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CORPORATE RESPONSIBILITY AND CLIMATE CHANGE

Graham Bradley

By common agreement on the part of the scientific community and groups such as the UN Intergovernmental Panel on Climate Change (IPCC), climate change (formerly global warming) is an inherently long-term phenomenon. In response to perceived long-term risks, governments around the world have passed laws and entered into commitments (mostly non-binding) to introduce policies to reduce greenhouse gas emissions over time.

What responsibilities do commercial companies and their boards have in relation to such policies?

In democratic societies, corporations must, above all else, obey all laws and regulations, respecting both the letter and the spirit of those legitimate expressions of their communities' requirements and expectations. It is fundamental that every company must obey the laws of all jurisdictions in which it operates. Their directors must also fulfil their fiduciary duties under relevant corporation law. Beyond legal compliance, corporations must in the long-term interests of their owners protect their company's reputation and nurture customer, employee and community goodwill and loyalty by being good corporate citizens that contribute positively to the societies affected by their operations.

Under the laws of most Anglo-American countries, the primary fiduciary duty of company directors is owed to the company and its owners: those are its primary stakeholders. It is the owners who appoint the directors and charge them to protect and grow the value of their investment. It is they who remove directors who fail to achieve this objective. The Anglo-American corporation law and general law is crystal clear in this regard and ex cathedra statements by Business Roundtable CEOs do not alter this legal position.[1,2]

It is equally clear, however, that company directors are entitled to consider a wider group of stakeholder interests in their pursuit of the long-term sustainable prosperity of their corporations. Considering wider stakeholders, including

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employees, customers, suppliers and the communities in which companies operate, is not inconsistent with, and arguably is squarely consistent with, their duty to their primary stakeholders.

Does this mean, however, that company directors have an obligation to go beyond existing laws and regulations in relation to long-term climate change? Many voices advocate this outcome. They are, in my view, misguided.

Many companies do, of course, seek to reduce their energy usage and thereby reduce the carbon emission intensity of their operations. There are good economic reasons for doing this in addition to any reputational benefits that flow from it. To adopt corporate policies that are inconsistent with maximising long-term shareholder value would, I contend, be a fundamental breach of the directors' fiduciary duties.

Corporate law in the U.S., U.K., and Australia all permit company directors to consider the interests of a wide group of stakeholders in deciding what will create the best long-term value for shareholders. U.K. law states that directors "have a duty to promote the success of the corporation for the benefit of members as a whole, while having regard to" the impact of the company's operations on a wide group of other stakeholders.[3] It not only permits but encourages such consideration by directors.

By contrast The Indian Company's Act 2013 imposes a dual obligation upon company directors. In India, directors must act in good faith in order to promote the objectives of the company for the benefit of its members as a whole (as is the case under U.S., U.K., and Australian law), but in India they must also act "in the best interest of the company, its employees, the shareholders, the community and for the protection of environment."[4]

I would argue that the Indian formulation puts a very high onus on directors to make political policy judgements that they are neither equipped nor entitled to make. Indeed, this onus is impossible to discharge without applying significant company resources (clearly not possible for smaller companies struggling to survive) to assess objectively what is in the best interests of the community or of "environment." The Anglo-American approach is in my view preferable: it allows directors to consider wider stakeholder interests, as they see fit, in judging how to create the best long-term value for shareholders, but does not require them to assess the best interests of all possible stakeholder groups whose interests will often be in direct conflict with one another.

Were the Indian formulation to apply in the U.S., I suspect that the potential for litigious activists to challenge companies on every aspect of their operations would overtop the dam, let alone open the floodgates of litigation.

No responsible company directors would seriously contend that companies should <u>not</u> take care to avoid environmental harm. Quite apart from the importance

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of ethical corporate governance, a host of laws have been enacted in most countries to avoid risk of pollution to water, forests, agricultural land, and the air itself as well as to protect biodiversity. All of these requirements should be respected absolutely by corporations. What should be their responsibility beyond this?

Unarguably, directors of public companies must take into account and disclose foreseeable risks to their business operations arising long-term climate change—to the extent that they can reasonably do so given the enormous uncertainty about long-in-the-future events. I would argue that the precise risks associated with long-term climate change are largely unforeseeable—be they the physical impacts of changing weather conditions, or the legislative or regulatory impact of possible government action linked to climate change that adversely impacts the company's business, or be they actions of third parties such as climate activists that negatively impact the company's operations or its business reputation.

To require companies and their directors to accurately foresee future climate change impacts is asking the impossible. It is also asking directors to weigh the contending scientific predictions relating to the long-term impacts of climate change—including the uncertainties enunciated by even the IPCC itself such as those contained in its Extreme Weather Report of 2012.[5]

Let me cite just two examples: the media often cites increased droughts, floods and cyclones/hurricanes as being likely effects of global warming but to quote the IPCC:

> "There is medium confidence that some regions of the world have experienced more intense and longer droughts, particularly in Southern Europe and West Africa, but in some regions, droughts have become less frequent, less intense or shorter, for example, in Central North America and North Western Australia … There is limited to medium evidence available to assess climate driven observed changes in the magnitude and frequency of floods at regional scale … There is low agreement in this evidence and thus overall low confidence at global scale regarding even the sign of these changes."

And also the following:

> "There is low confidence in any observed long-term (i.e. 40 years or more) increase in tropical cyclone activity (i.e. intensity, frequency or duration) … The uncertainties in the historical tropical cyclone records, the incomplete understanding of the physical mechanisms linking tropical cyclone metrics to climate change, and the degree of tropical cyclone variability provides only low confidence for the attribution of any detectable change in tropical cyclone activity due to anthropogenic influences. Attribution of single extreme events to anthropogenic climate change is challenging."[6]

So, how should directors of a company whose business is potentially affected by droughts, floods or cyclones predict possible future impacts on the company in the face of such statements from the IPCC's scientific advisors? Businesses face many uncertainties, and some of them pose severe and even existential threats to

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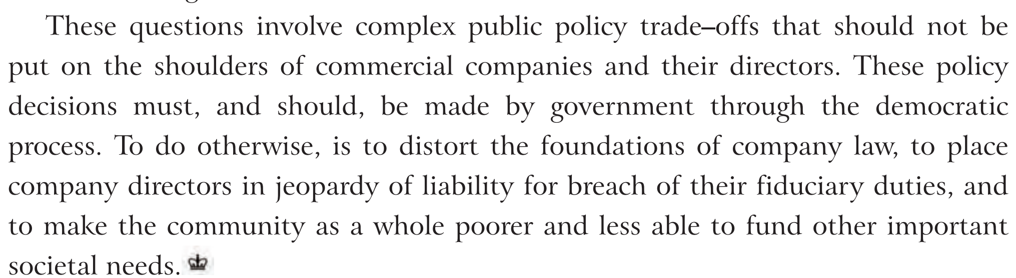
the sustainability of corporations. Amongst these many uncertainties, predicting long-term climate change impacts would be at the extreme end of the spectrum of uncertainty. It is unreasonable to call companies or their directors to account for failing to see future events when everyone's crystal ball is so clouded."

While much derided, the "shareholder primacy" principle remains an important foundation underpinning our laws governing corporations—organisations that have secured for the world an unprecedented creation of wealth and prosperity, broadly shared across the globe over the past 200 years. This principle does not require companies to take a short-term view. On the contrary, directors' fiduciary duty is to promote the long-term value of the corporation and not primarily to maximise short-term gains. To fulfill this duty, directors must use their collective business judgement to reconcile competing interests amongst a wide range of stakeholders—employees, customers, suppliers, the environment, communities and shareholders. It does not, however, require directors to usurp the role of legislators nor to pursue non-commercial interests at the expense of the future prosperity of the company.

Let us consider some real-world examples of the challenge companies would face if climate change objectives were elevated above those of shareholders.

Should a coal mining company voluntarily decide to liquidate its operations rather than open a new, fully licenced and environmentally approved mine, even when strong customer demand exists, in the interests of lowering global carbon emissions? Should a power utility with coal plants that provide firm, reliable power voluntarily close its thermal operations to curtail its GHG emissions, even if doing so reduces the reliability of the electricity network and jeopordises its ability to support a greater mix of wind and solar power?

Similarly, should a bank decline to finance a gas-fuelled power station because it burns fossil fuels—even if it replaces a coal station and, thereby, reduces aggregate GHG emissions significantly? The answer to all these questions in my view should be a resounding "no."



These questions involve complex public policy trade–offs that should not be put on the shoulders of commercial companies and their directors. These policy decisions must, and should, be made by government through the democratic process. To do otherwise, is to distort the foundations of company law, to place company directors in jeopardy of liability for breach of their fiduciary duties, and to make the community as a whole poorer and less able to fund other important societal needs.

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Notes

[1] Australia's Corporations Section 180(1), UK Companies Acts Section 172; majority of US State Corporations Act.

[2] "US Business Roundtable Statement on the Purpose of a Corporation," August 19, 2019.

[3] Oxford Law Faculty, "Section 172 of the UK Companies Act 2006: Desperate Times Call for Soft Law Measures," September 1, 2017, https://www.law.ox.ac.uk/business-law-blog/blog/2017/09/section-172-uk-companies-act-2006-desperate-times-call-soft-law.

[4] The Companies Act 2006, Section 166(2), India, 2006, http://mca.gov.in/SearchableActs/Section166.htm.

[5] "Managing the Risks of Extreme Events and Disasters to Advance Climate Change Adaption: Special Report of the Intergovernmental Panel on Climate Change," Cambridge University Press, 2012.

[6] Ibid.

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