

# **The World Economic Forum Principles on “Climate Governance on Corporate Boards”: can soft law help to face climate change around the world?**

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**Abstract.** Climate change is a financial factor that carries with it risks and opportunities for companies. To support boards of directors of companies belonging to all jurisdictions, the World Economic Forum issued in January 2019 eight Principles containing both theoretical and practical provisions on: climate accountability, competence, governance, management, disclosure and dialogue. The paper analyses each Principle to understand scope and managerial consequences for boards and to evaluate whether the legal distinctions, among the various jurisdictions, may undermine the application of the Principles or, by contrast, despite the differences the Principles may be a useful and effective guidance to drive boards' of directors' conduct around the world in handling climate change challenges. Five jurisdictions are taken into consideration for this comparative analysis: Europe (and UK), US, Australia, South Africa and Canada. The conclusion is that the WEF Principles, as soft law, is the best possible instrument to address boards of directors of worldwide companies, foster convergence of their conduct and effectively help facing such global emergency.

*Key words:* World Economic Forum, Climate Change, Climate Governance, Board of directors, Climate risks, Climate opportunities, Task Force on Climate-related Financial Disclosure.

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**Sommario. I principi del World Economic Forum sulla governance del clima: può la soft law essere di aiuto per fronteggiare la sfida del cambiamento climatico nel mondo?** Il cambiamento climatico è un fattore finanziario che comporta rischi e opportunità per le società. Al fine di supportare i consigli di amministrazione delle società di tutte le giurisdizioni, il World Economic Forum ha emanato nel gennaio 2019 otto principi guida che contengono disposizioni sia teoriche che pratiche in materia di: responsabilità, competenza, governance, gestione, trasparenza, dialogo. Il paper analizza ciascun principio per comprenderne ambito e conseguenze gestorie per i consigli di amministrazione e per valutare se le differenze giuridiche tra i vari ordinamenti possano compromettere l'applicazione dei Principi o, viceversa, se nonostante le differenze essi possano costituire un'utile ed efficace guida per i CdA nel mondo al fine di fronteggiare le sfide del cambiamento climatico. Cinque giurisdizioni sono prese in considerazione: Europa (e UK), US, Australia, Sud Africa, Canada. La conclusione è che i principi del WEF, come soft law, sono il migliore strumento possibile per rivolgersi ai CdA di tutto il mondo, incoraggiare la convergenza della loro condotta ed efficacemente aiutare a fronteggiare questa emergenza globale.

*Parole chiave:* World Economic Forum, cambiamento climatico, governance del clima, consigli di amministrazione, rischi ed opportunità da cambiamento climatico, Task Force on Climate-related Financial Disclosure (TCFD).

## 1. Introduction

A recent survey by Morrow Sodali shows that climate change is one of the top issues for institutional investors around the world: as factor taken into consideration for voting decisions (highly relevant for 54% of investors); as issue of engagement with other investors both in connection with the AGMs of portfolio companies (most important for 26% of investors) and with boards of directors (highly important for 57% of them together with social issues); and, as object of disclosure (the most important topic – among ESG factors – for engagement in 2019, highly important for 76%, while 72% of investors believe companies should adopt the Recommendations issued by the Task Force on Climate-related Financial Disclosure (Morrow Sodali, 2019, p. 6 ff.). A recent international report released by the Carbon Disclosure Project has in fact quantified risks and opportunities related to climate change by analysing responses from worldwide companies to CDP's questionnaire focusing on what companies reported in 2017 and 2018 about the risks and opportunities they may face from climate change and its potential financial implications (CDP Climate Change Report, 2018). In an analysis of 500 of the world's biggest compa-

nies by market capitalization – where 215 provided estimations of the potential financial implications for a proportion of their reported risks –, CDP found to be at risk approximately one trillion dollars (US\$970 billion) (*ibidem*, p. 5 where it is reported that over half of the companies qualified these risks as “likely/very likely/virtually certain” and approximately \$250 billions of this figure is linked to asset impairments or write-offs (i.e. stranded assets). However, opportunities, according to the same report, are bigger than risks as 225 of the world’s 500 biggest companies reported them to total over US\$2.1 trillion (*ibidem*). Also in this case, almost all of the opportunities were classified to be “likely/very likely/virtually certain” with the majority materializing in the short to medium term).

The World Economic Forum, to better understand the dynamics of the global economic system, reports on global risks (Evans, Allan & Cantle, 2017). Being aware of these risks and opportunities and on the premise that climate change is a *financial* factor, in January 2019 the institution released a document that aims at supporting boards of directors of any company, around the world, in addressing the issue. It delivered eight principles and guiding questions that have been built on existing Corporate Governance frameworks, such as the International Corporate Governance Network’s (ICGN) Global Governance Principles and the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations (World Economic Forum, 2019, p. 6).

The World Economic Forum Principles can be qualified as soft law – term that entered the international lexicon since the 70’s to differentiate «anything that was not in fact, hard law promulgated by a government body authorized to enact it, but that nonetheless was designed to affect, or actually did affect, behaviour and that might in time solidify into hard law or otherwise affect the development of hard law» (Bjorklund, 2012, p. 51).

The drafting process involved consultations with executive and non-executive directors and various experts. The Principles contain both theoretical and practical provisions and address worldwide jurisdictions. The aim of this Article is to analyse each Principle and understand their scope and managerial consequences for boards and whether the legal distinctions, among the various jurisdictions taken into consideration, may undermine their application or, by contrast, whether the Principles can be, despite these differences, a useful and effective guidance to drive and harmonize boards’ of directors’ conduct around the world in handling climate change challenges. In particular, five jurisdictions are taken into consideration for this comparative analysis: Europe (and UK), US, Australia, South Africa and Canada.

There is no literature, to my knowledge, on the topic.

## 2. The first Principle: climate accountability

The first Principle poses the climate accountability on the board of directors. This Principle is not in contrast with any of the jurisdictions under consideration. Governing climate change means taking account of it in the management of the company both by establishing the business strategy and by approving major long term investments. Under all jurisdictions the company's management is allocated to the board of directors.

However, looking at the specific contents of the first Principle, it is doctrinal and assumes a concept which actually does not represent current law almost in all jurisdictions, that is, that the board is «ultimately accountable to shareholders for the long-term stewardship of the company». This is the premise of the following provision under which: «Accordingly, the board should be accountable for the company's long-term resilience with respect to potential shifts in the business landscape that may result from climate change». The second proposition, according to its wording, is meant as the logic consequence of the first statement. The first Principle is very important because it represents the foundation of all the other Principles but as said, from a strictly legal viewpoint, it is not correct: long-term stewardship is certainly not contemplated under US state legislations nor under almost all European jurisdictions. For example, the Italian Civil Code (or other Italian legislations) do not ever mention long term or stakeholders' consideration in describing directors' duties and liability. There are some exceptions, such as the UK Companies Act 2006, Section 172, expressly referring to consideration, among other matters, of «the likely consequences of any decision in the long term» by directors. In addition, it is worth mentioning *Le Plan d' Action pour la Croissance et la Transformation des Entreprises (PACTE)* adopted in France by *Loi 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises* that, among other measures, provides for an amendment of Article 1833 c. civ. to change the definition and the scope of the company's interest and include directors' duty to take into consideration social and environmental matters in carrying out its activity. Also Canadian law – belonging to common law jurisdictions – contemplates stakeholders: while the Canada Business Corporation Act 1985, Section 122 (1) requires directors to «act honestly and in good faith with a view to the best interests of the corporation» and to exercise care, diligence and skill, the Supreme Court of Canada held that the «best interests of the company» should not be read simply as «the best interests of shareholders» but that various other factors, including the environment, may be relevant and the board of directors is required to reflect

on the interests of the corporation both as «an economic actor» and as «a good corporate citizen» (*People Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 416, 481); in addition, it was held that «directors and officers must treat affected stakeholders in a fair manner, commensurate with the corporation’s duties as a responsible corporate citizen» (*BCE Inc. v 1976 Debentureholders*, 2008 SCC 69 at para 39). Finally, South Africa is worth to be mentioned: while the fiduciary duties of directors are based on loyalty, good faith and the avoidance of conflicts of interest, the Supreme Court of Appeal held that there is no “closed list” of fiduciary duties but room for development of the law outside of established categories (*Volvo (Southern Africa) (Pty) Ltd v Yssel (247/08) [2009] ZASCA 82*). Apart from these exceptions, no other law provisions or common law cases in the jurisdictions under consideration expressly refer to long term. It is true that long-term stewardship is contemplated under Corporate Governance Codes everywhere. Just to mention, as example, the least known, the King IV Code on Corporate Governance for South Africa, 2016, Principle 2 in South Africa emphasizes the importance of the ethics of the organization, the interaction with «both internal and external stakeholders and the broader society»; Principle 3 states that «the governing body should ensure that the organisation is and is seen to be a responsible corporate citizen»; Principle 4 refers to «sustainable development» and contemplates also «the long-term strategy» (Institute of Directors Southern Africa, 2016). However, these Codes are a set of recommendations assisted by the «comply or explain» rule and do not have any legally binding nature. The problem is that, according to the first Principle of the WEF Guidance, from the assumption that the board is «ultimately accountable to shareholders for the long-term stewardship of the company» the consequence follows that «Failure to do so [i.e. to consider long-term resilience of the company with reference to climate change] may constitute a breach of directors’ duties» (World Economic Forum, cit., p. 11). As matter of fact, this consequence may apply only to those jurisdictions that contemplate long term or stakeholders – as we will further analyse below in this paragraph. The consequence, i.e. breach of directors’ duties, indeed also applies in Europe but not because directors have breached the inexistent duty of long-term stewardship of the company but because the Directive N. 2014/95/EU requires disclosure on the policy adopted by relevant companies with reference, among other matters, to climate change that assumes the evaluation and assessment on the company’s resilience to it. By requiring disclosure on climate-related risks and opportunities, the Directive actually drives the board’s whole activity on how to govern climate change:

it presumes an understanding and assessment by the board of the impact of climate change on the business and vice-versa of the business on climate. In particular, the description of the business model – which is one of the four pillars of information (according to the Directive N. 2014/95/EU, art. 1(1) inserting Art. 19a (1), the four pillars of information are: business model, policies and due diligence, outcome of those policies, risks and their management) assumes that the board of directors has planned the company's strategy taking into consideration, among others, the climate in the short, medium, long term, that is, a perspective which is longer than the one usually considered even in strategic plans and that involves also financial planning, both in terms of capital expenditures and of revenues, to take full account of all risks and opportunities. The issue at stake here is whether the company's business is resilient to climate change different scenarios (from 1.5° C to above, depending on the geographic location – since nobody knows which scenario will occur) and it is the board of directors to be responsible for this evaluation.

Therefore, the first Principle, from a strictly legal viewpoint, is of no help for US jurisdiction or Australia – where no duty of directors to shareholders for the long-term stewardship of the company has ever been held by case or state law and therefore its breach could never be enforced – and not so useful for European jurisdictions – where the breach may arise because of the disclosure requirements not by reason of an inexistent directors' accountability for «the long-term stewardship of the company». The first Principle does not contravene, however, Canadian or South Africa law where legal developments towards long term and stakeholders' interests can be witnessed and where, therefore, the first Principle may be useful to better assess directors' conduct.

However, more than the first Principle, it is the guidance to it to be more precise and helpful. It qualifies climate change as «a foreseeable financial issue within mainstream investment and planning horizons». Economic literature, since decades ago, has been illustrating that environment-related risks can have a significant impact on corporations' assets today and these risks are likely to seriously increase over time: these environment-related risks can strand assets of corporations belonging to various industries (Caldecott, 2018, p. 1, 5 also for definitions of stranded assets). This is actually the legal reason why directors should consider and mitigate climate risk like any other financial risk. In addition, the guidance to the first Principle states that, despite all the uncertainties, directors should use «the best available information to make informed decisions that will leave their companies resilient in the face of a variety of different policy and econom-

ic outcomes». The duty to inform themselves is part of the contents of the duty of care in the various jurisdictions under exam. As for Europe, in all member states directors shall manage the company in compliance with the duty of care and loyalty; there are slight variations from one jurisdiction to the other and case law is obviously different – because enforcement rules vary – but the duty of care and loyalty applies to directors in any European jurisdiction and the first one includes the duty to gather all available information (Davis and Hopt, 2013, p. 346 ff.; Gerner-Beurle and Schuster, 2013, p. 13). Likewise, in US the duty of care in general «requires active diligence» and «a degree of attentiveness to relevant information and its critical evaluation» (*Cede & Co. v. Technicolor, Inc.*, 634 A. 2d 345, 368 (Del. 1993); *Smith v Van Gorkom*, 488 A. 2d 858, 872 (Del. 1985) 873; *Aronson v. Lewis*, 473 A.2d 805, at 811 (Del. 1984) 812). In Australia, directors are required to maintain an «irreducible core» of knowledge and understanding of the fundamentals of their corporations and also to proactively inquire and to «take a diligent and intelligent interest in the information available to them or which they might appropriately demand from the executives or other employees and agents of the company» making further inquiries where a dearth of material or conflicting materials are before them, also by seeking «professional or expert advice» (*ASIC v Australian Property Custodian Holdings Ltd* [2013] FCA 1342 at 571; *Centro* [2011] FCA 717; *Alcoa of Australia Retirement Plan Pty Ltd v Frost* [2012] VSCA 238; *Finch v Telstra* (2010) 242 CLR 254). In Canada, the duty of care requires directors to act prudently and on a reasonably informed basis while reasonableness is evaluated in the light of all the circumstances that directors «knew or ought to have known» (*People Department Stores Inc (Trustee of) v Wise*, cit., at 493). Finally, in South Africa the duty of care centres on competence and a director satisfies the duty of care if he «has taken reasonably diligent steps to become informed about the matters» (Sec. 76 (4) (a) (i) Companies Act 2008). Therefore, from the assumptions, highlighted in the guidance to the first Principle that climate change is a «foreseeable financial issue» and that directors have the duty to get the best available information, the consequence is drawn by WEF that it is upon directors to evaluate the company's resilience to climate change challenges «in the face of a variety of different policy and economic outcomes» (World Economic Forum, cit., p. 11). It is interesting to point out that all jurisdictions under examination – as just shown – contemplate the directors' duty to gather all available information as component of the duty of care; however, we can observe a convergence on the consequential identification of the directors' duty to consider climate related risks and opportu-

nities in all jurisdictions with the exception of US. In Europe, through disclosure (recently enhanced by the European Commission Communication N. 2019/C 209/1 – European Commission, 2019), climate change imprints the contents of the directors' duty of skill and care: in planning the company's strategy or deciding whether or not to make medium-long term investments, they shall certainly take into consideration – to fully comply with the duty of care – the climate change factor and, in particular, all different scenarios because nobody knows what the situation will be like in the medium-long term; the board shall try to prevent any possible climate crisis and exploit any possible opportunity in order to faithfully meet its duties. In South Africa, given the juridical premises on long term and stakeholders mentioned above it is believed that

«it is clearly conceivable that a director's failure to consider climate risks that pose a foreseeable and material financial risk to the business, could constitute (based on the legal convictions of the international and South Africa community) a failure to take reasonable steps to become informed about the matter, and hence a failure to act in the best interest of the company»;

a Court may judge the failure of a director to consider climate change «a breach of the fiduciary duties under section 76(3)(a) and (b) of the Companies Act» because fiduciary duties evolve with society and because the environment is protected under South Africa Constitution for the benefit of present and future generations (Reddell, cit., p. 10, 12). Similarly, in Australia, it is stated that ignorant directors would become liable for this risks «on the basis that a reasonable person would have known of them. When it comes to climate change, the science has been ventilated with sufficient publicity to deduce that this point has already passed» (Hutley and Hartford-Davis, 2016, p. 2). A failure to consider climate related risks and opportunities for want of relevant knowledge presents grounds for breach of the duty of care; Australian courts tend «to hold directors to particularly high standards of proactivity, professionalism and robust process» (Barker, 2018, p. 16, 23). Also in Canada, from the position held by the Supreme Court and other case law referred to above, it is argued that being a «good corporate citizen» means considering climate change risks that poses a challenge for our world also because the «COP 21 agreement recognizes that deep reductions in global emissions through both climate adaption and mitigation are required and urgent»; so directors' fiduciary duties require to identify relevant climate risks for their business and climate change policies, to put appropriate strategies to manage these risks, and to have mech-



anisms to respond rapidly to changes in the risk profile, and to integrate «asset climate risk and resiliency in the firm’s investment decision making»; failure to act according to such principles it «is likely to attract liability given the reasonable expectations of stakeholders» (Sarra and Williams, 2018, p. 14 f.). By contrast, the situation is different in United States where, according to various authors, a rigid interpretation of the business judgment rule would apply also in case a board’s decision leads to ultimately catastrophic effects for the corporation unless bad faith or some type of fraud is established by shareholders: consequently, the board need not even to consider the issue of climate change risks “in depth” and is free to decide that taking steps to mitigate such risks is not in the best interests of the company as long as the issue is reviewed «honestly with reasonable reliance on some substantive information»; even applying the duty of good faith – as subset of the duty of loyalty and different from the duty of care – the result would be likely the same and the inaction of the board would be subject to the business judgment presumption, in the absence of any evidence of fraud or breach of other fiduciary duties, if the board decides that inaction is in the best interest of the company: the author believes that the decision to prepare the corporation for potential losses in the event of a climate change-related catastrophe «is a quintessential business decision» (Risley Jr., 2017, p. 413). Similarly it is believed that plaintiffs would face a number of significant hurdles in establishing a breach of the fiduciary duties for directors «who consciously disregard or are wilfully blind to stranded asset risks in their governance of risk and strategy» because of the business judgment rule unless an extraneous interest pursued by directors is shown: for example, a «default denialism» consistent with a political or industry-based association with which the director is affiliated, or a potential conflict of interests «where (for example) contingent or discretionary components of remuneration are tied (in whole or in part) to reserve replacement ratios» (Barker, 2018, *An Introduction to Directors’ Duties in Relation to Stranded Assets*, p. 199, 210 f.). The conclusions of the mentioned authors are clear: the probability of success of this kind of litigation is very low in US.

### **3. The following Principles: climate competence, governance, management**

The second Principle recommends diversity in the composition of the board so that various knowledge, skills and experiences may favour debate

and informed decisions as well as awareness and understanding of the issue. This is a useful Principle for all jurisdictions as it helps defining the contents of the duty of care with reference to climate change taking into consideration that maintaining and enhancing climate competence is fundamental because climate change is «a disruptor to business as usual» and that special inductions for directors to be regularly updated or advice from an external expert may be needed (World Economic Forum, cit., p. 12). It is arguable whether one or more climate scientists are required on board to offer such competence. Especially in the United States investors have been bringing proposals, under Rule 14a-8, asking for the appointment of at least one climate expert as director. For example, Exxon Mobil in 2017 has appointed a leading atmospheric scientist to its board to meet demand raised by a number of investors – the previous year the same proposal was opposed and rejected by the company and won support in the general meeting from just 20.9 per cent of shares (*The Financial Times*, 2017). Two American authors believe that, in order to successfully confront climate change, more expert directors should sit on boards, in particular in the audit committee who would foster «climate change literacy among board members» (Taylor and Kay, 2011, p. 221 f). However, the risk of having one climate scientist among directors is that of her/his insulation within the board whereas climate change, on the opposite, should imprint the entire strategy, the risk management and the correct evaluation of assets by the board collectively conceived. Climate competence is certainly fundamental but it should be rather spread among all members of the board and the management; at the beginning, as admitted by the WEF Principles, this expertise should be enhanced through inductions sessions and consultancy from external advisors. In addition, it should be noted that in the market there are several providers of climate data analytics specializing in scenario analysis for the various geographic regions of the world that boards of directors might refer to for being able to anticipate what the situation might be like in the medium-long term in a certain area before taking decisions on strategy or medium-long term investments. Recently, for example, it was released the news of an acquisition of a global leader for climate change scenario analysis by a major provider of services for the global investment community (MSCI, 2019).

According to Principle 3 climate considerations should be integrated into the board structure and committees depending on the board's model (World Economic Forum, p. 13). Also this Principle is a useful guidance on how to structure climate governance within the organization assigning to internal committees, such as the sustainability or strategic or audit com-

mittee or an ad hoc committee, the task of preliminarily gathering and analysing all necessary and most updated information and tools, keeping in mind that climate change is a cross-functional issue that may require involving more than one committees and that, in any case, the responsibility to govern it is upon the board of directors collectively.

Principle 4 specifies that it is responsibility of the board to ensure that «management assesses the short-medium-and long term materiality of climate-related risks and opportunities for the company on an ongoing basis» and also that «the organization’s actions and responses to climate are proportionate to the materiality of climate to the company» (*ibidem*). This Principle is the consequence of having qualified climate as a material financial factor even though the impact will of course vary from one company to the other depending on industry, size, and geography. The guidance further specifies that reference should be made to various scenarios and that the assessment may involve budget or operating cycle planning (*ibidem*). As for the jurisdictions under consideration, almost all of them recognize that climate change can be a material financial risk for companies of any industry. In Europe the logic premise of the European Directive N. 2014/95/EU and the Action Plan on Sustainable Growth issued in 2018 (Regulation (EU) 2018/1999 of the European Parliament and of the Council on the Governance of the Energy Union and Climate Action planning 2030 targets and a transition to a climate neutral economy of December 11, 2018, L 328/1) is financial materiality of climate change. In particular, the European Commission stated that:

«Between 60 and 80 per cent of the coal, oil and gas reserves of publicly listed companies are “unburnable” if the world is to have a chance of keeping global warming well below 2°C and as closely as possible to 1.5°C as agreed at the COP21 in Paris. This means in practice that a very substantial source of global systemic risk – in the form of what has been called “the carbon bubble” – is currently embedded within EU and global financial markets. [...] This means that, in practice, the business model of the “carbon economy” as a whole depends on rent extraction and ultimately of implicit subsidies as the costs associated with these risks are pushed forward to the future whereas current market players benefit from a present call on future resources» (Committee on Economic and Monetary Affairs of the European Parliament Draft Report, February 2, 2018).

In South Africa, it is recognized that the heavy reliance on fossil fuels will need a quick transition to meet the international commitments set in the Paris Agreement (settled at the 21<sup>st</sup> Conference of the Parties to the United Nations Framework Convention on Climate Change (COP21) on

December 12, 2015) and that there is a high risk of stranded assets also because South Africa is particularly vulnerable to physical impacts of climate change; therefore directors need to identify risks now «to ensure enough lead time to manage risks appropriately» (Reddell, cit., p. 33). In Australia it is established by legal authors that climate change risks «are capable of representing risks of harm to the interests of Australian companies, which could be regarded as foreseeable at the present time» (Hutley and Hartford-Davis, cit., p. 2). The same is recognised by Canadian authors (Sarra and Williams, cit., p. 5). As for USA, some state legislations acknowledge climate change risk. For example, California mentions that: «climate change is a long-term problem... [whose] effects... are already occurring... and will accelerate... [and consist of] an array of material financial risk, including transition risk, physical risk, and litigation risk» and that

«If global temperature is to be limited to no more than 2° C, or the aspirational target of 1.5° C proposed in the COP 21 agreement now in effect, governments must act to limit warming and hasten the transition to a low-carbon economy by halting the extraction and development of carbon reserves. This regulatory risk will affect major sectors of the global economy» (California Senate Bill No. 964 Chapter 731. An act to add and repeal Section 7510.5 of the Government Code, relating to public retirement systems, Section 1, approved by Governor on September 23, 2018).

However, this is the premise of an act that will require CalPERS and Calstrs (public employees' retirement systems) to report publicly on the climate-related financial risk of their portfolio; so no reference is made to boards of directors. In addition, SEC issued in 2010 the first interpretive release specifically focusing on climate change that acknowledges that: «for some companies, the regulatory, legislative and other developments could have a significant effect on operating and financial decisions, including those on capital expenditures to reduce emissions and, for companies subject to “cap and trade” laws, expenses related to purchasing allowances where reduction targets cannot be met»; other companies may be «indirectly affected by changing prices for goods or services»; «there may be significant physical effects of climate change that have the potential to have a material effect» that can impact «personnel, physical assets, supply chain and distribution chain»; and financial risks may consequently be associated to entities other than those affected by climate change consequences (e.g. suppliers, banks etc.) (17 CFR Parts 211, 231, and 241 Commission Guidance Regarding Disclosure Related to Climate Change; Final Rule, February 8, 2010, at 6291). However, the SEC Guidance did not amend any

provision of the Code of Federal Regulations and, in any case, it refers to disclosure while as for directors' duties the position is the one described above under parag. 2.

Principle 5 recommends to incorporate climate considerations into the strategic planning, business models, financial planning and other decision-making processes so that the board may ensure climate risks and opportunities are identified, mitigated, managed and monitored across the company (World Economic Forum, cit., p. 14). This Principle stems from the recognition that climate change is a financial risk and, at the same, a potential source of new investment opportunities for companies. This is the reason why it should be embedded in the strategic plan: to design the company's business model and to drive all investment decisions. At the same time, being it a risk, it should be well identified and managed by the board of directors – who has primary accountability – and by the management. The first international body that has well recognised and assessed both risks and opportunities for companies has been the Task Force established by the G20's Financial Stability Board on which see below under parag. 4.

Principle 6 recommends the board that executive incentives «are aligned to promote the long-term prosperity of the company» also considering to include climate-related targets and indicators in the executive incentive schemes (World Economic Forum, cit., p. 15). In such a way all the organization is encouraged to pursue consideration and implementation of climate risks and opportunities. This is certainly an incentive that can help aligning the interest of executive and management to meet the climate change targets and indicators that the board of directors approves. Reference could be made to reduction of CO2 emissions, to inclusion of the company in climate international indexes, etc.

#### **4. The seventh and eighth Principles: disclosure and dialogue**

Principle 7 refers to disclosure asking the board to ensure «that material climate-related risks, opportunities and strategic decisions are consistently and transparently disclosed to all stakeholders» in financial filings (annual reports or accounts) and be subject to the same disclosure governance as financial reporting (World Economic Forum, cit., p. 16). This Principle does not add much to the European legislation – summarised above under parag. 2 – but can be of great help for US or other jurisdictions. It is worth stressing that it encourages integrated reporting to communicate a clear and concise picture – and not separate reporting: the aim

is to increase the quality of the reporting rather than its volume. It also encourages compliance with the TCFD Recommendations that were published in June 2017 by the Task Force established by the G20's Financial Stability Board to foster financial institutions and companies to disclose clear, comparable and consistent information on climate-related risks and opportunities in order to correctly price asset values. The Recommendations highlight that climate change has financial implications that affect «most economic sectors and industries», not only fossil fuel companies, and that include risks but also opportunities – the transition to a lower-carbon economy is estimated to require around \$1 trillion of investments a year for the foreseeable future (Task Force on Climate – Related Financial Disclosures, 2017, p. ii ff.). According to the Recommendations climate-related risks relate to: 1) the transition to a lower-carbon economy and 2) the physical impacts of climate change (Id., p. 5). The first class may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change as well as a reputational risk. Physical risks may directly damage a company's assets or, indirectly, its supply chain as consequence of weather events (cyclones, hurricanes, or floods) or sea level rise or chronic heat waves (Id., p. 6 ff.). Climate-related opportunities may entail all those measures that are meant to reduce operating costs, increase the company's reputation, seeking opportunities in new markets or types of assets to diversify products and services such as: energy efficiency interventions, innovations in technology, use of renewable energy, issuing green bonds. With reference to these risks and opportunities, the Final Report recommends companies to disclose: governance (i.e. how the entity is organized around climate change in terms of board's oversight, management role); strategy (i.e. impact on business, strategy and financial planning over the short, medium, and long term, as well as description of the company's resilience taking into consideration different climate-related scenarios, including a 2 degree C or lower scenario); risk management (i.e. how risks are identified, assessed and managed within the organization, identifying the processes); metrics and targets used to assess and manage risks and opportunities (also disclosing Scope 1, 2, and 3) (Id., p. 13 ff.). A supplemental guidance is referred to the financial sector (banks, insurance companies, asset owners, foundations) and to the industries that account for the largest proportion of GHG emissions, energy and water usage (i.e. energy, materials and buildings, transportation, agriculture, food and forest) (Id., p. 15 ff.). As mentioned, this Principle can be of great help to those jurisdictions that lack disclosure requirements (basically, with reference to those analysed in this paper all

but for Europe). As for Australia, there is no specific legislation on climate change disclosure even though companies' reliance on soft law guidance on material disclosures, such as the TCFD Recommendations, is encouraged (Barker, cit., p. 28 ff., 35). In Canada the authorities have been dealing with climate change disclosure since 2010 but, at the moment, the latest document is the Report on Climate change-related Disclosure Project issued on April 5, 2018 where the study by the Canadian Securities Administrators offers some data on the level of climate-related disclosure by issuers (under general securities law as one of the material risks) but did not encourage any specific requirement (Staff Notice 51 – 534). In South Africa, there is no *ad hoc* legislation on climate disclosure. However, the King IV Code on Corporate Governance expressly refers to short, medium and long term prospects in the reporting and to «matters that could significantly affect the organisation's ability to create value» (Principle 5) and it is believed that climate change is included among these matters (Reddell, cit., p. 19 ff.). Being the reference contained in the Code on Corporate Governance, it is a recommendation and not a legal provision. Finally, as explained under parag. 3, there is no specific legislation or SEC regulation in USA on climate disclosure. However, in July 2019 a draft bill has been submitted before the Congress, the Climate Risk Disclosure Act of 2019, to amend the Securities Exchange Act of 1934 and require issuers to disclose information on their exposure to risks associated to climate change on an annual basis and SEC to establish quantitative and qualitative climate-related disclosure metrics and guidance (H.R. 3623 116<sup>th</sup> Congress 2019-2020). It is just a draft Bill and the likelihood of being approved, pending this administration, is unfortunately not so high.

To sum up, the seventh Principle on disclosure may be very helpful for all jurisdictions but for Europe. In general, disclosure is fundamental because once risks and opportunities have been identified in public reporting they must be consequently managed by the board of directors otherwise its inaction can amount to breach of directors' duties for damages to the company's assets (occurring if risks are not monitored or opportunities are not exploited). Confronting the various jurisdictions, it should be noted that where a country lacks of direct disclosure specifications on climate change, the consequence is that of having an uneven level of information across corporations that are not comparable; for investors, consumers, employees it is very difficult to make their choices among issuers. In this respect, Europe because of its recent legislation may really lead the way for a more harmonised level of disclosure that may attract more investors, consumers and employees. Finally, another risk of lacking a specific disclosure legis-

lation on climate is that companies, applying common securities laws, shall concentrate only on risks and will leave aside opportunities. Also the recent American Bill, Climate Risk Disclosure Act of 2019, just refers to risks. This attitude shall undermine companies' profitability because, as very well highlighted by the TCFD Recommendations of the TCFD, the climate change challenge can also be a source of new investments and new growth for companies and for the economy as whole.

Principle 8 recommends the board to «maintain regular exchanges and dialogues with peers, policy-makers, investors and other stakeholders to encourage the sharing of methodologies» and to stay informed and updated on all new developments (Task Force on Climate – Related Financial Disclosures, cit., p. 17). The duty to be regularly updated on a topic which is subject to continuous scientific development has to be considered part of directors' duty of care as explained under Parags. 3 and 4 and the dialogue with all stakeholders, peers and policy-makers can be very useful for a confrontation and the best possible assessment of the approach to be adopted.

## 5. Conclusions

The World Economic Forum Principles on Climate Governance, as soft law, may help featuring the correct practical conduct for boards of directors' worldwide with reference to climate related risks and opportunities especially for those countries who lack stringent regulation such as US and, as for Europe, for those companies that are not subject to the Directive N. 2014/95/EU (because do not reach the thresholds therein fixed) and need a guidance on climate governance.

This “soft law” instrument may help corporations and directors on how to inform themselves and then critically evaluate the information for the best possible discharge of their duty of care with reference to climate change. Soft law has, of course, its limitations but also its value because it may be «applied intelligently and promptly to deal with changing circumstances and it can be translated into hard law when required and possible» (Clarke, 2016, 571 ff). Its inherent flexibility is very important given the subject of climate change that heavily depends on scientific and rapidly changing research, in particular, with reference to scenario analysis. In addition, as it has been pointed out: «Soft law does possess authority. For example, the UN Declaration on Human Rights is the most translated document in the world (in 370 languages), and yet has no legal status» (*ibi-*



dem). Likewise, the World Economic authority may encourage the application of the Principles in all jurisdictions.

The Principles and its guidance issued by the World Economic Forum are a highly valuable instrument that can be applied all around the world especially when or where legislation is not considering climate change. So far, among the continents, only Europe has issued hard law to implement the Paris Agreement, in particular the EU's 2030 Climate and Energy Policy Framework (Oberthür, 2019, 18 ff.). Even the first pioneering Principle, that does not represent current law, can be an incentive for future legislation to transform into law those statements. This is, after all, the real meaning of soft law: pushing conducts that are beyond legislature, that look at the future. In addition, soft law is fundamental when the addressees belong to the entire world. Climate change is an international issue that must be dealt at the same time and following a convergent pattern by all jurisdictions otherwise single efforts are useless.

The WEF Principles represent a useful, practical instrument to design board of directors' climate governance. Convergence of corporations' conducts around the world is fundamental to effectively face such global emergency.

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