Climate Commitments: Key Learnings from the 2021 Proxy Season and Implications for Canadian Companies

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While the “S” pillar of ESG may have held the spotlight for much of 2020 given the compounding impacts of the pandemic and social justice issues on workplaces/people, the 2021 proxy season made it apparent that the “E” has not gone away, and in fact the expectations for actions and clear disclosure has accelerated. This piece provides an overview of the **current pressure on emissions targets in the energy sector, including highlights from the 2021 US proxy season and the implications for Canadian companies and smaller producers**.

Shareholder Activism Towards Major Oil Companies

Many industry observers were caught by surprise by the activist shareholder and legal action taken towards oil majors ahead of their 2021 AGMs:

ExxonMobil –A complicated set of issues led to three dissident directors being elected to the Board. At the heart of the conflict was activist shareholder concern about the company’s lack of progress on emissions reduction and energy transition. The dissidents questioned the perceived lack of industry experience on the Board and raised concerns that the executive compensation programs focus too much on production and growth and do not have enough rigour with respect to emissions targets, nor do they incentivize management to consider the opportunity of an energy transition.

https://fortune.com/2021/05/26/exxonmobil-agm-landmark-vote-shareholders/

Chevron – 61% of shareholders voted in favour of a proposal to cut “scope 3 emissions”, meaning all indirect emissions that occur in the value chain of the company – in other words, the emissions of all of the company’s suppliers and customers. The proposal does not require Chevron to commit to a reduction target by a set date, and while the concept of reducing Scope 3 emissions is somewhat contentious among the investor community, the 61% shareholder support for the proposal shows the growing frustration with companies that are perceived as lacking in their commitment to proactively managing their contributions to climate change.
https://cn.reuters.com/article/chevron-agm-idCNL3N2ND3WU

Royal Dutch Shell – A Dutch court ordered Royal Dutch Shell to reduce its emissions more quickly than set out in the company’s existing climate policy. The Dutch court ordered the company to reduce its emissions by 45% by 2030 relative to their 2019 levels; this compares to Shell’s existing climate commitment to reduce emissions 20% by 2030, 45% by 2035, and to become net zero by 2050. While Shell intends to appeal the ruling, this landmark legal case could cause companies, regulators, and legislators to put further pressure on emissions reduction targets. https://www.reuters.com/business/sustainable-business/dutch-court-orders-shell-set-tougher-climate-targets-2021-05-26/

It is notable that the pressures on emissions targets continue to originate primarily from shareholders, and those shareholders are moving beyond engagement with companies to leverage a range of tactics including proxy contests, shareholder proposals, and the legal system.

Implications for Canadian Companies

Although Canadian TSX60-listed companies did not experience a high degree of public shareholder activity this proxy season, we believe the pressure to make direct commitments as to emissions reductions and energy transition (and to provide related disclosure) will make its way North of the border – if it isn't already here. While many companies in the oil and gas industry have been working to develop and communicate their emissions and energy transition strategy, the shareholder events noted above may accelerate initiatives that are already underway. In recent weeks, announcements of such as the "Oil Sands Pathway to Net Zero" initiative (an alliance between the five largest producers, representing 90% of oil sands production - https://www.oilsandspathways.ca/) and the "Alberta Carbon Grid" partnership between Pembina Pipeline Corporation and Trans Canada energy (https://www.pembina.com/operations/projects/alberta-carbon-grid-proposed/), were made, demonstrating that emissions and carbon footprint reduction are top of mind for many of Canada's largest energy sector players.

Beyond the energy sector, Hugessen's 2021 review of TSX60 proxies showed 54 companies disclosed a climate-related goal in their 2021 proxy, with 25 of them declaring a net zero/carbon neutral goal and 2050 being the most common timeframe for achievement. While most of the companies with such targets are in the resource sectors (oil and gas or mining), all of the big banks (BNS, RBC, TD, BMO, CIBC, National Bank) have also declared net zero goals. As the banks tend to be on the leading edge of governance trends, we expect to see greater adoption and disclosure of climate-related goals to continue to evolve at a rapid pace.

Although the proxy advisors (ISS and Glass Lewis) and institutional shareholders have yet to explicitly request Canadian companies communicate their intentions with regards to emissions targets, these conversations may be starting to occur behind closed doors. The increasing amount of space dedicated to the ESG portion of proxy advisor reports and voting guidelines suggests that Boards are being pressured to lean in on this issue. While continually evolving, more insight on ISS & Glass Lewis' voting guidelines with regard to the Board's role in ESG management can be found here: https://www.hugessen.com/en/news/iss-glass-lewis-update-guidelines-2021-canada.

Another indication of the growing pressure on Boards and Companies to be able to articulate their stance on emissions targets and other climate related issues is the introduction of "Say on Climate" which provides shareholders the opportunity to vote on a Company's climate transition action plan. To date, only two Canadian companies (CN Rail and CP Rail) have committed to adopting a non-binding "Say on Climate" vote, however, Glass Lewis notes it has arguably been the most dominant issue of the 2021 proxy season globally. While it is early days, we expect the number of companies implementing Say-on-Climate votes will increase as climate activism increases and stakeholders demand high quality disclosure on ESG related strategy, goals, and metrics, particularly in the resource sector.

While developing and communicating ESG strategy and targets often falls under the purview of management, it has become clear that oversight of ESG is a core Board responsibility. As noted above, shareholder activism can be targeted at directors (as was the case at Exxon), and stakeholders expect the Board to drive the ESG strategy

forward and hold management accountable. Shareholders are beginning to show willingness to express their dissatisfaction by voting against directors, and often there is a spotlight on the Board Chair and other key Committee Chairs (e.g., Governance & Compensation).

Recognizing this is a complicated issue, we offer the following to provide directors with some initial considerations:

- While it may be stating the obvious, if your Board has yet to develop an ESG strategy (including a plan for emission reductions), turning your minds toward developing a plan is critical
- If your Board does have a clear ESG plan and strategy, consider whether is it being effectively communicated externally, beyond a traditional "Corporate Social Responsibility" report
- Considering director led engagement with stakeholders on this topic
- Although it may be premature for some organizations to incorporate quantitative emission reduction targets in executive incentive plans, Boards can begin to consider how a focus on reducing emissions and energy transition may impact traditional measures of success/performance
    - For example, how do you set targets/measure success using a carbon-adjusted return for measurements such as ROE and ROCE? How will this change the typical goal/metric setting process?

Regardless of where a company is in developing its emissions strategy and related disclosure, the focus on climate change is coming at directors from many perspectives (not just institutional shareholders) and is gaining momentum rapidly. While the traditional role of the director is to make decisions regarding the affairs of the business and provide governance oversight, stakeholders expect directors to be accountable regarding all aspects of strategy, including energy transition. Recent events have displayed the willingness of shareholders to be bold and act if they believe a company (and its Board) is falling short.

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