# The Evolution of Corporate Sustainability in the U.S.

## (And what it means for your company!)

BY RITCHIE PRIDDY

*MENTION SUSTAINABILITY TO THE AVERAGE PERSON AND YOU GET A VARIETY OF VIEWPOINTS. MOST PEOPLE ACT AS IF THEY CLEARLY KNOW WHAT IT IS—RENEWABLE ENERGY, DOING MORE WITH LESS, SAVING THE EARTH FOR FUTURE GENERATIONS, AND OTHER "FEEL GOOD" DESCRIPTIONS. BUT, TO A GROWING NUMBER OF COMPANIES IN THE UNITED STATES, AND AROUND THE WORLD, IT IS BECOMING ONE OF THE MOST IMPORTANT MEASURING STICKS OF SUCCESS. YET, MANY BUSINESS LEADERS CANNOT ADEQUATELY DEFINE WHAT SUSTAINABILITY IS. THEY AREN'T ALONE.*

In fact, many energy executives – who oversee companies that are mandated by utility commissions to "lead" the effort – struggle with an adequate definition. Their struggles hamper the efforts to develop new products and services their customers are beginning to demand.

For the purposes of this article, sustainability is...

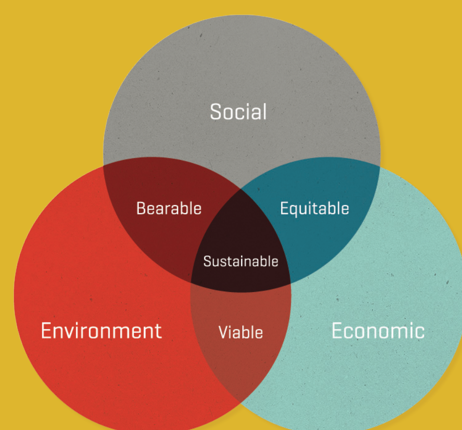
"An approach to business that creates long-term stakeholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. In short, sustainability is the result when responsible actions lead to long-term success."

Simply put, *sustainability is effectively managing risk.*

Sustainability is becoming more than just the latest buzzword, as evidenced by the rapidly increasing number of companies who have hired Chief Sustainability Officers (CSOs), adopted formal sustainability programs, publish annual sustainability reports, and require suppliers to adhere to stricter standards.

Sustainability is now an entrenched part of Corporate Social Responsibility (CSR), also known as the "Triple Bottom Line"—that is, it resides at the intersection of a company's Social, Environmental and Economic performance. It has been legitimized.

*CORPORATE SOCIAL RESPONSIBILITY (CSR)*




We're on the cusp of a huge wave that will soon break over the island that we call existing business, and will forever change our paradigm of how the world works. Any company that doesn't realize this is in danger of missing the early opportunities to win in the new paradigm. If they fail to understand that all businesses are increasingly "graded" by their customers, peers and even suppliers on sustainability issues, they do so at their own peril. Chances are, their competitors are seeing that same wave, and some of them are realizing that sustainability can be a differentiator.

How did we come to a point in the evolution of business that we have to be so concerned about something we can't adequately define – that the overall public really has never shown much interest in – but is rapidly growing in importance, despite lack of mandates, at least in private industry? Was it legislation, regulation, executive orders or mandates?

The answer is not so simple, but the trend is easy to pick up. The conclusion one walks away with, based upon the evidence and subsequent actions, is that as far as corporate America is concerned, peer pressure and the search for a competitive advantage are the leading influencers of behavior as it relates to climate change.

There are several reasons for that conclusion. First of all, there are the signposts, and second, there are drivers. Lastly, there are specific actions caused by the drivers.

The signposts include:

- *Signpost 1:* Widespread acceptance that climate change is real, and humans have had a dramatic impact (a lot of this has to do with the media, but increasingly and more recently, it has been bizarre weather events). Skeptics are ostracized and given no voice.
- *Signpost 2:* The money grab from emerging economies and governments (it's almost a North-South/ Haves-vs-Have Nots Cold War).
- *Signpost 3:* The scarcity (real or imagined) of resources (energy, water, food) in the face of growing demand and growing populations.
- *Signpost 4:* The successful attempt by environmentalists and other stakeholders to tie a company's economic performance to its social and environmental performance.
- *Signpost 5:* The very real lack of investment in energy resources and infrastructure.
- *Signpost 6:* The U.S. Department of Defense (DOD) findings that climate change poses a national security threat. That conclusion, found in several DOD policy publications, has led to the transformation of the entire federal government policy towards climate change, and that has serious implications for private industry.

What is surprising is that the signposts, and subsequent actions, have largely bypassed the international treaty process characterized by the Kyoto Protocol. Few would consider Kyoto, and the successive iterations, successful. In fact, the entire process has largely been discredited, or ignored. The truth of the matter, however, is that it has led to other signposts and actions, many of which have now been codified in law.

Each of these signposts have led to identifiable drivers (many overlapping), which are manifesting themselves into specific actions. (For the purpose of this article we'll focus on U.S.-specific drivers and actions.)

All of the signposts have led to the following drivers in the United States:

- It's not just media or academic hype anymore. The first six months of 2011 had the highest insured loss globally on record ($55 billion). Source: Insurance Information Institute (www.iii.org).

  Insurance companies have some of the largest holdings in real estate, and have tremendous influence on building codes, financing, legislation and regulation, and, of course, insurance rates. They can force changes that governments cannot, and they are waking up to the perceived financial threat climate change poses to their investments.

- The amount of litigation that has stemmed from climate change perceptions is staggering, and it is just beginning. Many consider climate change litigation to be the "next frontier" in law. Shareholder lawsuits related to corporate climate change actions or inactions are increasing, but it is the climate change "nuisance" suit that keeps many energy executives up at night. [For a good indicator of the number of lawsuits related to climate change see: http://www.climatecasechart.com/.] The threat of CC litigation is changing behavior of many companies. This is very similar in nature to the tobacco lawsuits.

- The complete transformation of U.S. policy towards climate change. Despite the fact that skeptics will never accept the legitimacy of climate change, it is a settled issue with the federal government. The most important driver of U.S. policy comes from the DOD, the largest energy user in the entire government, which concluded in the 2007 CNA Military Advisory Board (MAB) report entitled "National Security and the Threat of Climate Change," that climate change constitutes a "threat multiplier" to existing security risks in some of the most volatile regions in the world. The follow-on 2009 report concluded that fossil fuels, as well as the nation's fragile electricity grid, pose significant security threats to the country as a whole and to the military in particular.

  To the military, climate change is a fact. It is already shaping the operating environment, roles and missions it undertakes. And, it has embarked upon a course of mitigation, which it defines as "simply taking steps to lessen the severity of climate change." Now, that philosophy is shaping the entire federal government's response to climate change.

  In 2009 President Obama signed Executive Order 13514, which requires all federal agencies to set sustainability goals and to make improvements in their environmental, energy and economic performance (http://edocket.access.gpo.gov/2009/pdf/E9-24518.pdf).

- The realization that the energy infrastructure is falling apart due to lack of investment. The extreme heat and stress on the nation's electric grid last summer exposed the clear risk to energy reliability. There were times in ERCOT (Texas), in particular, that the reserve margin fell below five percent, possibly just hours from rolling blackouts.

Specific actions relating to these drivers include:

- 2010 SEC Guidance Document – all publicly traded companies must disclose all climate change-related risks and opportunities in their annual reports. This has led to a growing number of companies hiring a Chief Sustainability Officer, and publishing a sustainability report annually.

- Supply chain reporting – popularized by Wal-Mart, but rapidly being adopted by thousands of companies. This forces suppliers to disclose energy use, emissions and sustainability actions. It also pushes risks and costs to suppliers. Quite frankly, this action alone will have a greater impact on compliance than any international treaty ever could, simply because if a supplier does not comply it could be de-listed.

- Public disclosure of energy and emissions for both government and private companies. Ex: NYC, Austin, Seattle, California and more on the way. This has particular importance for real estate companies because public disclosure of energy and emissions data (and subsequent energy ratings) directly influences the value of their properties. [Note: insurance companies are large investors in real estate.]

- State and local legislation and regulation mandating energy and emissions reductions. Some 22 states have energy efficiency and energy reduction mandates. A good number of these rules are the result of lack of investment, particularly in larger metropolitan areas with older infrastructure and located in non-attainment areas. System operators are finding it increasingly difficult to provide a reliable power supply, particularly on peak days.

- Existing and pending EPA regulation such as the Cross State Air Pollution Rule (CSAPR) that could force the closure of significant numbers of coal plants and some older gas plants. This will have significant, and, in some cases, immediate impact on reserve margins. That means more emphasis will be placed on demand side management, including demand response and efficiency.

- Investment in clean technologies. According to Cleantech Group LLC (www.cleantech.com) global IPOs for clean technology companies rose to 93 in 2010, raising $16.3 billion; there were 716 global clean tech mergers and acquisitions worth $35.98 billion. There were also 161 joint ventures valued at more than $14 billion; and venture capital groups poured almost $8 billion into U.S. companies. These numbers do not include the untold billions spent by private companies and individuals on R&D. The top sectors, at least in the U.S., were Energy Efficiency with 21 percent of the 715 VC deals announced last year ($595 million); followed by Solar (16 percent); Storage (8 percent); Transportation (7 percent) and Smart Grid (6 percent).

- Research findings that working for a responsible and clean company is growing in importance to employees.

- The growing number of university courses and curriculums relating to sustainability. Universities respond to what corporate America wants, and the trend is clear.

So, what does this all mean to the future of business? Obviously, things are changing, and business as usual is becoming a thing of the past. Behavioral change will become more important, though history shows that the only long-term impact on behavior change is sustained, high prices.

Efficiency improvements and demand side management will become far more important than in the past, and we will increasingly rely on technology to maintain our standard of living. Companies will need to stay abreast of innovation. Public disclosure of energy (and water) usage and emissions will become increasingly commonplace because that influences peer pressure and drives compliance.

Cutting costs by improving efficiency enables companies to lower energy use, which leads to lower emissions, so they can claim the mantle of sustainability. If done properly, these improvements can lead to a competitive advantage.

In the end, barring some unforeseen event, we won't need more legislation or regulation because peer pressure is driving sustainability action. What company can successfully fight peer pressure from investors, insurance companies, environmentalists, the military (Mom, Apple Pie, and America), and yes, their own employees?

Businesses that don't adapt will lose.