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# GLOBAL CLIMATE CHANGE CREATES A NEW CARBON BUSINESS FOR U.S. COMPANIES

by Michael J. Zimmer\*

## INTRODUCTION

Attempts to manage and mitigate global warming can emerge as a major U.S. business opportunity. A sensible, sustainable policy to mitigate climate risk can earn returns, promote lower energy and operating costs, and create high quality, productive jobs built on technology and climate based business solutions. Ancillary banking, trading, insurance, venture capital, and private equity activities will compliment the opportunity and promote economic development. Companies in the United States are just starting to appreciate the business prospects in the formation of their strategic plans.

The U.S. stimulus for action is coming from states, certain companies, and consumers recognizing that climate change creates risks for companies we operate and support, invest in, and manage. As part of a global economy, U.S. companies operating abroad are already participating in carbon management schemes because of local Kyoto compliance obligations in their host countries. Disclosures of climate risk increasingly appear in lending decisions, credit reviews, and in financial reporting. Industries are being assessed, and how companies respond and measure this issue already counts. In the near future, climate risk strategies may assume levels of fiduciary responsibility with shareholder, stockholder, and litigation exposure.

We are already seeing the potential impacts on corporate value from carbon discussions. Presupposing that corporate counsel can help the company manage these impacts requires several areas of critical contribution working with the financial, engineering, marketing, public affairs, and technical staffs of the company. The development of a portfolio of strategies to recognize and diversify the basis for climate risk over as broad a base is no longer merely pioneering, it is prudent. Company performance, market survival, competitive market positions and opportunities are at stake because carbon is now a commodity.

## CARBON BUSINESS OPPORTUNITY

Climate change management can emerge as a major U.S. business opportunity independent of Kyoto compliance obligations as well as a critical economic development imperative for U.S. businesses.<sup>1</sup> Companies face escalating international pressure, natural pressures, rising energy prices, water supply uncertainty, and mounting concerns about air quality affecting their business operations. A sensible, sustainable carbon policy to mitigate climate risk can earn returns, promote lower energy and operating costs, and create high quality, productive jobs for U.S. companies built on cleaner technology and climate solutions integrated into their core business activities.<sup>2</sup> A company's management of these issues can create market differentiation trans-

lating to corporate value. Opportunities are not limited to manufacturing or utility companies, but also include service companies and commercial buildings in their operations and business choices. New stakeholders such as banking, trading, insurance, venture capital, engineering, pension plans, and private equity firms will enhance the opportunity and promote economic development with global benefits.<sup>3</sup> U.S. companies are just starting to appreciate the business prospects in the formation of their business plans and competitive models to manage climate-based change.

At present, federal and state initiatives do not dictate solutions for the private sector; instead the policies encourage domestic companies to address these challenges with balance. This industry-driven policy approach could be more lasting because government is pointing business in the right direction through various Department of Energy and Environmental Protection Agency climate-based programs, whose policy guidance compliments the interests of the insurance, pension, financial, and banking interests that promote separate risk management objectives. Instead of mandating change, the government thus serves as an incubator for new solutions regarding climate management in a process similar to the formation of the advance markets for biotech, defense, homeland security, satellite communication, clean energy, and the internet industries in the U.S. economy.

Carbon management, stewardship, and sustainability will ultimately become good business in the United States as companies examine and alter their business models for the future<sup>4</sup> precisely because the old rules of competitive market advantage have changed. New market strengths and business models are required that go beyond the old metrics of cheap labor, energy, raw materials, and commodities. These new models will be centered on capital, innovation, efficiency, transportation, raw energy transformation into new fuels, and technology deployment in the new carbon economy. The old metrics reward risk management and the bottom line; whereas, the new paradigm in a carbon constrained world centers on branding and reputation enhancement, creating a competitive edge, developing new products or systems, reducing fossil fuel consumption, or the "greening" of existing products.

Once again, as part of a global economy, U.S. companies are already being forced to and manage an array of climate risks. The time horizon for risk management is accelerating and busi-

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ness models are changing as a result. Advanced technologies and new energy strategies will offer new models for the future and strand the assets of companies built on the past. Disclosures of climate risk are now appearing in lending decisions, credit reviews, and in financial reporting.<sup>5</sup> Industries are being reassessed, and how companies respond and measure climate challenge already counts. In the near future, climate risk strategies may assume levels of fiduciary responsibility with shareholder, stockholder, and litigation exposure.<sup>6</sup>

## CORPORATE VALUE

We are already seeing carbon discussions impact corporate in leading U.S. companies across industries. Positive impacts on new investments in infrastructure improvements are arising that create Clean Development Mechanism benefits under the Kyoto Protocol. These investments are being explored by the manufacturing sector, as well as the oil and gas industry mining and chemical industries. U.S. multinationals have retained Wall Street firms for this purpose since 2005.

The electric industry experiences direct costs for emissions abatement through the purchase of allowances and shifts in fuels, deployment, or geographic location of plants.<sup>7</sup> Differences do exist within the industry over the preference of various control strategies such as using a cap and trade system or a carbon tax. Indirect costs to cap emissions are recognized and valued through, market perceptions of shareholder value, as confirmed in the Carbon Disclosure Project's annual carbon reporting and disclosure exercises.

Assessments for insurance, bonding, and costs of capital reflect climate risk factors; this in turn impacts the price and availability of underlying insurance coverage.<sup>8</sup> As a result, new insurance products coupled with financial risk management techniques are appearing in the United States. Climate change is creating a new evaluation of risk factors for investment decisions versus credit purchases, business units for sales, or acquisitions.<sup>9</sup>

For the future, transportation logistics impacts and arbitrage opportunities for fuel, supply, international trade for import products, airlines, ports and harbors, railroads, and new industries like biofuels will become even more critical in a carbon constrained world.<sup>10</sup> Energy conversion from fuels, environmental, transportation, environmental finance, and climate change management strategies are converging. Certain industries are leading, while dramatic prospects lie ahead for electric utilities, oil and gas, commercial real estate, airlines, mining, and transportation sectors to develop more dynamic, market-centered carbon strategies.<sup>11</sup>

## FUTURE CONTRIBUTIONS TO CARBON OPERATIONS BY COUNSEL

Counsel working with the financial, engineering, marketing, public affairs, and technical staffs can help a company in several areas of critical contribution to carbon operations.

Standardization is an area whereby counsel can provide assistance. Counsel can help promote standard terms, definitions, and protocols in contracting, procurement, and chain of supply transactions. Counsel can also provide assistance by linking carbon and tax or accounting treatments into financial

services, financing and product evaluations. If a company has contingent liabilities caused by climate exposure, how would the auditors report those liabilities?<sup>12</sup> The degree and extent of reporting disclosure on this subject would be a concern for the U.S. Securities and Exchange Commission or the Financial Accounting Standards Board.<sup>13</sup>

Carefully assessing the legal nature of a carbon allowance or credit is another area counsel would be able to provide assistance. For example, counsel would be able to deem if it is a financial investment, commodity, intangible, derivative, or security. The utilization of metrics for measurement, which will provide new tools to gauge corporate performance are changing, and should include technical emissions, accounting and economic data on products and services, is another area requiring legal expertise.<sup>14</sup>

Integrating carbon strategy with procurement, logistics, transportation, environment, and fuel conversion into energy functions of a company will be another topic requiring legal assistance. Such functional integration requires top down management direction and support because the efficiencies will create cost offsets.<sup>15</sup> Single dimensional analysis of merely costs without applying savings efficiencies does not offer the complete picture enhanced through cross-functional terms.

Counsel will also be able to help businesses keep current with regulatory advice and strategy in Canada, Europe, and Asia since they are setting the trends for the future to 2012. After Kyoto expires or is transitioned to a new regime, understanding regulatory strategies for extension of carbon management and trading is essential for protection of corporate assets, divestitures, targets, and merger strategies.<sup>16</sup>

Assisting companies with linkages to competitive market intelligence by industry, peer groups, trade associations, and other benchmark activities on carbon management and finance will be another responsibility of counsel. Monitoring market intelligence is of vital importance to ensuring maintenance of a company's competitive edge. Additionally, information technology linkages will also require the assistance of counsel. Speed of information management is important, but also creates new risks.

Counsel must also work with companies to help expand risk management strategy over carbon for insurance, bonding, construction, fuels, safety codes, material securities disclosures, and corporate governance obligations of the company.<sup>17</sup>

Supporting interactive energy, environment, and fiscal budgeting tools to measure these new performance parameters and a new analytical paradigm for carbon is another potential responsibility of counsel. Intensity and productivity are new metrics of the future. Counsel must be careful with internet and data management platforms compromising a company's confidentiality and data security interests.

Communicating a company's results to stockholders, shareholders, employees, regulators, and governance bodies to establish a leadership position and brand on carbon management is another issue counsel can provide assistance. Further, companies will need aid from counsel to manage fiduciary responsibilities. Guidance will likely be sought to help establish internal systems

to measure risks, liability, and to minimize future litigation by early actions that have a strong governance base grounded in fiduciary responsibility.

Counsel will also be able to provide companies with assistance to reduce environmental/energy costs in existing operations, creating potential profitability, productivity and sustainability benefits. Additionally, if carbon disclosure is measured in lending and insurance underwriting, counsel can help evaluate whether carbon disclosures should become incorporated into representations, warranties in financing, and mergers and acquisitions transactions for companies.<sup>18</sup>

## CONCLUSION

Developing a portfolio of strategies to recognize and diversify the basis for climate risk over as broad a base as possible is now prudent, not pioneering, because a company's economic performance, markets, competitive market positions, and opportunities are at stake. Investors will demand a management approach for carbon to assess financial risk from liabilities, investment opportunities in green products, process or technology, and for stakeholder and public relations.<sup>19</sup> Responsible companies will benefit, others will pay.

Carbon is now a commodity with economic value. The United States must now participate in offset projects in foreign countries and between industries and in supply chain planning to satisfy its carbon objectives. Comparable links to carbon trading platforms in other countries will make a U.S. system more efficient and effective while successfully participating in a global economy. Moreover, the recognition of such opportunities will provide the linkage of capital and innovation with clean energy and carbon management to capture and support the major sustainable investments and growth of the twenty-first century. This can only be powered by fundamental business recognition of Thomas Friedman's current admonition that: "Green is the new red, white and blue,"<sup>20</sup> and that the United States must lead in a changing global economy by incurring the short-term costs, in creating new high tech jobs to achieve improved, sustainable corporate performance.

But in the execution of new policy and a new order of things, the devil is the details. The United States cannot afford to create structural errors in a global economy with developing markets that do not carry the same burdens and responsibilities. Change is needed. Carbon management and implementation cannot become a tool to alter the competitive balance of the world economy and convert the important corporate mission merely into a new environmental financial derivative. Legacy markets would face their demise, crippling under costs they cannot pass-through; developing markets would gain the new competitive edge in costs, labor, commodities, and materials, and the only final market winners will be the traders of a derivative for a newly conceived commodity product with little long-term global value.

The new arbiter of competitive advantage will become innovation, access to capital, new products and processes, sophisticated technology deployment, fuel conversion into more refined forms of energy, and managing the strength and costs of the

transportation system and logistics to move, store, and ship products. This will ensure that physical assets stand behind carbon management in the new business model to sustain value and not merely proprietary financial trading with little physical support nor reality.



## Endnotes: Global Climate

<sup>1</sup> See generally Andrew J. Hoffman, *Getting Ahead of the Curve: Corporate Strategies That Address Climate Change* for the PEW CENTER ON GLOBAL CLIMATE CHANGE (2006), available at [http://www.pewclimate.org/docUploads/Synthesis\\_Report\\_CorpStrategies.pdf](http://www.pewclimate.org/docUploads/Synthesis_Report_CorpStrategies.pdf) (last visited Feb. 8, 2007).

<sup>2</sup> Hoffman, *id.* at 1.

<sup>3</sup> Hoffman, *id.* at 2.

<sup>4</sup> Abyd Karmali, *Best Practice in Strategies for Managing Carbon*, in THE FINANCE OF CLIMATE CHANGE: A GUIDE FOR GOVERNMENTS, CORPORATIONS AND INVESTORS 259, 259-270 (Kenny Tang ed., 2006).

<sup>5</sup> See *Investors Seek Climate Change Information*, N.Y. TIMES, June 15, 2006, at C8.

<sup>6</sup> See Security and Exchange Commission's website, <http://www.sec.gov> (last visited Feb. 15, 2007) (providing basic information regarding disclosure requirements).

<sup>7</sup> DELOITTE RESEARCH, WHICH WAY TO VALUE? THE U.S. POWER AND UTILITY SECTION 2005-2010 (2005), available at [http://www.deloitte.com/dtt/cda/doc/content/DTT\\_DR\\_WW2V\\_Sept05a.pdf](http://www.deloitte.com/dtt/cda/doc/content/DTT_DR_WW2V_Sept05a.pdf) (last visited Feb. 8, 2007).

<sup>8</sup> See PEW CENTER ON GLOBAL CLIMATE CHANGE, THE AGENDA FOR CLIMATE ACTION, available at [http://www.pewclimate.org/docUploads/PCC\\_Agenda\\_2.08.pdf](http://www.pewclimate.org/docUploads/PCC_Agenda_2.08.pdf) (last visited Feb. 8, 2007) (reporting that European insurers are showing leadership, while U.S. companies are escalating their own activities).

<sup>9</sup> Jeffrey A. Smith, *The Implications of the Kyoto Protocol and the Global Warming Debate for Business Transactions*, 1 N.Y.U. J. L. & BUS. 511, at 511-550 (2005).

<sup>10</sup> Sen. Energy & Nat. Resources Comm., *Hearing Notice*, available at [http://energy.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing\\_ID=1607](http://energy.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=1607) (last visited Feb. 8, 2007) (hearing to be conducted on Biofuels before full committee on February 1, 2007).

<sup>11</sup> See *Companies and Climate Change: Can Business Be Cool?*, ECONOMIST, June 10, 2006 at 70; Marilyn A. Brown et al., PEW CENTER ON GLOBAL CLIMATE CHANGE, *Towards A Climate — Friendly Built Environment* (2005), available at [http://www.pewclimate.org/docUploads/Buildings\\_FINAL.pdf](http://www.pewclimate.org/docUploads/Buildings_FINAL.pdf) (last visited Feb. 8, 2007).

<sup>12</sup> This determination ventures into risky grounds. See, SEC Regulation S-K, 17 C.F.R. § 229.101 (2005).

<sup>13</sup> See SEC Regulation S-K, 17 C.F.R. § 229.303(a)(1) (2005) (requiring management discussion and analysis to disclose "known certainties" that could result in material consequences. This disclosure includes "currently known trends, events, and uncertainties, that are reasonably expected to have material effects").

<sup>14</sup> Hoffman, *supra* note 1, at 10.

<sup>15</sup> Hoffman, *supra* note 1, at 37-45.

<sup>16</sup> See CARBON DISCLOSURE PROJECT (4th Ed. 2006).

<sup>17</sup> See 17 C.F.R. §§ 229.101-303 (2005); see also *TSC Industries v. Northway*, 426 U.S. 438, 448 (1976) (demonstrating that "materiality" is a matter or development that has significantly altered the total base of information made available to the investor).

<sup>18</sup> Cf. Letter from Investor Network on Climate Risk (INCR) Investor Group to Christopher Cox, Chairman, Securities & Exchange Commission (June 14, 2006), available at [http://www.ceres.org/pub/docs/Ceres\\_INCR\\_SEC\\_letter\\_061406.pdf](http://www.ceres.org/pub/docs/Ceres_INCR_SEC_letter_061406.pdf) (last visited Feb. 8, 2007).

<sup>19</sup> Ceres, *Investors Call on SEC to Require Corporate Disclosure on Climate Change* (June 14, 2006), available at [http://www.ceres.org/news/news\\_item.php?nid=197](http://www.ceres.org/news/news_item.php?nid=197) (last visited Feb. 8, 2007).

<sup>20</sup> Thomas Friedman, Speech to American Council on Renewable Energy (ACORE) Policy Conference (Nov. 30, 2006).