

Cos. Need ESG Strategies That Address Climate Change

By **Todd Roessler** (June 25, 2021)

A day does not pass without another article on the environmental, social and governance trend accelerating around the world, and climate change is at the forefront of the ESG movement.

Recently, the U.S. Securities and Exchange Commission has taken several steps to accelerate the push for more standardized ESG disclosures, including, in February, enhancing its focus on existing climate risk-related guidance.

One month later, the SEC announced that it is seeking the public's comments in developing new climate change disclosure rules, and the creation of an ESG task force to crack down on potential disclosure violations.



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In response to recent scrutiny, activist shareholders of ExxonMobil Corp. — likely the most targeted company for climate change lawsuits and enforcement actions — elected new directors to its board in an effort to force the company to adjust its strategy and address the effects of climate change.

Virtually every part of the complex global economy is potentially affected by some aspect of climate change. There are myriad disclosure frameworks, standard-setting entities and evaluation models. Shareholders, suppliers, customers, communities, employees, governments and nongovernmental organizations must all be considered.

Consumer and investor concerns, when combined with the federal government's increasingly active role in addressing climate change, reinforce the need for companies to develop and evolve their ESG policies. It can be a challenge to know where to turn as companies assess risk and set ESG strategy using the best science to navigate uncertainty.

I recently spoke with other industry leaders David Golden, former senior vice president, chief legal and sustainability officer, and corporate secretary of Eastman Chemical Co., and Carol Anne Clayson, Ph.D., senior scientist and former director of the Ocean and Climate Change Institute at the Woods Hole Oceanographic Institution, in a webinar addressing ESG, climate change science, uncertainty and organizational strategy. Some key takeaways from our conversation are summarized below.

Climate change knows no borders.

Although we don't know precisely how, when and where, there should be no dispute that the climate is changing. Temperatures are increasing, wet areas are becoming wetter, dry areas are becoming drier, storms are becoming more destructive and sea level is rising.

Climate change is more than physical risks.

The law is evolving as a result of climate change and the ESG trend, and companies will face new legal, regulatory and transitional risks, including:

- Identifying and assessing ESG risks, vulnerabilities and opportunities;

- Mandatory and voluntary ESG disclosures;
- New regulatory developments related to ESG and climate change;
- Increased enforcement, including potential criminal prosecution, related to ESG and climate change;
- New and evolving litigation risks;
- Reopeners for contaminated sites; and
- Evolving sustainable finance programs, including green, blue, social and sustainability bonds.

Not only is there potential liability, but other issues exist as well, including reputation risks, brand protection and shifting consumer preferences.

ESG is emerging as a "new regulator."

Each level of government is not only taking an increasingly active role in addressing ESG and climate change, but a new regulator has emerged. Investors, shareholders, consumers and supply chains are driving companies to develop and evolve their ESG and climate change policies.

Understand risks before disclosure.

For public companies in the U.S., the SEC does not mandate specific ESG or climate change disclosures. Instead, it focuses on the broader requirement to disclose material risks. Potential disclosure violations and potential lawsuits, however, are not limited to mandatory disclosures made by public companies.

Many companies have increased the scope and quantity of voluntary ESG disclosures over the past decade, in response to demands by investors and consumers for greater visibility. A number of voluntary disclosure frameworks and standards have been developed to assist companies in making ESG disclosures.

Before a company makes any disclosures, it needs to understand what risks climate change poses to its company. The disclosures should include quantitative information and metrics.

The disclosures should also include any opportunities that climate change presents.

Risk assessments vary based on a company's capabilities and priorities. Companies should begin by developing an inventory of assets, evaluating the importance of each asset, and implementing a high-level initial screening of core operations and value chains, to prioritize those areas that are most at risk and may require more detailed assessment.

Risk must be understood in two parts: (1) the probability that an adverse event will occur; and (2) the consequences of the adverse event. Existing risk management programs can be used, but they need to be adapted to include specific risks and time frames associated with climate change.

Have a clear, defined strategy.

It's not just about disclosures. Investors and stakeholders want to see a company's plan to address climate change. Recognizing risk is one thing; having a clear strategy that can be implemented is another.

Plans and compliance programs must be based on risks and material issues. These will be different for each company. There is no one-size-fits-all plan to address ESG and climate change.

It's critical to determine what is important to your company. When developing a plan, the plan should address attaining resilience, decarbonizing and how the company will finance these activities.

Adapting to climate change and building resilience is really no different from what prudent companies have already been doing: strategic planning, risk assessment, investing in infrastructure, diversifying the supply chain, safeguarding employees and using the best available information and science to address potential risks. Successful companies are seeking to gain competitive advantages and seize opportunities by effectively assessing and managing climate change risks.

Scientists believe that it is essential that we meet the goal of net zero carbon emissions by 2050, at the latest, with an interim goal of a 45% emissions reduction by 2030. Many companies have established decarbonization as a priority, and pledged to attain net zero. Very few companies, however, have a clear, attainable plan for how they will meet this goal.

All net zero policies are not equal. When some companies say they are aiming for net zero, they are only talking about the emissions that come directly from their own operations.

To be a meaningful policy, net zero must include a company's Scope 3 emissions — which include emissions from customers that use a company's products, as well as from a company's supply chain. Achieving net zero is not a simple task, and will look different for each company.

A company's plan must also include how it is going to pay for these measures to address climate change. There is no easy answer. These investments may require substantial up-front costs that only generate benefits over many years.

There are, however, new and evolving financial mechanisms, and companies will need to look at a variety of ways to finance these measures, including corporate green bonds, public sector financing and new insurance products.

There are uncertainties with climate change, but these uncertainties are bounded. When faced with uncertainty, companies should stay close to the science and build protections into their plan. Companies should develop strategies that are adaptive, flexible and can be changed as more is learned about the nature and vulnerability to climate change.

It's not a sprint, it's a marathon — and you need to start the race.

Inaction comes at a cost. The quicker more adaptable companies will be the companies that overcome these risks and thrive. The conversation needs to shift from "the world is falling apart" to "what can my company do?"

You're not alone.

A number of voluntary disclosure frameworks and standards have been developed to assist companies in making ESG and climate change disclosures. Look to industry groups and corporate sustainability experts to access information. But remember that not all experts are equal.

Companies will need to establish climate transition teams to meet their goals. It's not just up to the compliance or sustainability department: ESG and climate change should be integrated into a company, and involve corporate leadership, directors, internal ESG and sustainability personnel, and outside experts. Find the best technical and legal experts that work together and collaborate.

Addressing climate risk is not altruism — it's about securing the safety and the future of your company. Companies that successfully develop ESG and climate change strategies will not only reduce risk and ensure compliance, they will find opportunities to protect their reputation and brand, enhance resiliency, and achieve long-term profitability and value creation.

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