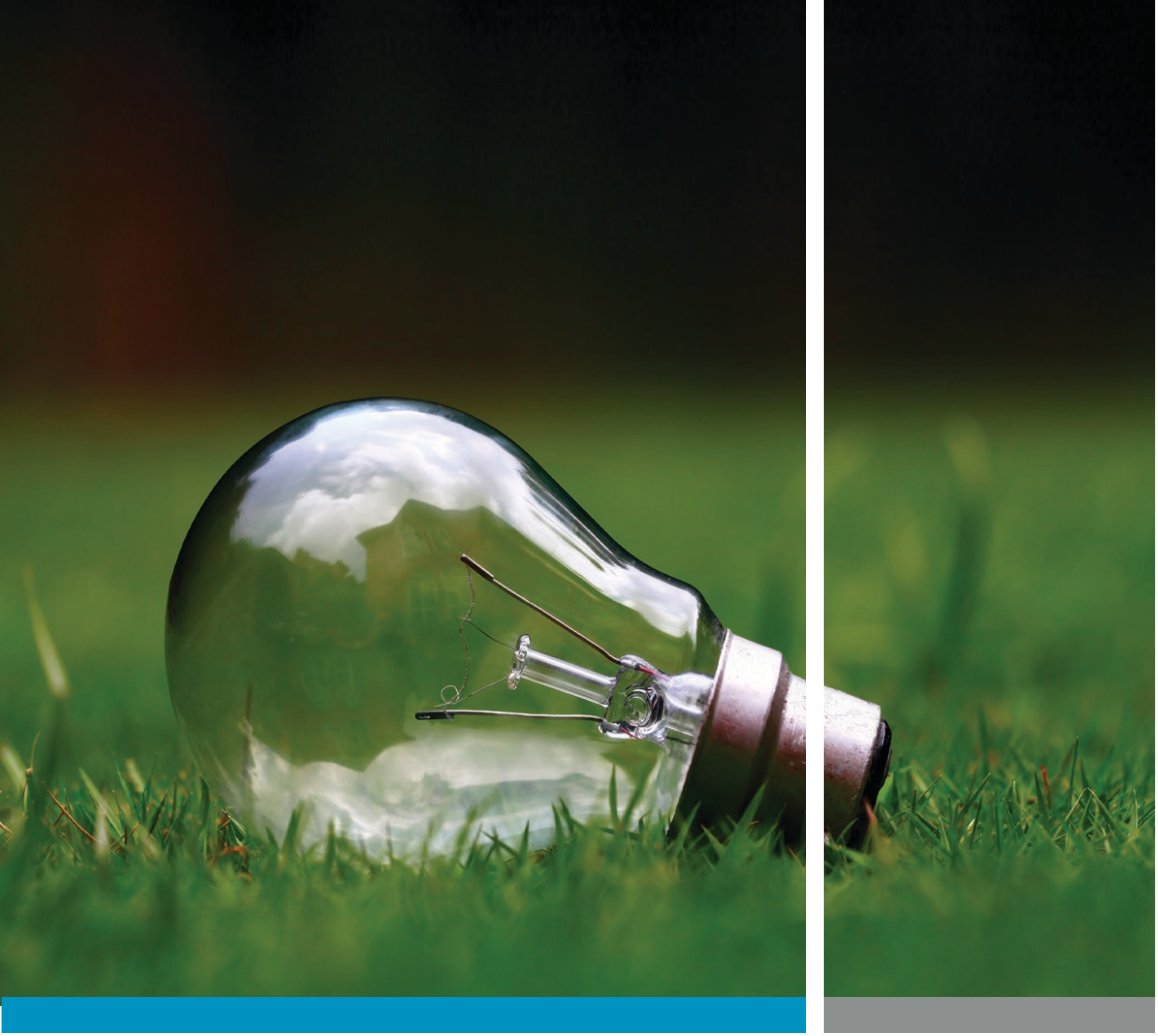

TAKING CLIMATE ON BOARD

Are Canadian energy and utilities company boards equipped to address climate change?

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Why climate change is a board-level issue

"…in a post-Paris world, the legal and financial risks associated with climate change must be a board-level issue"[1]

Climate change poses an unprecedented risk to global socio-economic, political, and bio-physical systems, and thereby threatens the ability of companies and investors to proceed with 'business as usual'.

However, because the exact physical, regulatory and legal implications are still unclear, the most pronounced risk is that corporate boards of directors will aim to do exactly that – proceed with business as usual – without fully understanding or addressing the risks climate change may pose to their business strategy.

Risk management is a fundamental responsibility of the board of directors. In order to manage risks effectively, boards of directors must have a full *understanding* of the risks to their business model.[2]

Consider a scenario in which you are a director of a Canadian energy company reviewing management's proposals for major capital expenditure plans. Are you considering the impact of changes in water availability in areas where you operate or plan to operate? Are you considering a range of scenarios for demand for fossil fuels over the next 10 to 15 years? Does this include a scenario that keeps greenhouse gas (GHG) emissions within a two-degree global warming limit?

Do you know which questions to ask to fully understand and consider the impact of climate-related risks to your plans?

If the answer to these questions is no, would you be meeting your responsibilities as a board?

How boards are or should be addressing climate change risks is a subject of increasing interest not only as a corporate governance issue but also as a legal question. A recent legal opinion found that Australian company directors "certainly *can*, and in some cases *should* be considering the impact on their business of 'climate change risks'" and furthermore, "… directors who fail to consider 'climate change risks' now could be found liable for breaching their duty of care and diligence in the future." [3]

Climate change issues are inextricably linked with areas of business like corporate strategy, risk assessment, capital expenditures, operations, trade, financial performance and asset valuation. How a company manages climate risks and opportunities now will impact its success in the long-term.

Shareholders elect and rely on boards of directors to provide strategic oversight and mitigate risks. Boards must keep up with the changing context in which they operate; the responsibilities and, therefore, the skills required on the board will naturally evolve to meet the changing demands.[4] And yet, in spite of the increasing recognition of climate change as a risk management issue for businesses, it is not clear that companies are acknowledging this risk at the board level, let alone positioning the company to address it.

Only 6 per cent of the 863 public company directors surveyed in the 2014 Annual Corporate Directors Survey by Price Waterhouse Cooper (PWC) stated that their board had "substantially" discussed climate change, while 56 per cent stated that their board had not discussed climate change at all.[5] In PWC's 2016 survey, only 6 per cent of corporate directors claimed that social or environmental risks pose the greatest oversight challenge to their board, which suggests either great confidence in the board's ability to address these risks, or that the full extent of climate risks is not well understood.[6]

Climate change 'competency'

*"**Climate Change Competency:** The degree to which board members bring to the table a demonstrated understanding of the climate change risks and opportunities their companies face, and how this may affect their company's strategic orientation"* [7]

Because climate risks are complex and multi-faceted, effective oversight at the strategic (i.e. board) level requires dedicated awareness of the issues and the ability to ask the right questions. Improving a board's climate change competency (also known as climate competency) starts with seeking directors with the right expertise and experience or developing that knowledge on the current board.[8]

The challenge for investors is that, based on public disclosures, it is difficult to discern the current level of climate competency on boards. Few companies include mention of whether their board members have climate competency when disclosing the range of skills and knowledge the board believes is necessary to oversee the company's strategic direction.

While many boards do address *environmental risks* in their committee and board mandates, the issues under consideration may be substantially different from the specific challenges emerging from climate change. Traditional environmental considerations might include, for instance, meeting regulatory requirements related to pollution and remediation, protected areas, and endangered species. Climate change poses its own multifarious risks and uncertainties that warrant their own consideration by a company's board. These might include changes in physical weather patterns, availability and access to natural resources, regulatory frameworks, and market conditions, amongst others.

Growing investor demand for climate competent boards

"…it is my duty as a director to review the steps being taken now by my companies to identify, assess, disclose and mitigate climate change risk."
– Russell Caplan, Director of Aurizon and former Chair of Shell Australia[9]

Investors are beginning to recognize that climate change will have impacts on their holdings, portfolios and asset values across the short, medium and long-term. Investors increasingly want to know about the risks associated with climate change that might affect the company,[10] and increasingly view oversight of material sustainability issues as part of a board's fiduciary duty.[11] As the impacts of climate change on businesses become more apparent, concerned investors are pushing boards to equip themselves to deal with the risks and opportunities that climate change presents.[12]

In 2016, for example, the largest pension fund in the US, California Public Employees Retirement System (CalPERS) updated its governance principles to affirm that climate change should be addressed at the board level. The principles state that companies owned by CalPERS should have board members with "expertise and experience in climate change risk management strategies"[14] and companies should assign climate change oversight to a "board member, board committee or full board."[15] In addition, a growing number of large institutional investors are putting forward shareholder resolutions calling for companies to appoint a board member with environmental or climate expertise.[16]

"Boards must have the information and agenda time to ask tough questions about carbon asset risk in their company business models and incorporate risk analysis into strategic planning."
– Richard Ferlauto, former deputy director of the SEC's Office of Investor Education and Advocacy and a member of the governing board of the 50/50 Climate Project[13]

How climate competent are Canadian energy and utilities company boards?

The Canadian energy and utilities sectors are associated with large emissions of greenhouse gases and are arguably facing the highest direct exposure to climate-related risks including regulatory, physical, legal, and stranded asset risks. One recent report estimates that together, the utilities and energy sectors account for 72 per cent of total GHG scope 1 and 2 emissions exposure within the S&P/TSX Composite Index.[17]

SHARE looked at the public disclosures of 39 companies in the TSX Energy sub-index and 13 companies in the TSX Utilities sub-index to determine how boards are disclosing risks related to climate change and the extent to which they are overseeing those risks.[18] The disclosures surveyed include the most recent company Annual Information Forms (AIFs), proxy circulars, board and committee mandates, company websites, and responses to the CDP Climate Change 2016 questionnaire.

SHARE's study examined company disclosures across three aspects: board skills and experience, oversight, and risk disclosure.

1. **Climate board skills and experience** - Do companies include climate change expertise or experience in their board skills matrices? An analysis of skills matrices and lists reported by companies to demonstrate the competencies of the board of directors.
2. **Climate risk oversight** - What board-level mandates or committees are in place to address climate-related risks and opportunities? Consideration of whether climate risk is incorporated into board committee mandates or whether companies have identified board-level direct responsibility for climate change.
3. **Climate risk disclosure** - What types of climate risks are companies disclosing in their public securities filings and CDP Climate Change responses? Identification and classification of any mention of climate-related risk in AIFs and CDP responses. We have adapted a framework for classifying climate related risks using five categories outlined in Box 1.[19]

This report is based on information gathered from publicly available sources and boards of directors were not surveyed directly. Therefore, this report reflects the relative importance boards are placing on climate risk and their expectations related to investor interest as represented in public disclosures.

It is possible that company practice is further ahead of company disclosure. Some boards may be engaged with the issue of climate change but have not yet clearly communicated this to investors. At the same time, others may include mention of the issue but are achieving little in practice.

For investors, having the right information is the key issue: it supports their capacity to fully assess the board's ability to oversee strategic risks. How well are boards communicating their interest and oversight of salient environmental, social and governance matters that concern investors and other company stakeholders?

Box 1. Climate risk categories

Regulatory Risk

The company acknowledges that business might be affected by changes in the regulatory environment, including through initiatives such as carbon pricing mechanisms, fuel standards, cap and trade programs, building codes, energy efficiency standards and environmental permits.

Physical Risk

The company acknowledges that business might be affected by the physical impacts of climate change, including changing weather patterns, changes in temperature, increased frequency of extreme weather events, rising sea levels, and changes in water availability.

Litigation Risk

The company acknowledges the risk that class action or other lawsuits related to climate change and/or greenhouse gas emissions may be brought forth by government bodies, communities, institutional shareholders or individuals.

Stranded Asset Risk

The company acknowledges that any of its current assets might become 'stranded' if climate change related regulation or activity changes the conditions (financial or otherwise) under which such assets were considered economical.

Reputational Risk

The company recognizes that a failure to address the impacts and risks associated with climate change could jeopardize the company's reputation, including consumer confidence, investor confidence, brand value and employee loyalty.

Key findings

What we found amongst Canadian energy and utilities companies

Climate board skills and experience

Most energy and utilities companies are disclosing board skill/competency matrices to investors. Eighty-five per cent of companies surveyed published a matrix or list of desired board experience and skills in their 2015 proxy circular. While board competency matrices are by their nature a simplistic summary of board experience, they do provide a useful overview to investors of the range of skills represented on the board, and moreover, the range of skills and experience valued by the board. Disclosure of a board matrix can help to identify gaps in board skills and competencies that need addressing and should be seen as a positive step towards good governance.[20]

Board competency matrices do not include climate change as a desired area of board competency, and very few companies report any climate-related experience of board members. Not a single company in the study referred to 'climate change' in their list or matrix of board skills and experience. Three companies had climate-related experience listed in at least one board member biography. From these findings, it seems that companies are not placing emphasis on demonstrating climate competency at the board level. Without proper disclosure of board climate competency, it is difficult for investors to know whether the board has the appropriate skills and experience to tackle climate risks.

Environmental experience was listed as a desired board competency by 38 per cent of companies in the utilities sector and 67 per cent of companies in the energy sector. However, in most cases, environment was mentioned as part of a broader reference to 'health, safety and the environment' (HSE), which would imply a focus on regulatory compliance. Whether this competency would extend to include long-term planning and consideration of the full range of climate risks was not specified.

Climate risk oversight

Board and committee mandates do not specifically mention climate change risk. Thirty-five per cent of companies identified the board, an individual or sub-set of the board, or other committee appointed by the board as having direct responsibility for climate change in their responses to the 2016 CDP Climate Change questionnaire.

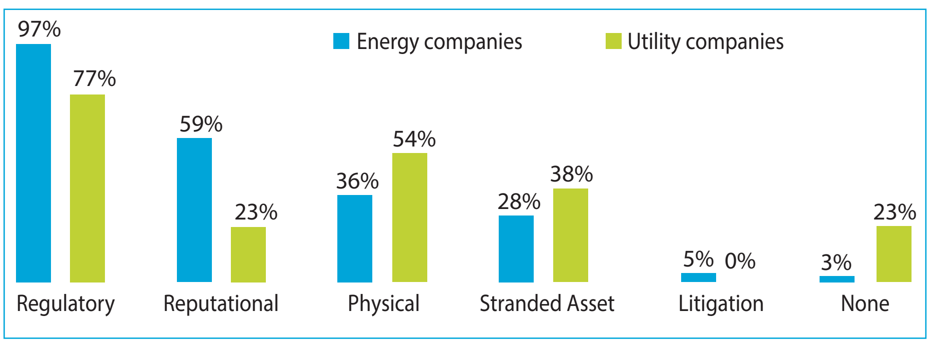
However, none of the companies surveyed explicitly reference climate change risk in board governance documents or committee mandates. In fact, 25 per cent of companies had no board documents or committee mandate that specifically address environmental risk, climate risk, or even risk more generally. While boards should be expected to consider any risks identified in the AIF, this consideration may be perfunctory. Referencing climate change or other risks in a board committee mandate demonstrates a heightened attention to the issue and a public commitment that tends to raise the profile of the issue within the board. With no mention of climate risk in board governance documents or committee mandates, it may fall lower on the list of priorities and never get properly addressed.

Climate risk disclosure

Climate-related risks are being discussed in AIFs and/or CDP responses, but companies tend to stick to a narrow definition of what constitutes climate risk. Most companies appear to be aware that they are exposed to some form of climate-related risk; 48 out of 52 companies surveyed disclosed some climate-related risk in their 2015 AIF or 2016 CDP Climate Change response. Many companies mentioned more types of climate-related risk in their CDP responses compared to their AIFs, highlighting the important role that CDP responses can play in providing information to investors.

The most frequent type of climate risk disclosed was regulatory risk; 92 per cent of companies, including all but one energy company, mentioned regulatory risks related to climate change in their reporting. Overall, there was more limited disclosure around other types of climate-related risks. For instance, only two companies referred to risk of litigation. An overview of the climate risk disclosure found is shown in Figure 1.

Figure 1: Climate risk disclosure by risk type



The sparse disclosure on physical and stranded asset risks is striking when contrasted with a growing body of research predicting wide ranging climate-related risks to carbon-intensive sectors such as utilities and energy.[21] One recent study calculated that in Canada, approximately 75 per cent of oil reserves, 24 per cent of gas reserves and upwards of 75 per cent of coal reserves are 'unburnable' before 2050 if we are to keep within a two-degree global warming limit.[22] Given the magnitude of this perceived risk, one would expect to see it mentioned more frequently by utilities and energy companies.

Conclusion

Public companies in some of Canada's most carbon-intensive sectors are not currently disclosing to investors the extent to which their boards are adequately equipped with the right skills and experience, comprehensive understanding, and proper oversight processes and systems to tackle the risks climate change poses to their businesses (see Appendix B for full description of study findings).

While, as noted above, most companies are starting to talk about climate change risk in their reporting, which is positive, this discussion is often limited. At best, this shows a lack of transparency, and at worst this suggests a lack of consideration of the broader strategic implications of a transition to a low carbon global economy.

Collectively, the findings of this study suggest that a gap exists between the acknowledgment of climate risks and the disclosure of specific competencies at the board level to address these risks. Whereas companies are broadly acknowledging climate risk, they are not disclosing how they are taking steps to establish the board competency that is necessary to adequately address this risk.

SHARE urges boards at publicly traded corporations to speak more forcefully and openly about their efforts to address one of the most serious challenges of our times. Long-term corporate strategy needs to take the risks and opportunities associated with climate change into account. Boards that develop a comprehensive understanding of the issues and place it firmly on their agenda will be better positioned to meet this challenge.

The transition to a low-carbon economy will be neither easy nor quick, but it is necessary and it is happening. In the face of that transition, the future value and sustainability of an energy or utilities company depends on its board's ability to demonstrate real climate competency and translate that into business planning for a low-carbon world.

Appendix A. List of companies and sectors reviewed

Energy

1. ARC Resources Inc. (ARX)
2. Advantage Oil and Gas Ltd. (AAV)
3. Baytex Energy Corporation (BTE)
4. Birchcliff Energy Ltd. (BIR)
5. Bonavista Energy Corporation (BNP)
6. Bonterra Energy Corporation (BNE)
7. Canadian Energy Services and Technology Corporation (CEU)
8. Canadian Natural Resources Limited (CNQ)
9. Cenovus Energy Inc. (CVE)
10. Crescent Point Energy Corporation (CPG)
11. Crew Energy Incorporated (CR)
12. Encana Corporation (ECA)
13. Enerflex Ltd. (EFX)
14. Enerplus Corporation (ERF)
15. Ensign Energy Services Inc. (ESI)
16. Freehold Royalties Ltd. (FRU)
17. Gran Tierra Energy Inc. (GTE)
18. Husky Energy Inc. (HSE)
19. Imperial Oil Limited (IMO)
20. Kelt Exploration Ltd. (KEL)
21. MEG Energy Corp. (MEG)
22. Mullen Group Ltd. (MTL)
23. NuVista Energy Ltd. (NVA)
24. Parex Resources Inc. (PXT)
25. Pason Systems Inc. (PSI)
26. Penn West Petroleum Ltd. (PWT)
27. Peyto Exploration and Development Corporation (PEY)
28. PrairieSky Royalty Ltd. (PSK)
29. Precision Drilling Corporation (PD)
30. Raging River Exploration Inc. (RRX)
31. Secure Energy Services Inc. (SES)
32. Seven Generations Energy Ltd. (VII)
33. ShawCor Ltd. (SCL)
34. Suncor Energy Inc. (SU)
35. Surge Energy Inc. (SGY)
36. TORC Oil and Gas Ltd. (TOG)
37. Tourmaline Oil Corp. (TOU)
38. Vermillion Energy Inc. (VET)
39. Whitecap Resources Inc. (WCP)

Utilities

1. ATCO Ltd (ACO)
2. Algonquin Power and Utilities Corp. (AQN)
3. Brookfield Renewable Energy Partners (BEP)
4. Canadian Utilities Limited (CU)
5. Capital Power Corporation (CPX)
6. Emera Incorporated (EMA)
7. Fortis Inc. (FTS)
8. Innergex Renewable Energy Inc. (INE)
9. Just Energy Group Inc. (JE)
10. Northland Power Inc. (NPI)
11. Superior Plus Corp. (SPB)
12. TransAlta Corporation (TA)
13. TransAlta Renewables Inc. (RNW)

Appendix B. Full description of findings

Indicator	Total	Energy companies	Utilities companies
***Metric*: Board skill or experience**			
Company publishes a matrix or list of board competencies	85%	82%	92%
Key term 'risk management' is included in the list of director skills or experience	62%	64%	54%
Key word 'environment' is included in the list of director skills or experience	60%	67%	38%
Key word 'climate change' is included in list of director skills or experience	0%	0%	0%
Company does not include climate change, risk management or environment in director skills or experience	31%	~	~
Company explicitly discloses director climate change experience or expertise	6%	3%	15%
***Metric*: Board oversight**			
Board has a separate risk committee	23%	15%	46%
Board has a mandate or committee that explicitly references environmental risk	73%	72%	77%
Board has a mandate or committee that explicitly references climate risk	0%	0%	0%
Board has no committee or mandate to specifically address risk, environmental risk or climate risk	25%	~	~
***Metric*: Climate risk disclosure**			
Company reports to CDP that the board or individual/ sub-set of the board or other committee appointed by the board has direct responsibility for climate change	35%	31%	46%
Company identifies climate-related regulatory risks	92%	97%	77%
Company identifies climate-related reputational risks	50%	59%	23%
Company identifies risk of stranded assets	31%	28%	38%
Company identifies climate-related litigation risks	4%	5%	0%
Company identifies climate-related physical risks	40%	36%	54%
Company makes no reference to climate-related risks	8%	3%	23%

Notes

[1] Sam Hurley, Policy Director, Centre for Policy Development, as cited in Future Business Council (FBC). "Australian company directors must consider and disclose climate change risks". Fiduciary Duties and Climate Change: Media Release. Retrieved on November 1, 2016 from http://www.futurebusinesscouncil.com/fiduciary_duties_media-release.

[2] For instance, see Office of the Superintendent of Financial Institutions Canada (OFSI). (2013). Corporate Governance: *Sound Business and Financial Practices*. Ottawa: Government of Canada.

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[4] Pp. 11-12 in Watson, E. (2015). 20 Questions Directors Should Ask about Building and Sustaining an Effective Board. Toronto: Chartered Professional Accountants of Canada.

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[6] P.31 in PWC (2016). *The swinging pendulum: Board governance in the age of shareholder empowerment: PwC's 2016 Annual Corporate Directors Survey*. Retrieved on November 1, 2016 from http://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/assets/pwc-2016-annual-corporate--directors--survey.pdf.

[7] P.3 in Murphy, S. E. (2016). *The top 25 U.S. Electric Utilities: Climate Change, Corporate Governance and Politics*. Washington and New York: Sustainable Investment Institute (SII) and The Investor Responsibility Research Center Institute (IRRCI).

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[12] Murphy, S. E. (2016). *The top 25 U.S. Electric Utilities: Climate Change, Corporate Governance and Politics.* Washington and New York: Sustainable Investment Institute (SII) and The Investor Responsibility Research Center Institute (IRRCI).

[13] Ferlauto, R. (2016, May 31). "Investors push for climate-competent boards." Corporate Secretary. Retrieved on September 22, 2016 from https://www.corporatesecretary.com/articles/boardrooms/13131/investors-push-climate-competent-boards.

[14] P.16 in California Public Employees' Retirement System (CalPERS). (2016, March 14). "CalPERS Revises Governance Policy, Adopts 12 Years as Threshold for Director Independence on Corporate Boards." Retrieved on November 1, 2016 from https://www.calpers.ca.gov/page/newsroom/calpers-news/2016/calpers-revises-governance-policy.

[15] P. 31 in California Public Employees' Retirement System (CalPERS). (2016, March 14). "CalPERS Revises Governance Policy, Adopts 12 Years as Threshold for Director Independence on Corporate Boards." Retrieved on November 1, 2016 from https://www.calpers.ca.gov/page/newsroom/calpers-news/2016/calpers-revises-governance-policy.

[16] For instance, see Loving, J. (2016). "Dominion Add Board Member with Climate Expertise 2016." *Ceres - Shareholder Resolutions*. Retrieved on September 22, 2016 from https://www.ceres.org/investor-network/resolutions/dominion-add-board-member-with-climate-expertise-2016.

[17] CIBC. (2016, October 10). "Carbon Risk Is Difficult To Predict And Manage." *CIBC Institutional Equity Research*. Toronto and New York: CIBC World Markets Corp./Inc.

[18] For a full list of companies, see Appendix A.

[19] For an example of other climate risk categories, see Financial Stability Board Task Force on Climate-Related Financial Disclosures (FSB TCFD). (2016). *Phase 1 report of the Task Force on Climate-Related Financial Disclosures*.

[20] Governance Institute of Australia. (2015). Good Governance Guide: Creating and disclosing a board skills matrix.

[21] For instance, see Sustainability Accounting Standards Board (SASB). (2016). *Climate Risk Technical Bulletin* (B001-10182016). San Francisco: Sustainability Accounting Standards Board and see Carbon Tracker Initiative (CTI). (2013). *Unburnable carbon 2013: Wasted capital and stranded assets.* Carbon Tracker Initiative and the Grantham Research Institute on Climate Change and the Environment.

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