Addressing Climate Change Through Corporate Governance

As climate change continues to gain increased attention from legislators, regulators and investors, it is poised to have a profound effect on business in the coming years. The risks and opportunities presented by climate change will vary by industry and company, but virtually every business will be affected. How companies address climate change as part of their larger corporate governance structure may be a determining factor in their success in adapting to the rapidly changing regulatory landscape and in taking advantage of opportunities in the marketplace. Regardless of the industry and company involved, the specific risks and opportunities presented by climate change should be thoroughly analyzed and addressed by each company’s board of directors, officers and other management employees, and in applicable company policies and guidelines.

Increasing Efforts in Climate Change Regulation and Enforcement

Despite the current economic recession, the new administration has ushered in an increased emphasis on addressing climate change through regulation. President Obama, during the first week of his administration, signed two executive orders pertaining to climate change; one directed the U.S. Environmental Protection Agency (the EPA) to reconsider its denial of California’s request for a waiver of Clean Air Act preemption to enforce higher greenhouse gas emissions standards for motor vehicles, and the other directed the Transportation Department to finalize rules in early 2009 to increase the fuel economy requirement for motor vehicles. The EPA subsequently granted the waiver sought by California, and also issued rules to require greenhouse gas reporting by large emitters beginning in 2010, and proposed rules that would require construction and operating permits for new facilities (or existing facilities undergoing major modifications) that emit over 25,000 tons of greenhouse gases annually. The U.S. House of Representatives passed the American Clean Energy and Security Act, the first climate change legislation adopted by either house, and the Senate is currently considering similar legislation. The Securities and Exchange Commission (the SEC) has also started to take a “serious look” at imposing specific disclosure obligations on public companies with respect to climate change risks. Significant judicial decisions regarding greenhouse gas emissions have also been issued in 2009, including the decision of the U.S. Court of Appeals for the Second Circuit in Connecticut vs. American Electric Power, allowing claimants to pursue federal common law public nuisance claims that the greenhouse gas emissions by the five defendant power companies had contributed to global warming.
Increasing Investor Focus

Investors are focusing increasingly on climate change issues. According to Ceres, a U.S. network of investors, environmental organizations and other public interest groups that works with companies and investors to address sustainability challenges, “Investors managing trillions of dollars in assets have been petitioning the SEC since 2004 for interpretive guidance on corporate disclosure of climate risks and opportunities, and to ensure that shareholders have the right to vote on resolutions seeking disclosure of climate risks.” In November 2009, a coalition of institutional investors representing more than $1 trillion of assets petitioned the SEC to issue guidance to public companies that requires disclosures of climate related risks in periodic filings. Among the group of investors was the California Public Employees Retirement System (CalPERS), which manages $202 billion of assets and is the largest public pension fund in the world. Anne Stausboll, the Chief Executive of CalPERS, said, “The SEC should strengthen and enforce its current requirements so investors’ decisions fully account for climate change’s financial effects.” Although the SEC has yet to respond by issuing specific disclosure guidelines, it has indicated that climate change disclosure is an area of focus. Additionally, in October 2009, the SEC revised prior guidance regarding shareholder proposals that implicate risk assessment, indicating that the SEC will be less inclined to permit companies to exclude shareholder proposals under Rule 14a-8 that deal with broad policy matters such as climate change, even if such proposals also implicate risk assessment. The combination of increasing investor scrutiny of climate change issues and increasing SEC attention to climate change disclosure will force companies to focus as never before on the ways in which climate change affects their specific business.

Increasing Business Partner and Competitor Focus

For many companies, climate change initiatives may come not only from shareholders or regulators but from business partners. Since as early as 2005, large public companies like Walmart and General Electric have focused on bringing climate change issues to the forefront of their business operations by investing money in environmental technologies, media and advertising campaigns focusing on sustainability, and working more closely with suppliers to encourage green practices across the supply chain.

Addressing climate change issues can afford significant competitive advantages even to companies operating in industries other than clean-tech and sustainable energy. For example, U.S. automakers have struggled in recent years to catch up with foreign automakers that embraced hybrid technology years earlier. Such hybrid technology will be increasingly important as car companies compete for the business not only of environmentally conscious U.S. consumers but also for lucrative expanding markets overseas, such as China, where it is estimated that less than a quarter of American-made passenger cars and light-duty trucks meet China’s 2008 emissions standards. Many observers believe that the marketplace will increasingly assign value to companies that prepare for and capitalize on business opportunities posed by climate change.

Legal Responsibilities of Corporate Governance

Against this backdrop, boards of directors and officers must consider the ways in which their corporate governance obligations require that they consider and address the effects of climate change on their companies. Directors have a duty to exercise good business judgment and to use ordinary care and prudence in the operation of the business. They must discharge their actions in good faith and in the best interests of the corporation, exercising the care an ordinary person would use under similar circumstances. In the exercise of these duties, board members should educate themselves regarding the potential effects of climate change on their company, and evaluate the potential business and financial consequences. Depending on the industry, directors need to consider whether they have fully complied with their duty of care if they have not considered how the current state of the climate change landscape may impact their business.
Corporate Governance Alert

Climate Change Will Affect Your Business and Industry

Climate change has implications for the economy in general and will therefore affect all businesses. The extent to which climate change will affect any specific company will depend on the nature of the industry involved. Business risks from climate change include the possibility of increasingly volatile weather conditions, with resulting impacts on business resources, personnel, and corporate operations, increasing legal and regulatory pressures, and mounting public and shareholder interest and activism. Many consumer-oriented businesses have highlighted concerns about climate change, recognizing the importance that consumers give the issue. Ceres last year issued a report that assessed how 63 of the world’s largest consumer and information technology companies are preparing themselves to face climate change. Corporate Governance and Climate Change: Consumer and Technology Companies (December 2008) [PDF]. Companies that have taken action include IBM, Nike, and Coca-Cola, which have reduced their carbon footprints, and Google, Yahoo!, and Dell, which have issued statements expressing their intent to become carbon-neutral.

What You Can Do Now

Good corporate governance will be a key tool in addressing climate change issues. Analyzing the impacts of climate change in the context of a company’s corporate governance structure can be a significant and time-consuming endeavor, but comprehensive preliminary planning can help to minimize wasted efforts.

Analyze Your Business Environment

In determining how climate change issues may intersect with corporate governance in your company, it is important to first understand the climate change issues that are specifically raised within the context of your business. Every organization should consider whether it has implemented appropriate climate risk mitigation strategies to prepare it for the potential effects of climate change on its operations, including the potential effects on production, customer service and employees, and the adequacy of the organization’s insurance coverage with respect to the potential impacts of climate change. Members of management should evaluate their own company’s performance relative to the company’s particular circumstances and the performance of the company’s industry peers.

Publicly reporting companies will need to consider how to disclose risks regarding climate change, as well as stay abreast of new SEC positions on disclosure requirements, which are likely to continue to evolve in the coming year. Privately held companies may also wish to consider how best to disclose their policies and approaches to climate change to their customers and stakeholders. All companies, both public and private, should examine potential challenges and opportunities brought by climate change, and how corporate governance at various levels can address them.

Board and Management Level Action

The board of any company that emits large amounts of greenhouse gases is in all likelihood already heavily involved in climate change issues. But boards of companies that are not traditional large GHG emitters should not discount the value of forming a climate change committee, or assigning a specific director or board committee to oversee a company’s climate change issues. Such organizational efforts to address climate change issues at the board level can help to ensure an early and effective response to climate change issues and opportunities.

Regardless of the impact that climate change may have on a company, the board should reach down into a company’s management structure for help. Climate change issues may be best addressed not only by board involvement, but also by the participation of an executive officer charged with managing the company’s climate change issues, by an environmental specialist, by a member of the legal team, or by an operations specialist who is well versed in climate change issues within the company’s industry. Involving the chief executive officer may make sense in situations where implementing a company-wide strategy is important and where monitoring the effects of climate change on all parts of a company’s business is crucial to its success. Monitoring and addressing climate change issues may require action at many levels within the corporate hierarchy.
Public Disclosure and Corporate Policies

The company’s board and executives should also work together to clearly define the company’s goals with respect to climate change. Such action will not only help a company to work efficiently toward such goals but will increase transparency regarding the kinds of regulations or policies the company supports. Again, depending on how much impact climate change may have on a company, such action may include creating binding corporate policies, more general corporate governance guidelines, or even values statements that indicate to consumers or customers your company’s desire to address climate change issues. Such policies may involve setting GHG reduction targets, developing or purchasing new clean technology, or reducing the company’s energy usage or carbon footprint. Companies that foresee climate change regulations substantially affecting their industry and business may also wish to seek a prominent and active role in shaping such regulations and government policy through lobbying or working directly with interest groups. The combination of strategies will depend on the company’s industry and individual challenges.

It is important that a company consider how disclosure regarding climate change may be beneficial to its business. In addition to complying with disclosures mandated by the SEC regarding climate change risks, a company may create distinct competitive advantages, and establish itself as a leader in its particular industry or sector, if it can communicate effectively to customers, suppliers, analysts, and shareholders its objectives regarding climate change and the way in which it plans to meet these objectives.

Effective approaches to climate change will require a combination of immediate action and long-term goal setting. The manner in which a company internally assesses its risks and opportunities and creates corporate governance structures to manage such risks and opportunities will be crucial to success in this process.