

Looking Forward and Back on Climate Change

Heightened Risks From the New Push for Supply-Chain Disclosure and the Evolving Role of the Courts

Whether it is the cover of that populist American icon, *Sports Illustrated*, depicting a baseball stadium under water due to the rising seas or that arbiter of haute style, the quintessential New York retailer Barneys, putting a “Prius in a pear tree” at the top of their “green” Christmas list, concern about climate change and the environment has become pervasive. Indeed, it would have been nearly impossible a year ago to predict the convergence of significant developments that have propelled climate change to the front pages of newspapers and caused it to become a key issue for so many. These developments have spanned the worlds of science, economics, politics, law, and popular culture and include:

by Gary S. Guzy

- A comprehensive international scientific assessment finding that global warming is “unequivocal,” human induced, and has already resulted in extensive ecosystem and human impacts across the globe;
- The improbable combination of these scientists and Academy Award winner Al Gore sharing the Nobel Peace Prize;
- A ruling by the United States Supreme Court that greenhouse gases are pollutants that can be regulated under existing federal law and that litigants can demonstrate sufficient harm and causation to raise challenges regarding climate change in federal court;
- Oil prices rising to the previously unfathomable level of \$100 per barrel;
- Respected economists concluding that the costs of inaction in addressing greenhouse gases can impose a future drag on the economy of the same magnitude as the Great Depression;
- Respected retired military leaders finding long-term security concerns likely to be exacerbated by conflicts spawned by resource scarcity resulting from climate change;
- The endorsement by major company CEOs of mandatory, economy-wide greenhouse-gas cap-and-trade regulation in the United States;

- The introduction of more than 150 climate-related bills in the U.S. Congress, with the leading vehicle being authored by a Republican and an Independent;
- More and more states and cities adopting their own greenhouse-gas regulations or combining to do so;
- The Secretary General of the United Nations convening the world's leaders for a special United Nations session on global warming;
- President Bush convening the leaders of “major emitting economies” to find solutions to climate change;
- Institutional investors who manage \$41 trillion in assets seeking enhanced disclosure from companies of their greenhouse-gas footprints and climate-risk assessments;
- The largest leveraged buyout in history being altered to gain the approval of environmental advocates due to concerns over greenhouse-gas emissions; and
- The world's largest retailer turning to its suppliers to ask them to report on their greenhouse-gas emissions.

Surely similar developments will continue apace as world leaders consider a future global agreement to mitigate climate change and avoid what is known in global treaties as “dangerous anthropogenic interference” with the world's climate. Moreover, one of the key scientific insights that has emerged over the past year is that – even with



aggressive measures to reduce greenhouse-gas emissions – certain global consequences are already locked in and will require active management to enhance resiliency and avoid harmful consequences through adaptation. From a risk-management perspective, the goal is to “avoid the unmanageable and manage the unavoidable,” as a group of scientific experts convened by the United Nations Foundation aptly phrased it.

What, then, is business leadership to do in the face of this profoundly shifting landscape? As a preliminary matter, the luxury to sit back and simply observe these trends without any particular consequences appears to have dissipated. Society, so it seems, is at an inflection point where companies are now being characterized either as part of the solution or part of the problem. Indeed, many nimble companies today are staking out positions as first movers taking advantage of new market opportunities – such as in clean energy, promoting energy efficiencies, and with the emerging carbon markets. Others are finding opportunities to participate in designing the emissions regulatory framework by which they undoubtedly will live for some time. Increasingly sophisticated financial analyses and targeted investment funds are demonstrating the existence of an “ecoefficiency premium” in the value of companies who recognize the strategic advantage that can result from these trends.

A key starting place for any organization is broad thinking about climate impacts. For many companies, climate risk goes way beyond a simple compliance issue and implicates basic strategic choices. Climate-related physical events

can be broadly disruptive of basic business requirements such as power supply, transportation, telecommunications, as well as access to facilities, employees, and customers – regardless of a company’s industrial sector. Storms, wildfires, and drought can be devastating without adequate planning. New climate regulations, customer-driven demand, and a newly imposed price on carbon can make some products more or less attractive and may alter a firm’s value proposition. Key business resources, such as clean water for industrial production, energy, or timber, may become increasingly scarce or more expensive. It will be critical to assess and plan for each of these impacts over the short, medium, and long terms.

Three emerging trends – alone or perhaps even in combination – may prove central to the adequacy of business climate strategy development. In the United States, certainly, climate issues are increasingly moving into the courtroom. The spring 2007 decision from the Supreme Court – finding that greenhouse gases from motor vehicle emissions can be regulated under existing federal laws – was complemented by a predicate finding that litigants can demonstrate sufficiently imminent harms, such as from rising sea levels and more intense storms, and sufficient causation to the challenged emissions to be allowed to press such challenges today. This threshold determination was enormously significant. Litigation has now been brought in state and federal courts against huge segments of the American economy. Challenges have been brought to the adequacy of governmental considerations in writing regulations and permits in view of climate change. Other cases have been brought against emissions



from manufacturing, as well as against manufacturers for emissions from their products. Still others implicate emissions from power suppliers, or raise claims over emissions facilitated by credit agencies or by insurers. While these cases have faced mixed results thus far, they change the tenor of the debate as they heighten the imperative to have taken necessary and prudent steps to understand and begin to manage climate risks.

The second key trend is that of enhanced demands for disclosure of greenhouse-gas footprints, physical risks, and the strategic implications of climate change on businesses. The latest report from the Carbon Disclosure Project – which asks for such disclosure from more than 2,000 public corporations – is made on behalf of institutional investors managing in excess of \$41 trillion in assets. The Carbon Disclosure Project is deepening its efforts by serving in the future as the secretariat of a new international voluntary standards body – known as the Climate Risk Disclosure Standards Board – that will seek to compel more rigorous and complete disclosure around this range of climate risks. Couple these developments with a sophisticated petition filed in September 2007 by advocates and institutional investors asking the Securities and Exchange Commission to clarify the nature of required public reporting around climate risk. The power of this issue was exemplified by subpoenas filed shortly thereafter by New York State’s attorney general, asking companies to provide internal documents that would justify their limited climate-risk disclosures. The appropriate scope of the subpoenas and of underlying corporate risk analysis has been subject to contest.

These developments happen, of course, in an era where it is clearer than ever that businesses do not operate alone in the world. Complex supply chains and instantaneous global communications multiply the potential effect of an issue or incident in any one area. Stakeholders and outside interest groups provide the opportunity for new partners – or they may constitute new critics.

The third key trend derives from this connectivity. One feature of greenhouse gases is that they combine in the atmosphere and remain there for a long period of time. Scientists estimate that their effects last from 50 to 200 years. Nor does their source determine these effects – it really is the aggregate impact of emissions in the atmosphere that is of consequence. Yet the contributors to those emissions are shifting rapidly on a global scale. For years the United States has been the largest emitter of greenhouse gases. It remains the largest contributor to the levels of greenhouse gases aggregated over time and is far and away the largest emitter on a per-capita basis. As it industrializes, China – along with other developing economies – is rapidly moving up in the scale of its emissions. China's annual emissions are projected to outpace those of the United States sometime this year. That change shifts the focus significantly to business operations in the developing world. Concerns about developing-country emissions are growing more acute during the global climate change negotiations, beginning with the Bali talks in December 2007, to find a comprehensive and inclusive successor to the Kyoto Protocol.

For American and European companies that manufacture or source their supply chains in developing countries, this shift can mean a new attention to the climate impacts of their operations. Just as Western companies could not ignore child-labor practices in developing countries, so too is it increasingly likely that businesses will be held, in some measure, accountable for “outsourcing” emissions to the developing world. Indeed, some new studies estimate that nearly 30% of greenhouse-gas emissions in China result from the production of goods for export.

In an effort to get ahead of this issue, Wal-Mart – the world’s largest retailer – is working with the Carbon Disclosure Project to seek greenhouse-gas reporting from its 10,000 China-based suppliers. The company intends to work with key suppliers to find emissions reductions and, presumably, will factor the results of this disclosure into its purchasing decisions. Other companies, such as Cadbury Schweppes, are stepping up their supply-chain reporting around greenhouse gases. Private oversight and contracting may be seen by advocates as a substitute for insufficient government inspection capabilities in many developing countries. As the focus sharpens on developing-country manufacturing operations, companies should expect new calls to assess all of the strategic elements this implicates – from physical risk vulnerabilities to climate-related events to the adequacy of assessment and management of greenhouse-gas risks and opportunities in a carbon-constrained economy.



Where these emerging trends lead to likely is bound up with far broader issues concerning the success of legislative and regulatory measures in the United States and the ultimate development of a new and comprehensive global framework for addressing climate change. In the absence of success in these efforts, scrutiny of individual company behaviors can be expected to grow. It would be the combination of these trends – a focus on disclosure from global operations that’s enforced by litigation regarding the adequacy of such disclosure – that would perhaps be most challenging for many businesses. Under any scenario, proactive management of the full suite of climate-change risks will become increasingly essential for avoiding pitfalls as well as for optimizing new opportunities.



Gary S. Guzy is the global practice leader for Climate Risk and Sustainability at Marsh. He spearheads Marsh’s climate risk advisory and insurance services and leads sustainability efforts at MMC. Mr. Guzy came to Marsh after his appointment by President Clinton to serve as the general counsel of the U.S. Environmental Protection Agency (EPA).