

The Boardroom Climate on Climate Change



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On February 14, 2007, Illinois Governor Rod R. Blagojevich stated that “[t]he impact of global warming in Illinois and around the globe could be devastating, and we can’t wait for the federal government to act because scientists worldwide have warned that we must address climate change within the next decade to avoid serious and irreversible consequences.”

In fact, boardrooms are not waiting for federal legislation to take action to cut their greenhouse gas emissions, although, in an ironic twist, many companies would find federal legislation in this area preferable to the variety of state and regional regulatory schemes under development.

At Foley’s sixth annual National Directors Institute on March 8, 2007 in Chicago, “The Boardroom Climate on Climate Change” was a featured breakout session topic. The panel discussion was led by Lawrence McBride and Katherine Lazarski from Foley & Lardner LLP, along with Peter Breitstone, Aon Corporation; William Ferretti, Chicago Climate Exchange, Inc.; Steve Kline, PG&E Corporation; and Howard Sharfstein, Kimberly-Clark.

Companies are Not Waiting for Federal Legislation

For many companies, the commitment to reduce emissions is internal and multi-national. Companies doing business in other countries, for example, are potentially already subject to restrictions imposed by the Kyoto Protocol. Managers, firm-wide, may be directed to meet certain environmental and efficiency goals, and compensation or promotions are tied, in part, to meeting those goals. Companies report on both their commitment and their achievements to the public through sustainability reports or other mechanisms. Other companies have made a more public commitment by joining the Chicago Climate Exchange and voluntarily committing to reducing emissions by six percent by the end of 2010 from a 1998-2001 baseline, or by participating in the Department of Energy’s voluntary reductions program.

These efforts are sometimes costly and are not required by U.S. law, but there are a number of reasons why businesses are addressing greenhouse gas emissions now, rather than waiting for federal legislation.

First, for large-scale energy consumers, reducing emissions goes hand in hand with reducing energy consumption and production costs. In some instances, companies may still be hesitant to make initial investments in new technologies in order to be able to benefit from reduced energy costs over time. This is overcome where the senior management sets out goals across the company for reducing energy consumption, and ties compensation and advancement, in part, to achieving those goals.

Another motivating factor is customer demand. This impacts both large scale energy consumers and producers. In an era where a customer boycott of one or two percent can have serious impacts, some companies with a high consumer profile have chosen to respond to customer concerns about global warming and sustainability. For consumer products, carbon labeling, similar to nutritional labeling, may be part of a future regulatory scheme. Work done now to reduce emissions could pay off later when carbon labeling is standard and customers can more easily compare products. For energy



producers, customer demand for “green” energy alternatives is manifesting itself through public service commissions, which are increasingly looking at the greenhouse gas emissions of proposed projects.

For some companies, greenhouse gas reduction efforts are, in part, shareholder driven. The Dow Jones Sustainability Index is becoming increasingly important to a growing segment of “green” investors. Other companies view a commitment to emission reductions as an important element of protecting shareholder value where a company’s future performance will likely be impacted by greenhouse gas regulations and/or climate change itself.

Finally, California has passed greenhouse gas legislation that directs the California Air Resources Board to establish a cap and trade system designed to scale back emissions to 1990 levels by 2020. California also has legislation requiring its major utilities to produce at least 20 percent of their electricity from renewable sources by 2010. Although there is a possibility that federal greenhouse gas legislation will ultimately preempt the California program, companies in California have this obligation to address greenhouse gas emissions.

Cap and Trade Programs are Under Consideration

Much of the proposed greenhouse gas legislation being considered at the federal, state and regional levels involves establishing “cap and trade” regulatory programs. Basically a maximum emissions threshold (a cap) would be established for an industry, group of industries or a region. Allowances, or credits, are distributed among the affected companies permitting them to emit specified amounts of greenhouse gases (generally measured as carbon dioxide equivalents). If a company can reduce its emissions such that it does not need all of the allowances that it owns, those extra allowances can be sold to other companies. Some programs may also allow the use of “offsets,” where a company would be permitted to have emissions in excess of its allowances if it can take carbon out of the atmosphere in another way, such as purchasing and conserving a section of rainforest or prairie or by using geological sequestration (putting carbon back into the earth).

A cap and trade program has been operating in Europe for several years now under the “Kyoto Protocol Phase 1” cap. Companies with European experience suggest that the Kyoto Protocol Phase 1 cap was not very stringent, leading to lower market prices for emissions credits than originally anticipated. The Phase 2 caps are expected to be significantly more stringent, which will likely lead to higher prices for credits or offsets.

California has enacted legislation establishing a cap and trade program and there are a number of regional initiatives under development that would also establish cap and trade programs, such as the Regional Greenhouse Gas Initiative in the northeast and the Western Governors Association Initiative in the west. In addition, three of the bills currently introduced in Congress contemplate the use of cap and trade programs.

The Chicago Climate Exchange currently runs a voluntary cap and trade program, which allows trading of credits among its members. For companies leading their sector in emissions reductions, joining the Chicago Climate Exchange can be a way to monetize the



value of emissions reductions now and gain experience (looking forward to future regulations) with quantifying emissions and reductions.

Key to the credibility and success of cap and trade programs will be scientifically sound methods for measuring emissions and verifying emission reductions and offsets. If federal legislation is not forthcoming in the relatively near future, the current state and regional programs may mandate different methodologies for measurement and verification. Many national, and multi-national, companies would prefer to see a uniform system at the federal level – particularly if that will allow more flexibility in operations and broaden the market for allowances.

Risk Management Considerations

Companies face a variety of risks related to climate change. First, is the risk associated with actual global warming? As weather changes, sea level may rise, and certain locations may be more prone to natural disasters, and many predict that weather events — from rainfall and drought to hurricanes — will intensify. Second, companies will face risk associated with regulatory compliance. For example, if a company purchases offsets in order to comply with a cap and trade regulatory regime, what happens if the offsets fail? There may also be regulatory risk associated with disclosure, if companies fail to adequately disclose exposure to climate change under financial disclosure laws. For example, in December of 2005, 20 leading investors sent letters to the top 30 insurance companies in North America, expressing concern about the potential impacts of climate change and requesting disclosure of climate change risk exposure and preventative strategies. See [“From Risk to Opportunity: How Insurers Can Proactively and Profitably Manage Climate Change”](#) by Evan Mills and Eugene Lecomte, published by Ceres, August 2006. Finally, some companies are wondering if global warming will become a source of personal injury style litigation, following the trend of asbestos, tobacco, and lead paint litigation.

Insurance companies are still grappling with how to help their clients manage these risks. Innovative products are being developed to help back up the risk associated with emission reduction activities, such as energy savings policies to protect the installer or owner of energy efficiency technologies from under-achievement of predicted energy savings, renewable energy project insurance, and policies to address risk associated with carbon trading markets.

The Energy Sector

The energy sector, as a major emitter of greenhouse gases, faces a heightened challenge to reduce emissions while meeting increased demand. Each of the major climate change bills currently under debate in Congress contains special provisions for electric utilities. For example, the Sanders-Boxer bill (Senate bill 309, considered the “Gold Standard” among the bills currently in Congress) would impose new source low-carbon emissions standards, require retrofits of existing units, and create efficiency standards to reduce total electricity demand.

Many electric utilities will be increasing their investments in renewable energy technologies, as well as focusing on increasing consumer efficiency. The U.S. Climate Action Partnership, a coalition of corporations and environmental groups, advocates for



stronger efficiency standards in building codes and for equipment and appliances. Electric utilities are investing research and development dollars in concentrated solar, biomass, and wind sources of energy.

Potential Federal Action

Although there is currently a flurry of activity in Congress in the form of hearings, draft legislation and special committees, final legislation is not expected to pass until a new administration is in the White House. Meanwhile, states and regional coalitions continue to move forward with their own regulatory programs. The uncertainty hinders investment in renewable energy and other technical solutions, because it is difficult to assess the value of those potential investments in providing marketable emissions credits or offsets. Although the regulated community is often opposed to greater federal regulation, when federal regulation falls behind state regulations and the business practices forced by consumers and shareholders, the prospect of a uniform federal system for limiting and quantifying emissions gains appeal.

For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the panelists directly.

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Save the date! The 7th Annual National Directors Institute will be held on March 6, 2008 in Chicago. Learn more at Foley.com/ndi.