D&O EXPOSURES TO CLIMATE CHANGE RISK

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A LEGALIGN GLOBAL IN-DEPTH LOOK AT DEVELOPMENTS AROUND THE WORLD

In the wake of COP26 – and with the latest Intergovernmental Panel on Climate Change's report[1] indicating the temperature could rise 1.5 degrees within the decade and the UN referring to the situation as a "code red for humanity"[2] – climate change risks continue to make headlines worldwide.

Around the world, regulators have also declared climate-risk to be a systemic risk and many have provided guidance on appropriate governance activities for climate-related risks, including financial disclosure recommendations.

Institutional and activist investors are also making their views felt and are causing change to corporate behaviours around climate change decisions and reporting.

Given the high levels of public interest, regulatory scrutiny and investor activity, directors and officers who fail to properly consider, act on and disclose climate risks are facing increasing exposures. In some jurisdictions, such as the US, D&O climate-related claims are already being tested before the courts. In many others, where the risk is still emerging, D&O insurers are watching the developments closely.

The rise of liability exposures

Regulatory action is increasing liability risks for directors and officers around the world. For example, regulators in New Zealand and the UK have already made climate-related financial disclosures mandatory, with new requirements being introduced in 2022 and 2025 respectively.

Regulators in other countries are also being proactive around climate-related financial disclosures. In the US, for example, the Securities and Exchange Commission has flagged it is likely to introduce new rules on climate-risk disclosures for companies in the second half of 2021. In Australia, the corporate regulators have endorsed the Taskforce on Climate-Related Financial Disclosures' (TCFD) recommendations and made statements indicating their intention to enforce those.

Regulator activity in several jurisdictions has also included crackdowns on the practice of "greenwashing", which is when companies embellish their environmental credentials to impress investors focused on the transition to net-zero carbon emissions.

However, regulatory action is not the only factor heightening climate-related risks for directors and officers.

Investors are also increasingly changing corporate behaviours. A strong example of this was seen in December 2019 when BlackRock, a US investment manager responsible for around USD6 trillion in assets, wrote to 120 companies requesting clearer, more comprehensive disclosure of climate change risks.[3]

Activist investors are also disrupting operations to force change, as seen in Poland when ClientEarth purchased €20 of shares in energy company Enea. ClientEarth then brought a successful claim as a minority shareholder, blocking Enea from building a new coal factory that would expose Enea to climate-related financial risks.

Public interest factors are also playing out in the courts. In *Milieudefensie et al. v. Royal Dutch Shell plc* in May 2021, the Dutch court ordered Royal Dutch Shell to reduce its emissions by 45% by 2030 in response to an action filed by 17,000 Dutch citizens who said Shell's investment in fossil fuels would threaten their human rights.

While the *Enea* and *Royal Dutch Shell* actions were brought against the companies, these decisions have broader D&O liability implications.

Causes of exposure

There are several potential avenues of liability that arise for directors when disclosing information to the market, including failure to disclose:

- that the company emits greenhouse gases or consumes coal in violation of relevant regulations
- how known uncertainties of climate change regulation will impact the company's performance, even if no relevant regulations apply to the company at the time
- how the company's performance could be affected by climate change, for example because of broader economic stability risks, current or future assets exposed to climate change declining in value, current or future assets becoming stranded assets or environmental risks – even if it is not perceivable that

relevant regulations will ever apply to the company because of the services or products it provides

- the risk of the company being sued in negligence for failing to foresee or mitigate climate change risks, or
- risks arising from increased costs of projects because of
  - government approvals being declined or delayed due to environmental concerns, or
  - other delays to projects because of environmental concerns.[4]

A cautionary note on D&O exclusions

Many D&O policies typically exclude claims arising from pollution – however, these tend to be defined in terms of specific kinds of physical pollution, for example asbestos or heavy metals.

Academics in the US have argued that pollution exclusions will be unlikely to apply to litigation arising from climate change, given that "in such circumstances the misleading of investors has no discernible connection to issues such as the use, exposure, presence, existence, detection, removal, elimination, or avoidance of greenhouse gases."[5] In other words, climate change is not a typical 'pollutant'.

Even if specific climate change exclusions are adopted, D&O insurers should tread carefully.

The US experience, as shown by securities class actions such as *Owens Corning v National Union Fire Insurance Co*[6], indicates that the construction of exclusions is not a simple issue. This is because courts consider D&O policies are obtained for these very risks, so are loath to interpret the policy in a way that makes it commercially useless. In *Owens Corning*, the court found the securities class action – which alleged the company misrepresented its exposure to asbestos claims in its financial reports – did not "arise out of" asbestos, but rather out of the directors misleading investors regarding the company's projected financial performance.

Given the prominence of climate change risks to directors and officers, it is possible that courts in other jurisdictions, applying a commercial interpretation, may also read down such an exclusion in D&O policies. For example, Australian courts have previously applied a narrow application to insolvency exclusions on the basis that a wide application would render the policy "practically illusory"[7].

The implications for insurers

D&O insurers should assess the climate-related risks to insureds based on governance issues, continuous disclosure obligations and the insured's interactions with institutional investors. The changing regulatory, societal and investment environment has also created an expectation that directors should consider and act on financial risks caused by climate change and do not participate in greenwashing.

These risks vary in their maturity across jurisdictions, as discussed in the country analysis in the following pages. While in some jurisdictions, such as the US, climate-related risks are already leading to securities class actions involving directors and officers, the risk is still emerging in many others. One thing is consistent across all of our analysis – D&O exposure to climate-risk is an issue that insurers worldwide should watch closely.

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DEVELOPMENTS AROUND THE WORLD

In this paper, Legalign Global provides a snapshot of the regulatory and legal developments in D&O climate-related risk in a range of jurisdictions around the world.

AUSTRALIA

In 2019, Noel Hutley SC issued an opinion saying:

"It is increasingly obvious that climate change is and will inevitably affect the economy, and it is increasingly difficult in our view for directors of companies of scale to pretend that climate change will not intersect with the interests of their firms. In turn, that means that the exposure of individual directors to "climate change litigation" is increasing, probably exponentially, with time."

Two years later, there is still not a mandatory requirement in Australia for specific climate change information in company reporting – although there is regulatory encouragement for it. Arguably, the need for disclosure is also addressed by the requirement to report on material risks.

Given this uncertainty, many companies are not adequately addressing climate-change risks in their decision-making and annual reports[8]. In Australia, only 62 percent of mining, 50 percent of financial services, and 57 percent of the construction sector state that they report in line with the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations that have been endorsed by Australian regulators.[9]

Regulators

The regulators have made statements indicating their intention to enforce climate change disclosure. In February 2021, the Australian Securities and Investment Commission (ASIC) released a statement[10] saying it considered "disclosing and managing climate-related risk is a key director responsibility." It has now completed a round of surveillance of companies' performance in managing and disclosing this issue under the framework established by TCFD, which ASIC has recommended for listed companies. As a result of the review, ASIC is now planning to "pass on targeted guidance" as companies begin their next reporting cycle. The announcement also said: "we may consider enforcement action should there be serious disclosure failures. This includes whether the failures relate to the impact of climate change, or to other matters such as operations or the prospects of the business."

ASIC makes four high level recommendations relating to climate-risk governance, management and disclosure, to:

- consider short and long-term climate risk – boards should consider climate risk in their decision-making process
- develop and maintain strong, effective corporate governance – boards should consider governance structures to assess, manage and disclose climate change risks and opportunities

- comply with the law - including disclosures in annual reports under s299(1)(a)(c) of the *Corporations Act* 2001, prospectuses or continuous disclosure announcements, and
- disclose useful information to investors – ASIC recommends listed companies with material exposure to climate risk consider reporting under the TCFD framework.

In November 2021, the Australian Prudential Regulation Authority (APRA) released its guidance to banks, insurers and superannuation trustees on managing the financial risks of climate change. The *Prudential Practice Guide CPG 229 Climate Change Financial Risks* (CPG 229)[11] is aligned with the TCFD recommendations. It suggests banks, insurers and superannuation funds treat climate change risks in the same way they address other systemic issues, such as credit and underwriting risks, and re-assess their client portfolios accordingly.

In its response to climate-related risks[12], APRA also announced it will commence a series of Climate Vulnerability Assessments (CVAs) of major Australian banks and will engage with the Reserve Bank and ASIC to ensure it takes a consistent approach to the disclosure of climate-related risk information.

The TCFD's disclosure regime recommendations have also been endorsed by the Australian Securities Exchange (ASX), including in its guidance publication *Climate change risk disclosure: A practical guide to reporting against ASX Corporate Governance Council's Corporate Governance Principles and Recommendations*.

There is a real possibility that ASIC will begin to pursue companies and directors personally for failures to disclose climate change information to the market – whether for breaches of the *Corporations Act* 2001 (Cth), including directors' duties (s.180), operating and financial review disclosures in annual reports (s299(1)(a)(c)) and continuous disclosure obligations (s.674), or for misleading and deceptive conduct under consumer law.

ASIC has announced a crackdown on the practice of greenwashing, a practice of selectively disclosing exposures to climate change or declaring green goals while lacking credible plans to achieve them that could lead to directors being liable for "misleading or deceptive conduct".

Investors

Australia has started to see strong examples of shareholder activism as well.

In *Abrahams & Anor v Commonwealth Bank of Australia* shareholders of the Commonwealth Bank of Australia (CBA) alleged that it violated the *Corporations Act* by issuing its 2016 annual report, which failed to disclose climate change-related business risks specifically including investment in the controversial Adani Carmichael coal mine. The shareholders withdrew their suit after the CBA released a 2017 annual report that acknowledged the risk of climate change and pledged to undertake climate change scenario analysis to estimate the risks to CBA's business.

In *McVeigh v Retail Employees Superannuation Pty Ltd* (REST) a beneficiary of a superannuation fund, REST, alleged that it breached its fiduciary duties by failing to properly consider climate change risks when making investment decisions, and breached section 1017C of the *Corporations Act* by failing to provide adequate information that would allow him to make an informed decision about the management and condition of the investments. In late 2020, the parties settled the proceedings with REST announcing its commitments regarding managing climate change risk.

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CANADA

Climate change litigation has been relativity limited in Canada. The most noteworthy cases have involved class actions against the federal government for not taking more decisive action on climate change. These cases have faced significant challenges through the certification process and remain under appeal. Claims brought against corporate greenhouse gas emitters have been all but non-existent.

There are signs that this may be changing. One prominent non-profit organization is trying to organize a class action to be brought by local governments in nuisance for climate adaptation costs against fossil fuel companies. The class action is planned to be brought against large greenhouse gas emitters, primarily oil and gas companies, for their share of greenhouse gas contribution for the period during which the companies knew they were causing climate change.

Pursuing claims against directors and officers for historical emissions will likely prove difficult. The *Canada Business Corporations Act* (CBCA), RSC 1985, c C-44 imposes a fiduciary duty on directors, which is owed exclusively to the corporation. The CBCA and the common law also impose a duty on directors to exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances; *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at paras 36-17. The law remains unsettled on whether this duty of care could be owed to the wider public. However, even if this is the case, the standard of care would need to be assessed within the context of the director's fiduciary obligations to the corporation and considering what constituted reasonably prudent conduct at the material time within a particular industry. Within this context, it seems unlikely that a director could be found liable for alleged losses arising out of historical greenhouse gas emissions.

Directors and officer's exposure to liability is more likely to arise from failing to properly account for climate risks going forward. Canadian courts consider climate change risk as uncontroversial and beyond reasonable dispute. In the recent *References re Greenhouse Gas Pollution Pricing Act 2021 SCC 11*, the Supreme Court of Canada stated that "Climate change is real. It is caused by greenhouse gas emissions resulting from human activities, and it poses a grave threat to humanity's future." Similarly, in July 2021, the *Canadian Net-Zero Emissions Accountability Act* received royal assent. This new federal legislation requires the federal government to set targets for greenhouse gas emission reduction every five years with the goal of reaching net-zero emissions by 2050.

Regulators

Directors and officers are likely to be held to new and evermore exacting standards regarding corporate disclosures. Directors and officers may face liability under securities statutes for misrepresentations of material information related to climate change by way of their continuous disclosure obligations. The Canadian Securities Administrators provided guidance in a 2019 notice[13]. The notice acknowledged that "[c] limate change-related risks are a mainstream business issue" and directed boards to "take appropriate steps to understand and assess the materiality of these risks." The notice stated that most industries have exposure to climate change-related risks, necessitating thoughtful risk assessments. The notice confirmed that climate-change related risks may be material and therefore necessary to disclose. Due to continuous disclosure obligations, directors and officers may be liable to stakeholders for improper disclosure. An omission or misstatement on material climate change information may lead to civil liability as per provincial securities statutes, for example, s.131 of *Securities Act* [RSBC 1996] c 418.

The evolving expectations concerning corporate governance and climate change were discussed in the 2019 "Final Report of the Expert Panel on Sustainable Finance". This government-commissioned report states that directors must build capacity to include climate disclosures in financial filings and annual reports. The panel recommended that the Canadian Council of Insurance Regulators and Canadian Insurance Services Regulatory Organizations harmonize provincial regulatory approaches with the international TCFD recommendations, which include disclosing how the boards govern and assess climate-related risks and the impacts of climate-related risks on the organization. The federal government has endorsed the TCFD's disclosure standards and called for a phased adoption approach by major Canadian businesses.

Section 122(1.1) of the CBCA enumerates factors for directors and officers to consider in exercising their duty of care including the environment and the long-term interests of the corporation. In *BCE Inc*., the Supreme Court of Canada ruled that in determining the best interests of the corporation, directors may consider the interests of various entities including the stakeholders, creditors, consumers and the environment (para 40). Directors will need to consider and assess the risks that climate change pose to their corporation. Failing to do so could expose them to personal liability for a breach of a duty of care or fiduciary duty under s 247 of the *CBCA*.

As disclosure obligations become more onerous and corporations begin implementing stronger measures to reduce emissions, directors and officers of industry laggards may face a heightened risk of liability for failing to meet the "reasonably prudent person" test. While it is difficult to making any strong predictions in this regard, the legal landscape is clearly shifting.

"Climate change litigation has been relativity limited in Canada… There are signs that this may be changing."

Local regulator guidelines and activity

Regulatory authorities in France, including the ACPR, the AC, the AMF and the CNIL, are publishing positions on environmental matters. For example, in July 2020 the ACPR published a report called "Pilote climatique"[14]. It is designed to make the banking and insurance sectors aware of the situation and financial consequences they may face in 2050, and to encourage them to integrate a longer-term vision into their strategic decisions.

In 2020, eight regulatory authorities also published guidelines for the future in terms of the environment in "Accord de Paris et urgence climatique: enjeux de régulation"[15]. These guidelines aim to establish incentive rules and recommendations to encourage companies to respond to climate issues and to provide better information to market participants.

The various reports show that the French regulatory authorities are actively addressing climate change at the corporate level. However, in the regulatory reports and guidelines that have been published recently, managers' responsibilities are not specifically addressed. The guidelines are also more like obligations of processes rather than of results.

Directors' duty of care and diligence

Legally, there have been some developments in the environmental field. Indeed, the aim of the PACTE law was to "rethink the place of companies in society". Article 1833 of the Civil Code was supplemented by a paragraph stating that "the company is managed in its social interest and taking into consideration the social and environmental issues of its activity".

This paragraph is the subject of many legal articles and is arguably designed to encourage directors to consider the social and environmental consequences of their business activities. However, as the rule is presented to the director as a management rule, it is doubtful that it offers third parties any possibility of taking action against the company itself. It also does not allow third parties to engage the personal liability of the directors, unless it is established that the indifference to the environment in their decisions constitutes a personal fraud that is separable from their functions.

This text is criticised because the pursuit of environmental objectives is obviously not always compatible with the development of the business. It also raises the legal question of how directors can be blamed for putting the company's interests ahead of environmental considerations. So, while the duty of care is enshrined in the law, this legal question is likely to mean directors or officers will not be held liable in practice.

However, a 15 December 2020 article by Jean-Marc Moulin in *La Gazette du Palais*[16] does not share the same opinion. Moulin said: "there can be little doubt that the civil liability of the company and its directors may be envisaged if it turns out that the decision-making process did not or imperfectly took into account environmental and societal considerations at the various stages of the process". Moulin believes that corporate leaders will have to map out environmental issues.

Class actions risks

In France, class action was created in the consumer sector in 2014 and then extended to the environment in 2016. However, despite the extension of its scope, the results of this new procedure are that only 21 group actions have been brought since 2014, and no company has yet been held liable.

In the environmental field, no group action has been brought to date. Environmental group action is intended to compensate for damage caused to the environment. It can also aim to put an end to a breach of duty. However, only approved environmental protection associations can exercise this action. Moreover, France has chosen the opt-in system in which consumers must express their wish to be included in the group even before the decision is made. As a result, there has been little significant progress.

Nevertheless, the future European directive on group actions is likely to reform the current legal regime. It will feature a broad scope of application, costs that are not dissuasive, and access to justice through legal aid.

Predicted trends

It is likely the ACPR recommendations for banks and insurers will influence the behaviour of directors and officers in France.

More broadly, corporate trends show CSR has become a focus for managers. The *2019 Mercer Global Talent Trends Report* shows there are positive signs that directors and officers are gaining a growing awareness of these issues and that environmental issues are gaining in importance in the ranking of executives' priorities. This trend suggests that leaders are gradually taking responsibility for their climate-related actions.

GERMANY

Climate-related issues have been making news across Europe, from Turkey's wildfires and Germany's flooding through to the European Union's recent announcement of a draft of climate change proposals aimed at achieving its goal of becoming carbon neutral by 2050.

Despite this, and the 2019 guidance from the German regulator, BaFin, that makes clear the strategic assessment of sustainability risks and the implementation of an appropriate strategy are the responsibility of the management board, climate-related risks are not regularly seen as a D&O topic in Germany.

One high profile case has the potential to change that.

Saul Luciano Lliuya is a Peruvian farmer living near a glacial lake that is threatening to overflow due to climate-related glacial melting. He is suing German energy company RWE, the second-largest emitter of carbon dioxide in Europe, for 0.47% (argued as the share of RWE's greenhouse gas emission since industrialisation) of the cost to protect his property from flooding. This is despite the fact that RWE does not operate in Peru.

The case, brought under the German Civil Code (s1004), was championed by environmentalists from Germanwatch. In the initial 2016 decision, the case was unsuccessful. But on appeal the Higher Regional Court in Hamm ruled the case could proceed to gathering evidence. This sets a significant precedent as it means the causal link between a German company's emissions and Peruvian farmer's plight is legally relevant. The matter is still ongoing. However, if the Peruvian farmer is successful, it is possible the company will take action against its directors under the standard liability approach in Germany.

"BaFin has made it clear that the strategic assessment of sustainability risks and the implementation of an appropriate strategy are the responsibility of the management board"

NEW ZEALAND

The corporate legislative framework in New Zealand currently allows for claims to be made against directors or officers if they fail to consider and respond to climate change risks that cause harm to a company, such as claims alleging:

- a breach of directors' reporting obligations or duties under the *Companies Act* 1993, commenced by a shareholder
- a failure to exercise reasonable care and skill in the administration of a trust, a breach of the general duty of care of trustees or a specific breach of the duty to invest trust property prudently (under sections 29 and 30 of the *Trustees Act* 2019), made by a beneficiary,[17] and
- misleading and deceptive conduct in trade under the *Financial Markets Conduct Act 2013 or the Fair Trading Act 1986*, made by investors or consumers.

Such claims have not arisen yet but are available. In 2020 climate activist Mike Smith commenced proceedings against some of New Zealand's largest companies raising three tortious causes of action: public nuisance, negligence and breach of a new and "inchoate" duty of care. Mr Smith claimed that the defendants' activities or products they supply:

1. release greenhouse gases that have contributed to (and will continue to contribute to) *"dangerous anthropogenic interference with the climate system and to the adverse effects of climate change"*[18], and
2. will cause damage due to sea level rise to land and other resources in or around Mahinepua, Northland, which Mr Smith claimed an interest according to Māori custom and tikanga.

The High Court struck out the first two causes of action but was "reluctant to conclude that the recognition of a new tortious duty which makes corporates responsible to the public for their emissions, is untenable"[19] and that further evolution of the law is possible. The High Court judgment was appealed, and the Court of Appeal decision is reserved. In the event the *Smith* case is ultimately successful, directors of companies who produce (or supply products that emit) greenhouse gases could be vulnerable to litigation seeking orders that compel more ambitious emissions reduction targets.

Claims involving local government authorities are also emerging, which is unsurprising given councils' broad authority, high public profile, significant asset base held in climate-vulnerable areas such as coastal regions. In 2020, the High Court quashed the Thames-Coromandel District Council's decision not to approve the mayor signing the Local Government Leaders' Climate Change Declaration. The Court, in commenting that climate change is a significant issue, ordered[20] the Council to reconsider its decision in line with the requirements of the *Local Government Act 2002* and the Council's Significance and Engagement Policy. The decision highlights the importance for directors of following robust decision-making processes, especially when addressing topics that are subject to increased scrutiny, such as climate change.

A more likely avenue for claims against directors arises from legislation introduced in New Zealand to make climate-related disclosures mandatory for 200 large organisations, including publicly listed companies, banks, large insurers, non-bank deposit takers and investment managers. The legislation, a world-first, requires disclosures to be made from the financial year commencing in 2022 with the earliest disclosures being made in 2023.

The purpose of the disclosure regime is to move away from "an ongoing and systemic overvaluation of emissions-intensive activities"[21] and require companies to assess and explain how climate-related risks and opportunities will be managed and mitigated. In the event companies fail to comply with the new climate-related disclosure obligations, the Financial Markets Authority may take enforcement steps against the companies and their directors.

In a more general development, New Zealand is increasingly seeing indigenous te ao Māori principles being incorporated into corporate culture and the regulatory framework and used as a motivation for legislative amendment. The principles emphasise natural justice, collective redress and guardianship of natural resources.

The Law Commission is "committed to taking into account te ao Māori across all of its law reform work"[22] and specifically sought submissions on this point in the current review of Class Actions and Litigation Funding. Directors who are unfamiliar with te ao Māori practices or companies who fail to abide by evolving cultural and citizen expectations may suffer damage to their brand or reputation, or ultimately be targeted in litigation.

SPAIN

Regulators

Nationally, the key legal regulation related to the fight against climate change and the worrying effect on our environment is the Law 7/2021, introduced on 20 May 2021.

This recent law inserts in the Spanish Legal System the commitments agreed by Spain in the Paris Agreement. The law establishes a general framework, which will be developed through the approval of subsequent and minor regulations. As a result, Law 7/2021 does not establish, by itself, specific obligations for companies, their D&Os, and public institutions. These obligations will be established by subsequent regulations which, in most cases, have not been approved yet.

However, it is interesting to refer to Section 32 of Law 7/2021, which regulates the "integration of climate change risk by entities whose securities are admitted to trading on regulated markets, credit institutions, insurance and reinsurance companies and companies based on their size". In line with the provisions of the law, entities must publish an annual report assessing the financial impact on society of the risks associated with climate change generated by their activities, including the risks of the transition to a sustainable economy and the measures adopted to address these risks.

Law 7/2021 establishes that the content of reports on the financial impact of the risks to society associated with climate change will be determined by royal decree within two years of the approval of the law – that is by 2023. The changes will include:

- the governance structure of the organisation, including the role of its various bodies, regarding the identification, assessment and management of risks and opportunities related to climate change
- the strategic approach, in terms of both adaptation and mitigation, of the entities to manage the financial risks associated with climate change, considering the risks already existing at the time of the drafting of the report, and disclosure standards for those that may arise in the future, identifying the actions required at that time to mitigate such risks
- the actual and potential impacts of the risks and opportunities associated with climate change on the organisation's activities and strategy, as well as on its financial planning
- processes for identifying, assessing, monitoring and managing climate-related risks and how these are integrated into its overall business risk analysis and integrated into the organisation's overall risk management, and
- the metrics, scenarios and targets used to assess and manage relevant climate change related risks and opportunities and, where calculated, the scope of its carbon footprint and how it addresses its reduction.

The twelfth final provision of the Law 7/2021 relates to the "carbon footprint and greenhouse gas emission reduction plans of companies". This provision stipulates that the Spanish Government must establish, within one year of the enactment of Law 7/2021:

- the types of companies operating in Spain that must calculate and publish their carbon footprint
- the "initial terms" from which this obligation will be enforceable
- its periodicity, and
- any other element necessary for the configuration of the obligation.

Companies that will eventually be obliged to calculate their carbon footprint, in line with what the Spanish Government will establish in the coming year, will have to draw up and publish a greenhouse gas emissions reduction plan which, among other issues, will have to include a quantified reduction target within a five-year timeframe, together with the measures to achieve it. Companies will be able to voluntarily offset their carbon footprint.

These obligations will have to be specified by regulation by the legislators through the amendment of Royal Decree 163/2014 (14 March), which created the registry of carbon footprint, offsetting and carbon dioxide absorption projects.

This is the first year climate change, as a specific topic, has acquired a substantive relevance in the Spanish Legal System by means of the Law 7/2021. The law will have to be developed by means of subsequent minor regulations to establish a proper framework preventing the climate change, including establishing the obligations for companies, their D&Os, and public institutions, as well as the liabilities that may arise from the infringement of those obligations.

Litigation

Climate change is a very new topic under the Spanish Legal System. As a result, we have hardly any relevant cases concerning to the infringement of the regulations related to climate change on the part of Spanish companies.

Class actions are exceptional in the Spanish Legal System, and they are only allowed in practice regarding certain consumers claims. However, there is a general framework to protect the environment and natural resources in Spain, which is mainly supported by:

a) Criminal protection – Sections 325 to 331 of the Spanish Criminal Code establish a catalogue of conducts relating to damages to the environment, which are criminally punished. D&Os and companies may be held criminally liable of the commission of the offences against the environment.

b) Administrative protection: Law 26/2007, of 23rd October 2007, of Environmental Liability, establishes a penalty system that means companies may be fined if they carried out certain conducts damaging the natural resources in the development of their businesses.

For the time being, litigation concerning to climate change in Spain remains at a low level and mainly involves the Spanish authorities[23]. This scenario may change in the upcoming years with the implementation and development of Law 7/2021, which will mean companies and their D&Os could be involved as defendant parties in relevant litigation cases.

Horizon issues

Once the companies and their D&Os have specific climate change obligations, they may incur liability if they infringe those obligations. This will probably lead to an increase in insurance claims in this field.

Considering the current wordings of the D&O policies existing in the Spanish market, climate change claims should be approached in a similar way to environmental claims. In this sense, the exclusions of personal injury and property damage and pollution may be of interest.

There are also some D&O wordings in Spain that grant coverage to defence costs relating to environmental claims. This is a specific extension of cover, which is limited to defence costs, and that consequently does not provide cover to other concepts like bonds or civil liabilities.

The UK has not yet seen D&Os in court facing allegations on climate change, but the regulatory environment and societal expectations regarding climate change in the UK are changing, and this will no doubt increase the risk of liability in the future.

Regulators

In 2019 the UK made a commitment in law to reach "net zero" by 2050. In this context UK regulators are taking climate change seriously and the Bank of England has made it clear that it considers climate change poses a threat to the stability of the wider financial system, and the safety and soundness of the firms that it regulates.

Compulsory disclosures regarding climate change have already been introduced, and these are expected to extend to a large part of the economy in the next three to five years.

- In 2019, the Prudential Regulation Authority, the body that regulates and supervises financial services firms in the UK, introduced rules that require certain financial services firms to nominate a senior manager responsible for identifying and managing financial risks from climate change.
- In December 2020, the Financial Conduct Authority (FCA), which regulates the conduct of financial services firms and financial markets in the UK, brought in new rules that require UK firms with a premium listing to include a statement in their annual financial report (for accounting periods beginning on or after 1 January 2021) that sets out whether their disclosures are consistent with the TFCD recommendations and provide an explanation if they are not.
- In November 2020, the government's economic and finance ministry, HM Treasury, published "A Roadmap towards mandatory climate-related disclosures" setting out the path towards mandatory climate-related disclosures across the UK economy by 2025 aligned with the recommendations of the TCFD, with the majority in place by 2023 (the Roadmap).
- As part of the Roadmap, in June this year the FCA launched consultations setting out proposals for climate-related financial disclosure rules and guidance for asset managers, life insurers and FCA-regulated pension providers (CP21/17), and a separate consultation for standard listed equity shares (CP21/18). It has also said it is introducing a new "Environmental, Social and Governance (ESG) Sourcebook" in the FCA Handbook to set out its proposed rules and guidance, which is anticipated to expand over time to include new rules and guidance on other climate-related and wider ESG topics.

Failure to comply with regulatory rules risks investigations, civil or criminal proceedings, fines and other penalties, such as prohibiting an individual from carrying on regulated activities. While these rules are still being introduced, we expect the regulators will take a cooperative approach, working with businesses through their supervisory divisions. However, once the rules are established, it is more likely the regulators will use their enforcement powers where directors and their companies are not working hard to ensure compliance.

UK regulators are also alive to the issue of greenwashing. In June this year the government appointed a new expert group, the Green Technical Advisory Group, to overseas the Government's delivery of a "Green Taxonomy" and advise on standards for green investments to help clamp down on greenwashing.

Potential liabilities

There are already rules in place that could lead to liabilities should D&Os participate in greenwashing. For example, the FCA's financial promotion rules require that companies and directors ensure any financial promotions are clear, fair and not misleading. Misleading statements regarding climate change credentials will likely breach these rules, leading to a risk of investigation and disciplinary action by the FCA, possible court proceedings and orders to pay compensation to anyone who entered into an agreement in reliance of the misleading statements and suffered a loss as a result[24].

Misleading disclosures can also lead to a civil claim for misrepresentation, and in some circumstances, a civil right of action for damages by a private person who suffers loss because a breach of the financial promotion rules (s138D FSMA).

Claims can also be brought against directors in circumstances where a prospectus or listing particulars are published that contain untrue or misleading statements and an investor suffers loss as a result (s.90 FSMA).

Again, we are not aware that a claim has been brought against a D&O for misleading information specifically regarding climate change, but in 2019 we saw the environmental charity *ClientEarth* file a complaint against BP PLC (BP) to the UK National Contact Point for OECD Guidelines for Multinational Enterprises alleging the company's advertising campaign misled the public in the way it presented BP's low-carbon energy activities. BP withdrew the advertising campaign as a result.

Under English law, directors have duties, amongst others, to promote the success of the company for the benefit of its members as a whole. As part of this there is an express obligation on directors to consider specific factors. One of these factors is the impact of the company's operations on the community and environment. Directors also have a separate duty to exercise reasonable care, skill and diligence.

Given climate change presents a financial risk to firms and the wider financial system, we consider that the statutory wording of directors' duties is wide enough to impose a duty on directors to identify and mitigate climate and other environmental risks, as well as identify their own company's environmental impact, reduce its emissions and become more sustainable. We are yet to see a case in the UK against directors for breach of their duties due to a failure to consider climate change risks and adapt green strategies, but cases are being argued on similar grounds elsewhere, such as *ClientEarth v ENEA* (2019) in Poland.

While we consider the wording of directors' duties wide enough in English law to put a duty on directors to consider climate risks, under English law it is generally only the company (acting via its board of directors) that can bring a claim for breach of directors' duties. This means we rarely see claims for breach of directors' duties until a company has gone insolvent.

Shareholders and derivative actions

One of the exceptions to the directors' duties rule is a derivative claim, brought by a shareholder (or shareholders) on behalf of the company. It is a tool available to shareholders in circumstances where the majority wrongfully prevent a company bringing or proceeding with a claim against a director for breach of duty, negligence or breach of trust.

We have seen a rise globally in activist shareholders and institutional investors putting pressure on directors and the companies they invest in to do more to tackle climate change. In the UK, this year at Shell's AGM a shareholder resolution was proposed asking for the setting and publishing of targets consistent with the Paris Climate Agreement. A similar resolution was proposed at BP's AGM. While both resolutions were not passed, they did receive significant support – 20.65% BP and 34.47% Shell. It is against this backdrop, that we may see a rise in derivative actions against directors' breaching their duties by failing to properly consider climate change.

That said, it is unlikely we will see derivative actions on the scale that we have seen in the US, such as the class action shareholder derivative complaint *Ramirez v. Exxon Mobil Corporation* et al. The reason for this is twofold.

First, while collective actions are available in the UK, except for competition claims heard in the Competition Appeal Tribunal (CAT), all collective actions are "opt-in", i.e. claimants must elect to join an action to be considered a member of the class. Outside of the CAT, courts can use their powers to join one or more proceedings together where the claims can be "conveniently disposed of in the same proceedings". They can also issue Group Litigation Order, where more than one claimant has a cause of action raising common or related issues of fact or law to be grouped together (members of the class will have the opportunity to opt-in by a date specified by the court), or hear representative actions, where one or more claimants can represent other claimants with the same interest.

Collective actions are becoming more popular in the UK, especially with the rise of professional third-party funders operating in the UK market. Environmental disputes is an area that collective litigation is commonly used in, for example, for loss caused by pollution or nuisance from odours and emissions[25]. In 2019, we also saw the first judgment in the UK in a shareholder collective action, the HBOS / Lloyds litigation[26], albeit the shareholders were unsuccessful. This case highlighted some of the difficulties in shareholder actions, including the principal of reflective loss, which makes it clear that it is normally the company, rather than shareholders, that has the right to recover loss.

Second, investors in the UK need to overcome significant hurdles to get derivative claims to trial. Firstly, the court's consent is needed to pursue a derivative claim. The court must refuse permission if:

a) a person acting in line with the statutory duty to promote the success of the company would not seek to continue the claim, or

b) the proposed or past act or omission was authorised before it occurred or ratified since it occurred.

Even if those preconditions are met, the court still has discretion on whether to permit a member to continue a claim, considering all relevant matters, such as whether the member is acting in good faith and whether the company has decided not to pursue the claim.

In summary

Given the trends in climate change litigation we have seen to date in the UK, we do not expect an imminent rush of claims against directors. That said, the regulatory landscape is changing and demands from investors, activist groups and society as a whole means the risk for D&Os regarding climate change is increasing. In the short-term, this will lead to more scrutiny of D&Os from investors and regulators on climate change disclosures, and the steps they are taking to mitigate environmental risks and reduce their company's emissions. In the medium to long-term, we expect to see litigation and / or regulatory action against those D&Os who are not making the required changes or who are exaggerating their company's green credentials.

THE UNITED STATES

For the most part, the proliferation of litigation involving climate change in the United States has primarily focused on the corporate entities. Recently, however, there have been some suits filed against directors and officers. These have been mostly alleged failures to disclose corporate exposure regarding a company's use of fossil fuels and the nexus between such non-disclosure and a host of environmental concerns. These include claims against D&Os of large oil companies, such as Exxon Mobil, as well as automobile companies, including Volkswagen.

Litigation

One such matter is *Ramirez v. Exxon Mobil Corporation* et al before the US District Court, Northern District of Texas (16-cv-03111). This class action shareholder derivative complaint against the D&Os of Exxon concerned alleged violations of federal securities law. The complaint describes "well-documented history of intentionally misleading the public concerning global climate change and its connection to fossil fuel usage, as well as the impact the changing climate will have on Exxon's reserve values and long-term business prospects." The complaint notes that several statements by the D&Os "provided investors with a materially misleading description of Defendants' efforts to evaluate and account for the potential climate change-related risks associated with Exxon's reserve assets and long-term business prospects."

The *Ramirez* complaint also includes allegations that the D&Os "failed to disclose these risks despite the fact that Exxon's scientists had warned the company's management that policy changes to address climate change might affect profitability." The complaint outlines alleged violations of Section 10(b) and 20(a) of the *Federal Securities Exchange Act* of 1934 and, regarding the D&Os, states: "they knew or recklessly disregarded [and] were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." On August 14, 2018, the *Ramirez* court found that the plaintiffs adequately pleaded securities fraud claims against the D&Os for certain statements related to specific investments, though none of the statements was only related to the growing concern on climate change. The class certification motion has been filed, but not yet ruled on by the court.

Another noteworthy suit in the same Texas court is the In *Re Exxon Mobil Corporation Derivative Litigation*, a 2019 shareholder derivative action for violations of Federal securities law and breach of fiduciary duties also against the D&Os for Exxon Mobil. The *Exxon Mobil* matter involves the consolidation of six different shareholder derivative complaints, including one filed in February 2021. The basis for potential liability for the D&Os under the Federal securities laws stems from "Exxon's failure to employ carbon proxy cost policies that actually corresponded to its public statements violated Generally Accepted Accounting Principles ('GAAP'), SEC accounting and disclosure requirements, and established accounting practices and guidance." Like *Ramirez*, this case is still ongoing.

Disclosure-related suits such as *Ramirez and Exxon Mobil* may just be the beginning of climate change-related actions against D&Os. However, most US climate change actions continue to only name the company, including the July 7, 2021 pair of lawsuits – *Conservation Law Foundation v. Shell Oil Co. et al.*, case number 3:21-cv-00933, and *Conservation Law Foundation v. Gulf Oil* LP, case number 3:21-cv-00932. These lawsuits by the Conservation Law Foundation argue that the oil companies are not accounting for the increased risk of flooding, major storms, and elevated sea levels, which could impact their fuel storage facilities and put the surrounding community in peril. Trade press reports on the subject have identified other potential areas of D&O litigation. These include suits involving climate condition, such as *U.S. v. Southern California Edison Company*, (20-cv-11020) in the US District Court, Central District of California, the suit against California's utility company in the wake of the California wildfires, as well as potential suits by nongovernmental organizations such as *Mayacama Golf Club, et al v. Pacific Gas and Electric Company*, (SCV-266679) Superior Court of California, Sonoma County.

Another noteworthy suit is the active litigation against Volkswagen's former CEO and chairman, *SEC v. Volkswagen Aktiengesellschaft, et al.*, for alleged securities violations. The claims against Winterkorn in the amended complaint filed on September 4, 2020 are for violations of Section 10(b) and 20(a) of the *Exchange Act* and Section 17(a)(2) of the *Securities Act* for reckless conduct of making untrue statements of material fact in the sale of corporate bonds. The alleged misstatements by Winterkorn are about the company's claimed "clean diesel" engines. It is asserted that Winterkorn and other senior officials and engineers at VW knew that VW's clean diesel engine was a fraud because it failed to comply with applicable U.S. emissions laws. Once it was disclosed to the United States Environmental Protection Agency that such "clean diesel" claims were fraudulent, and after VW pleading guilty in US Court to three criminal felony counts, the price of its bonds fell. This litigation is still in its infancy.

While potential corporate scrutiny concerning climate change is likely to continue to grow, the bullseye may not be focused directly on the D&Os in the United States.

Investors and regulators

Shareholder activism for Environmental and Corporate Governance (ESG) is forcing D&Os to look at the global environmental impact of their organizations' activities, which, in turn, may entail voluntary and mandatory disclosures regarding certain issues, including climate change. For instance, in May of 2021, an activist hedge fund, with less than a one percent ownership interest in Exxon Mobil arguing that the company was slow in strategic transitioning to a low carbon economy, was able to gain seats on the Exxon board because of its strong commitment to ESG. In that same vein, a group of state Attorneys General, led by New York and California, recently sent the SEC a letter urging it to impose on corporations broad ESG disclosures regarding financial risks stemming from climate change.

Regulatory scrutiny, as well as lawsuits by environmental groups could also impact the decisions of the D&Os of the companies. In the near term, this may increase the number of D&Os being subject to government subpoenas and investigations.

At this point, it does not appear that there is a growing concern for class actions naming D&Os as defendants in the United States. There are many other event-driven litigations in the United States that are actively targeting D&Os, including their response to cyber security incidents, racial diversity, sexual harassment, and, most recently, the COVID-19 pandemic. For the present, at least, these other issues are more likely to represent a bigger exposure to D&Os than climate change. Still, with the increased awareness of the importance of climate change, corporate leaders around the world, and their D&Os, will remain in the spotlight.

Analysis of US developments was initially published on the PLUS Blog on 20 September 2021

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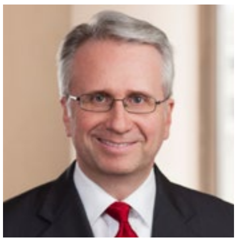

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