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TRANSFORMING THE RISK OF CLIMATE CHANGE INTO A CANADIAN OPPORTUNITY

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OVERVIEW

Global greenhouse gases ("**GHGs**") have continued to increase at an alarming rate, despite the various global initiatives undertaken over the past three decades to mitigate the risks of climate change to the world economy, and the relatively material impact of environmental, social, and governance ("**ESG**") investing on corporate behaviour in recent years.

Few doubt the global impacts of climate change, or "climate disruption," as some commentators have, perhaps, more aptly described it. Yet, the collective efforts of several organizations; the holding of annual global climate summits; the publishing of numerous books and studies on the subject; the warnings of leaders stretching as far back as Margaret Thatcher and, more recently, including Angela Merkel, Ursula von der Leyen, and Mark Carney; and the movement of trillions of dollars into ESG investments, collectively have resulted in very little progress.

Arguably, tackling what author, Frank Incropera, terms the "wicked problem" of climate change[1] will ultimately require a global solution that can survive continual domestic political setbacks, such as the proposed withdrawal of the United States from the *Paris Agreement* effective November 4, 2020.[2]

THE CATALYZATION OF GOVERNMENT AND BUSINESS

The climate change challenge can be viewed and addressed through a uniquely Canadian lens. As we observed in our previous paper, "Made in Canada: How ESG Can Assist with the Transition to a Greener Economy,"[3] Canada has a reputation for high governance standards and Canadian companies are known for their commitment to corporate social responsibility. These characteristics have been of real assistance to Canadian companies in doing business around the world.[4] A national action plan to reduce carbon emissions could be developed, based on this uniquely "Canadian ethos." Such a plan would require the catalyzation of government and business.

There are precedents for such coordinated efforts by government and business leaders, particularly in times of national crises. In 2008, when the world was faced with an epic financial crisis, Canada's economy fared much better than other western economies, largely due to the cooperative efforts and leadership of Canadian businesses and the Bank of Canada.[5] As a result, Canada's economy and its banking system emerged relatively unscathed.

DEVELOPING A COHERENT, NATIONAL ACTION PLAN

This level of cooperation between business and government is a testament to Canadian best practices and business ethics in action. It also represents a good model for the kind of cooperative crisis management that is needed to fashion a national action plan to address the climate change challenge.

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[1] Incropera, Frank. "Climate Change: A Wicked Problem," *Cambridge University Press*, October 2015.

[2] The United States gave notice of its proposed withdrawal from the agreement on November 4, 2019. The withdrawal is to be effective as of November 4, 2020.

[3] Mingay, Cam and Phillips, Jackson. "Made in Canada: How ESG Can Assist with the Transition to a Greener Economy" (February 15, 2020).

[4] "Blake Hutcheson in conversation with Bruce Flatt: Real Estate and the Global Investment Landscape: The state of the industry and where it will go from here." Speaking engagement at the Empire Club of Canada on November 28, 2019. See also Brookfield Asset Management Inc. Q3 2019 Interim Report dated November 14, 2019, pages 7 and 8.

[5] "Canada dodged the worst of the Financial Crisis, and it wasn't just dumb luck," *Financial Post* (September 18, 2018).

The development of a coherent, national solution to the climate change problem would require: (i) recognition of the nature of the "wicked problem"; (ii) development of a plan to jointly mitigate the carbon emissions of individual businesses; (iii) encouragement of buy-in and the willingness to take action; (iv) identification of the tools to finance innovation; and (v) the creation of centers of excellence for technological innovation.

While achievable, a Canadian-centric action plan would require multiple behavioural changes underpinned by elusive concepts such as good governance, a "Canadian ethos," and a deep-rooted belief that capitalism is continually evolving and becoming more sustainable and socially responsible along the way. While such ideas are gaining currency, they have not yet become widely accepted or part of mainstream thinking.

ZERO CARBON TARGET ANNOUNCEMENTS

Recent announcements by leading companies of their intentions to achieve carbon neutrality by certain future dates have bolstered the feasibility of such a plan. In the past few months, Microsoft, BP,[6] Teck Resources,[7] and Cenovus[8] — all prominent players in diverse industries — announced their respective intentions to achieve carbon neutrality by various future dates. Most committed to a percentage target improvement by 2030 and with the goal of full carbon neutrality by 2050, in accordance with the 2015 Paris Agreement.

Within the past few months, Jeff Bezos[9] and Microsoft each announced multibillion-dollar investment commitments to identify and develop technologies to combat climate change. Microsoft's President, Brad Smith, observed in a recent Microsoft blog:

> Solving our planet's carbon issues will require technology that does not exist today. That's why a significant part of our endeavor involves putting Microsoft's balance sheet to work to stimulate and accelerate the development of carbon removal technology.[10]

Likewise, the world's largest asset manager, BlackRock Inc., announced sweeping changes to its investment approach in a recent letter to CEOs by BlackRock Inc.'s Chairman and Chief Executive Officer, Larry Fink. A signatory to Climate Action 100+, Blackrock Inc. proposed pushing investee companies to set science-based emissions reduction targets.[11]

ALLEGATIONS OF "GREENWASHING"

While these public announcements of zero carbon targets appear both dramatic and laudable, skeptics have questioned just how realistic these public pledges are in the absence of detail regarding the costs and specific actions necessary to achieve carbon neutrality. They have alleged that these pledges were made to (among other things) quiet critics; placate shareholders; satisfy environmental assessment criteria; or attract ESG investors.

Indeed, a February 21, 2020, *Financial Times* article[12] reported that a record $21 billion flowed into ESG investment funds in the United States alone, and that companies with the top ESG rankings were trading at a

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[6] "BP Sets Ambition for Net Zero by 2050, Fundamentally Changing Organisation to Deliver," BP Press Release (February 12, 2020).

[7] "Teck Announces Goal of Carbon Neutrality by 2050," Teck News Release (February 3, 2020).

[8] "Cenovus aims for 'net zero' GHG emissions by 2050," CBC (January 9, 2020). See also "Climate & greenhouse gas (GHG) emissions."

[9] https://techcrunch.com/2020/02/17/jeff-bezos-announced-a-10-billion-fund-to-fight-climate-change/

[10] "Microsoft will be Carbon Negative by 2030," Microsoft Blog (January 16, 2020).

[11] https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter

[12] "'Monstrous' Run for Green Stocks Stokes Bubble Fears," *Financial Times* (February 21, 2020).

30 percent premium to the poorest performers. Despite the lack of consistent metrics on which ESG claims are being assessed, the movement of large pools of capital into ESG investments provides a major impetus for "jumping on" the carbon reduction "bandwagon" to attract capital and avoid being stranded.

CARBON NEUTRALITY AND CORPORATE SELF-INTEREST

Nonetheless, these announcements may belie a paradigm shift in the approach of businesses to the climate crisis; it is no longer farfetched to suggest that businesses may reap benefits from proactively altering their carbon-emitting behavior. Without specific regulations or the imposition of dramatically higher carbon taxes, businesses are recognizing that the pursuit of carbon-reducing strategies aligns with their self-interest.

Carbon neutrality target announcements also align with the proposition underlying our proposed national action plan — namely, that companies should take it upon themselves to act. While any company making such an announcement should be given the time needed to identify, plan, and cost out the requisite measures to mitigate carbon emissions, backing up such an announcement with a written plan — proposing actions to be taken promptly and identifying a common set of rigorous measures to ensure transparency and comparability — could go a long way towards quelling accusations of "greenwashing" and a lack of scenario analysis.[13]

This paradigm shift removes several of the "wicked" aspects of the climate change problem. First, the shift recognizes that the challenge of climate change is urgent, requiring immediate action. Second, it accelerates the pace of tackling the climate crisis by removing the need for coherent, enforceable global regulations to incite meaningful change. This shift in perception may herald a shift in the focus of global capitalism towards the search for cost-effective technologies to combat climate change.

THE SCIENCE-BASED TARGETS INITIATIVE: A RELIABLE AND ROBUST PROTOCOL

The carbon reduction claims being made by companies should be capable of transparent and comparable assessment. They should also be independently verified and reported so that investors and other stakeholders are not required to make their own determinations.

The *Science-Based Targets Initiative* ("**SBTi**") — a collaboration between the CDP (formerly the "Carbon Disclosure Project"), the United Nations Global Compact, the World Resources Institute, and the World Wildlife Fund for Nature[14] — arguably represents a reliable, robust protocol for the validation of companies' carbon mitigation plans. The SBTi showcases companies that set science-based emissions reduction targets; defines and promotes best practices in science-based target setting; and independently assesses and approves companies' targets.

A good example of an organization that has adopted a robust carbon emissions quantification technology is The Atmospheric Fund ("**TAF**"), a regional climate agency that invests in — and helps scale up — low-carbon solutions for the Greater Toronto and Hamilton Area. The goal of TAF is for the GTA to be carbon neutral by 2050.

[13] "Google, Microsoft and the strange world of corporate greenwashing," *Wired* (January 31, 2020).

[14] "About the Science Based Targets Initiative," Science Based Targets.

WIDESPREAD ACCEPTANCE AND ADOPTION

Gaining widespread acceptance and adoption of the SBTi's common set of measurement and mitigation standards in Canada would be the next significant hurdle. While the difficulty of this task should not be underestimated, a precedent exists for the implementation of a similar disclosure system.

In 2017, under the auspices of the Financial Stability Board and launched by the G20, the Task Force on Climate-related Financial Disclosures ("**TCFD**") published a widely-endorsed report that called for voluntary, consistent, climate-related risk disclosures for use by companies.[15] This disclosure system has been gaining acceptance internationally and has kick-started the process of engaging businesses in recognizing the importance of acknowledging the risks of climate change.

In August 2019, the recommendations of the TCFD were adopted by the Canadian Securities Administrators ("**CSA**") in Staff Notice 51-358, "*Reporting of Climate Change-related Risks"* ("**Staff Notice 51-358**"). That Staff Notice outlined the relevant factors for consideration in assessing the materiality of climate change-related risks; provided examples of some of the types of climate change-related risks to which issuers may be exposed; and included questions for boards and management to consider in the climate change context.

Staff Notice 51-358 also provided an overview of the disclosure requirements for issuers who chose to disclose forward-looking, climate change-related information. Currently, over 1,000 organizations, representing a combined market capitalization of nearly $12 trillion, support the TCFD.[16]

COMPARABLE REPORTING REGIMES

CSA National Instrument 43-101 — *Standards of Disclosure for Mineral Projects* and CSA National Instrument 51-101 — *Standards of Disclosure for Oil and Gas Activities* also provide examples of comparable reporting regimes: both Staff Notices require natural resource and oil and gas companies to (respectively) consistently report on their mineral and oil and gas reserves and extraction operations in a manner that is verifiable by experts.

Such reporting regimes allow investors, analysts, and other stakeholders to evaluate performance on a consistent basis. As in the financial sector, companies who made outrageous claims about their carbon reduction goals would be ultimately held to account.

THE CASE FOR PUBLIC REPORTING

A national action plan would take the TCFD's recommendations one step further, albeit in a similar "comply or explain" vein. In the same way that climate-related financial disclosure is commonly being reported in companies' audited financial statements, the adoption of SBTi's measurement and mitigation standards may lead to companies publicly reporting their carbon mitigation plans against such standards. This kind of reporting would be comparable to reporting a company's performance against its financial forecasts.

Encouraging Canadian companies to adopt ambitious, proactive, and transparent carbon mitigation plans, and convincing them of the merits of the SBTi as a reliable and robust protocol, would: give Canadian companies a global advantage in accessing ESG investment; enhance Canada's reputation for sound governance, risk

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[15] Task Force on Climate-related Financial Disclosures. "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures" (June 2017).

[16] "More than 1,000 Global Organizations Declare Support for the Task Force on Climate-related Financial Disclosures and its Recommendations," Task Force on Climate-related Financial Disclosures Press Release (February 12, 2020).

management and regulation; and establish Canadian companies as leaders in the shift towards an innovative, sustainable economy.

The pursuit of such an action plan may, one day, lead to the release of carbon emissions being considered akin to the release of hazardous or toxic materials and, accordingly, no longer be viewed as someone else's problem.

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