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Climate Change: Why It Matters for Your Business

By E. Lynn Grayson

Climate change? Sustainable development? Greenhouse gases? Global warming? Traditionally, these concepts conjured up tree hugger-led environmental activists' warnings of the Earth's doom resulting from industrial fallout and natural resource use and misuse. Today, these hotly debated, frequently misunderstood scientific theories more often are the subject of critical analysis in corporate boardrooms, among business management and between leading U.S. CEOs. Despite some conflicting reports on the true effects of greenhouse gas emissions and other industrial-related impacts, all agree that the Earth's climate is warmer and continues to heat up annually. No consensus exists as to what can or should be done, how it shall be accomplished or by whom.

Consumers and investors alike increasingly look to U.S. businesses to take on these environmental challenges and to determine how best to address them. An ever-growing share of consumers and investors favor socially responsible, green companies and impose these political views through selective spending and investment in like-minded businesses. The difficult task for every company's general counsel is to understand the regulatory and political aspects of climate change, to ascertain their footprint on impacting the environment and to develop effective green strategies to minimize these adverse impacts. More important, companies must determine how to accomplish these objectives in a politically correct, socially responsible manner acceptable to consumers, investors and the eco-organizations that guide them. General counsel will be called upon to ensure that these objectives are accomplished in a legally sound, cost effective manner consistent with corporate philosophy, industry expectations and shareholder demands.

Corporate Social Responsibility

Climate-change considerations are emerging as key components in a more global initiative to hold corporations socially responsible for their actions and inactions. The concept, commonly referred to as corporate social responsibility ("CSR"), extends beyond compliance with legal mandates or even charitable donations and good deeds. CSR advocates charge a company has a clear duty of care to all stakeholders connected to or impacted by a company's operation. The World Business Council for Sustainable Development defines CSR as " … the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large." Sustainable development, as a critical component of CSR, takes into account social, economic, environmental and natural resource issues potentially affected by business. As a part of CSR, sustainable development addresses how the needs of the present can be met without compromising the ability of future generations to meet their own needs. CSR and sustainable development both require business to evaluate greenhouse gas emissions in order to positively influence the ongoing climate change controversy.

Climate Change

The combustion of fossil fuels from a variety of consumer and industrial activities have led to an increase in greenhouse gases ("GHGs") in the atmosphere. These gases trap the sun's heat like a blanket, warming the Earth's climate. Scientists now believe that the Earth's mean temperature has been higher over the past few decades than in any period in the preceding four centuries. During the 21st century, the Earth is projected to warm by an additional 2 degrees to 6 degrees C — it is important to understand that the difference between the last ice-age and today's climate is less than 5 degrees C. Scientists predict that these warming trends will dramatically change weather patterns, particularly precipitation rates, resulting in an increase in floods, fires and drought. Some scientists also conclude that climate change factors are intensifying hurricanes and other tropical storms. The precise impact of climate change on the Earth is not clearly understood but enough is known to make clear that warming impacts are and will continue, often with disastrous repercussions.

The adverse impacts of climate change can be minimized and certain outcomes avoided altogether if GHG emissions are greatly reduced. Even if all emissions ceased tomorrow, the time lag between the emission and its full impact in changing the climate means there is more warming to come in the

E. Lynn Grayson is a partner in the Environmental Energy and Natural Resources as well as the Climate Change and Clean Technology Law Practice Groups at Jenner & Block LLP in Chicago. She may be reached at lgrayson@jenner.com.

next few decades. For this reason, in part, the U.S. National Academy of Sciences has concluded that "the scientific understanding of climate change is now sufficiently clear to justify nations taking prompt actions." In short, the sooner action is taken, the more likely mitigation efforts will succeed in curbing climate change impacts.

Regulatory Initiatives/New Supreme Court Decision

Struggling with what needs to be done and who should set the course is at the heart of a growing international debate. Regulatory requirements range from the Kyoto Protocol to the United Nations Framework Convention on Climate Change imposing binding GHG reductions on industrialized nations through 2012 to similar mandates developed by other countries as well as U.S. regions, states and even cities. One such regulatory mandate is the Regional Greenhouse Gas Initiative, originally formed by several northeastern states in 2003, it seeks to reduce carbon dioxide through a cap-and-trade system. Another mandate is the California Global Warming Solutions Act of 2006 aimed at comprehensively reducing GHG emissions at the state level. As these few regulatory mandates illustrate, U.S. businesses increasingly face a growing patchwork of regulatory requirements focused on differing climate change concerns.

While some of the regulatory confusion stems from the global aspect of climate change — it being a worldwide dilemma where the actions of one nation directly impact many other nations — in the U.S., the confusion results from the lack of a clear national policy or federal law on climate change. In 2001, the U.S. decided against ratifying the Kyoto Protocol, primarily citing as reasons its failure to adequately regulate large developing countries like China and India, and its disproportionate economic disadvantage to the U.S. In lieu of the Kyoto Protocol mandates, the U.S. domestic policy favors voluntary emissions reductions and research of alternative fuels and renewable energy sources. One of the better known and more respected voluntary initiatives is the U.S. EPA's Climate Leaders — an industry/ government partnership that works with companies to develop long-term comprehensive climate change strategies. Climate Leaders requires its partners to establish GHG reduction goals and to inventory GHG emissions, in order to measure progress. *See* www.epa.gov/climateleaders. Some U.S. companies also signed on to the Combat Climate Change Business Leaders' Initiative, the "3C Initiative," demanding an integration of climate issues into world markets and trade facilitated by means of a global framework coming into force in 2013. The 3C Initiative businesses asked the European Commission on January 11, 2007 to take more aggressive action to reduce emissions of GHGs as rapidly as possible and to work to secure affordable energy for stable, global development. *See* http://combatclimatechange.org. Likewise, on Jan. 22, 2007, a diverse group of U.S. based businesses and environmental organizations called upon the federal government to quickly enact strong national legislation to achieve significant GHG emissions reductions. The U.S. Climate Action Partnership also issued a Call to Action providing a blueprint for a mandatory, economy-wide market driven approach to climate protection.

Complicating the regulatory forecast even further was the U.S. Supreme Court's decision handed down on April 2, 2007 in *Massachusetts v. EPA*, concluding that the Clean Air Act gives the U.S. EPA the authority to regulate emissions of carbon dioxide and other GHGs from cars. In probably the best-known climate change lawsuit in the U.S., Massachusetts and eleven other states, three cities and several environmental organizations had filed a petition for review of the U.S. EPA's refusal to regulate GHGs emitted by new motor vehicles under the Clean Air Act. The Supreme Court majority decided U.S. motor vehicle emissions make a "meaningful contribution to greenhouse gas concentrations," and hence, to global warming. In writing for the majority, Justice Stevens wrote, "a well documented rise in global temperatures has coincided with a significant increase in the concentration of carbon dioxide in the atmosphere. Respected scientists believe the two trends are related." While environmental organizations applaud the Court's decision, the political reality for U.S. business may be continuing patchwork efforts by Congress to regulate GHG emissions in order to maintain leadership until such time as U.S. EPA responds to this decision, likely following the 2008 presidential elections.

Investors Focus on Climate

Climate change is a key concern for investors and the growing legion of organizations that guide them. Likewise, investors want to know more about a company's CSR performance, including both climate change and sustainability considerations. Traditionally, an examination of such factors was limited to a relatively small group of socially aware, eco-driven investors. Increasingly, CSR and particularly, climate change factors, play a significant role in decisions about whether to invest in one company or another. Investors now recognize that companies with significant GHG emissions and energy-intensive operations face greater risks from emerging climate change regulations. Investors also understand that *all* companies, regardless of industry sector, likely will be adversely impacted by regulatory initiatives and other climate-related changes. Investment analysts anticipate that climate change will have a profound impact on the financial performance of companies and portfolios across sectors, markets and securities. For investors, possible risks that are understood can be managed and therefore, investors want more information from companies about GHGs, sustainability and climate change-related matters. Even companies that believe they face little risk may determine their supply chain is vulnerable or that physical or regulatory factors combine to raise the price of essential goods and services such as energy

To aid investors, a growing number of initiatives focus on improved analyses and disclosure of climate-related risks by companies. The Investor Network on Climate Risk, initiated in 2003, now has over 50 institutional investors managing in excess of $3.7 trillion. Directed by Ceres, a national coalition of investors, environmental groups and other public interest organizations working with companies to address sustainability challenges, Ceres published a 2006 report *Corporate*

Governance and Climate Change: Making the Connection that evaluated 100 leading global companies on their climate change practices. *See* www.ceres.org. The Carbon Disclosure Project, a coordinated effort by global investors to obtain more information relating to the corporate management of climate change, was launched in 2002. In 2006, the Carbon Disclosure Project surveyed the top 500 companies in the U.S. on climate risk disclosure. Less than half of the companies responded and the responses received fell short of guidelines recommended by the Global Framework for Climate Disclosure, a new statement of the information investors expect from companies on their climate change risks. *See* www.cdproject. net and http://www.ceres.org/pub/org/docs/Framework.pdf. Similar initiatives include Principles for Responsible Investment and Institutional Investors Group on Climate Change. *See* http://www.unpri.org/ and http://www.iigcc.org/. Moreover, sustainability listings that showcase a company's green performance exist such as the Dow Jones Sustainability Index, Business Ethics 100 and Fortune's Most Admired. *See* www.sustainability-index.com/, www.business-ethics.com/100best.htm, and www.fortune.com/fortune.

What investors want, and the organizations that guide them now are demanding, is more company-specific information on the overall impact of climate change and sustainability-related concerns. Following the issuance of the Global Framework on Climate Risk Disclosure in October 2006, there is clear guidance on what investors specifically want to see from companies. These informational needs fall into for broad categories as follows: 1) strategic analysis of climate risk and emissions management; 2) historical and future emissions disclosure; 3) physical risks; and 4) regulatory risks.

Company Response Strategy

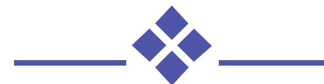
Understanding what investors want is only part of the equation for companies. Moving forward, responsible companies need to evaluate the development of a CSR strategy aimed at addressing a host of CSR-related inquiries, particularly those focused on climate change and sustainability. In its *Climate Risk Disclosure by the S&P 500* report issued in January 2007, the Carbon Disclosure Project recommended that companies undertake the following activities: 1) respond to investor requests for disclosure; 2) assess the impacts of climate change on the company; 3) improve corporate governance and strategic management of climate change; 4) manage emissions better; and 5) examine regulatory impacts better. In addition, the Carbon Disclosure Project also promotes a discussion of climate change in annual securities filings, the development of sustainability reports and as part of ongoing dialogues with investors and other stakeholders. These recommendations provide a "wish list" of actions the Carbon Disclosure Project would like companies to undertake but each item truly needs to be evaluated on a case-by-case, company-specific basis.

While getting started may seem like an overwhelming task, there are some first steps companies may consider as more detailed response strategies are being evaluated and/or developed. These first steps, focused on climate change issues, include: 1) organize a company team to manage climate change matters; 2) prepare climate change/sustainability policy or policies; 3) evaluate the green practices of the company and determine possible environmentally responsible improvements; 4) inquire into the green practices of suppliers and subcontractors identifying these considerations as a business priority for your company; 5) consider how best to address GHG emissions within your business and if an inventory of the same is appropriate as a starting point; and 6) mandate that all company responses on the emerging topics of CSR, climate change or sustainability require legal department review and approval before public disclosure. Company general counsels and the law departments they manage can ensure responses are consistent with one another and information disclosed is legally sound, cost effective, and compliant with corporate philosophy, industry expectations and shareholder demands.

Conclusion

On April 6, 2007, the Intergovernmental Panel on Climate Change ("IPCC") released its latest assessment confirming with high confidence that warming caused by humans is linked to adverse climate change impacts as well as emerging concern on its effects on human health and agriculture. These latest findings from a respected organization like the IPCC will focus even greater attention on climate change and increase global scrutiny on what needs to be done to mitigate these adverse impacts.

In addressing these concerns, responding to investors and shareholders sends an important message that company management is assessing climate change risks and working to position the company's operations to succeed in the ever changing, environmentally responsible world. As to climate change and sustainability, it appears there may be a coming together of good deeds and good business. Quite simply, doing the right thing now to safeguard the environment for future generations also may be the best business decision a company can make today.



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