SHAREHOLDERS ACT TO CUT EMISSIONS

Notwithstanding the uncertain fate of the Kyoto Protocol, climate change regulations continue to take shape around the globe, even in countries that have not ratified it. There is recognition within business and insurance communities that business value may be affected by the costs and effects of climate change.

According to a paper by Robert Wyman, a partner at law firm Latham & Watkins, the emergence of these risks has not gone unnoticed by shareholder activists, many of whom are urging greater corporate disclosure regarding the magnitude of such risks and regarding their company's risk management strategies. He says that prudent corporate managers will address these developments, and implement appropriate disclosure and risk management strategies. Some activists have argued that failure to do so could be a breach of duty of care.

Shareholder activities

2003 was a watershed year for shareholder resolutions related to climate change. According to Wyman, shareholders filed 30 resolutions against 27 companies during the year. Several of these garnered significant support. For example, at American Electric Power, the largest US generator of coal-fired power, a shareholder resolution urging the company to take action to reduce greenhouse gas (GHG) emissions received 27% support. Other companies saw similar support: ChevronTexaco 32%; ExxonMobil 21%; GE 23%; Southern Company 23%; TXU 24%. While even the passage of such a resolution would not compel management action, the level of support for the resolutions has management's attention.

2004 promises to continue the trend in shareholder activism on the climate change issue. According to CERES, a coalition of US investment funds, environmental organisations and public interest groups, and a major force behind the groundswell of investor activity, shareholders filing climate change resolutions represent more than $250bn in assets.

On 19 February 2004, two of America's largest coal-fired generators – American Electric Power and Cinergy – responded to these developments, making significant commitments to manage climate change risk. These include promises to assess impacts of, and responses to, several legislative proposals that would limit GHG emissions and permit a committee of independent directors to oversee their reports. At the end of 2003, some major oil companies took significant steps to meet shareholder demands. For example, ChevronTexaco and ConocoPhillips committed to set GHG targets, while ExxonMobil provided more detailed emissions reports for operations in 2003.

Regulatory developments

Wyman says it is no simple task for a corporation to survey the wide range of climate change-related regulatory developments to determine how it may be affected by emerging climate change programmes. Companies cannot predict, for example, whether Russia will ratify the Kyoto Protocol, thereby allowing it to take effect. Even if Kyoto takes effect, it is difficult to predict to what extent its flexibility mechanisms (eg, emissions trading, clean development mechanism and joint implementation) will offer practical alternatives to otherwise costly facility- or product-specific GHG reductions. Likewise, companies can't predict whether US Congress will impose a mandatory GHG reduction programme in place of the President's current voluntary one and, if it does, what level of control it will impose.

But Wyman says the European Union seems committed to implement a cap and trade programme even if Kyoto does not take effect. Most EU member states have issued their National Allocation Plans and are gearing up for the 2005 commencement of the first of two phases of GHG reductions to achieve the EU's overall 8% reduction in emissions from 1990 levels by 2012.

Many other countries are in the process of implementing their own GHG reduction programmes, although they differ significantly in design. Although Canada has ratified Kyoto, it has pursued voluntary agreements with industry and implemented a variety of demand-side strategies to improve energy efficiency. In Australia, which did not ratify Kyoto, the government has set generator efficiency standards for new power plants and required existing plants to meet best practices standards.

Wyman believes many nations will have significant GHG plans in place in the not-too-distant future. However, until many of the critical details of these programmes take shape, it will be difficult to predict their likely cost on corporate operations. Indeed, even as regulations take shape, litigation is likely to influence further the development of programmes around the world. Recent and anticipated litigation may address fundamental issues, such as which levels of government will regulate GHG emissions, whether quasi-government investments in fossil fuel projects must consider GHG impacts and whether proposed allowance allocation methods have been distributed fairly.

Recommended strategies

Wyman gives advice as to how companies can best address climate change-related risks. His suggested steps are:

- Develop inventories of GHG emissions from products and processes, incorporating any anticipated changes in emission factors due to new controls or changes in product design.
- Benchmark GHG emissions and efficiency performance against peers.
- Track developments in relevant jurisdictions, evaluate the effect of different regulatory approaches (eg, cap and trade vs efficiency-based models) and participate actively in regulatory development.
- Identify, evaluate, rank and, as appropriate, implement potential GHG emissions-reducing actions.
- Participate in emerging GHG emission credit markets.
- Diversify products and fuels.
- Identify and evaluate appropriate long-term strategies.
- Integrate potential climate change impact analysis into disclosure reviews for reporting.

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Useful links

- ***Disclosing and Managing Climate Change Risks in an Uncertain World* can be found at *www.lw.com***
- **Contact Robert Wyman at robert.wyman@lw.com**