May 27, 2021

Carbon, *Caremark*, and Corporate Governance

Developments this week highlight the urgent imperative for boards and management teams to address climate-related challenges as part of their regular risk assessment practices:

- A Dutch court held Royal Dutch Shell partially responsible for global warming and ordered the company to reduce its carbon emissions.
- Engine No. 1, an activist investor laser-focused on climate change, won at least two seats on ExxonMobil's 12-person board in a proxy fight.
- Likewise bucking management's recommendation, Chevron stockholders approved an investor-backed resolution calling for cuts in carbon emissions, focusing on the challenging area of "Scope 3" emissions.

These developments come on the heels of a federal executive order and related statement from the Secretary of the Treasury announcing that "financial regulators, financial institutions and investors need to have the best information and data to measure climate related financial risk" and declaring a policy to "*act* to mitigate [climate] risk and its drivers" (emphasis added) and support "science-based [carbon] reduction targets."

All of this will reverberate in boardrooms and courtrooms. Directors should expect continuing waves of electoral challenges from issue-oriented activist investors seeking representation on corporate boards. And companies should anticipate the risk of, and take prophylactic steps to avoid, costly fiduciary litigation alleging corporate failures to address and adequately disclose climate-related costs, risks, and mitigation plans. As we have written previously, the *Caremark* doctrine—which requires directors to monitor enterprise-level risk and is newly invigorated by recent Delaware court rulings—is the likely tool of choice for plaintiffs complaining about board inaction in the face of climate-related exposure.

The growing challenge ranges far beyond natural resource companies. Firms throughout the economy—anyone who manufactures, sells, or finances products that are implicated in environmental harm—should be preparing today for governance, regulatory, and litigation challenges. Thus, among other steps:

- Companies should focus on robust disclosure of climate-related economic and business risks.
- Management and boards should consider new playbooks and strategies for engaging with institutional shareholders, asset owners, and even activist investors focused on climate and other ESG-related issues.
- Boards should ensure regular consideration of climate-related risk, oversight structures, and robust documentation of risk-management and monitoring efforts.

Companies that take these steps, and then tailor bespoke responses to any remaining climate-related risks, will earn goodwill with regulators and investors and be better prepared to weather the climate-litigation and climate-activism storm.

William Savitt
Sabastian V. Niles
Sarah K. Eddy

W/4037958