of this emerging engagement on climate change.

### *B. U.S. Interview Findings*

In our interviews with the 14 U.S. participants, questions concerning shareholder engagement included how they approached company-investor engagement, how investors use proposals to pressure companies on issues like climate change, how companies respond to proposals, whether proposals have affected company practice related to climate change, and whether their employer supported proposals to limit use of Rule 14a-8. In the following sections, we describe some of the patterns we saw in their answers that

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<sup>229</sup> Tamas Barko, Martijn Cremers, & Luc Renneboog, *Shareholder Engagement on Environmental, Social, and Governance Performance*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2977219](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977219).

<sup>230</sup> *Id.* at 13.

<sup>231</sup> *Id.* at 3, 20.

<sup>232</sup> Adib, *supra* note 207, at 2.

<sup>233</sup> Philipp Krueger, Zacharias Sautner, & Laura T. Starks, *The Importance of Climate Risks for Institutional Investors* 27-28, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3235190](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235190), at 29.



provide a practice-based lens on some of the debates in the literature discussed above.

All of our participants saw ESG matters as receiving a greatly increased degree of attention from both investors and company management compared to the norm not that many years ago. This was regarded as true both for shareholder proposals and for more informal engagement between investors and companies. For instance, a director at an energy company commented, “I’ve been briefed that some large shareholders say, ‘don’t call us we’ll call you’ because everyone is doing more engagement.”<sup>234</sup>

Climate change was identified as one of the leading topics for shareholder engagement within the general rubric of environmental and social matters. Votes on these proposals are also increasing. As one investment manager at a nonprofit foundation noted: “15% used to be a good showing on a social environmental proposal, and we are now getting majority votes on climate resolutions, at both big companies, like Occidental or Exxon, and even smaller companies; [that’s] enough ... to make corporate secretaries and boards pay attention.”<sup>235</sup>

Participants noted that there is a two-way interaction between formal and public shareholder proposals, and informal and private dialogue. On the one hand, proposals often emerge after a process of informal discussion has gone on for a while. A sustainability officer at a food company described the process as follows:

Typically for us, we’ve been engaged with a shareholder for some period of time before they even file a resolution. So, we will have had at least three or four conversations with them, explaining our position, talking about what we’re doing, and in some cases, and in some cases, talking about disclosure. There have obviously been cases where we’ve increased our disclosure of what we’re doing, which resulted in not getting a resolution filed.<sup>236</sup>

On the other hand, sometimes a shareholder may use a proposal to initiate a conversation. A pension fund activist characterized the use of shareholder proposals as “really an invitation to engage” and “a way of trying to get the board’s attention.”<sup>237</sup>

Our interview findings indicate that companies’ responses to receipt of climate-related shareholder proposals vary considerably.

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<sup>234</sup> US14, Sept. 7, 2018.

<sup>235</sup> US3, Aug. 30, 2018.

<sup>236</sup> US5, Sept. 27, 2018.

<sup>237</sup> US10, Nov. 9, 2018.

Some companies will engage little or not at all and either try to exclude the proposal or alternatively allow it to be included on the assumption that it will not receive majority approval. Other companies will engage with the proponents and try to assuage their concerns, either by convincing them that they are already behaving as the proponents wish or sometimes by changing their behavior to comply.<sup>238</sup> There is likely to be a trend for more companies to move to the latter, more responsive camp, as proposals become more common and attract more yes votes, and as large, actively engaged shareholders become more insistent. As one securities lawyer noted, clients opting to do nothing in response to a proposal were increasingly “a minority of companies in this day and age; most choose to engage.”<sup>239</sup>

As for informal engagement dialogues, these can be in person or on the phone. On the investor side, our interviews indicated that a growing number of investors are bringing up climate change in their discussions with companies. A sustainability officer commented that this is particularly a focus of “smaller ESG boutique investment firms: but “increasingly, large investment firms or shareholders are asking us to talk about these issues, [with it] typically [being] the ESG specialist from those firms that we’re engaged with.”<sup>240</sup>

On the company side, in an engagement where sustainability issues are likely to arise, company participants will often include someone from the corporate secretary’s office or investor relations and a chief sustainability officer or another employee in the sustainability group. Directors are less likely to be involved, although they may join discussions with large shareholders. An investor-side participant from a company based in the UK, but with a U.S. presence, observed:

In the US our positions are much smaller. It varies, but I would say that the most typical combination of people who are on the phone is the head of investor relations or some sort of corporate secretary and often they will bring their internal head of sustainability, head of CSR, head of environmental strategy. There’s some content person who tends to be responsible for disclosure, and then maybe there’s going to be some lawyer on the phone who’s worried about disclosure issues.”<sup>241</sup>

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<sup>238</sup> US4, Sept. 20, 2018; US9, Oct. 30, 2018.

<sup>239</sup> US12, Dec. 6, 2018.

<sup>240</sup> US5, Sept. 27, 2018.

<sup>241</sup> US6, Oct. 5, 2018.

Several interview participants on the investor side noted a growing practice of engaging with groups of investors rather than one investor on its own. The groups could be informal networks, or through formal organizations and alliances. A former activist at a pension fund confirmed this trend of “collaboration with other shareholders,” often as a way to overcome the capacity constraints of working alone.<sup>242</sup>

Interviewees noted that the topics of both shareholder proposals and informal engagement may not seem immediately relevant for climate change, but are nonetheless importantly related. For instance, a number of proposals now ask companies to disclose their expenditures on lobbying. One pension fund activist involved with Climate Action 100 talked about filing a lobbying disclosure proposal directed at uncovering situations where companies “state one position publicly while spending their money privately in ways that are inconsistent with their public stated views.”<sup>243</sup>

Another common type of proposal not explicitly about climate change but relevant for achieving climate change-related aims, calls for proxy access, asking companies to adopt rules allowing shareholders to use the company proxy to nominate candidates for the board. This can then be used to pressure companies to put persons on the board with significant experience related to the environment, and climate change in particular, an emerging focus that several interview participants noted. As one interviewee said, “It’s our strategy to try and elevate climate risk into the boardroom, and if our boards aren’t climate competent then [proxy access] gives investors a tool to put new directors on the board who may be a little more sensitive to those risks or knowledgeable.”<sup>244</sup>

As with disclosure, the ultimate question about shareholder engagement is whether and how it is affecting underlying company operations and risk management. Engagement around climate change on a widespread basis is still quite new and rapidly evolving. Changes to behavior may take time and further evolution of engagement. Moreover, it is hard to disentangle the effects of engagement from a variety of other factors that are pushing companies to address climate change. Perhaps for these reasons, it is hard to discern from our interviewees clear and hard signs that engagement has yet significantly changed company behavior, but there are some signs of early achievements.

The reactions differed notably for interview participants on the company side versus those on the investor side. On the company side,

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<sup>242</sup> US13, Dec. 12, 2018.

<sup>243</sup> US10, Nov. 9, 2018.

<sup>244</sup> US10, Nov. 9, 2018.

the general reaction was that engagement may cause their company to more clearly and fully disclose what they are doing, but that they were already actively addressing climate issues before investor engagement, for other reasons.<sup>245</sup> Noting the uncertainty on this issue, one said:

It's always a little hard to say where it's coming from, right? I mean the fact that at one meeting hearing you're getting a shareholder proposal on this issue. Does that have some incremental increase in your interest in asking questions about it at future meetings? Probably. But I think a lot of that, what the board discusses and what the board reviews is still very much driven by management putting the agenda together of what they view as most impacting the business.<sup>246</sup>

Interview participants on the investor side were sometimes more cautiously optimistic about the effects of engagement on behavior. They rarely identified specific effects, but they made two broader points. First, along the lines of the old adage, “you can’t manage what you don’t measure,”<sup>247</sup> there is evidence of “incremental movement by these firms to (1) disclose more about what they know and (2) really start to think about internally what they do.”<sup>248</sup> This was described as “a first step” and “a tracking mechanism,” with the effect that as “more and more assets ... are tied to these environmental performance indicators and as asset dollars move, that gets everyone’s attention.”<sup>249</sup>

Second, investor participants expressed a view that engagement is changing communication and culture among directors and officers. For instance, one remarked, “I think we are changing conversations in the boardroom, which is healthy.”<sup>250</sup> Another noted examples of “certain companies integrating environmental risk throughout the whole organization,” creating “a real culture shift.”<sup>251</sup>

### *C. Australian Interview Findings*

Australia has a much more nascent experience of shareholder activism than the U.S.,<sup>252</sup> but one which is evolving quickly and increasingly embracing activism with respect to climate change. In our

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<sup>245</sup> US4, Sept. 20, 2018; US5, Sept. 27, 2018.

<sup>246</sup> US12, Dec. 6, 2018.

<sup>247</sup> US10, Nov. 9, 2018.

<sup>248</sup> US9, Oct. 30, 2018.

<sup>249</sup> US6, Oct. 5, 2018.

<sup>250</sup> US10, Nov. 9, 2018.

<sup>251</sup> US6, Oct. 5, 2018.

<sup>252</sup> AUS5, Mar. 2, 2018.

24 Australian interviews, we asked participants for their views on how climate-related shareholder proposals were impacting companies, and how this avenue compared to “behind-the-scenes” corporate-investor engagement on ESG issues.

In Australia, investors have traditionally preferred to engage privately with companies, with shareholder proposals (more commonly termed “resolutions” in Australia) seen as a more extreme approach that was the purview of activist organizations.<sup>253</sup> While private engagement remains a major avenue for company-investor dialogue, paralleling the United States, there has been a steady increase over the last decade in the number of resolutions brought to Australian companies addressing ESG issues, and in particular, a more recent surge in resolutions addressing climate change specifically. The latter have been directed mostly at energy sector companies, including large electricity retailers such as Origin Energy and AGL, resource companies and large coal miners such as Whitehaven Coal, Rio Tinto and BHP, and financiers and insurers with significant exposure to fossil fuel investments such as ANZ, Westpac, NAB and QBE.<sup>254</sup> Three general trends are discernable: (1) generalist institutional investors becoming involved in co-filing resolutions with civil society groups; (2) an increasing sophistication of the substantive demands made in resolutions related to climate risks, for instance, to address disclosure of transition planning or lobbying that is inconsistent with Paris temperature goals; and (3) resolutions receiving a higher percentage of the shareholder vote at companies’ annual general meetings (AGMs).<sup>255</sup>

The legal framework for shareholder resolutions in Australia has notable differences from that in the U.S. with more constraints on the use of non-binding, advisory resolutions. As discussed above, however, recent developments in U.S. practice to limit ESG and climate-related shareholder proposals may result in more convergence in the future. To bring an “ordinary resolution” to a company’s AGM in Australia, shareholders require a minimum of 5% of the votes or a group of at

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<sup>253</sup> AUS3, Jan. 13, 2018; AUS4, Mar. 7, 2018; AUS5, Mar. 2, 2018; AUS8, Mar. 15, 2018.

<sup>254</sup> See, ACCR, <https://accr.org.au/shareholder-action/current-resolutions/>.

<sup>255</sup> See ACCR, *Overview of Resolutions*, <https://accr.org.au/shareholder-action/resolution-voting-history/>. Cf finding that big asset managers and pension funds failed to support any climate change resolutions at Australian businesses during the 2018-19 annual meeting season: Attracta Mooney, *Big Australian investors under scrutiny over climate change*, FINANCIAL TIMES, Jan. 18, 2020, available at <https://www.ft.com/content/de4317c0-f8da-4ec5-85bb-337ddcdaed1>.

least 100 shareholders.<sup>256</sup> This threshold would be prohibitively high in the United States but has not proved to be the main barrier to shareholder resolutions in Australia. Rather, companies have declined to put these resolutions to the AGM on the basis that they unduly interfere in the board's management powers.<sup>257</sup> This interpretation was upheld by Australia's Federal Court in a test case concerning climate change resolutions put to the AGM of the Commonwealth Bank of Australia.<sup>258</sup> As a result of this restriction, more recent shareholder resolutions on climate change have been brought in two parts, with a first resolution seeking to amend the company's constitution to permit non-binding advisory resolutions, and a second resolution presenting the substantive demands regarding the board's management of climate change risks.<sup>259</sup> While constitutional amendments require a 75% majority vote and are therefore highly unlikely to pass,<sup>260</sup> the advantage of this strategy is that the board is required to put the resolution to the AGM. In most cases, companies have also allowed a vote on the substantive element of the resolution and reported this vote publicly.<sup>261</sup>

Our interviews with Australia participants indicated a shifting attitude to shareholder engagement on climate issues, with "investors ... much more willing to use every tool available to them in the

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<sup>256</sup> *Corporations Act 2001* (Cth) s 249N.

<sup>257</sup> In particular, members cannot use their powers to requisition a members' meeting (ss 249D, 249F) or demand a motion be put to a members' meeting (s 249N) if the subject is a matter exclusively within the purview of the board. See Michael Jefferies, *The third wave of shareholder influence and the emergence of informational activism in Australia*, 34 *AUS. J. CORP. L.* 305 (2019); Stephen Bottomley, *Rethinking the law on shareholder-initiated resolutions at company general meetings*, 43 *MELB. U. L. REV.* 93 (2019).

<sup>258</sup> See first instance decision at *Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia* (2015) 325 ALR 736; [2015] FCA 785 (Jul. 31, 2015); upheld on appeal in *Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia* (2016) 248 FCR 280; [2016] FCAFC 80 (Jun. 10, 2016).

<sup>259</sup> For example, a resolution was put to Downer-EDI in 2017 to amend the constitution to provide the following: "In the exercise of their powers and duties pursuant to clause 5.1 (a) the Directors shall ensure the business of the company is managed in a manner consistent with the objective of holding global warming to below two degrees Celsius above preindustrial levels."

<sup>260</sup> *Corporations Act 2001* (Cth) s 9.

<sup>261</sup> See, e.g., climate change resolutions put to the BHP Billiton Ltd AGM held in Sydney on Nov. 7, 2019, receiving 27.07% of the vote (<https://www.asx.com.au/asxpdf/20191107/pdf/44bcnszd5qn6v2.pdf>) and put to the Rio Tinto AGM held on May 2, 2018, receiving 18.03% of the vote (<https://www.asx.com.au/asxpdf/20180502/pdf/43tqsy22jfb8xx.pdf>).

toolkit,”<sup>262</sup> including resolutions and potentially also the divestment of shares if companies are unresponsive. When large institutional investors – often pension (or “superannuation”) funds in an Australian context – were involved in shareholder resolutions, this was often seen as a strategy to escalate engagement with a company that was failing to adequately respond to private engagement on climate change.<sup>263</sup>

Investors voting on climate resolutions in an Australian setting demonstrate a similar variation of approaches to voting their shares as those in the United States. Some funds remain committed to more traditional engagement approaches and would be unlikely to vote against management except in extreme situations.<sup>264</sup> Further, they would be particularly uncomfortable with supporting constitutional amendments as a way to effect change on climate risks. Others will assess each case on its merits and then make a decision to engage behind-the-scenes on the resolution or to vote in a certain way.<sup>265</sup> Some Australian funds, notably superannuation funds such as Local Government Super, have even taken the lead in co-filing climate resolutions.<sup>266</sup> Several funds also noted that their approach to voting shares differs between jurisdictions: in Australia where they perceive good access to boards and a strong engagement culture, these funds are more likely to vote with management and not support a resolution, even though they may vote in favor of an almost identical resolution in other jurisdictions such as the U.S.<sup>267</sup>

Regarding the question of whether shareholder engagement, and particularly the use of shareholder resolutions, helps shift corporate behavior on climate change, our Australian interview findings revealed a similar divide to that among U.S. interviewees. On the investor and civil society side, interviewees expressed optimism that recent shareholder resolutions had produced tangible changes in the approaches taken by target companies to climate risks. But they

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<sup>262</sup> AUS6, Mar. 22, 2018.

<sup>263</sup> AUS18, Apr. 26, 2018; AUS19, June 6, 2018; AUS20, June 4, 2018; AUS21, May 30, 2018; AUS22, Apr. 27, 2018; AUS23, Apr. 26, 2018; AUS24, May 17, 2018.

<sup>264</sup> AUS18, Apr. 26, 2018; AUS24, May 17, 2018.

<sup>265</sup> AUS19, June 6, 2018; AUS20, June 4, 2018; AUS21, May 30, 2018; AUS22, Apr. 27, 2018.

<sup>266</sup> In 2018, resolutions put to QBE Australia (part of the QBE Insurance Group, one of the world’s top 20 general insurance and reinsurance companies) were co-filed by Local Government Super (a medium sized Australian superannuation fund) together with the Church of England Pensions Board and the Swedish National Pension Fund (representing \$84 billion worth of assets under management).

<sup>267</sup> AUS22, Apr. 27, 2018; AUS24, May 17, 2018.

emphasized that these changes were occurring in the context of ongoing private engagement and also emerging targeted climate change engagements being pursued by coalitions of investors, such as Climate Action 100+.<sup>268</sup> At the same time, the overall response of Australian companies to the lodging of shareholder resolutions on climate change was described as generally defensive, often quite adversarial or dismissive.<sup>269</sup> From the company side, participants did however report a shift in their approach to climate-related resolutions, including increased emphasis on engagement with investors on climate risk.<sup>270</sup> Various factors affected the nature of the company's response, such as whether resolutions had broader investor backing and the level of support for the resolution.<sup>271</sup> As one interviewee expressed it, echoing a similar sentiment seen in the U.S., "even ...five percent of shareholders voting against management is significant ... when you start getting up around that 10 to 15 percent mark, things get very serious for a board."<sup>272</sup>

These findings suggest the Australian experience of shareholder engagement on climate change is largely tracking that in the United States even though the use of climate-related shareholder resolutions is a more recent phenomenon there. This is despite the significant legal constraints on the filing of ordinary shareholder resolutions in Australia. Indeed, these constraints seem to have spurred experimentation in Australia with shareholder resolutions that may offer useful lessons for U.S. practice. This includes more sophisticated substantive demands, such as efforts to expose whether companies' lobbying strategies are consistent with Paris Agreement temperature goals. The Australian experience also demonstrates the potential effectiveness of more informal company-investor engagement

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<sup>268</sup> AUS3, Jan. 13, 2018; AUS4, Mar. 7, 2018; AUS5, Mar. 2, 2018; AUS6, Mar. 22, 2018; AUS7, Feb. 23, 2018; AUS8, Mar. 15, 2018. *Climate Action 100+* is an engagement initiative launched in 2017 backed by 370 investors with nearly USD \$35 trillion in assets under management. It is delivering a 5 year program of engagement with important greenhouse gas emitters and other companies highly exposed to climate risk across the global economy that have significant opportunities to drive the clean energy transition. Investors are calling on companies to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures by implementing the recommendations of the TCFD. <https://climateaction100.wordpress.com/about-us/>

<sup>269</sup> AUS3, Jan. 13, 2018; AUS4, Mar. 7, 2018; AUS8, Mar. 15, 2018; AUS9, June 18, 2018; AUS22, Apr. 27, 2018; AUS23, Apr. 26, 2018.

<sup>270</sup> AUS9, June 18, 2018; AUS11, Apr. 27, 2018; AUS13, Aug. 20, 2018.

<sup>271</sup> AUS3, Jan. 13, 2018; AUS5, Mar. 2, 2018; AUS11, Apr. 27, 2018.

<sup>272</sup> AUS3, Jan. 13, 2018.



strategies in advancing companies' responses to climate risk where climate change is an issue of concern for investors. This kind of engagement has been facilitated in Australia by the concentrated shareholding of large institutional investors, such as superannuation funds, in the ASX200.<sup>273</sup> Potentially, the United States may be moving in a similar direction with the growing influence of the "Big Three" and their preference for using engagement over shareholder proposals.

## V. FIDUCIARY DUTY

The final legal tool considered in this Article focuses on the fiduciary duties of directors and officers. Directors and officers have a duty to act loyally on behalf of their corporation.<sup>274</sup> Some have advocated suing boards that have failed to adequately monitor and manage risks arising from climate change. Such suits aim to encourage a faster energy transition by causing companies to shift resources from dirtier to cleaner operations.<sup>275</sup> To date, no cases seeking to enforce such a duty in a climate change context have been brought in the United States, but there has been discussion both here and more extensively in other countries, such as Australia, about the possibility of such suits.<sup>276</sup> Even without such suits, many companies have revised their risk management practices to recognize climate change risks. This Part

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<sup>273</sup> Ellis, *supra* note 91.

<sup>274</sup> For an overview, see Claire A. Hill & Brett H. McDonnell, *Fiduciary Duties: The Emerging Jurisprudence*, RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 133 (Claire A. Hill & Brett H. McDonnell, eds. 2012)

<sup>275</sup> See *supra* note 97 and accompanying text.

<sup>276</sup> Osofsky *et al.*, *supra* note 4, at 675-79; NOEL HUTLEY SC & SEBASTIAN HARTFORD-DAVIS, CLIMATE CHANGE AND DIRECTOR'S DUTIES: MEMORANDUM OF OPINION (2016), <https://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf>; NOEL HUTLEY & JAMES MACK, MARKET FORCES: SUPERANNUATION FUND TRUSTEE DUTIES AND CLIMATE CHANGE RISK: MEMORANDUM OF OPINION (2017); KEITH BRYANT & JAMES RICKARDS, THE LEGAL DUTIES OF PENSION FUND TRUSTEES IN RELATION TO CLIMATE CHANGE: ABRIDGED JOINT OPINION (2016), <https://www.documents.clientearth.org/wp-content/uploads/library/2016-12-02-the-legal-duties-of-pension-fund-trustees-qc-opinion-ext-en.pdf>; CLIENTEARTH, RISKY BUSINESS: CLIMATE CHANGE AND PROFESSIONAL LIABILITY RISKS FOR AUDITORS (2017), <https://www.documents.clientearth.org/wp-content/uploads/library/2017-12-13-risky-business-climate-change-and-professional-liability-risks-for-auditors-ce-en.pdf>.

explores the law surrounding monitoring of climate change risk and how corporate practice has developed.

#### *A. Legal and Institutional Developments*

There is some concern that the duty of loyalty could inhibit consideration of sustainability matters like climate change because the duty requires maximizing financial returns to shareholders.<sup>277</sup> However, addressing climate change often improves the long-term profitability of companies,<sup>278</sup> and given the broad discretion granted by the business judgment rule, directors need not fear liability for addressing climate change as long as they plausibly link the issue to long-term profitability.<sup>279</sup>

There is a more affirmative potential use of fiduciary duty. Suits enforcing this duty could become part of a new wave of climate change litigation. An early wave of litigation focused mostly on claims based in tort and environmental law.<sup>280</sup> A second wave of litigation is focused on federal and state securities law claims, arguing to false and misleading disclosure by companies (mostly energy companies) that allegedly were well aware of the risks to their business models of climate change.<sup>281</sup>

Our focus here is on a potential new wave of litigation based on state corporate law fiduciary duty. In 1996, the Delaware Chancery Court held that directors have “a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists. . . .”<sup>282</sup> Some argue that given the significant risks that climate change poses to the business of many corporations, this *Caremark* duty creates a risk of liability for the

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<sup>277</sup> *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010); Brett H. McDonnell, *The Corrosion Critique of Benefit Corporations*, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3450747](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450747).

<sup>278</sup> See *supra* notes 37 through 44 and accompanying text.

<sup>279</sup> McDonnell, *supra* note 277; Joan MacLeod Heminway, *Let's Not Give Up on Traditional For-Profit Corporations for Sustainable Social Enterprise*, 86 UKMC L. REV. 779 (2018).

<sup>280</sup> *Id.*; Hari M. Osofsky & Jacqueline Peel, *Litigation's Regulatory Pathways and the Administrative State: Lessons from U.S. and Australian Climate Change Governance*, 25 GEO. INT'L ENVTL. L. REV. 207 (2013).

<sup>281</sup> See *supra* note 100.

<sup>282</sup> *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996).

boards of such corporations should they fail to adequately monitor and respond to those risks.<sup>283</sup>

Any such suit would confront serious obstacles. Liability under *Caremark* is extremely unlikely. The *Caremark* court called it “possibly the most difficult theory in corporation law upon which a plaintiff might hope to win judgment.”<sup>284</sup> The court said that “only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability.”<sup>285</sup> In over two decades since *Caremark* was decided, only a few cases have even survived motions to dismiss.<sup>286</sup>

But two recent cases have increased the odds of success of a *Caremark* claim. In upholding *Caremark*, the Delaware Supreme Court specified two ways in which plaintiffs could claim oversight liability: “(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or control, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.”<sup>287</sup> For each of these two paths, plaintiffs have recently survived a motion to dismiss.

In *Marchand v. Barnhill*,<sup>288</sup> the Supreme Court overturned a Chancery Court dismissal of a suit against Blue Bell Creameries. After a listeria outbreak caused by its ice cream, the court found the complaint adequately alleged the company had no monitoring system at all. The lack of a food safety monitoring system in a regulated company that only produces ice cream was critical to the court.<sup>289</sup> *In re Clovis Oncology, Inc. Derivative Litigation*<sup>290</sup> involved a drug clinical trial by a biopharmaceutical company. Here there was a monitoring system, but the board allegedly ignored numerous facts that raised red

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<sup>283</sup> Lisa Benjamin, *The Road to Paris Runs Through Delaware: Climate Litigation and Directors’ Duties*, forthcoming, UTAH L. REV., available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3450747](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450747).

<sup>284</sup> *Caremark*, 698 A.2d at 967.

<sup>285</sup> *Id.* at 971.

<sup>286</sup> Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 101, 120 (2019).

<sup>287</sup> *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

<sup>288</sup> 212 A.3d 805 (Del. 2019)

<sup>289</sup> *Id.* at 821-23.

<sup>290</sup> 2019 WL 4850188 (Del. Ch. 2019).

flags showing that the trial failed to follow standard protocol and regulations.<sup>291</sup>

Though these cases indicate some life within *Caremark*, potential plaintiffs cannot take too much comfort. They only involve motions to dismiss, and the courts emphasize the importance of the fact that the companies had just one product line in a highly regulated industry, so that compliance with those regulations was central to the business.

Even more important for the prospect of climate claims, *Caremark* involved legal compliance oversight, as did those few cases which have allowed *Caremark* claims to continue. Plaintiffs have tried to extend *Caremark* to monitoring business risk. The Delaware courts have never accepted this extension, and their comments suggest great skepticism.<sup>292</sup> Some think this limitation to legal compliance is the appropriate function of *Caremark*.<sup>293</sup> Others argue that monitoring business risk is functionally very similar to compliance risk, so that *Caremark* could apply to business risk as well,<sup>294</sup> and some argue that *Caremark* liability should apply where boards fail to supervise risks that impose serious social harms.<sup>295</sup> But case law does not extend beyond extreme legal compliance oversight failures.

Thus, if a plaintiff claims that a company broke a law related to climate change and the board failed to adequately monitor compliance with that law, *Caremark* and its progeny offer some limited hope, particularly if climate risk is truly central to the company's business model and it either had no legal compliance system in place at all or the board ignored major red flags. But if the claim is that the board ignored risks that climate change poses to financial performance, a *Caremark* suit seems doomed to fail, absent major change in the case law.

Even if the risk of legal liability is negligible, a threatened *Caremark* suit could still affect director behavior. Companies may choose to have aggressive compliance programs to avoid any chance of liability given legal uncertainty.<sup>296</sup> Regulators encourage companies

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<sup>291</sup> *Id.* at \*13-\*15.

<sup>292</sup> See Pollman, *supra* note 286, at 131-32; Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis*, 2013 ILL. L. REV. 859, 862-63.

<sup>293</sup> See, e.g., Pollman, *supra* note 286, at 132-33; Robert T. Miller, *Oversight Liability for Risk-Management Failures at Financial Firms*, 84 So. Cal. L. Rev. 47 (2012).

<sup>294</sup> Stephen M. Bainbridge, *Caremark and Risk Enterprise Management*, 34 J. CORP. L. 967 (2009).

<sup>295</sup> Hill & McDonnell, *supra* note 292.

<sup>296</sup> Hill, *supra* note 41, at 684-85.

to have robust compliance programs.<sup>297</sup> Reputational concerns may also encourage companies to go beyond the minimum required to avoid *Caremark* liability.<sup>298</sup>

Oversight duty suits may have a greater chance of success in other countries. We discuss the situation in Australia below.<sup>299</sup> In Poland, ClientEarth sued (as a shareholder) two energy companies, Enea and Energa, over construction of a new coal-fired power plant, claiming that the project poses unjustifiable financial risks in the context of rising carbon prices, increased competition from cheaper renewables, and the impact of EU energy reforms on state subsidies for coal power. A District Court held in ClientEarth's favor, although on other grounds.<sup>300</sup> In the United Kingdom, ClientEarth has written to 14 pension funds asking them to disclose what steps they are taking on climate risk, and threatening legal action if those steps are not sufficient.<sup>301</sup> A prominent Canadian law professor argues that Canadian law imposes a duty on companies to monitor climate change risks.<sup>302</sup> This may be an area where Delaware is less responsive to shareholders than courts in other countries.

Even without legally binding obligations, boards monitor business risks, and best practices have evolved rapidly. A widely-cited comprehensive approach is the COSO Enterprise Risk Management Framework. COSO issued guidance for a framework on enterprise risk management in 2004, which was updated in 2017.<sup>303</sup> In 2018, COSO and the World Business Council for Sustainable Development issued guidance on how the COSO framework applies to ESG risks.<sup>304</sup> The guidance stresses that ESG matters pose financial risks to companies in

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<sup>297</sup> *Id.* at 689.

<sup>298</sup> *Id.* at 688-89.

<sup>299</sup> *See infra*

<sup>300</sup> <https://www.clientearth.org/press/court-win-world-first-climate-case-ostroleka-c-future-in-question/>. An English translation of the decision is on file with the authors. The District Court found that the resolution consenting to construction of the plant was an impermissible instruction to the Board and therefore legally invalid; it did not, however, reach the question of whether the project would harm the economic interests of the company.

<sup>301</sup> <https://www.clientearth.org/top-uk-pension-funds-put-on-notice-over-climate-risk/>.

<sup>302</sup> Janis Sarra, *Fiduciary Obligations in Business and Investment: Implications of Climate Change*.

<sup>303</sup> COSO, *Enterprise Risk Management: Integrated Framework*, <https://www.coso.org/Pages/erm-integratedframework.aspx>.

<sup>304</sup> COSO & WBCSD, *Enterprise Risk Management: Applying Enterprise Risk Management to Environmental, Social and Governance-Related Risks, Executive Summary* (2018).

the short, medium and long term, and stresses that this understanding brings ESG risks within mainstream risk management processes.<sup>305</sup> The guidance stresses collaboration between the board, executive management, and sustainability practitioners as well as internal and external communication of ESG risks.<sup>306</sup>

Ceres has recently issued guidance on board oversight of ESG issues.<sup>307</sup> This also recommends stakeholder and shareholder input,<sup>308</sup> regular board discussion of ESG risks and integration into strategic planning,<sup>309</sup> incorporating ESG factors into executive compensation,<sup>310</sup> and building ESG factors into both audit committee and other relevant board committee processes.<sup>311</sup> Still, not all boards follow best practices. A PwC 2018 survey of corporate directors found that 29% of directors say shareholders are too focused on corporate social responsibility, and 39% think climate change should not impact company strategy at all.<sup>312</sup>

At both the board and management levels, a critical question is who has responsibility for monitoring ESG risks. The full board has some responsibility, but there is a need to have more focus at the board committee level as well. The audit committee is responsible for overall risk monitoring, but should it be primarily responsible for ESG risks, or should another committee be charged with that? Large corporations increasingly have sustainability teams. Should management-level responsibility be primarily with them, and to whom should they report? What role do other departments such as compliance, legal, and audit play? There is a tradeoff. Giving responsibility to a specialized group will ensure someone has expertise and incentive to pay attention to climate change. But there is a risk of becoming siloed, leaving central decisionmakers out of touch. The COSO and Ceres guidance suggest some specialization but also much coordination between various departments, committees, and levels.<sup>313</sup>

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<sup>305</sup> *Id.* at 7.

<sup>306</sup> *Id.* at 8-9.

<sup>307</sup> Ceres, *Running the Risk: How Corporate Boards Can Oversee Environmental, Social and Governance (ESG) Issues, Executive Summary* (2019).

<sup>308</sup> *Id.* at 8.

<sup>309</sup> *Id.* at 9.

<sup>310</sup> *Id.* at 11

<sup>311</sup> *Id.* at 12.

<sup>312</sup> PwC, Governance Insights Center, *The Evolving Board: Signs of Change*.

<sup>313</sup> COSO, *supra* note 304; Ceres, *supra* note 307.

### *B. U.S. Interview Findings*

In our interviews with the 14 U.S. participants, we asked several open-ended questions concerning fiduciary duty and risk oversight and management related to climate change. These included how climate change issues filter up to the board, the lines of communication and processes in place around climate change, whether independent advice is sought and if so from whom and how, and whether they perceived a widespread understanding among U.S. directors about how fiduciary duties apply to climate change. We describe here some of the patterns that emerged in the participants' answers.

Although directors and officers are very much aware of the duty to oversee and manage corporate risk, the understanding of the role of climate risks within that duty is mixed. Investors tended to view the duty as encompassing climate risks, but when engaging with companies do not "hang their hat on the fiduciary duty piece."<sup>314</sup> Perceptions also vary by industry, which to some extent is proper. A securities' lawyer thus noted:

If you are an energy company it is very different. You probably have this fully integrated in your business and in your thinking. You just have to. But I think for the bulk of our clients that are in the manufacturing space it is still not. Margin is still more important than climate change.<sup>315</sup>

Another interviewee who is a pension fund activist generally concurred with this view, commenting:

A lot of boards are just trying to fend off a hedge fund or other short-term thinking which kind of contradicts any long-term planning that they would do. It's another big elephant in the room. Unless the company is managing and thinking about the long-term, this kind of stuff doesn't make sense to them.<sup>316</sup>

For those companies addressing climate risk, our interview findings revealed a great deal of variation in how companies allocated responsibility for that risk, and ESG risk more generally. Some examples give a sense of the range of options. At a retail company, the board's nomination and governance committee is responsible for corporate social responsibility issues and there is a CSR management

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<sup>314</sup> US9, Oct. 30, 2018.

<sup>315</sup> US12, Dec. 6, 2018.

<sup>316</sup> US13, Dec. 12, 2018.

team.<sup>317</sup> At a food company, a public responsibility committee handles reputational risk related to sustainability, there is a sustainability group, and a governance committee of top managers discusses risks of all types.<sup>318</sup> Another company has a matrixed reporting environment, where the sustainability group reports to finance and legal, and sometimes to the board as well.<sup>319</sup> At another company there are two sustainability teams, and a sustainability executive advisory team.<sup>320</sup> At an energy company, both the audit committee and an operations, environmental and safety committee oversee ESG risk.<sup>321</sup>

Beyond internal company structures, a number of participants discussed outreach to various stakeholders other than shareholders on a regular basis on ESG and climate issues. At a food company, one participant commented, “we’re engaged with quite a few NGOs, but campaigning NGOs like Greenpeace as well as operational NGOs like The Nature Conservancy or World Wildlife Fund or the Xerxes Society, who are actually doing things on the ground. ... We talk to anybody who wants to talk to us about these issues, and in some cases we rely on their technical expertise.”<sup>322</sup> An energy company director noted his company has an annual stakeholder meeting that is large and comprehensive, with the CEO attending.<sup>323</sup>

As in the case of shareholder engagement,<sup>324</sup> a number of interviewees discussed the emerging focus on having board expertise around climate or more generally environmental issues. A participant who works as a consultant described this as “a growing trend.”<sup>325</sup> A question is what counts as environmental expertise, with “a lot of reinterpreting people’s experience in that space.”<sup>326</sup> As a mutual fund manager participant remarked, “It doesn’t have to be an environmental scientist that you’re sticking on a board, that has no relevant experience, but someone who just has a real appreciation for this kind of broader risk.”<sup>327</sup> A securities lawyer noted that this kind of experience may slowly grow across companies over time, with a

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<sup>317</sup> US4, Sept. 20, 2018.

<sup>318</sup> US5, Sept. 27, 2018.

<sup>319</sup> US9, Oct. 30, 2018.

<sup>320</sup> US11, Nov. 15, 2018.

<sup>321</sup> US14, Sept. 7, 2018.

<sup>322</sup> US5, Sept. 27, 2018.

<sup>323</sup> US14, Sept. 7, 2018.

<sup>324</sup> See *supra* note 244 and accompanying text.

<sup>325</sup> US9, Oct. 30, 2018.

<sup>326</sup> US9, Oct. 30, 2018.

<sup>327</sup> US6, Oct. 5, 2018.



“ripple effect”<sup>328</sup> as “you get the board members having been people who were part of an executive team that was spending more time on that.”<sup>329</sup> One lawyer also noted that some companies are starting to pay attention to how compensation affects the incentives to pay attention to ESG matters.<sup>330</sup>

No duty to monitor climate change risk suits have yet been brought in the United States, so they were not yet on the radar screen for most of our participants as a factor that might drive shifts in corporate behavior around climate change. However, several participants remarked that such a suit, if it were to emerge, would get a company’s attention. As one participant noted, in the litigious U.S. market, “the risk of a lawsuit gets everyone’s attention in a way that I think can trump anything else in terms of focus.”<sup>331</sup>

### C. Australian Interview Findings

Directors’ duties under Australian corporate law are of similar content to fiduciary duties under Delaware law, although broader interpretations, and a “public interest” orientation of enforcement in Australia, potentially enhance the prospects of a successful lawsuit.<sup>332</sup> The principal duties considered most likely to be a basis for finding liability in a climate change context are the duty of due care and diligence, and duties related to the disclosure of business risks.<sup>333</sup> In our interviews with Australian participants, we asked them for their views

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<sup>328</sup> US12, Dec. 6, 2018.

<sup>329</sup> *Id.*

<sup>330</sup> US12, Dec. 6, 2018.

<sup>331</sup> US6, Oct. 5, 2018.

<sup>332</sup> As discussed *supra* note 89, the term “fiduciary duties” is used as a convenient shorthand in this section to cover directors duties but in fact the duty of due care is not a “fiduciary” duty under Australian law as it is both a common law duty and an equitable duty. For a comparative discussion of fiduciary duties and public interest norms see Jennifer G. Hill, *Shifting Contours of Directors’ Fiduciary Duties and Norms in Comparative Corporate Governance* (Feb. 5, 2020), <https://clsbluesky.law.columbia.edu/2020/02/05/shifting-contours-of-directors-fiduciary-duties-and-norms-in-comparative-corporate-governance/>.

<sup>333</sup> Hutley & Hartford-Davis (2016), *supra* note 25, at [51]. This position was reaffirmed in their 2019 opinion, *supra* note 25, at [2]. Significantly, their 2019 opinion also gave importance to the 2018 IPCC report, *Global Warming of 1.5°C* [10]-[13] and provided guidance that directors should be assessing the possible of impacts of (and steps to avoid) 1.5°C scenarios [14]. The *Corporations Act 2001* also provides additional duties in s 181(1): the duty to act in the best interests of the company and the duty to act for a proper purpose. See further AUSTIN & RAMSAY, *supra* note 89, para. [8.065]. . .

of whether companies see such duties as extending to climate risks, and what response was being taken by directors if any as a result. The following sections first explain the relevant duties that apply under Australian corporate law and then highlight key findings from the interviews about how these duties are being interpreted by Australian companies in practice.

For the duty of due care and diligence, under Australian law, directors must show they exercised the degree of care and diligence that a reasonable person in their circumstances would exercise.<sup>334</sup> As in the United States, directors can raise a defense of “business judgment.” However, this operates only in relatively narrow circumstances where directors can show, *inter alia*, that they informed themselves about the subject matter of the judgment to the extent they reasonably believed to be appropriate, and rationally believed that the judgment was in the best interests of the corporation.<sup>335</sup> This imposes a relatively high threshold for invocation of the business judgment rule compared to the United States.<sup>336</sup>

Although Australia, like the United States, has not yet seen a climate change breach of duty suit against company directors, there has been extensive consideration of this possibility in two legal opinions from leading commercial law advocates commissioned by the NGO, the Centre for Policy Development. In these opinions, Noel Hutley QC, and barrister Sebastian Hartford-Davis outlined how the duty of due care and diligence would apply to climate change based on existing statutory law and case law interpretations.<sup>337</sup> They concluded that, as a general matter, there is ample evidence that climate change is likely to pose potentially foreseeable harm to company interests in many situations.<sup>338</sup> As a result they advised, at a minimum:

... directors should consider, and, if it seems appropriate, take steps to inform themselves about climate-related risks to their business, when and how those risks might materialise, whether they will impact the business adversely or favourably, whether there is anything to be done to alter the risk, and otherwise consider how the consequences of the risk can be met. In complex situations, directors should seek out

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<sup>334</sup> *Corporations Act 2001* (Cth) s 180(1).

<sup>335</sup> *Id.* s 180(2).

<sup>336</sup> Barker, *supra* note 65, at 14.

<sup>337</sup> Hutley & Hartford-Davis (2016) & (2019), *supra* note 25.

<sup>338</sup> Hutley & Hartford-Davis (2016), *supra* note 25 at [14]-[33].

expert or professional advice pursuant to s189 of [Corporations] Act.<sup>339</sup>

The Hutley/Hartford-Davis opinions have been described by ASIC (the Australian equivalent of the SEC) as “legally sound and ... reflective of our understanding of the position under the prevailing case law in Australia in so far as directors’ duties are concerned,”<sup>340</sup> thus amplifying their influence. Further, commentators, such as MinterEllison lawyer, Sarah Barker, have discussed specific circumstances where directors may be in breach of the duty of care and diligence in relation to climate risk.<sup>341</sup> These include situations where there is either “a total failure to consider and govern for such risks in strategic planning and risk management,” or “inadequate or deficient consideration and/or governance of climate change-related risk exposures.”<sup>342</sup> Hutley and Hartford-Davis themselves described the prospect of “litigation against a director who has failed to perceive, disclose or take steps in relation to a foreseeable climate-related risk that can be demonstrated to have caused harm to a company (including perhaps reputational harm)” as “likely to be only a matter of time.”<sup>343</sup>

Such liability theories are being tested in an ongoing case against the REST superannuation fund, which alleges that the fund’s corporate trustee failed to act with care, skill and diligence and in the best interests of beneficiaries by not adequately considering the risks posed by climate change to the fund’s investment portfolio in the best

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<sup>339</sup> *Id.* at [36]-[37].

<sup>340</sup> Price, *supra* note 26.

<sup>341</sup> In thinking about how the Australian duty of care might develop to promote action by directors to deal with climate change, a member of our Expert Reference Group for this research – Professor Ian Ramsay of Melbourne Law School – noted that the development of so-called “stepping stones” liability might possibly provide a pathway. There is now a series of judgments by Australian courts where directors have been held to breach their duty of care by allowing the company to breach the Corporations Act. *See*, for example, *ASIC v Avestra Asset Management Ltd (in liq)* (2017) 348 ALR 525; 120 ACSR 247; [2017] FCA 497 at [216]. The cases so far have considered whether the director is liable where the director allowed the company to contravene a section in the Corporations Act, but arguably stepping stones liability under the duty of care may extend to breaches of other statutes e.g. environmental laws. For a discussion of stepping stones liability see Austin & Ramsay, *supra* note 89, para. 8.305.15.

<sup>342</sup> Barker, *supra* note 65, at 14-24.

<sup>343</sup> Hutley & Hartford-Davis (2016), *supra* note 25 at [51].

interests of its members.<sup>344</sup> While the *REST* case does not concern directors' duties under corporate law, it is testing the scope of similar trustees' duties under prudential laws applicable to superannuation funds.<sup>345</sup> In an initial procedural ruling in the case delivered by Justice Perram of the Australian Federal Court, his Honor determined that it was legitimate to characterize the litigation as a public interest suit as the case appeared "to raise a socially significant issue about the role of superannuation trusts and trustees in the current public controversy about climate change."<sup>346</sup>

Our findings from interviews with Australian participants suggested that growing discussion of directors' duties and climate change – particularly through the Hutley/Hartford-Davis opinions – has helped shift norms in this area such that the conclusion that duties apply to climate risks is now largely considered uncontroversial.<sup>347</sup> As one interviewee described it, these developments are leading to "a slow broadening [of] understanding of what those duties and expectations are, and how current law would be applied if it was ... tested."<sup>348</sup>

Despite growing understanding of the links between directors' duties and climate risks, our interviews showed that actual practice within companies remains highly variable. Whereas directors of large listed companies, especially those in sectors where climate risks are perceived to be material in the immediate and near term, are increasingly likely to be well-informed and active on climate change, the same cannot be said of the broader directorship of Australian companies, particularly for those companies where climate risks are perceived as more remote.<sup>349</sup> Participants also expressed the opinion that skepticism of climate science remains a prevalent attitude on boards of ASX100 companies.<sup>350</sup>

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<sup>344</sup> *McVeigh v Retail Employees Superannuation Pty Ltd* [2019] FCA 14 (Jan. 17, 2019).

<sup>345</sup> The content of corporate trustees' duties is informed by both the *Corporations Act 2001* (Cth) s 1017C and the *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52(2)(b) and (c), 52A. See also Noel Hutley & James Mack, MARKET FORCES: SUPERANNUATION FUND TRUSTEE DUTIES AND CLIMATE CHANGE RISK: MEMORANDUM OF OPINION (2017).

<sup>346</sup> *McVeigh v Retail Employees Superannuation Pty Ltd* [2019] FCA 14 (Jan. 17, 2019), at [9].

<sup>347</sup> AUS3, Jan. 13, 2018; AUS4, Mar. 7, 2018; AUS5, Mar. 2, 2018; AUS6, Mar. 22, 2018; AUS7, Feb. 23, 2018; AUS8, Mar. 15, 2018.

<sup>348</sup> AUS6, Mar. 22, 2018.

<sup>349</sup> AUS4, Mar. 7, 2018; AUS6, Mar. 22, 2018.

<sup>350</sup> AUS4, Mar. 7, 2018; AUS5, Mar. 2, 2018; AUS8, Mar. 15, 2018; AUS16, May 24, 2018; AUS17, Apr. 19, 2018; AUS18, Apr. 26, 2018.

When responding to questions on directors duties and climate change, many participants reflected on the longer-running debate over corporate purpose and the relevance of stakeholder interests versus those of shareholders discussed above.<sup>351</sup> They noted the challenges for Australian company directors in moving beyond a focus on short-term shareholder-related interests and the tendency for directors to view climate change as a long term concern, rather than a materially actionable risk to company interests in the near term.<sup>352</sup>

For those companies that are considering climate risk, the way that this consideration is integrated into broader governance processes varied considerably, echoing some of the diversity seen in the United States. Company-side interviewees provided various examples of governance processes for ensuring board oversight of climate risks, including risk management governance processes, such as regular materiality assessments and reporting to the board by risk and audit committees,<sup>353</sup> or sustainability committees providing regular analysis of climate risks to the board and developing company policy and position statements on these issues for board endorsement.<sup>354</sup> Some companies have also developed formal processes for the board to obtain external perspectives on climate risk. This may include appointing expert climate change advisors and/or meeting regularly with civil society leaders for input on emerging risks and responses.<sup>355</sup>

Overall, the picture that emerged from the Australian interviews was of growing understanding of the links between climate change and directors' duties, prompting some new processes and consideration of climate risks, particularly by large, risk-exposed companies but not yet causing a wider corporate behavioral shift. As in the United States, though, the potential for litigation – and personal liability for directors found in breach of relevant duties – was seen as a potential gamechanger. The general perception was that if, and when, litigation, regulatory investigation, or shareholder reaction around potential breach of duty to manage climate risks does emerge, the pressure on directors to ensure they are fulfilling their legal obligations in this area will heighten considerably.<sup>356</sup> Given the broader interpretations of relevant duties and the widespread acceptance and high profile of these

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<sup>351</sup> *See supra* Section II.A.

<sup>352</sup> AUS6, Mar. 22, 2018; AUS15, July 11, 2018; AUS16, May, 24, 2018; AUS17, Apr. 19, 2018; AUS20, June 4, 2018; AUS24, May 17, 2018.

<sup>353</sup> AUS9, May 28, 2018; AUS10, July 12, 2018; AUS12, June 28, 2018.

<sup>354</sup> AUS9, May 28, 2018; AUS11, Apr. 27, 2018; AUS14, Apr. 30, 2018.

<sup>355</sup> AUS9, May 28, 2018; AUS11, Apr. 27, 2018; AUS15, July 11, 2018.

<sup>356</sup> AUS3, Jan. 13, 2018; AUS8, Mar. 15, 2018; AUS15, July 11, 2018; AUS17, Apr. 19, 2018.

interpretations, Australia is a likely jurisdiction for the emergence of climate change breach of duty suits and a potential test ground for their feasibility elsewhere, including in the United States.

## VI. FUTURE POSSIBILITIES

In this Part, we suggest legal reforms that could make each of the three corporate and financial tools more effective in driving behavioral change. These suggestions draw upon experiences with use of those tools to date and interviewees' reflections upon them. In Section A we provide a general framework for potential legal reforms. Then in Sections B through D we apply that framework to disclosure, shareholder engagement, and fiduciary duty respectively.

### *A. Framework for Reform*

Part II outlined the varying positions that corporate governance and environmental law scholars take towards the role of non-shareholder interests in corporations. The middle-ground approach that guides most corporate climate activism accepts shareholder primacy, but argues that the long-term profitability of many corporations is increasingly impacted by climate change, so that tools focused on shareholder interests can be effectively used. Critics from one side argue that climate change does not yet matter enough within the time horizon of stock markets; corporations focused on profitability therefore are not promising targets for climate change activists and so we should focus on other forms of regulation. Critics from another side argue that as currently constructed, corporations are indeed unlikely to respond effectively to climate change, but corporate law should be reconstructed to require corporations to consider the public interest in addressing climate change.<sup>357</sup>

The analysis of Parts III through V drawing on our interviews provides support for each position. Those skeptical about the ability of corporations to address climate change can point to the lack of clear progress in changing corporate behavior despite the great attention being paid to disclosure and shareholder engagement.<sup>358</sup> We see a central truth here: activists should not fool themselves about the potential for these corporate governance tools to save the day. Other forms of regulation are much more important. For-profit corporations

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<sup>357</sup> See *supra* notes 37 through 51 and accompanying text.

<sup>358</sup> See *supra* notes 170 through 171, 187 through 189, 245 through 246, 269 and accompanying text.

aren't designed to solve a long-term, planet-wide collective action problem like climate change.

Those advocating deep reform of corporate law can flip the script on what to infer from the limited results of corporation-focused activism. Given the ongoing failure of governments to seriously respond to climate change, the urgency of addressing climate change, and the central role that corporations play in the economy, if corporations as currently constituted are not up to the task, we need to re-constitute them.

Those advocating the middle path of working within corporations under current law and institutions can argue that our results are not so definitive and dire. The disclosure and engagement initiatives described here are still new. Even now there are glimmerings of changed behavior, and many investors told us that as disclosure and proposals become more sophisticated and widespread and have time to take root, we can expect to see more change.<sup>359</sup>

We have much sympathy for the stakeholder approach. The limitations of existing corporations and corporate law are great, and the need for drastic, fast responses to the threat to our climate are greater. In our discussion below for each of the three legal tools, we will begin by sketching how corporate or securities law would respond if we adopted an aggressive, legally binding stakeholder theory of the corporation. If environmental law does not transform soon, it may be that anything short of such a fundamental shift in corporations will be inadequate to our situation.

And yet that fundamental shift in corporations and corporate law is unlikely to occur. So, we fall back on proposals that build upon existing corporate and securities law and initiatives as described in Parts III through V. We suggest ways that these can be strengthened. These more pragmatic proposals will have less effect than adopting the stakeholder-focused proposals, but they are more feasible. Still, the stakeholder proposals are not merely a dream: They help shape our more pragmatic proposals, so that our suggestions push the shareholder-focused approach closer to the stakeholder view of the world.

Throughout this analysis, we consider how U.S. strategies might learn from the Australian experience. Because the jurisdictions have fundamental similarities, but differences in the details of law and implementation, there are possibilities for the U.S. approach to borrow from the most effective Australian strategies.

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<sup>359</sup> See *supra* notes 172 through 173 and accompanying text.

### *B. Disclosure*

Current initiatives have modestly increased disclosure in mandatory securities filings, and greatly increased the use of voluntary sustainability reports.<sup>360</sup> Much work has been done to devise reporting frameworks,<sup>361</sup> but the lack of a common framework in the United States makes reports hard to compare, and the voluntary nature of most reporting leads to vagueness and cherry-picking of positive news.<sup>362</sup> Australia, in this respect, provides an interesting model for the United States because of the more consistent use of one standard for disclosure there.<sup>363</sup>

These weaknesses, as well as the siloing of voluntary disclosure from the securities disclosure process that involves more central decisionmakers and formal audit and oversight, keep disclosure from having the effect on operations that it could in the United States.<sup>364</sup> The time has come for strengthened required disclosure.

An aggressive U.S. stakeholder-focused disclosure initiative would focus on a range of ESG issues, not just climate change. Investors, customers, and employees are currently focusing on a wide range of ESG issues, and many of the voluntary initiatives, like GRI and SASB, cover issues beyond climate change.<sup>365</sup> A coalition of groups on a range of issues would be more likely to prevail politically. At least portions of the disclosure requirements would need to be rules rather than standards, both to ensure greater comparability across companies and to make it harder to greenwash. Disclosure could occur in separate sustainability reports rather than securities documents, but would be subject to similar anti-fraud rules, both increasing the accuracy of the disclosure and forcing companies to devote greater and higher-level attention to collecting the information.<sup>366</sup> The materiality of what information needs to be disclosed would be judged by more than the effect on financial performance.<sup>367</sup> Such an approach would echo

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<sup>360</sup> *See supra* notes 101 through 117 and accompanying text.

<sup>361</sup> *See supra* notes 106 through 112 and accompanying text.

<sup>362</sup> *See supra* notes 138 through 142 and accompanying text.

<sup>363</sup> *See supra* Part III.C.

<sup>364</sup> *See supra* notes 163 through 165 and accompanying text.

<sup>365</sup> *See supra* notes 108 through 110 and accompanying text.

<sup>366</sup> *See supra* notes 163 through 165 and accompanying text.

<sup>367</sup> *Non-Financial Reporting Directive (NFRD) 2014/95/EU*. In June 2019, the European Commission published guidelines specifically on reporting climate-related information. *See further* [https://ec.europa.eu/info/publications/non-financial-reporting-guidelines\\_en](https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en).



reforms being pursued in the EU through the elaboration of guidelines under its Non-Financial Reporting Directive.

An important element of climate disclosure would discuss the impact of how a concerted effort to respond to climate change would affect the disclosing company. The two-degree scenario analysis of TCFD and many shareholder proposals in Australia and the United States points the way, as does the recent French law requiring companies to disclose how their company would contribute to meeting GHG emissions and clean energy targets set in the law.<sup>368</sup> However, early TCFD analyses by Australian companies still tend to self-select favorable scenarios to report on.<sup>369</sup>

Such a requirement would need to be created by legislation, a major obstacle in deadlocked U.S. politics. It would also require creation of a new administrative agency to implement and enforce the required disclosure.<sup>370</sup> Corporate opposition would likely be strong, and the prospects of passing such legislation do not appear great. There are also considerable potential costs. Precise disclosure rules are difficult to create for many ESG topics, and what topics really matter may vary significantly over time, with the legal disclosure framework not reacting quickly. Thus, even were a stakeholder-focused system of ESG disclosures politically feasible, its desirability would be debatable.

A more modest approach working within existing securities law would be more feasible and less risky. If new disclosure rules can be crafted within the authority of existing statutes, then all that would be required is action by the SEC. Several options are possible within existing securities law.

Most modestly, the SEC could provide greater guidance as to how climate change fits within current disclosure requirements. The SEC provided some guidance in 2010,<sup>371</sup> but that could be updated and expanded. Tied to such guidance, the SEC could engage in stricter oversight of how well companies follow the guidance. Australian regulators appear to be moving in this direction, having tentatively embraced the TCFD as a model for companies to disclose climate risks and recently advising regulated entities that they will scale up monitoring of climate disclosures.<sup>372</sup> There is also the potential for

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<sup>368</sup> See *supra* note 127 and accompanying text.

<sup>369</sup> See *supra* notes 188 through 189 and accompanying text.

<sup>370</sup> See Lipton, *supra* note 119.

<sup>371</sup> See *supra* notes 101 through 102 and accompanying text.

<sup>372</sup> See recent advice of the Australian Prudential Regulatory Authority (APRA) in this regard: APRA, *Information Paper: Climate Change – Awareness to Action* (March 2019), 7.

greater regulatory guidance from Australian accounting standards bodies regarding how to integrate and quantify climate risks within financial statements.<sup>373</sup> These steps provide important models for the United State to consider in its reform efforts.

More aggressive is the sustainability discussion and analysis requirement proposed by Jill Fisch.<sup>374</sup> This would require a narrative analysis of the three most significant sustainability risks that a company faces. Climate change would not be a top three risk for all companies, but it would be for the companies that most significantly contribute to, and are affected by, climate change. The sustainability discussion is a standard rather than a rule, and so would not help comparability as much as more detailed rules, but Fisch argues many common practices would emerge and help with comparability.<sup>375</sup>

The most aggressive option would impose a new, more detailed set of rules for climate change and other ESG topics. Since it would be part of securities law, only information that is material to financial performance would be required, reducing costs of compliance. We suggest a comply or explain approach: companies that feel portions of the new required disclosure are not relevant to them could choose not to comply and explain why.<sup>376</sup> This creates more flexibility, and diminishes the risk of ill-considered rules creating high costs, though it would increase the risk of under-disclosure. The SEC could devise new rules from scratch, but better would be to adapt, at least as a starting point, one of the current voluntary disclosure frameworks.<sup>377</sup> The rulemaking process would be a good way to sort out which framework investors prefer.

It is currently hard to say which of several alternatives is likely to win out.<sup>378</sup> We suspect that SASB is the best option.<sup>379</sup> It is adapted for securities-based disclosure, covers a wide range of ESG topics, and provides detailed, industry-specific rules. A downside of SASB,

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<sup>373</sup> See, e.g., Australian Accounting Standards Board and Auditing and Assurance Standards Board, *Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB Practice Statement 2* (December 2018).

<sup>374</sup> See *supra* note 135.

<sup>375</sup> See *id.* at 961-62.

<sup>376</sup> [https://www.cairn-int.info/article-E\\_RIDE\\_232\\_0129--the-comply-or-explain-approach.htm](https://www.cairn-int.info/article-E_RIDE_232_0129--the-comply-or-explain-approach.htm)

<sup>377</sup> See *supra* notes 106 through 110 and accompanying text.

<sup>378</sup> See *supra* notes 152 through 153 and accompanying text.

<sup>379</sup> Larry Fink's most recent letter to CEOs committing to pushing BlackRock's portfolio companies to use SASB may increase the salience of that standard. See *supra* note 37.

though, would be that it currently has less support outside the United States than some alternatives. As noted, Australia focuses on the TCFD.

Such a broad rules-based disclosure system would give investors the comparability they crave and reduce the tendency for vague, optimistic greenwashing. The comply or explain feature could lessen company opposition. Some companies might even support such disclosure, since the current proliferation of standards and information requests creates a dilemma for well-intentioned companies. New rules would provide one common framework and a level playing field. Though shareholder-focused, the disclosure would be useful for others as well.

### *C. Shareholder Proposals and Engagement*

Both formal and informal shareholder engagement have increased greatly, with climate change a major element of that growth.<sup>380</sup> It is not clear that this engagement has yet had a major impact on operations. But there are signs of positive effects, and as engagement takes root and becomes more sophisticated, its impact could grow.<sup>381</sup>

An aggressive stakeholder approach to governance and voting might further enable shareholder voice, given the current use of such voice to promote ESG issues. Or it might not, given the potential use of expanded shareholder voice by hedge fund activists seeking short-term profits.<sup>382</sup> What a stakeholder approach would distinctively do is give more voice to stakeholders, including persons or groups with environmental expertise. A direct voice in making decisions could have much more impact than disclosure or fiduciary duties.<sup>383</sup>

The most extensive approach to greater voice would be positions on the board of directors. Senator Elizabeth Warren, for example, has proposed that 40% of the directors on the boards of the largest corporations be elected by their employees,<sup>384</sup> which due to her presidential campaign, has brought greater public attention to this issue. The case for board representation of environmentalists is weaker than for employees. Environmentalists have a less intense stake in the operations of a corporation, and there is serious question as to who

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<sup>380</sup> See *supra* notes 192 through 194 and accompanying text.

<sup>381</sup> See *supra* notes 245 through 251 and accompanying text.

<sup>382</sup> See *supra* note 208 and accompanying text.

<sup>383</sup> Brett H. McDonnell, *From Duty and Disclosure to Power and Participation in Social Enterprise*, 70 ALA. L. REV. 77 (2018).

<sup>384</sup> See *id.* at 100.

would have power to vote for such a representative.<sup>385</sup> But one could certainly imagine taking the environmental expertise proposals that are beginning to appear and turning them into a legal requirement.

A lesser degree of voice would take the form of advisory councils. These would have no binding vote over decisions, but would be regularly consulted by the board or officers on issues within their expertise. One could imagine either a general sustainability council with representatives of various interests, or different councils for different interests, with one focused on the environment.<sup>386</sup>

Mandatory stakeholder voice mechanisms might have the strongest effects of any of the possible reforms considered here, but they would also create the greatest change in corporate structure and hence provoke the greatest opposition, and impose the highest costs. They would require legislation, making them hard to achieve.

Working instead within the current corporate legal structure turns our attention to shareholder, not stakeholder, voice. Institutional investors have evolved to a point where shareholder voice may plausibly reflect (imperfectly) many stakeholder concerns, including climate change. Funds with a sustainability focus, along with individual investors concerned about such issues, are raising climate change repeatedly in both proposals and informal engagement. The big universal asset managers like BlackRock and Vanguard, with long-term stakes and broad portfolios, plausibly represent the public interest (imperfectly) in voting on those proposals, which determines whether they will pass. There are plenty of problems in the incentives and information facing the managers of such institutions, but they are enough aligned with public concerns to push for positive changes.<sup>387</sup>

Several legal issues should be addressed to give more room for shareholder ESG activism. The ERISA fiduciary duty interpretations that limit the ability of fund managers to base investment and voting decisions on climate change concerns should be changed.<sup>388</sup> Ideally, ERISA could be interpreted or amended to allow consideration of the non-financial interests of beneficiaries.<sup>389</sup> More feasibly, the seesawing guidance on incorporating ESG concerns into considerations of financial risk should return to the Obama era grant of greater discretion.

On Rule 14a-8 proponent eligibility, our suggestions are negative, opposing “reform” proposals. The Financial CHOICE Act proposed significant restrictions on shareholding requirements for eligibility to

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<sup>385</sup> Grant M. Hayden & Matthew T. Bodie

<sup>386</sup> McDonnell, *supra* note 383, at 109-10.

<sup>387</sup> See *supra* notes 206 through 207 and accompanying text.

<sup>388</sup> See *supra* notes 211 through 213 and accompanying text.

<sup>389</sup> See Webber, *supra* note 200, chapter 7.

make a proposal. The recent SEC proposal would impose less onerous restrictions, but is still a move in the wrong direction.<sup>390</sup> The eligibility requirements don't need fixing. Shareholder proposals impose limited costs, and serve a useful function. As several of our interviewees (even on the corporate side) noted, they provide a useful function of alerting managers to emerging concerns. Indeed in this case, the U.S. approach to non-binding advisory proposals provides a useful legal model for Australian reforms.<sup>391</sup>

The recent SEC practice of allowing exclusion of GHG emission reduction target proposals<sup>392</sup> should stop, given the usefulness of such proposals.<sup>393</sup> There is an easy fix. The analysis allowing exclusion has reasoned that the significant policy exception, which forbids exclusion for proposals raising significant policy issues, does not apply to the anti-micromanagement rationale for the exclusion.<sup>394</sup> That should be reversed, so that any proposal that addresses a significant policy issue which is genuinely relevant to the company's operations should not be excludable under the ordinary business exclusion.

Finally, the literature surveyed in Part III.B.1, our interviews, and our idealistic stakeholder vision suggest a few shareholder proposals that seem particularly worth pursuing:

- Reporting on targets to address climate change in accordance with a 2 degree scenario. These are specific and action-oriented, with the potential to induce greater operating changes than older reporting proposals.<sup>395</sup>
- Disclosure of lobbying and political spending. Addressing climate change ultimately requires major environmental legislation, and such proposals may reduce some of the political opposition to such legislation.<sup>396</sup>
- Tying executive and director compensation to success in meeting climate change targets. Executive compensation is a critical tool for creating incentives to induce desired behavior.<sup>397</sup>

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<sup>390</sup> See *supra* notes 214 through 216 and accompanying text.

<sup>391</sup> Reforming the legal framework for shareholder resolutions is a live debate in Australia, with reform proposals drawing on both U.S. and U.K models for advisory resolutions. See Sheehan, Kym, *Shareholder Resolutions in Australia: Is there a better way?* (2017)

<sup>392</sup> See *supra* notes 217 through 224 and accompanying text.

<sup>393</sup> See *supra* note 172 and accompanying text.

<sup>394</sup> See *supra* notes 172 220 through 224 and accompanying text.

<sup>395</sup> See *supra* note 172 and accompanying text.

<sup>396</sup> See *supra* note 243 and accompanying text.

<sup>397</sup> See *supra* note 330.

- Requiring a director or directors with significant environmental expertise. Many interviewees identified this as an emerging issue receiving growing attention, and it is a move in the direction of a stakeholder approach to governance.<sup>398</sup>
- Creating an environmental, or more broadly a sustainability, advisory council. Many companies already reach out to a variety of stakeholders in various ways. An advisory council would formalize stakeholder engagement, giving it a focus which could lead to more sustained attention from executive officers and the board. We have not seen such a proposal, but it (as well as the previous two proposals) would be a way of moving towards our more aggressive stakeholder engagement vision company by company, rather than by comprehensive legislation.

#### *D. Fiduciary Duty*

Emerging best practice in risk management incorporates climate change into the monitoring of company risk, but many companies do not yet follow that best practice.<sup>399</sup> *Caremark*-style suits claiming a failure to adequately monitor climate change risk provide a potential path to push more companies towards better risk management, but such suits face large obstacles.<sup>400</sup>

A stakeholder-focused duty to monitor would require that boards address severe risks to significant stakeholders and interests impacted by a company's operations. Given the policy reasons underlying the business judgment rule, such a duty would like *Caremark* give boards very wide discretion in deciding how to design and carry out such a supervisory system. But the duty to monitor would go well beyond supervising whether the company is complying with the law. One of us has suggested such a duty in the context of financial companies following the financial crisis.<sup>401</sup> A broad stakeholder-focused duty would make sense in the context of corporations whose core governance mechanisms reflect the voices of multiple stakeholders.

Such a duty seems extremely unlikely to be recognized by the Delaware courts. It greatly stretches *Caremark* and also reverses the core commitment to shareholder primacy. That commitment has if anything grown stronger and more explicit in Delaware recently. It is hard to imagine the courts switching direction anytime soon.<sup>402</sup>

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<sup>398</sup> See *supra* notes 324 through 329 and accompanying text.

<sup>399</sup> See *supra* notes 304 through 312 and accompanying text.

<sup>400</sup> See *supra* notes 282 through 295 and accompanying text.

<sup>401</sup> Hill & McDonnell, *supra* note 292.

<sup>402</sup> See *supra* note 277 and accompanying text.

A more modest approach might wait to see if supportive cases develop in other countries first – the law elsewhere may be more open to climate change supervision suits than Delaware is.<sup>403</sup> Once a plaintiff decides to test the waters in Delaware, the greatest chance for success would exist where a company has violated existing law limiting GHG emissions, or some other climate-related laws. Such a case could then make a traditional *Caremark* claim suggesting a failure to monitor legal compliance. Even in the wake of recent cases allowing such suits to continue, such a claim would face long odds, but it might have a chance.<sup>404</sup> However, focusing only on cases generated by violations of existing environmental or tort law would be very limiting – much of the point of the legal tools considered here is to prod corporations to change even though environmental law does not require it.

Thus, those proposing duty cases based on failure to address climate risk mostly conceive of climate risk as creating *financial* risk for a company. This goes beyond legal compliance risk, but is less of a challenge to Delaware law than the stakeholder conception of risk. Still, such a theory would run up against the many cases strongly questioning whether the *Caremark* duty extends to the monitoring of business risk. But those cases do not *quite hold* that the duty to monitor does not extend to business risk, so the point remains open to argue, even if the chances of success are slim.

To succeed, litigants would need to find a very attractive defendant. Climate change would need to pose a great and pressing financial risk to the company, and yet the company would either have to have no system for monitoring climate risk at all or be completely ignoring obvious and multiple red flags about such risk. An appropriate situation may be hard to find, especially given the current lack of regulatory risks posed by environmental and energy law reforms compared to the European context. Most companies in the industries most affected by climate risk are now claiming to do at least *something* about addressing such risk. It may not be much, but *Caremark* does not require much at all. Maybe, though, there is an energy company out there that publicly engages in climate change denialism – that could make a promising target.

Over time, Australia may provide some helpful models for an approach because, as described above, it has a more promising environment for breach of duty suits against directors. If that happens, its greater similarity to the United States than the European

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<sup>403</sup> See *supra* notes 299 through 302 and accompanying text.

<sup>404</sup> See *supra* notes 284 through 295 and accompanying text.

jurisdictions where the litigation has emerged to date, may suggest pathways for U.S. lawyers working to craft an approach.

## VII. CONCLUSION

As explored in Part II,<sup>405</sup> in both corporate and environmental law, there are those who argue for major reform of environmental law and express skepticism that tools focused on corporate governance can do much good. Our interview results in Parts III through V suggest their skepticism has much justification. They are correct that environmental and energy law reform would address climate change more effectively. But we are skeptical about the pace of such reform and our interviews do suggest that something can and needs to be done right now, with existing law and forward-looking corporations and investors, that does not preclude these longer-term efforts. Even if current approaches in disclosure, stakeholder, and fiduciary duty law are not yet advancing these goals substantially, we argue that – especially given the existing political climate – they form an important part of the regulatory toolkit that should be incorporated into strategic approaches.

This Article therefore includes both major and more limited reform proposals. We suggest deep changes taking a stakeholder approach, which could create companies much more willing to address climate change than current U.S. public corporations. But since significant reform is unlikely to pass in the near term, we also propose more modest reforms working within the long-term shareholder value approach underlying most of the activism we discuss in this Article.<sup>406</sup> The reforms that we regard as more realistic do not promise drastic, immediate change, and such change may well be required to avoid very serious consequences from climate change.<sup>407</sup>

But major reform to address climate change does not seem to be on offer from the U.S. political system in any relevant area of the law, including environmental and energy legislation and regulation crucial to addressing climate change. Cap-and-trade legislation has yet to pass in the U.S. Congress, and this shows no signs of changing in the near future.<sup>408</sup> Moreover, the Trump Administration is in the process of withdrawing from the Paris Agreement and has rolled back most of the

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<sup>405</sup> Part II.A and II.B.

<sup>406</sup> Part VI.A.

<sup>407</sup> Part II.B.

<sup>408</sup> Center for Climate and Energy Solutions, Congress and Climate Change, <https://www.c2es.org/content/congress-and-climate-change/>.



Obama Administration's environmental and energy law regulation.<sup>409</sup> That could change following the 2020 U.S. election, but the outcome of that election remains uncertain.

As the United States takes a step back in its efforts to mitigate climate change through energy and environmental law, at least serious efforts to do something are underway within the U.S. corporate governance system. And helped along by relatively modest and achievable legal reforms, those efforts have a chance to have some real effects, if not dramatic ones. Given the long-lasting impact of GHG emissions, real effects achievable soon are worth pursuing, as one part of a multi-prong effort of addressing climate change.

Even if major environmental and energy law reform were to occur in the future, corporate and financial law remains an important piece of addressing the problem. It will never be the sole solution to the problem of climate change, but it shapes the decisions of companies and investors that are crucial to the level of global GHG emissions and efforts to adapt to impacts.

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<sup>409</sup> Nadja Popovich, Livia Albeck-Ripka and Kendra Pierre-Louis, *95 Environmental Rules Being Rolled Back Under Trump*, N.Y. TIMES, Dec. 21, 2019, <https://www.nytimes.com/interactive/2019/climate/trump-environment-rollbacks.html>.