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REPORT

Environmental Disclosure

All Public Companies Need To Address Sustainable Business Practices, Experts Say

■ ***Practice Tip:*** *In light of the current heightened scrutiny of climate change risks by government regulators and investors, boards of public companies need to make sure that they have in place adequate governance structures and effective risk assessment measures.*

In the current business environment where government regulators and investors are increasingly concerned about the effects of climate change on corporate performance, boards of public companies need to instill an enterprise-wide comprehension of climate change and sustainability-related risks, experts in environmental regulation told BNA in recent interviews.

Regardless of whether or not public companies are direct emitters of greenhouse gases, boards must realize that energy consumption is a major factor related to climate change risks relevant to all companies, Mark A. Thimke, an environmental regulation and corporate compliance law partner at Foley & Lardner LLP in Milwaukee, Wis., told BNA April 12.

''Climate change risks have a broader context within corporate structure, and affect elements beyond just a pure environmental setting,'' Thimke said.

The most progressive business leaders understand that best practice business strategy should involve leveraging sustainability challenges into increased revenues, profitability, and competitive advantage, according to a March 11 Ceres report on best sustainable business practices. ''Comprehensive disclosure of sustainability performance and impacts is a key part of a company's sustainability journey,'' it said.

Meanwhile, investors and groups that have been the force behind the demand for better climate risk disclosures are generally pleased with the Securities and Exchange Commission's new climate disclosure guidance, Doug Cogan, head of climate change research for RiskMetrics Group's Financial Research and Analysis unit, told BNA April 23.

Energy Is Key Issue for All Companies. On a very basic level, there exist companies that are clearly direct emitters of pollutants such as utility, paper manufacturing, and large coal burning facilities, Thimke said. However, many other segments of the economy are affected by climate change issues indirectly through energy consumption, he said.

All companies need to heighten their awareness of energy use—especially in terms of its costs and efficiency both now and in the future, Thimke said. ''Evaluation of the use of energy involves much more than periodically collecting and comparing carbon footprint data,'' he said.

For example, ''Walmart has taken up a proactive stand with climate-related risks and demanded that their supply chain take into consideration a number of energy related issues,'' Thimke said. ''By doing this,

Questions for Assessing Sustainable Practices. Mark A. Thimke, an environmental regulation and corporate compliance law partner at Foley & Lardner LLP in Milwaukee, Wis., told BNA April 12 that companies should consider the following questions to ensure they are establishing an enterprise-wide comprehension of climate and sustainability related risks:

■ Does the company have adequate governance structures including accountability, policies and controls, and data collection systems?

■ Has the climate or sustainability related risk been appropriately assessed using reliable data and up-to-date information?

■ Are the company's disclosures consistent across all communication channels?

Walmart can better focus on climate risks from a broader perspective. In order for the company to compete effectively—especially in the long run—it must have its supply chain minimize energy costs,'' he said.

''At the board level, such focused initiatives as climate change risk assessments are typically delegated to an audit committee, environmental committee, or the like,'' Thimke said.

According to Thimke, while such an initiative will need to involve evaluating the company's carbon footprint, the evaluation needs to be broad enough to include a thorough examination of energy usage as well. This means examining the indirect effects of carbon on the business, he said.

Companies must also carefully examine their supply chain, Thimke said. ''They should assess where the key suppliers are located and what they are doing with respect to energy,'' he said.

Companies Should Have Emergency Plans. It is also vital that companies have in place emergency plans in the event of a disaster, Thimke said. ''Companies must take into consideration the physical risks associated with climate change that could possibly impact the company's major suppliers. Alternatives need to be in place in the event a major supplier is disabled,'' he said.

These issues are not only important from an environmental perspective, Thimke said, but to have an accurate appreciation of the company's circumstances as a whole, individuals from a management context who can look at relevant climate-related issues with a broader scope are needed.

This broader scope might take into account factors related to the physical aspects of the business, energy sources and consumption, as well as emissions, Thimke said.

Companies that are not emitters may wonder how climate-related issues are relevant to their businesses, Thimke said. ''This is where the broader perspective comes into play. Typically, energy costs have been so low in most parts of the country that it has not usually been a factor for most companies when relocating and conducting acquisitions,'' he said.

However, energy costs will inevitably rise as climate change progresses, Thimke said. ''Companies must consider that if, for example, they draw energy from mostly coal-based units which may be shut down or need to be refurnished with expensive new equipment due to regulations, energy costs will inevitably be affected,'' he said.

Investor Groups Generally Pleased With SEC. In related news, the SEC Feb. 2 issued interpretive guidance on how companies should apply existing SEC disclosure rules when deciding whether to tell investors about the risk that climate change developments may have on their businesses (8 CARE 118, 2/5/10).

Until more Form 10-K reports are filed with the SEC, it will be hard to judge just how much the SEC's guidance will impact disclosures this filing season, Cogan said.

It is likely the full effect of the SEC's new guidance will not be evident until disclosures for 2010 as well as 2011 have been filed with the commission, Cogan said.

''At this point in time, all of the companies in the major, carbon-intensive industries have generally recognized that the potential for carbon regulations poses a possible material risk that they need to disclose,'' Cogan said. However, in a number of other industries—particularly some of the less carbon-intensive sectors—adequate disclosure is still lacking, he said.

For example, ''big bucks'' retailers that consume a fair amount of energy through the electricity they purchase do not see themselves as directly associated with possible carbon emissions regulations, Cogan said. Regardless, some have made significant efforts to enhance sustainable business practices and improve their climate risk disclosures, he said.

Water-Related Concerns Are Gaining Interest. According to Cogan, the issue of improving water-related disclosures is the next major initiative for several investor groups.

''There are a number of institutional investors that are beginning to regard this as the next focus of disclosure activity,'' Cogan said. ''This is definitely an issue that companies should remain aware of for the time to come,'' he said.

There have also been a few shareholder resolutions filed this year on companies' management of water, Cogan said. ''In addition, there is currently a request before the SEC to provide guidance on environmental governance and social issues generally,'' Cogan said.

This is currently being taken up by an advisory committee created by the commission to advise the commissioners on a range of issues, Cogan said.

''There is the possibility that, in addition to the guidance on climate change disclosure, the SEC will eventually provide further guidance on how environmental, governance, and social risks should be dealt with overall in securities filings,'' Cogan said. ''It remains to be seen how far this will get,'' he said.

Investors Desire More Detailed Disclosures. More investors are now asking companies to detail and quantify sustainability risks and opportunities in their financial disclosures, according to the Ceres report. ''As company owners, they look to sustainability performance as an indicator of strong management, strong governance and long-term thinking about future growth potential,'' it said.

''Long-term investors reward companies that integrate sustainability into strategic planning. Sustainability-based stock indices benchmark corporate performance against peer companies and place pressure on businesses to meet increasing expectations,'' the report said.

An increasing number of investors are recognizing and taking action on governance issues, the report said. These include environmental and social issues that pose material business risks and have potential to directly affect long-term financial performance, it said. ''Conversely, [investors] see substantial benefits to be gained by financing companies that are proactive on these issues,'' it said.

Investors are rewarding companies that understand how sustainability issues impact their business and that are implementing strategies that will enable the business to thrive in a sustainable global economy, the report said.

Baseline Environmental Performance Is Key. Whether a business is trying to establish a leadership platform, improve its approach to sustainability, or is still considering where to begin, it should start by assessing the

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baseline environmental and social performance, the report said.

Companies should also analyze their corporate management and accountability structures and systems and conduct a materiality analysis of risks and opportunities, the report said. A company can then formulate its own route to sustainability—the route a company takes will vary according to sector and corporate culture, it said.

Also, policies covering all sustainability issues that have a material impact on the company's performance and plans should be developed, the report said. ''This should involve outlining the company's vision and strategy for implementing these policies,'' it said.

As part of this process, companies will need to engage with stakeholders to obtain feedback on the relevance of existing and proposed policies and to identify problem areas, the report said.

''These policies should guide the company's activities across its operations, the supply chain, logistics, the design and delivery of products and the management of its employees,'' the report said.

By Tina Chi

The Ceres report is available at http://www.ceres.org/Page.aspx?pid=1211.