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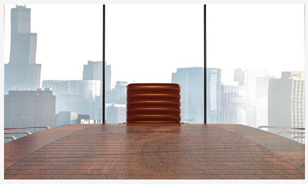

Corporate governance focuses on the who, what and how

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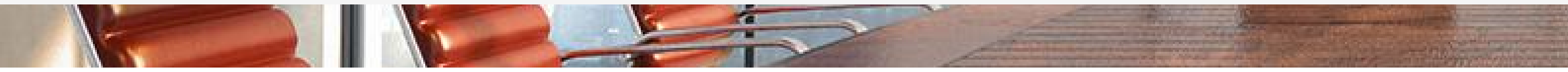

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The past year saw an increased focus on diversity beyond gender and new rules that add to the list of topics expected to be addressed at the board. A court decision released in 2023 provides comfort that while there may be strongly divergent views on how boards should be addressing vital issues such as climate change, diligent directors will be protected when their decisions are challenged in court.

In the coming year, Canadian issuers will be under increasing pressure to expand their diversity, equity and inclusion practices to address diversity beyond gender, with a specific focus on representation of racial or ethnic diversity. In addition, new legislative requirements addressing forced labour and child labour in supply chains as well as cybersecurity oversight and related disclosure will demand more board time and attention in 2024.

The increased focus in the United Kingdom on board oversight of matters related to the issuer's resilience statement, audit and assurance policy, material fraud risks and disclosure of distributions could be a harbinger of other areas that will demand increased board attention. While disagreements among stakeholders on the appropriateness of issuer climate action plans continue to raise the prospect of litigation in relation to board oversight of climate matters, there is reason to believe that courts will defer to board decisions made in good faith on an informed basis when such decisions are challenged.

The 'who': diversity remains on the agenda for 2024

Public company nominating committees have been under pressure for some time to expand the diversity of skills and backgrounds of directors on their boards.

Disclosure regarding the representation of women has now been required for nine years. As highlighted in our *2023 Diversity Disclosure Report*, the overall proportion of women directors continues to increase at a steady rate, while the rate at which women were added to boards in 2023 was higher than ever. Across TSX-listed issuers, women now hold 29% of all board seats.

Notwithstanding this progress, there was increased focus in 2023 on diversity beyond gender, especially racial or ethnic diversity. Since 2020, companies governed by the *Canada*

Business Corporations Act (CBCA) have been required to disclose the number and percentage of directors who are women, members of a visible minority, Indigenous and persons with a disability.

> Canadian securities regulators are focused on diversity beyond gender.

Ethnic diversity has long been a focus in U.K. company reporting. Nasdaq's listing rules now require each of its listed issuers to have one diverse director or explain why they do not. By the end of 2025, the requirement will increase to two diverse directors. For U.S. domestic issuers, at least one of these diverse directors will need to be from an underrepresented minority or identify as LGBTQ+. Institutional Investor Services announced that, starting in 2024, it will recommend withholding from voting for the chair of the nominating committee where the board has no racially or ethnically diverse members.

Canadian issuers are already responding, and the proportion of visible minority directors increased significantly in 2023, with 10% of CBCA company directors being from a visible minority.

Canadian securities regulators are also focused on diversity beyond gender. As we previously discussed in our Osler Update, in April 2023, the Canadian Securities Administrators (CSA) issued a request for comment proposing two alternatives to amend diversity disclosure requirements.

The more flexible approach in Form A leaves it up to the issuer to define which "identified groups" (other than women) are meaningful to its diversity strategy and to determine its approach to diversity. Form A contemplates narrative disclosure describing the issuer's diversity objectives, mechanisms for achieving those objectives and any written policies, processes and targets adopted by the board relating to women and individuals from the identified groups. Data on the number and proportion of directors and executive officers from its identified groups must be disclosed only if the issuer collects it.

Form B reflects a more prescriptive approach that is similar to the disclosure requirements under the CBCA. It mandates disclosure regarding the representation of "designated groups" and establishes targets for them. Like under the CBCA, designated groups include women, racialized persons, Indigenous Peoples and persons with disabilities, but Form B also includes LGBTQ2SI+ persons. Data on the representation of each designated group would be required, although disclosure respecting targets would be made separately for women and collectively for other designated groups.

The same two-alternative approach is followed with respect to proposed amendments to National Policy 58-201 *Corporate Governance Guidelines* relating to an issuer's approach to diversity. Form A changes are more flexible than Form B. Other proposed amendments would address the responsibilities of the board nominating committee, the adoption of a written policy setting out the director nomination process and the use of a composition matrix. Also proposed are effective succession planning and board renewal mechanisms, including term limits. The proposed amendments will also address the written diversity policy of the issuer and targets for achieving diversity among directors and executive officers.

The CSA proposals have generated considerable debate and many comments and it is unclear how the CSA will address the feedback received; however, there is no doubt that rule changes will come into effect in the future. Diversity beyond gender will remain an area of focus, and pressure to increase representation on boards of racially or ethnically diverse directors in particular will continue to increase.

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The 'what': expansion of the board's oversight responsibility

In 2023, the board's already full agenda was expanded in ways that will require attention moving forward.

New federal modern slavery legislation was approved in 2023 and will come into force on January 1, 2024. We discuss the requirements in detail in our *Supply chains, 'friend-shoring' and cooperation with allies* article. The legislation requires that the board approve the report that is required to be submitted and that a director sign it on behalf of the board. As a result, the board will be required to have direct oversight over the new reporting requirements regarding their company's supply chains. Management will need to examine and assess the risks of forced labour and child labour in the organization's supply chains – and the measures taken to address such risks – and to report on them to the board.

Oversight and disclosure relating to cybersecurity risks also received regulatory attention this year. The U.S. Securities and Exchange Commission (SEC) adopted rules that will now require disclosure of material cybersecurity incidents and the issuer's cybersecurity risk management, strategy and governance. The rules apply to U.S. domestic issuers and foreign private issuers filing on Form 20-F, but not issuers who file under the Multijurisdictional Disclosure System. We discuss the rules in more detail in our Osler Update.

The rules require issuers to disclose a cybersecurity incident within four business days after the issuer determines the incident to be material. Disclosure applies to the material aspects of the incident and the incident's impact (or reasonably likely impact). These requirements are generally aligned with Canadian securities law requirements and regulatory guidance. However, in Canada a press release must be filed and issued forthwith upon determining that a cybersecurity incident was material and disclosure is not subject to any safe harbour protection. If U.S. rules are successful in increasing the timeliness of reporting of cybersecurity incidents, Canadian issuers and their boards will be under greater pressure to assess the materiality of cybersecurity incidents faster than is currently the case.

The SEC rule also requires annual disclosure of the issuer's processes for assessing, identifying and managing material risks from cybersecurity threats, and the impact of such risks on the issuer's business strategy, results of operations or financial condition. Disclosure must also include an overview of management's role in assessing and managing such risks and the board's oversight of risks from cybersecurity threats.

Consistent with this theme, in the United Kingdom there has been an increased focus on the board's role in overseeing matters related to the issuer's resilience statement, audit and assurance policy, material fraud risks and disclosure of distributions by the business. The possibility of future regulation or increased investor expectation in this regard means that these trends warrant consideration by Canadian directors in the year to come.

The 'how': climate change hits the courts (and directors get deference)

There are many strong stakeholder views on the manner in which issuers should be addressing climate risk and making necessary trade-offs as they pursue their climate action plans. However, an important U.K. court decision suggests that courts will not second guess how diligent directors discharge their duties when it comes to climate-related matters.

In 2023, the U.K. courts twice dismissed a derivative action commenced against Shell plc's board of directors by an environmental NGO, ClientEarth. The action alleged that Shell's climate strategy was unreasonable as its interim greenhouse gas reduction targets did not cover Scope 3 emissions. ClientEarth argued that Shell plc's directors breached their duty to promote the success of the company and to act with reasonable care, skill and diligence by failing to adopt and implement a climate strategy aligned with the Paris Climate Agreement. ClientEarth also sought an injunction requiring the board to adopt and implement a strategy to manage climate risk in compliance with their statutory duties. The board would also be required to comply immediately with an order issued by a Dutch court that had directed Shell to reduce its emissions by 45% by 2030. Further detail is available in our *A tempest of change: impact of climate-related litigation and regulation* article.

In dismissing the action, the U.K. court recognized that a board of directors faces competing considerations that it must balance when managing a large and complex business. The court also recognized that courts are not well-suited to weigh in on or second-guess such business decisions.

Canadian law expressly permits directors to take into account various interests in determining what is in the best interest of the corporation. Under the business judgment rule, Canadian courts will defer to decisions of directors made in good faith and in the absence of conflicts of interest, provided the directors undertook reasonable investigation and consideration of the alternatives and the decision was within a range of reasonable alternatives.

No similar claims have been made in Canada to date, and a Canadian board's oversight of climate-related matters could be challenged in ways other than those litigated in the U.K. decisions. However, the U.K. judgments provide a basis for believing that the decisions of Canadian boards should also withstand challenge if the issuer can demonstrate that the board is appropriately focused on climate, is informed of the issuer's climate risks and impacts, and considers them appropriately when making decisions.