Corporate Due Diligence in the era of Climate Change

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Outline

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- Climate change and human rights issues under the global climate regime: where are we?
- The evolving conceptualization of climate change due diligence in corporate transactions
- Conclusions and future directions

Introduction

- Traditionally, corporate due diligence refers to the process in which enterprises investigate the economic, legal, fiscal, and factual circumstances of an asset, proposed transaction, activity or project in order to avoid legal risks.

- Legal risks refer to the risk of financial, reputational or investment loss, legal liability, or dispute settlement costs to a company or institution that may arise from a defective commercial arrangement or transaction.

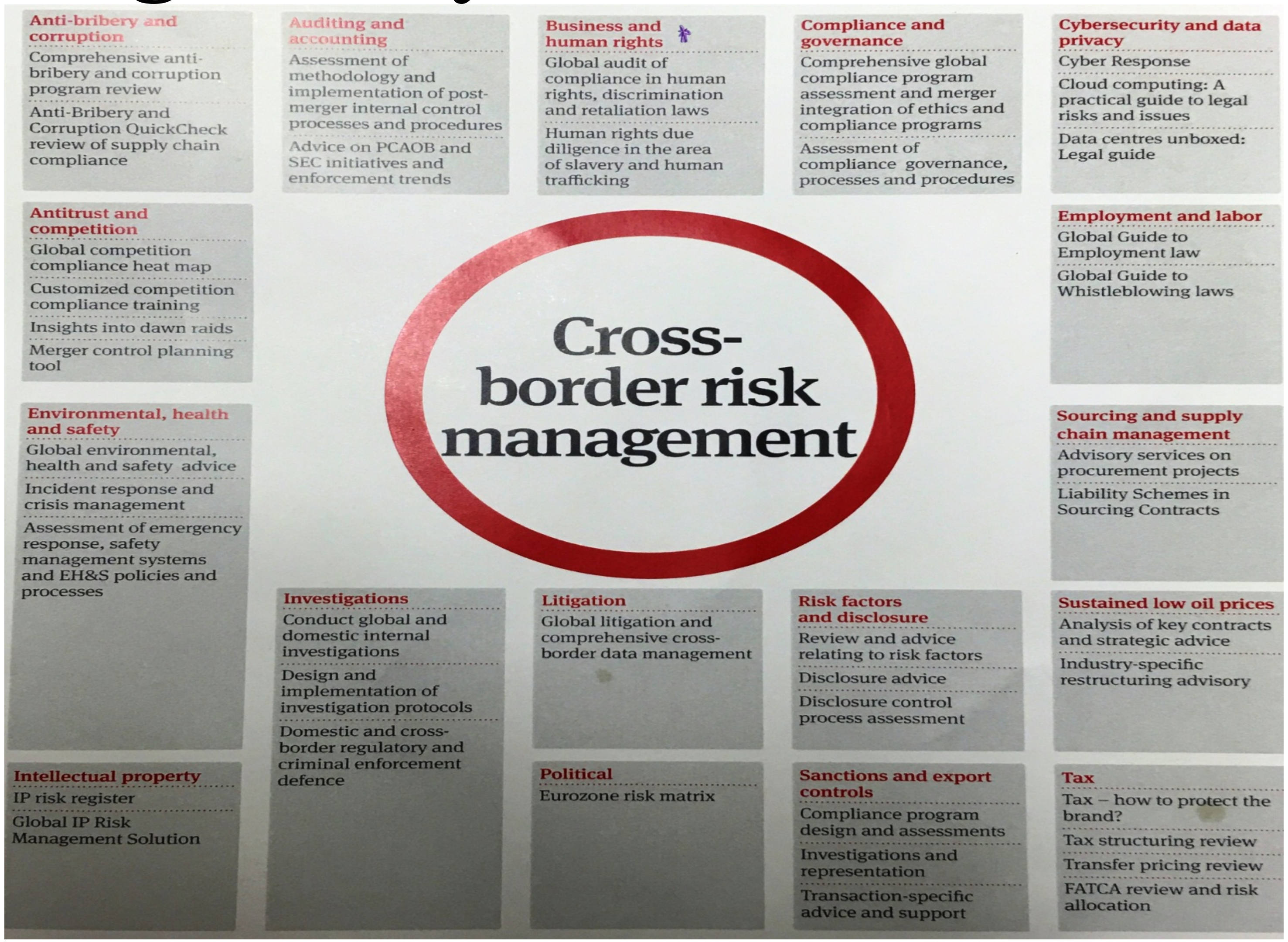
- Failure to effectively manage risks carries significant financial, legal and reputational risks for corporations. There is therefore a strong business case, in terms of cost, reputation and effectiveness, for entrepreneurs to effectively manage legal and business risks.

•Such risks may manifest in the form of disruption of projects; suspensions or closures of projects by supervisory bodies; hefty regulatory fines; director and shareholder liability; etc and may impact a company’s profitability or ability to maintain license to operate.

•Recent examples include the 671 Million Pounds fine on a car manufacturing company in Britain for bribery in Africa; $5 Billion dollar fine on MTN communications in Nigeria for non-compliance; 1 Million Qatar Riyals fine on two Qatari companies for failing to hold extraordinary general meetings; and billion dollars settlement claims against BP in United States for massive oil spillage.

•Case law also abound: *Kiobel v.Shell*, *Milieudefensie et al. v. Royal Dutch Shell*, *Urgenda Foundation (on behalf of 886 individuals) v The State of the Netherlands.*

Regulatory risks



The expanding scope of human rights due diligence

- The last decade has witnessed a consolidating consensus in the international community that climate change is a human rights issue, and that businesses are major drivers of climate change and its impacts.

- The B&HR enquiry here therefore relates to the direct or indirect human rights impacts of businesses activities relating to climate change.

- Business impacts on climate change and human rights are two fold:

  - Direct: failure to mitigate and reduce GHGs that cause climate change, thereby affecting the enjoyment of human rights, especially the right to environment, health, and livelihoods of indigenous peoples, local communities, and people in vulnerable situations

  - The indirect impacts of climate responses and actions on fundamental human rights. For example impacts of emission reduction schemes, clean development and REDD+ projects on land and forest rights, exclusion of women and youths from decision making processes, lack of transparency and accountability, inadequacy of judicial remedies for victims etc

Source: Damilola Olawuyi, *Climate Justice and Corporate Responsibility: Taking Human Rights Seriously in Climate Actions and Projects* 34:1 JOURNAL OF ENERGY & NATURAL RESOURCES LAW (2016) 27-44.

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- Cumulatively, the obligation of business enterprises to reduce their carbon foot print and to ensure that they respect human rights in all of their activities is coagulating.

- With respect to these questions, the Paris Agreement in its preamble recognized that Parties should, "when taking action to address climate change, respect, promote and consider their respective obligations on human rights."

- Article 4 (1) also emphasizes the need to achieve mitigation "on the basis of equity, and in the context of sustainable development and efforts to eradicate poverty."

- These provisions aggregate several studies, reports and declarations that recognize the need for human rights due diligence in all key sectors:

- **UN Guiding Principles on Business and Human Rights (UNGPs):** need for businesses to protect and fulfill human rights in projects (Pillar II, paras. 17-21)

- **African Union's *Resolution on a Human Rights-Based Approach to Natural Resources Governance*** (2012): ensure respect for human rights in all matters of natural resources exploration, extraction, development, management and governance.

- **EU Strategic Framework and Action Plan on Human Rights and Democracy**: "incorporate human rights in all impact assessments on an on-going basis." Also OECD Guidelines for Multinational Enterprises

- **Soft law initiatives:** on the need to address environmental, social and governance (ESG) concerns in investments. See UN Principles on Responsible Investment (PRI); Equator Principles III (EP); Report of the Task Force on Climate-related Financial Disclosures; Maplecroft Human Rights Risk Atlas (environmental risk and climate change)

- **Domestic** laws and national action plans on business and human rights, for example the Swiss Responsible Business Initiative and French Vigilance Law.

- These instruments raise the need for companies, investors, lenders, and insurance underwriters to appropriately investigate, assess and price climate-related human rights risks that may arise in the transactional context.

- Such risks may be structural, transitional and disclosures related

Risks	Human rights considerations
Structural Disruptions to a company's or third party's business or assets (e.g., facilities, infrastructure, land, or resources) due to physical impacts of climate change, such as rising sea levels, more extreme storms, floods, fires, and drought.	Are there possibilities of: flooding, air and water pollution, some levels of noise in the project construction and operational phase, mass displacements of people from their homes, loss of access to drinking water, loss of arable farmlands, risks of spillage or explosions? Who are those likely to be impacted? Does the target operate, or are its raw materials sourced, in areas prone to flooding or at risk of rising sea levels?
Transition Ongoing transitions to low carbon energy systems may result in new standards that may fundamentally change business structure and limit the availability or raise cost of, debts, capital and long-dated securities, and may result in stranded assets. (For example, SWFs in New Zealand, Norway, and France have announced plans to divest from high carbon industries. Norway's SWF has capped coal related portfolios at 30%)	Will the target be required to make significant capital expenditures to obtain or maintain compliance? Will ongoing or planned low carbon technologies and projects of the target (such as renewable energy projects) affect human rights, especially with respect to land and property rights?; any framework for ethical sourcing of carbon credits, and respect for human rights relating to water, environment, and food in emission reduction schemes?
Disclosures Emerging requirements to report on the financial impacts of climate-related risks and opportunities on the business and its shareholders (for example in May 2017, 62% of shareholders of ExxonMobil voted in favour of climate disclosures)	How are climate-related risks and opportunities likely to impact on current and future financial position of the target as reflected in its income statement, cash flow statement, and balance sheet? Has the target complied with climate disclosure requirements, or have they made public statements or disclosures concerning climate change risk that may in any way be considered misleading?

Implementing corporate climate and human rights due diligence: challenges

- Absence of comprehensive climate change legislation or inadequate human rights linkage
- Absence of operational guidelines on climate change and human rights due diligence in transactional context
- Difficulty in quantifying risks: climate-related human rights risks are multidimensional and quantifying them will require legal, scientific, technological, engineering, procurement, accounting and business analyses
- Tendency to focus on short and immediate risks while neglecting long term risks
- Limited capacity and knowledge of climate-related human rights issues within the business enterprise
- Training gaps in terms of climate and human rights due diligence

Need for internal climate change risk control and management system

Adopting tailored risk management principles and internal control for the enterprise may help enterprises to mitigate risks:

Guiding principles: (i) material risk identification; (ii) risk control methodology (iii) control mechanism (iv) information and communication; and (v) monitoring.

- **Material risk identification and human rights due diligence**: assess actual and potential human rights impacts through comprehensive HRDD; set risk appetite; and think creatively about liability scenarios in case of human rights impacts

- **Risk control methodology**: integrating and acting upon the findings. Need for an integrated, multidisciplinary and enterprise-wide risk management approach, as apposed to piecemeal approach, aimed at aligning corporate investment strategy with risk-appetite and risk management structure. For example, company-wide portfolio decarbonization and increase in green investments.

Guiding principles

- **Focal point for systemic risk control**: Establish risk management committee or appoint a focal point responsible for: risk identification, dispute resolution, negotiation and expert determination.
- **Corporate reporting:** Communicate how impacts have been addressed through proactive climate disclosures. Ensure disclosures are up to date; publish and disclose new information, facilitate timely access to information at a reasonable cost;
- **Education and Monitoring:** Track responses, also develop tailored training programs and executive courses on climate change due diligence and risk mitigation methodology in order to remain up to date with new risks.

Risk management matrix

Conclusion

- The expectations of business enterprises to anticipate and address climate-related human rights risks in their investments and projects is no longer an option but a necessity.

- Businesses can avoid the increasing backlash associated with climate-related HR risks by incorporating human rights considerations into investment analysis and management processes. There is a strong business case, in terms of cost, reputation and effectiveness for doing so even if the domestic law is silent on this.

- The need for human rights due diligence as part of internal climate risk control and management is not new. It is already part of international law on sustainable development, climate change, human rights etc. The HRDD framework only provides a toolbox for ensuring a coherent and less fragmented implementation of these principles, such that attempts to finance sustainable development does not result in environmental, social and human rights challenges.

- Adopting sound internal screening processes, as part of investment risk management frameworks, can help enterprises to build and maintain strong social license to operate and to foster relationships with host countries, local communities, customers and other stakeholders based on mutual respect, acceptance and trust.

Thank you

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