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Defining and Driving ESG Within Your Organization

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ESG: Why It Matters to Your Business

In January and February 2021, Bennett Jones hosted a three-part webinar series focusing on why ESG matters and how business leaders can drive ESG performance within an organization. This paper highlights the key takeaways from these sessions.

The term Environmental, Social and Governance, or ESG, refers to a broad set of issues or criteria relating to corporate behaviour and performance that generally fall outside of the traditional financial performance indicators. ESG issues might include, for example, how a company responds to climate change, how it supports equity, diversity and inclusion within its workforce, and how its board and management structures and corporate policies support ethical, accountable and transparent practices.

There has been a sharp increase in the focus on ESG issues across Indigenous communities and all stakeholders. Investors are increasingly evaluating the strength of a company's ESG performance as part of their investment decisions. Sound ESG practices have been linked with stronger operational performance, valuations and higher returns, and many investors are using ESG criteria to decide how to allocate capital. We are also seeing an increasing interest in ESG from other stakeholders. Employees often identify ESG performance as an important factor for retention and motivation within the workplace. Customers are increasingly looking to do business with companies and brands that are aligned with their personal societal values. There is no doubt that the momentum of ESG is accelerating, driven in part by factors such as the pandemic, social justice and ever-growing environmental concerns. Companies are responding by building resilient and sustainable business models.

Factoring ESG considerations into corporate decision-making is not new. There has been a shift over many years away from a shareholder-centric form of corporate governance, where decision-making focuses on short-term value and immediate profits, to a more holistic approach that considers multiple factors and interests as part of the overall sustainability and best interests of the business. This shift is occurring in public policy, legislation, and the general environment in which organizations operate.

When it comes to implementing ESG factors within an organization, it is not a one-size-fits-all approach. Rather, ESG platforms must be customized to address each company's unique circumstances—including the type of business, the sector, the geographic location of operations, supply chains, and importantly, the nature of the ESG issues that are of importance to the organization's communities and stakeholders. ESG provides a means by which organizations can identify these priority issues for their business, and implement systems to take an active, rather than passive, approach to managing them. In doing so, ESG values and considerations can be embedded within an organization in order to integrate these values and considerations into the core business strategy.

Recordings of the webinar series are available at BennettJones.com/ESGSeries


CSR
Sphere of Influence
ESG
Environmental
Social
Governance
Working with Governments
Investor Relations
Stakeholder Engagement
Reporting & Disclosure
Environment
Labour & Supply Chain
Product & Consumer Responsibility
Community Engagement & Investment
Indigenous Rights
Impact Investment
Alternative Legal Entities
Cybersecurity Risk Management

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The Legal Framework for ESG-Based Decision-Making

The legal foundation for ESG-based decision-making by corporations in Canada is set out in legislation as well as the common law. There are two principal duties imposed on directors of corporations in Canada. This includes the duty to act honestly and in good faith with a view to the best interests of the corporation, and the duty to exercise the care, diligence and skill that a reasonably prudent person would exercise in similar circumstances. It has long been accepted by the courts in Canada that a director's duty to pursue the best interests of the corporation is not confined to the short-term profits or immediate share value of the corporation.

In two frequently-cited decisions of the Supreme Court of Canada (*Peoples Department Stores Inc (Trustee of) v Wise* (2004)[1] and *BCE Inc. v 1976 Debenture Holders* (2008)[2]), the Supreme Court held that the "best interests of the corporation" are not solely aligned with the "best interests of shareholders" and that boards can look to other stakeholders, such as employees, suppliers, consumers, the government, and the environment, and that directors have a fiduciary duty to consider the longer-term interests of the corporation (assuming that the corporation is an ongoing concern).

The *Canada Business Corporations Act* (CBCA)[3] was amended in 2019 to codify these decisions, and section 122 of the CBCA now expressly provides that, when acting with a view to the best interests of the corporation, the directors and officers may consider a broader group of stakeholder interests, including the interests of shareholders, employees, retirees, consumers, government, the environment and long-term interests of the corporation (and this is not intended to be an exhaustive or exclusive list).

The legal framework in Canada therefore supports, and in some cases, requires, directors to make decisions that consider ESG issues and priorities for the business as part of the overall duty to act in the best interests of the corporation.

ESG Reporting

Reporting and disclosure is at the heart of demonstrating ESG performance.

ESG reporting creates a number of opportunities for organizations. They can be proactive and shape their own narrative and enhance their ability to attract investment. This is the case for both public and private companies. ESG reporting is another avenue for stakeholder and rights-holder engagement and for organizations to demonstrate they have incorporated stakeholder and rights-holder concerns into their decision-making processes.

There are challenges with respect to disclosure of ESG issues of which companies must be aware.

Securities legislation generally requires public companies to disclose material risks affecting their business, which can include ESG issues. Securities administrators in Canada have issued guidance to public companies with respect to assessing and reporting material issues in continuous disclosure filings, including, for example, with respect to environmental and climate risks.

Voluntary ESG reporting is not standardized and there are a multitude of voluntary disclosure frameworks for organizations to consider. Voluntary disclosure on ESG matters is largely based on guidance. The issue becomes one of determining the appropriate level of disclosure that is material, transparent and relevant to a company's stakeholders, Indigenous communities, and its business. Companies need to be careful that information disclosed under a voluntary ESG framework is not inconsistent with their other disclosures, which can open the door to an unclear disclosure picture, and potential liability.

Over the last few years, we have seen an increase in the number of shareholder proposals, litigation and regulatory action being commenced in relation to ESG-related disclosure, many of which relate to a perceived failure by organizations to include in their public disclosure an adequate response to ESG matters, inconsistent disclosure or the failure to inform stakeholders of ESG matters that are viewed by such stakeholders as material to business operations. More shareholder proposals around ESG disclosures can be expected in the future, as well as litigation and regulatory action. Organizations need to consider the breadth and scope of their ESG disclosure, whether voluntary or pursuant to public company disclosure obligations, to ensure that disclosure is effective and reliable, taking into account the facts, risks and opportunities that are material to their business and stakeholders.

Although much of the pressure for the implementation of ESG measures has been driven by public market investors and concerns, ESG strategies and performance are important to private companies as well as public companies. The stakeholders and local communities where private companies operate will evaluate the company based on their ESG performance. Private companies may seek to go public or to sell their business in the future, and ESG performance can enhance the attractiveness of the company in these scenarios.

Environment

Environmental issues have a significant impact on the strategy and long-term sustainability of many businesses. Investors and other stakeholders are increasingly looking to understand how a company impacts the natural environment, how environmental issues may impact a company's viability over the long term, and what steps the company is taking to manage, mitigate and adapt to environmental issues.

While compliance with environmental regulatory requirements is an important driver with respect to ESG performance, it is only the starting place. Stakeholders are interested in a broad range of environmental issues, including emissions, waste generation, product stewardship, energy consumption, water stewardship, use of non-renewable resources, reclamation and impacts to land, biodiversity, among others.

An ESG strategy should reflect the company-specific environmental issues that are most impactful to the business, local communities, stakeholders, and reflect how the communities and stakeholders can impact the business. This is a dynamic exercise; environmental priorities can change, including as a result of regulatory developments and shifts in public opinion, local community considerations and stakeholder concerns.

Survey results repeatedly indicate that businesses that transition to an ESG focus report a number of benefits separate from meeting the demands of investors interested in ESG information. This includes, for example, increased buy-in and attention from multiple levels within the organization with respect to environmental concerns, resulting in more robust and resilient management of environmental issues. Businesses often attribute improvements in innovation and new products and services, cost control, brand support and relations with local communities and government regulators as a direct result of implementing ESG systems within the organization.

Reporting environmental information and performance metrics is a key component of an ESG strategy. There is a myriad of ESG reporting frameworks and criteria that are being used to report ESG information. The lack of standardization can make it challenging. However, companies have to determine an approach to disclosure that best aligns with their needs, factoring in the environmental metrics that the company wants to highlight as well the expectations of stakeholders, and Indigenous communities, while also considering the increasing standards in their industry.

Businesses should be careful when reporting environmental objectives or goals as part of an ESG strategy. Such commitments should be thoroughly assessed to confirm that they are reasonable and achievable, the risks to meeting such goals have been appropriately identified and considered, and that steps will be implemented to track and support the attainment of such commitments. Companies should consider whether additional data or information will be collected, how it will analyzed, and whether information will be audited or verified prior to reporting. Reporting of environmental performance measures can yield significant benefits. However, this information can also, in effect, become a part of the standard of care or the lens through which the business' actions will be evaluated, by the public as well as others, such as regulators, and therefore, it must be done carefully.

Climate Change: GHG Emission Reduction Requirements and Carbon Pricing

Climate change is a significant ESG factor for businesses across many sectors. For organizations that are large emitters of greenhouse gases (GHGs), compliance with climate change legislation and identifying opportunities to reduce their footprint is often the cornerstone of an ESG strategy. As government legislation and policies continue to mature, become more prescriptive and far-reaching, Canadian companies need to understand not only the compliance requirements of such legislation, but the opportunities that they present as well.

Historically, regulation of GHG emissions had been left to the provinces, resulting in a patchwork of different regulatory approaches. Recently, the federal government enacted the *Greenhouse Gas Pollution Pricing Act*[4], commonly referred to as the Federal Backstop, which establishes a federal emission reduction requirement on large emitting facilities (large emitters) as well as a carbon tax on certain fuels, all of which are informed by a prescribed carbon price (currently $40/tonne of CO_2e). Provinces may pass their own climate change legislation, with the Federal Backstop only applying to the extent such provincial legislation fails to satisfy the Federal Backstop's minimum requirements. The federal government has announced its intention to raise the carbon price above the $50/tonne of CO_2e in 2022, by annual $15 increments, arriving at a carbon price of $170/tonne of CO_2e in 2030.

In addition, the federal government recently released draft Clean Fuel Regulations, anticipated to take effect in late 2022, which will require the life cycle carbon intensity of certain liquid fuels to be reduced by the importers or refiners of such fuels (primary suppliers).

The Federal Backstop, draft Clean Fuel Regulations and most of the provincial climate change regimes contemplate mechanisms whereby carbon credits can be created, traded and ultimately applied, to satisfy a GHG emission reduction requirement. As a result, a nascent carbon credit market has emerged, with large emitters/primary suppliers as consumers of such credits on the one side, and carbon credit project proponents as suppliers of such credits on the other side.

Climate change risks and opportunities will continue to evolve as Canada transitions to a low-carbon economy. Many sectors of the economy are being, and will continue to be, impacted by this transition. ESG systems can help organizations identify and implement climate strategies that support the long-term sustainability and viability of the business.

Project Management and Approvals

ESG is an opportunity for companies to think broadly about their life cycle, how to become more resilient and how to communicate their story to investors, regulators and the public. The life cycle of a project breaks down into three areas—approval, operations, and end of life liabilities. From an environmental perspective, there are opportunities to build and establish an "E" profile throughout a project's life cycle. The focus on the environment is nothing new to companies in the Canadian resource sectors.

The environment can be the trigger to move to different technologies or develop new ones. Many are high-tech, such as data accumulation and sophisticated analysis using artificial intelligence (AI) to find efficiencies. Innovations or changes in environmental technology can be costly at the outset, but over the life of the project can result in cost savings. We are also seeing that investors are increasingly valuing the non-financial ESG performance factors of a corporation when making investment decisions.

There are tremendous opportunities for projects that will benefit the environment in Canada. The hydrogen industry is an exciting development across the country. There is a great deal of activity in renewables, solar, wind, geothermal and biomass. Carbon capture and storage is attracting a lot of attention and new opportunities are developing in reducing methane emissions, managing water supplies, reducing land impacts and protecting biodiversity.

Indigenous Communities

Indigenous participation is relevant to all three ESG pillars—environmental, social and governance—and is multi-faceted. There continues to be an increase in the influence and autonomy of Indigenous peoples and a shift in non-Indigenous peoples' understanding of the content and scope of Indigenous rights and interests. This growth is supported in, and reflected in, legislation, government policy, public and investor expectations, and an organization's decision-making criteria.

Canada's existing duty to consult and related jurisprudence created as part of section 35 of the *Constitution Act*, 1982[5] has historically underpinned the legislative basis for government and organizations ensuring Indigenous participation in decision-making. Recent legislation such as the federal *Impact Assessment Act*[6] and British Columbia's *Declaration on the Rights of Indigenous Peoples Act*[7] continues governmental efforts to advance reconciliation by further increasing Indigenous participation, self-governance, and self-determination.

Similarly, companies, especially those in the natural resources sector, have led Indigenous inclusion in their operations and projects. Examples of existing mechanisms include mutual benefit agreements, joint ventures, Indigenous-led environmental monitoring, equity, diversity and inclusion (EDI) policies that are informed by and incorporate Indigenous perspectives, and, increasingly, equity ownership.

The evolution in ESG and related importance of Indigenous participation:

1. Supports the increasing role of Indigenous peoples as investors, proponents and/or partners in projects. This, along with the growth of social impact investing, could expand the focus of social impact funds to include the broader Indigenous perspective and thereby, create greater opportunities for organizations.
2. Enhances a company's competitive advantage, including through their reputation with investors, customers and the public. Through demonstrating appropriate mitigation of risk measures, and participation by Indigenous peoples across the areas influencing environmental, social and governance performance, companies can generate enduring and sustainable value.
3. Further emphasizes the importance of proper data gathering, management, and reporting both to manage expectations and to create opportunities.
4. Demonstrates the importance of robust due diligence and not solely relying upon ESG reporting frameworks which may not adequately reflect Indigenous considerations.

Employees

ESG is vastly important in the employment relationship. Leadership has to understand ESG and what it means for the organization.

As Canadian businesses consider what ESG means for their organization, it is imperative for them to understand the legal framework that they operate in—and how it might differ from other jurisdictions. A key example is how employee diversity-related data is treated in Canada, versus, for example, the United States. Whereas in the United States, employers have diversity-related information readily available to track employment-related ESG goals, Canadian human rights laws have generally discouraged collection of employee data that is unrelated to the employee's job. Canadian employers, therefore, have to consider how to measure and track diversity-related goals.

The pandemic has similarly brought to the fore a variety of other employment-related ESG issues—how are employers engaging with employees? How does an employer ensure a healthy and safe workplace for remote employees? How does an employer build its culture with remote employees?

All of these considerations create new opportunities for employers to bring timely perspectives into workplace policies in areas like employee well-being and work-from-home. There is also the opportunity for a greater dialogue with employees on ESG strategies. Employees similarly seem excited to have this dialogue.

As 2021 unfolds, we will continue to see employers having to consider ESG issues in novel situations—what, for example, is an employer's right to compel vaccinations when employees come back to work? What is the interplay between vaccinations and human rights considerations? Companies need to understand who they are from an ESG perspective, so that they are coherent and organized when facing ongoing novel and complex issues in the changing workplace.

Integrating ESG Into Your Business

ESG considerations have been a significant and influential aspect of corporate decision-making in many sectors for many years. A key success factor to improving ESG performance is for organizations to ensure they approach ESG in a holistic manner and weave ESG considerations into their corporate culture.

Below are some practical steps that organizations can take to promote a holistic approach to ESG:

- Make ESG an executive and board priority.
- Ensure senior management and advisors understand the importance of ESG to the company's performance and long-term sustainability.
- Embed ESG throughout the organization rather than in one department.
- Engage the communities in which you operate—your shareholders, employees, customers, NGOs, insurers and other stakeholders.
- Understand how competitors and regulators are dealing or proposing to deal with ESG issues and how they identify and report on such issues.
- Continually review the opportunities that ESG presents to create or enhance relationships and partnerships with Indigenous and local communities, stakeholders, and potential investors.

Environmental, Social, Governance Expertise

Businesses are increasingly being evaluated by their investors, employees, regulators, and other stakeholders on their approach to environmental, social and governance issues. ESG considerations have become as important to some stakeholders as business growth, return on investment and other measures of financial performance.

Like our clients, we know that ESG performance is about much more than making aspirational statements. ESG considerations must be embedded into the business' overall strategy, including its practices and systems, to allow for the early and continuous identification and assessment of significant environmental, social and governance issues.

Bennett Jones provides clients with comprehensive ESG-related advice based on our extensive knowledge and experience garnered from advising clients on domestic and international business law relating to corporate governance, securities disclosure, corporate reporting, environmental law, climate change, Indigenous relations, project development, supply chain management and crisis and risk management.

Our interdisciplinary team of legal experts helps clients define ESG factors that are relevant to their business, identify ESG risks and opportunities, formulate and integrate ESG policies and systems, implement strategies to support ESG performance and help develop the ESG narrative and communicate the narrative internally and externally.

ENVIRONMENTAL

- Climate change adaptation, response, and innovation
- GHG emissions, trading, and offsets
- Biodiversity
- Water management
- Environmental compliance and climate change litigation
- Waste management and circular economy
- Energy and clean technology
- Sustainable finance and impact investing

SOCIAL

- Equity, diversity and inclusion (EDI)
- Employment and labour relations
- Human rights protection
- Indigenous rights and relations
- Community engagement
- Corporate reputation management
- Supply chain management
- Product responsibility and stewardship

GOVERNANCE

- Board governance, diversity, best practises and transparency
- Stakeholder engagement
- Shareholder activism, preparation and response
- Investor relations and public disclosure compliance
- Compliance and internal controls
- Proxy advisory firm vesting guidelines
- Securities disclosure
- Cybersecurity and data protection

Notes

1. 2004 SCC 68, [2004] 3 SCR 461
2. 2008 SCC 69, [2008] 3 SCR 560
3. RSC, 1985, c C-44
4. SC 2018, c 12, s 186
5. Schedule B to the Canada Act 1982 (UK), 1982, c 11
6. SC 2019, c 28, s 1
7. SBC 2019, c 44

Defining and Driving ESG Within Your Organization, *March 2021*

Disclaimer

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The authors of this paper were all speakers on the Bennett Jones three-part ESG Webinar Series. Recordings of this series are available at **BennettJones.com/ESGSeries**.

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