Climate change: the existential threat of the century. Discuss the opportunity for the governance professional to be a part of the solution.

As the world slowly emerges from a gruelling pandemic, the threat of the climate emergency looms ever-present.[1] Following the COP summits of Paris in 2015 and Glasgow in 2021, over 70 governments, including the world's biggest polluters, have committed to reaching net-zero emissions.[2] This decade is a crucial point in attaining this goal and setting the world on a path that will avoid global warming of above 1.5°C and limit the most extreme consequences. To put this plainly, we have just over two business cycles to transform every sector of the global economy.[3] While governments have made these commitments, it is broadly recognised that companies will be key to the delivery of this target and provide most of the required investment.[4] This presents an enormous opportunity, and challenge, for governance professionals to play a part in this transformation. They have a central role in positioning climate as a major agenda point and articulating the benefits of strong action on climate. The profession, not known for its rapid rate of change, is now being tasked with ever-increasing climate obligations including ensuring that companies are accountable for their climate action plans and facilitating the effective delivery of these plans. Not only is this morally the right thing to do, but as I will argue, it is the right thing to do from a business perspective. This essay will look primarily at three key areas where governance professionals have an opportunity to contribute to the solution: reporting, board composition, and stakeholder engagement.

Fiduciary duty

First, however, it is important to outline the case for companies (and governance professionals) to enact climate-friendly policies. Shareholder value theory, which dominated corporate governance for most of the 20th Century, posits that the primary duty of a company is to its shareholders, particularly in delivering a return on their investment. Graham Bradley argues that as the risks of 'climate change' are inherently long-term and unpredictable, companies should not go beyond existing laws and regulations in their climate responsibilities.[5] He highlights the existential threat that the net-zero transition poses to industries such as coal mining, arguing that it is absurd to expect these companies to voluntarily liquidate their operations to combat climate change, thereby elevating climate objectives above those of shareholders.

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[1] Note on terminology: this essay refers primarily to 'the climate emergency' rather than 'climate change'. This is to capture the urgency of the climate situation.

[2] UN (n.d.) 'For a livable climate: Net-zero commitments must be backed by credible action', Available at: https://www.un.org/en/climatechange/net-zero-coalition [Accessed 18 March 2022].

[3] PwC (2020) 'The Building Blocks for Net Zero Transformation', Available at: building-blocks-net-zero-companies-transformation.pdf (pwc.co.uk) [Accessed 18 March 2022].

[4] Committee on Climate Change (2019) 'Reducing UK emissions: 2019 Progress Report to Parliament', Available at: https://www.theccc.org.uk/wp-content/uploads/2019/07/CCC-2019-Progress-in-reducing-UK-emissions.pdf [Accessed 18 March 2022].

[5] Graham, B. (2019) 'Corporate Responsibility and Climate Change', *Journal of International Affairs*, Vol. 73, No. 1, pp. 155-160.

I argue that this logic is misguided for two reasons. First, the 21st century has seen a shift away from shareholder value theory, towards taking account of a wide range of stakeholders including suppliers, customers, employees and society as a whole. This approach to corporate governance is enshrined in section 172 of the Companies Act 2006 (CA2006) and the 2018 UK Corporate Governance Code, which state that company directors should consider a range of stakeholders in promoting the company's long-term success. This shift has been driven by a realisation that in a globalised world, companies have a key role to play in tackling the world's most pressing issues, including the climate emergency. Partly driven by the entry of the millennial generation into the workforce and the power of social media, companies are more accountable to a wide group of stakeholders and can quickly come under scrutiny for perceived failures on ESG issues. Bradley argues that the effects of 'climate change' are long-term, as his terminology implies, but the situation is becoming increasingly visible and immediate; it is only right that companies consider their impact on people and the planet, rather than narrowly pursuing shareholders' short-term interests. While no one is seriously suggesting that companies in non-environmentally friendly sectors should voluntarily liquidate, it is now well-recognised that all companies must account for stakeholders in their business practices.

Second, directors' fiduciary duty to shareholders is not mutually exclusive with strong action on climate; in fact, the opposite is increasingly true. As Roger Barker argues, a strong ESG profile makes a company attractive to potential investors and customers and generates a positive reputation, while weak ESG performance can be a red flag.[6] Investors' decisions about where to put their money are, increasingly, guided by these broader imperatives. For example, the CEO of BlackRock, one of the world's largest financial institutions, has urged companies to cut their carbon emissions to net-zero by 2050, and recently justified their climate approach as being about profits, rather than being "woke".[7] Beyond the reputation angle, companies can use their response to the climate emergency as a way to make themselves more efficient and serve new customer needs.[8] Research by Oliver Wyman and CDP, a not-for-profit charity that runs the global disclosure system for environmental impacts, found that European corporations' investments in low-carbon projects were expected to save $20 for every metric ton of carbon dioxide equivalent avoided.[9] So, there's a growing consensus that the case for climate action is robust from both a shareholder and stakeholder perspective. Governance professionals should recognise this and ensure that they make this case to company directors and the wider organisation.

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[6] Barker, R. (2022) 'Turning tides', *Governance + Compliance*, March 2022 edition, pp. 52-53.
[7] Quoted in Kollewe, J. (2022) 'BlackRock's Larry Fink: climate policies are about profits, not being 'woke'', *The Guardian*. Available at: https://www.theguardian.com/environment/2022/jan/18/blackrock-larry-fink-climate-policies-profits-woke [Accessed 18 March 2022].
[8] Bailey, R. and McDonald, S. (2020) 'Climate Change is an Opportunity for Business to Thrive', *Oliver Wyman*. Available at: https://www.oliverwyman.com/our-expertise/insights/2020/oct/climate-change-is-an-opportunity-for-business-to-thrive.html [Accessed 21 March 2022].
[9] *Ibid*.

Climate reporting

Having reaffirmed the case for corporate climate action, I now look at several areas where governance professionals have the opportunity to make a difference, starting with reporting. Reporting is the baseline from which meaningful climate action can be made; accurate disclosures on emissions and climate action plans are essential in measuring progress and in ensuring accountability to stakeholders. This relates to two of the four established underlying principles of corporate governance – accountability and transparency.[10] Probably the biggest recent development on climate reporting is the emergence of TCFD (Task Force on Climate-related Financial Disclosures) requirements. Beginning as a set of voluntary recommendations in 2015, TCFD has now become part of the regulatory frameworks in many jurisdictions, with the UK making it mandatory for all UK premium listed companies to follow TCFD's climate risk recommendations from 2022 (or to explain why they have not).[11] TCFD recommendations, which seek to make climate reporting more consistent and geographically comparable, span four areas: governance, strategy, risk management, and metrics and targets.[12] Broadly speaking, it requires companies to outline how they have identified, and how they are managing climate-related risks and opportunities, as well as to disclose their Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas emissions.

On the face of it, TCFD and other climate-related disclosures represent a challenge for governance professionals. Not only must they get and remain up to speed with all the latest requirements, they must ensure that the board is also sufficiently informed to take ultimate ownership of reporting and facilitate information flows across the organisation. However, they should also recognise the opportunities. Rather than satisfying a tick-box exercise, the process of completing these disclosures encourages organisations to consider the quality of their climate governance and to recognise areas for improvement.[13] It is an opportunity back up net-zero ambition with meaningful disclosures, thereby avoiding accusations of 'greenwashing'. Transparent reporting also allows for better-informed investment; as the former Governor of the

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[10] Pearse Trust (2014) 'The Core Principles Of Good Corporate Governance', *Pearse Trust*. Available at: https://www.pearse-trust.ie/blog/bid/108866/The-Core-Principles-Of-Good-Corporate-Governance#:~:text=%20The%20Core%20Principles%20Of%20Good%20Corporate%20Governance,to%20act%20on%20behalf%20of%20the...%20More%20 [Accessed 21 March 2022].

[11] UK Government (2021) 'UK to enshrine mandatory climate disclosures for largest companies in law', *gov.uk*. Available at: https://www.gov.uk/government/news/uk-to-enshrine-mandatory-climate-disclosures-for-largest-companies-in-law [Accessed 18 March 2022].

[12] Deloitte (n.d.) 'What is the TCFD and why does it matter?', *Deloitte*. Available at: https://www2.deloitte.com/ch/en/pages/risk/articles/tcfd-and-why-does-it-matter.html [Accessed 18 March 2022].

[13] Price, N. (2019) 'What Is Corporate Climate Governance?', *Diligent*. Available at: https://www.diligent.com/insights/esg/what-corporate-climate-governance/ [Accessed 18 March 2022].

Bank of England Mark Carney has said, it "allows sceptics and evangelists alike to back their convictions with their capital,".[14]

Board knowledge and composition

Responsibility for climate action should stem from the very top of an organisation and permeate throughout. Under s. 172 of the CA2006, directors have a duty to act in a way that promotes the success of the company. A global survey of 300 board directors by INSEAD and Heidrick & Struggles found that 75% of respondents saw 'climate change' as "very" or "entirely" important to the strategic success of their companies.[15] S. 174 of CA2006 requires directors to have a reasonable level of knowledge, skill, and experience that one could expect from a director of a company and the importance of understanding climate risks. It is reasonable, therefore, to assume that climate knowledge should be included in this s. 174 duty and integrated into directors' near- and long-term decision-making. However, understanding of the climate emergency is inconsistent among company directors. Companies are being held accountable for their perceived lack of climate knowledge, with the board of Shell, for example, facing legal action from the environmental law organisation ClientEarth over its alleged mismanagement of climate risk.[16] Governance professionals, therefore, have an important role in ensuring that the board is equipped to effectively factor climate-related issues into their decision-making.

There are several ways that governance professionals can seek to do this. First, they can ensure that climate is effectively embedded into committee structures and that it has a prominent place on these committees' agendas. Second, they can provide incentivisation measures to tie climate-related performance to their remuneration. This approach has been adopted by a range of companies including Danone who have implemented monetary rewards for their senior management based on the delivery of climate-related objectives. A portion of their long-term incentive compensation is also based on the company's climate performance score in their annual CDP disclosure.[17] These methods are a powerful way of raising climate on the agenda and driving the delivery of climate plans. Third, climate understanding should be integrated into the learning and induction programme for new directors, and into their ongoing learning and development. This could include teach-ins throughout the year on climate issues, and reverse mentorships with employees throughout the organisation involved with reaching climate goals. Board knowledge can also be supported through external advisors and/or an external advisory

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[14] Quoted in Wentworth, A. (2018) 'Progress is being made on greening finance, says Bank of England', *Climate Action*. Available at: https://www.climateaction.org/news/progress-is-being-made-on-greening-finance-says-bank-of-england [Accessed 18 March 2022].

[15] INSEAD and Heidrick & Struggles (2021) 'Changing the Climate in the Boardroom', *INSEAD*. Available at: https://www.insead.edu/sites/default/files/assets/dept/centres/icgc/docs/changing-the-climate-in-the-boardroom-dec2021.pdf [Accessed 18 March 2022].

[16] Proactive (2022) 'Shell board faces legal action from ClientEarth over alleged mismanagement of climate risk', *Proactive*. Available at: https://www.proactiveinvestors.co.uk/companies/news/976724/shell-board-faces-legal-action-from-clientearth-over-alleged-mismanagement-of-climate-risk-976724.html [Accessed 18 March 2022].

[17] *Op cit.,* PwC (2020) 'The Building Blocks for Net Zero Transformation'.

board.[18] Fourth, governance professionals may also need to consider refreshing the board's composition if there is a lack of climate skills and knowledge amongst its members. The first step in factoring the climate emergency into board composition is to include it in the director skills matrix (69% of respondents to INSEAD and Heidrick & Struggles' survey said that it is not currently included).[19] This should form the basis for a board competency review to highlight potential areas of shortcomings. Governance professionals can then factor climate knowledge into succession planning and potentially seek to bring in new directors to fill these knowledge gaps.

The costs of inaction in this area are potentially severe as ExxonMobil discovered last year when a shareholder-requisitioned resolution by Engine No. 1, an activist hedge fund, was successful in ousting three board director candidates with their own candidates who they deemed to have more appropriate skills and knowledge.[20] This should serve as a wakeup call for governance professionals to ensure that their boards are adequately knowledgeable on climate, or else risk consequences with significant reputational damage.

Stakeholder Engagement

This leads onto the final area – engagement with stakeholders. The Engine No. 1/Exxon Mobil resolution is part of a growing trend of shareholder climate activism. Investors and activists have realised the power of their shareholdings and are using it to actively influence companies' directions on all matter of ESG issues, including climate. Another example is Follow This, who since 2016 have submitted resolutions to major oil and gas companies encouraging them to bring their climate plans in line with the Paris goals.[21] Governance professionals have a key role here in shaping and informing the way that companies engage with these stakeholders including proxy advisory firms. They play a crucial role in strategising engagement with these groups, recognising their points of view and facilitating engagement with the board. This engagement is key for companies' reputations in avoiding undesirable corporate actions, gaining and retaining customers and investors, and developing a reputation for responsible climate risk management. Governance professionals may also wish to consider engaging with movements such as 'Say on Climate', which implores companies to put their climate plans to a regular advisory vote at their AGM.[22] While at its worst, the 'Say on Climate' campaign can be a greenwashing strategy with investors blindly signing off on climate strategies, at its best it can be a platform for meaningful dialogue between a company and its investors, with governance professionals at its heart.

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[18] *Op cit.* INSEAD and Heidrick & Struggles (2021) 'Changing the Climate in the Boardroom'.
[19] *Ibid.*
[20] Droste, A. and O'Kelley, R. (2021) 'Why ExxonMobil's Proxy Contest Loss is a Wakeup Call for all Boards', *Harvard Law School Forum on Corporate Governance*. Available at: https://corpgov.law.harvard.edu/2021/07/05/why-exxonmobils-proxy-contest-loss-is-a-wakeup-call-for-all-boards/ [Accessed 18 March 2022].
[21] Follow this (n.d.) 'Our story'. Available at: https://www.follow-this.org/our-story/ [Accessed 18 March 2022].
[22] Say on Climate (n.d.) Available at: https://sayonclimate.org/ [Accessed 18 March 2022].

Another group of increasingly important stakeholders is employees who, in many organisations, make up a significant proportion of voting power. This group can be vocal in their disapproval where they feel that their views are inconsistent with the company's direction. This can have a negative impact reputationally, as well as impacting organisational unity and clarity of purpose. Governance professionals are responsible for listening to these concerns and for coordinating the board and executive team's staff communications. This is a pivotal role that will help ensure that the entire organisation is aligned on its purpose, which is key in delivering meaningful progress on climate. The role of governance in communicating on climate is also increasingly important in hiring and retaining the best staff, particularly amongst the millennial generation and Gen Z generations, many of whom are willing to take a pay cut to work for more responsible organisations.[23] This is a clear way that climate action is important in securing a company's long-term future, by ensuring that it remains an attractive place to work.

Conclusion

Tackling the climate emergency is one of humanity's greatest challenges in the 21st Century that will need input from all corners of the global economy. Governance professionals are in a privileged position, being able to influence, in measurable ways, the action that organisations take in response to this threat. As the 'conscience of the company', governance professionals have a duty to set an example for responsible climate behaviour and to persuade directors, who may otherwise pursue short-term profits, of the long-term benefits of helping to tackle the climate emergency. I have presented some of the key areas they can influence, in reporting, board knowledge and composition, and stakeholder engagement. In doing so, this essay has touched on the question of a company's purpose – whether their aim is solely to benefit shareholders, or for the benefit of a wider group of stakeholders. I have argued that when it comes to climate, these two aims are not mutually exclusive. I have also looked at some of the potential detrimental consequences when companies fail to adequately address the climate emergency, including legal implications and reputational damage. Overall, I argue that while they pose significant challenges for those in the governance profession, there are also important opportunities to positively influence the direction of organisations and provide the link between the organisation and stakeholders. In doing so, they can elevate the reputation of the profession and take pride in being part of the solution to the climate emergency.

[23] Kaneko, S. and Yamane, T. (2021) 'Is the younger generation a driving force toward achieving the sustainable development goals? Survey experiments', *Journal of Cleaner Production*, Vol. 292, pp. 1-14.

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