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Climate Suit Against Directors of UK's Largest Pension Plan Heads to Appeals Court

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A British appeals court will review the 2022 dismissal of a novel lawsuit accusing current and former directors of the United Kingdom's largest private pension plan of mismanagement for, among other reasons, failing to divest from fossil fuels. In 2021, two members of the **Universities Superannuation Scheme (USS)**, the principal pension plan provided by UK higher education institutions, sued USS and its directors on the grounds, among others, that they failed to act in the best interests of beneficiaries by not divesting the plan of fossil fuel investments, despite fossil fuels allegedly performing worst as a category among all plan assets, and the fact that results of a USS survey indicated that the majority of members favored divestment. They also **assert** that USS directors have no credible plan to address risks posed by climate change.

In May 2022, the lower court **dismissed** plaintiffs' claims in their entirety. The court found that plaintiffs failed to allege that the directors committed a deliberate or dishonest breach of duty or improperly benefited themselves at the expense of USS by continuing to invest in fossil fuels. The plaintiffs had alleged that the directors' decisions harmed USS's interests and, consequently, the company has suffered and will continue to suffer resulting damages. However, the court found that plaintiffs failed to identify any "further particulars of this loss" or otherwise "specify which investments the Company should have sold or when or what the consequences would have been." Nor did the plaintiffs explain why USS would have avoided those consequences if it had adopted an immediate divestment plan or specify the plan that the company should have adopted.

The court is scheduled to hear plaintiffs' appeal on June 13, 2023.

In response to the ruling, USS said in a **statement** that it was pleased the High Court dismissed the claims but noted that "we are concerned that anyone should feel it necessary to take such action. We are committed to moving forward and to building stronger relationships with all stakeholders." To that end, ahead of the appeal, USS **announced** on March 12 the implementation of a new Stewardship and Voting Policy that will allow USS to "vote more personally against responsible directors where possible." It will "do this where, among other things, a company hasn't disclosed its climate transition plan, doesn't meet our diversity expectations, or where executive pay doesn't align with company performance." In its announcement, USS also indicated that it would not support “various systemic risks that have a financial impact,” such as a bank’s failure to make public climate transition plans or an oil and gas company’s failure to detail spending on projects that will expand its carbon footprint. The company also shared a **link** to information about its voting history.

Taking the Temperature: While the USS action is one of the first climate-related suits against retirement plan trustees, it is unlikely to be the last, despite the initial dismissal by the court. Sustainability-focused litigation against directors are part of the larger trend of climate-focused civil litigation and enforcement NGO actions that we have discussed previously, often brought by interest groups such as ClientEarth and others, against companies and financial institutions under a variety of legal theories, laws and regulations.

For example, ClientEarth recently sued Shell plc’s board of directors, alleging that the board had breached its obligations under the UK Companies Act by failing to adopt and implement an energy transition strategy that was in line with the 2016 Paris Agreement and a 2021 judgment by a Dutch court ruling that Shell must reduce its carbon dioxide emissions by 45% (compared to its 2019 levels) by 2030. In that previous case, seven environmental groups and more than 17,000 Dutch citizens sued the British-Dutch multinational energy company seeking to force it to implement CO_2 emissions reductions that aligned with the 2016 Paris Agreement.

As we have previously observed, it is unclear whether these types of climate-related claims against directors will or should prove successful. In our view, it is not possible or productive to take a one-size-fits-all approach to addressing the various complex, nuanced issues arising from climate change, particularly for directors facing competing demands from various stakeholders as well as the imperative to consider and act in good faith on material climate-related risks and opportunities. For directors of Delaware and most other U.S. state-domiciled corporations, courts (in our view, correctly) are unlikely to second-guess board decisions in this area so long as those decisions are made on an informed basis, in good faith and in the best interest of the company and its stockholders.

Likewise, in the USS and similar situations in the UK, plaintiffs appear likely to face an uphill battle in successfully pleading claims for supposed climate-related failures. Despite plaintiffs’ citations to a Financial Times article and an empirical study from Imperial College London to support their claims that fossil fuel companies have performed worse than renewable energy portfolios since at least 2017, the court found that plaintiffs failed to show damages. Plaintiffs did not allege that the directors should have sold the plan’s fossil fuel investments in the short term, nor did plaintiffs plead that they have suffered financial loss caused by the plan’s investment in fossil fuels or the directors’ failure to adopt an adequate plan for the long-term divestment of fossil fuel investments. The court also reiterated that there is no generalized duty of divestment based on ethical grounds.

RBC Incorporates Climate Priorities into Executive Incentive Compensation Plans

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The Royal Bank of Canada announced that this year it will begin incorporating ESG considerations into incentive compensation plans for the bank's CEO and other top executives. In particular, the bank plans to take ESG considerations into account as part of its mid-term incentive (MTI) and long-term incentive (LTI) programs for senior executives, according to the bank's **2022 Climate Report** released on March 6.

The 2022 Climate Report summarizes the progress RBC made last year in implementing its climate strategy, known as the **RBC Climate Blueprint**, which outlines the bank's commitments to achieving its stated climate priorities. These priorities include:

- Working with clients to understand and support their transition plans and facilitate $500 billion in sustainable financing by 2025
- Reducing greenhouse gas emissions by 70% by 2025
- Achieving net-zero emissions in lending by 2050, with interim targets aligned with clients' plans and Net-Zero Banking Alliance commitments
- Producing research on climate issues and policies, and convening stakeholders to create meaningful actions and incentives for progress

Adding ESG-related considerations to the executive compensation program will increase leadership accountability for advancing RBC's climate priorities, the bank says in the Climate Report. The new climate-focused incentive assessment is intended to accelerate RBC's progress in achieving its short- medium- and long-term net-zero goals while maintaining flexibility to modify executives' MTI and LTI awards, says RBC.

Taking the Temperature: RBC's decision to incorporate climate-related priorities into its executive incentive program comes just ahead of the March 7 release by Canada's Office of the Superintendent of Financial Institutions (OSFI) of its guidance for banks and financial institutions on managing climate-related risk. Guideline B-15: Climate Risk Management, which outlines the regulator's expectations for governance, risk management and reporting around climate-related risks, advises that covered federally regulated financial institutions (FRFIs) should contemplate incorporating climate-related risk considerations into senior management compensation policies, but does not expressly require RFSIs, including RBC, to do so.

We have discussed recent reporting that companies and shareholders broadly support linking climate goals to executive compensation plans. In addition, like certain other

financial institutions, in its 2022 ESG Report, which reviews the bank's performance across its ESG strategic priorities and focus areas, RBC highlighted the importance of governance structures to "deliver on ESG strategic priorities." RBC has formed several committees dedicated to these issues, such as a climate steering committee, a climate performance and reporting forum, a diversity leadership council, an RBC Foundation board, a reputation risk oversight committee, and an ESG disclosure council. As we have explained, strong corporate governance structures and policies are important for boards of directors and management to effectively assess risks and opportunities arising from sustainability issues and to mitigate the risk of legal challenges from shareholder or regulators in connection with climate challenges.

Large Insurance Companies Leave Net-Zero Insurance Alliance

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Munich Re, Zurich and Hannover Re, three major insurance providers, announced their exit from the Net-Zero Insurance Alliance (NZIA) in the span of one month between March and April 2023. The **NZIA** is a UN-convened group of leading insurers and reinsurers launched at the 2021 G20 Climate Summit. Its members have committed to "transition their insurance and reinsurance underwriting portfolios to net-zero greenhouse gas (GHG) emissions by 2050." Though the NZIA now has approximately 30 members, Munich Re and Zurich were among the founding organizations.

Munich Re cited "material antitrust risks" as the reason for withdrawing from the NZIA. In **announcing** the exit, Joachim Wenning, CEO of Munich Re, said that "the opportunities to pursue decarbonization goals in a collective approach among insurers worldwide without exposing [them] to material antitrust risks are so limited that it is more effective to pursue our climate ambition to reduce global warming individually." It is reported in international press outlets that Zurich said it was leaving to help its customers focus on their transitions.

Hannover Re announced its departure from the organization, but did not explain the reasons for its decision; however, it **emphasized** its ongoing commitment to a sustainability strategy and policies required to reach net zero by 2050.

Taking the Temperature: Net-zero industry alliances have grown rapidly in the last few years. In October, we reported on how the Net-Zero Banking Alliance (NZBA), a UN-convened banking industry coalition, grew from 43 to 119 financial institutions since its founding in April 2021. As we analyzed in a more in-depth article, the current politicized situation in the U.S. is such that financial institutions, asset managers and other financial market participants joining alliances that further climate-related and broader ESG goals are facing threats of antitrust enforcement and being precluded from financial activities with certain Republican-led states. The most likely immediate sources of U.S. antitrust challenges to climate initiatives appear to be Republican State Attorneys General. On October 19, 2022, 19 Republican State Attorneys issued civil investigative demands raising antitrust concerns to six U.S. banks, seeking information related to their membership in the NZBA. Last month, Republican governors of 19 states announced an alliance to leverage state pension fund investments to force asset

managers to disregard the consideration of ESG factors when making investment decisions.

It appears that Munich Re, Zurich and Hannover Re have withdrawn from the NZIA in response to the perceived risk of similar retaliatory action in the U.S. Alliances in the insurance industry are not alone in struggling to balance perceived antitrust and blackballing risk with fiduciary obligations and publicly-stated net zero commitments. In December last year, Vanguard announced that it was withdrawing from the Net Zero Asset Managers initiative amid questions on the propriety of passive investment managers engaging in "stewardship issues," including on climate change, raised by the Minority Staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs.

Alliances are also responding to these challenges. We reported on how the Glasgow Financial Alliance for Net Zero (GFANZ) amended its membership rules by dropping its connection to the UN-supported Race to Zero campaign after major U.S. banks were considering withdrawing from the GFANZ. Such compromises, including the recent NZBA refusal to impose restrictions on fossil-fuel financing, have led to public challenges from green-focused member institutions which fear that alliance objectives are being unduly diluted.

Canada's Proposed Green Taxonomy Framework Follows Global Trends, With Some Notable Differences

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Last month, Canada's Department of Finance published the Sustainable Finance Action Council (SFAC) recommendations for the development of a green taxonomy for sustainable investment, as the country moves toward its goal of net zero greenhouse gas emissions by 2050. "**The Taxonomy Roadmap Report**," developed by the Taxonomy Technical Experts Group (TTEG) of the SFAC, in partnership with the **Canadian Climate Institute**, sets out emissions-based criteria for categorizing financial investments or assets into one of two investment categories—"green finance" and "transition finance." The TTEG has designed the taxonomy with the objective of encouraging the issuance of both green and transition financial instruments in a way that is consistent with Canada's Paris-aligned commitment to limit global warming to 1.5° C.

Under the recommendations set out in the SFAC Report, projects and activities within the green category must be low or zero-emitting (low or zero scope 1 and 2 emissions, low or zero downstream scope 3 emissions), and produce goods or services with expected significant demand growth in the global low-carbon transition. The report listed a number of specific examples for these type of projects: green hydrogen production, afforestation projects, zero-emissions vehicle manufacturing (with low-emissions supply chains), and electricity transmission infrastructure.

Projects and assets in the transition category must substantially decrease scope 1, 2 and 3 emissions from carbon-intensive sectors, without the use of carbon offsets. These activities must also have concrete and limited lifespans, and not impact negatively (in terms of difficulty and cost) the future transition to net zero.

The SFAC Report includes a recommendation that Canada's taxonomy should include "do no significant harm" (DNSH) criteria to ensure that included projects are not detrimental to other ESG priorities, including environmental, labor and indigenous right protections under Canadian law, noting that the DNSH criteria was pioneered in the EU taxonomy.

Taking the Temperature: Canada's proposed green taxonomy as set out in the SFAC report varies in certain significant respects from those in place or being considered in other regions. The inclusion of the transition category is one of the most notable

differences; neither the EU taxonomy for sustainable activities nor the proposed UK green taxonomy have this category. As we have previously reported, the current draft of the proposed Singapore taxonomy does include a transitional category in its "traffic light" categories: green (helpful), amber (transitionary), and red (harmful) activities as they relate to the net zero goal.

Another area that has garnered significant commentary is the question of whether nuclear power should be considered a green energy sector. As we reported last month, the UK announced that it would include nuclear power as a sustainable form of energy, a decision that, while controversial, is in line with the EU's similar determination from February 2022. According to statements from the SFAC, while nuclear power is currently excluded from the taxonomy (along with fossil fuels, firearms, alcohol and tobacco, and gambling) as proposed, future inclusion is possible.

As we have previously noted, taxonomies are essential in allowing investors and companies to understand what industries, businesses and projects will be considered sustainable. The development of regional taxonomies with varying approaches and rubrics underscores not only the difficulty in defining a sustainable activity or project, but also increases the regulatory and practical burdens investors and financial market participants will likely face in making investment decisions. Differences in categories and criteria will also impact the flow of investments across countries and regions. Canada reportedly has an estimated annual investment gap of $115 billion in order to reach the country's stated climate goals. As some commentators have observed, the SFAC report suggests that the lack of development of any climate-related sustainable investment taxonomy by the U.S. authorities may result in "potential competitiveness implications."