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ESG: Increased activity and activism

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- Environmental, Social and Governance (ESG)

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The past twelve months witnessed a rapid growth in environmental, social and governance (ESG) developments. Initiatives from a range of stakeholders – including regulators, institutional shareholders and the media – kept organizations and their boards focused on these emerging issues. Several new proposals for climate-related disclosure were launched. Shareholder activism turned more squarely towards ESG-related matters, targeting various topics such as climate change and health and safety. Increasingly, ESG activists are using litigation to challenge how companies market or portray their products, services or policies as being environmentally friendly. Further, "greenwashing" claims are attracting interest from both regulators and class action plaintiffs.

Proposed requirements for climate-related disclosure

Last year, we noted that the Canadian Securities Administrators (CSA) had released for comment proposed new National Instrument 51-107 [PDF] – Disclosure of Climate-related Matters (NI 51-107). The draft instrument proposed to make disclosure of climate-related matters mandatory in reporting issuers' information circulars and MD&A, based on a modified version of the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). Further information about the proposal is available on our Risk Management and Crisis Response blog.

However, in March of this year, the CSA's proposal was overtaken by two important international regulatory developments in the climate space. First, the U.S. Securities and Exchange Commission (SEC) issued a proposed rule, also based on the TCFD recommendations, mandating that issuers provide climate-related disclosures. The required disclosures under the SEC proposal are greater in scope and level of detail than those that were contemplated under draft NI 51-107. We previously wrote about the SEC's proposal.

Second, the International Sustainability Standards Board (ISSB) issued proposed global standards for financial reporting on ESG-related matters, including requirements for climate-related disclosure. The ISSB's proposals were also based upon the TCFD recommendations. If implemented, the ISSB's standards would require significantly more detailed disclosure than draft NI 51-107. However, the requirements would not be as onerous as those proposed by the SEC. Further detail on the ISSB proposal is included in our earlier update.

In light of these other proposals, in October 2022, the CSA indicated that it was analyzing the different approaches to climate-related disclosure requirements reflected in the SEC and ISSB proposals and was revisiting the feedback received on draft NI 51-107. The CSA also noted it was reviewing Canadian stakeholder feedback that was submitted directly to the SEC and ISSB in response to their respective proposals. The CSA has suggested that NI 51-107 may be revised to better align Canada's regulatory approach to that of other jurisdictions. As a result, any climate-related regulatory changes will not come into force in Canada until a

date substantially later than December 31, 2022.

The Office of the Superintendent of Financial Institutions issued draft Guideline B-15: Climate Risk Management in May 2022 to provide specific guidance to financial institutions on how they should address governance oversight of climate-related matters and the management of climate-related risks. The Guideline also introduces disclosure requirements, which are based on the TCFD recommendations.

ESG-related activism

This past proxy season was marked by a further increase in ESG-related shareholder activism and shareholder proposals in Canada, including shareholder proposals on "Say on Climate" and activism related to health and safety.

Following successful proposals to implement "Say on Climate" votes at Canadian Pacific Railway and Canadian National Railway in 2021, the shareholders of each issuer in 2022 approved their respective company's approach to climate change by significant margins. "Say on Climate" proposals seek a shareholder vote mandating specified climate-related disclosures consistent with TCFD recommendations and to allow shareholders to express a non-binding advisory approval or disapproval of the issuer's emissions reductions plans.

During 2022, Canada's five largest banks each received shareholder proposals to implement a "Say on Climate" vote. Each of these votes received significant shareholder support, although none of the proposals recorded more than 30% support. In light of this increasing pressure, we are seeing a growing number of issuers actively reviewing their existing climate change plans and associated disclosure in an attempt to mitigate the risk of activism.

During this past proxy season, we also saw some of the first shareholder activism in Canada related to health and safety matters.

In the first instance, Suncor was the subject of an activist campaign by Elliott Investment Management LP. The public campaign focused on missed production goals, high costs and safety failures, including recent deaths of employees or contractors in fatal accidents. After some public back and forth, Suncor eventually reached a settlement with Elliott, which led, among other things, to the appointment of three new independent directors.

Separately, we saw a handful of issuers receive shareholder proposals calling for reviews related to forced labour and human rights impact assessments with respect to migrant workers. The proposals were supported by the shareholder advocacy groups and underscore the focus on ESG-related matters as we look ahead to the coming proxy season.

Federal legislation against "modern slavery"

A variety of legislation has been proposed at the federal level relating to "modern slavery" that seeks to address child and forced labour matters in companies' supply chains. The most advanced piece of legislation is Bill S-211, which was passed by the Senate this year and is currently being considered by a House of Commons legislative committee. Additional detail on these proposals and developments can be found in our Trade article.

If passed in the current form, Bill S-211 would require Canadian public companies, certain private companies and governmental institutions to submit an annual report to the Minister of Public Safety and Emergency Preparedness and to publish it. The report would be required to outline the steps the company took in the prior fiscal year to prevent and reduce the risk

that forced labour or child labour was being used at any step in its supply chain, in addition to certain prescribed information. A company's annual report would need to be approved by the board of directors and contain an attestation from at least one director. The report must also be provided to each shareholder (in the case of a federally incorporated company). Companies will have until May 31 of the year following the date when the legislation comes into force to file their annual report.

Companies should consider whether any new procedures, policies or programs should be developed and implemented in anticipation of potential future reporting obligations.

Greenwashing risks are growing

In response to the increasing focus on ESG, there has been a corresponding escalation by businesses of their efforts to promote the "green" attributes of their products, services and operations. Marketing that promotes sustainable sourcing, energy efficiency and recyclability has become ubiquitous across a wide range of products. When these "green claims" convey a false or misleading impression about the environmental or social impact of a product or activity, they fall into what is colloquially referred to as "greenwashing."

The concerns from these activities are that consumers may not be able to accurately identify which green claims are legitimate (or not) and that legitimate environmental claims will therefore be devalued. This has resulted in increased efforts by environmental advocacy groups, non-governmental organizations and consumers to appeal for regulatory oversight. ESG claims are now prompting enforcement action, class action litigation and regulatory guidance.

Enforcement by the Competition Bureau

In January 2022, the Bureau announced a settlement agreement with Keurig Canada Inc. The settlement resulted from an application brought by environmental advocacy groups requesting that the Bureau investigate marketing by Keurig promoting the recyclability of its K-Cup® coffee pods. This was the Bureau's first enforcement activity targeting greenwashing. The Bureau's investigation concluded that Keurig's recyclability claims were false or misleading because, outside British Columbia and Québec, the K-Cup® pods were not widely accepted in municipal recycling programs. The settlement included a $3 million penalty, an $800,000 donation to a Canadian charitable organization focused on environmental causes and Keurig's agreement to pay $85,000 for the costs of the Bureau's investigation.

In April 2022, another application to the Bureau requested an investigation into representations by a Canadian chartered bank in its marketing materials touting its actions to address climate change. The application targeted two key representations that the bank made in its marketing literature. First, the bank disclosed that it "supports the principles of the Paris Agreement and the international goal to hold global warming to below 2°C" and stated that it is, therefore, committed to achieve "net-zero emissions in [its] lending by 2050" and "net zero emissions in [its] global operations annually." In addition, the bank disclosed that, as part of its climate strategy, the bank would provide "$500 billion in sustainable financing by 2025."

The application asserted that the bank's representations were "materially false" and "misleading" and were made for the purpose of attracting and retaining clients concerned about climate change. It also sought a number of remedies, including an order that the bank cease making the challenged representations until it makes significant efforts to wind down its financing of the fossil fuel industry and publishes more information on its sustainability

financing. The application also sought an order requiring the bank to pay a $10-million fine credited to the Environmental Damages Fund. In September 2022, the Bureau indicated it had commenced an inquiry into the bank's marketing practices.

During the year, the Bureau indicated that its existing guidance regarding environmental claims, originally published in 2008, may no longer reflect the Bureau's current policies or practice. While no comprehensive replacement has been provided, the Bureau has published some limited guidance, including some general best practices. Among other things, the Bureau suggests proponents ensure that their claims are specific, substantiated and verifiable. The Bureau also hosted a "Green Growth Summit" in September 2022, which is consistent with the Bureau's increasingly active role in this area.

Guidance from securities regulators on avoiding overly promotional ESG claims

The CSA has also begun to express views on "greenwashing." First published in January of 2022, the CSA published guidance for investment funds regarding disclosure of their ESG practices, noting the potential for greenwashing.

In January 2022, CSA Staff published CSA Staff Notice 81-334 – *ESG-Related Investment Fund Disclosure* to provide disclosure guidance for investment fund issuers with respect to ESG considerations, particularly funds whose investment objectives reference ESG factors and other funds that use ESG strategies, including with respect to how the current securities regulatory requirements should be applied to ESG-related investment fund disclosure. It also sets out best practices in this regard.

More recently, in its report [PDF] on its continuous disclosure review program for the years ended March 31, 2021 and 2022, the CSA addressed overly promotional disclosure regarding ESG matters. As in all disclosure matters, the CSA encourages avoiding misleading promotional language. Issuer forward-looking information should have a reasonable basis and material factors, assumptions and risks should be disclosed.

Class action proceedings

Outside the regulatory sphere, while there have been few greenwashing class actions in Canada to date, based on experience in other jurisdictions, particularly the United States, Australia, the United Kingdom and the European Union, it is expected that similar ESG-related litigation will become a more prominent feature of the Canadian landscape as well. For example, following the publication of the Keurig settlement, several class action lawsuits were launched against Keurig on behalf of individuals who bought K-Cup® coffee pods. These actions have not yet proceeded to certification.

The potential for claims grounded in misrepresentation to be brought against public companies in Canada in respect of their ESG-related disclosure or commitments is heightened by the prospect of additional disclosure being mandated by securities regulators.

Diversity

There is also a continued focus on diversity and inclusion matters, including at the board and senior management levels. Similarly, the proxy voting guidelines regarding the election of directors of the various proxy advisory firms and institutional shareholders continue to evolve in this respect. These trends are discussed in more detail in our *2022 Diversity*

Disclosure Practices report and in our Corporate Governance article.

Conclusion

The continued focus on ESG-related matters means that it is increasingly important for boards to be actively engaged in and conducting meaningful oversight over such matters generally and climate-related matters, in particular. Engagement and oversight are important to mitigate the potentially significant financial and reputational risks that a failure to be – or even to be seen to be – responsive to these shifting expectations of regulators, institutional shareholders and society as a whole can have on the organization and its stakeholders.