Creating a Corporate Climate Change Strategy: The Right Approach by Nick Loeb

About the Author

Nick Loeb serves as a Managing Partner at the firm of Carbon Solutions America (CSA) which provides climate change advisory services to corporate and government clients. Previously he was a banker for Lehman Brothers, Inc. and President of Loeb Investments, a private investment company. At Loeb Investments he partnered with HGC Capital, an environmental remediation firm to create carbon credits though methane capture of landfills in alignment with the UN's Clean Development Mechanism. More recently Mr. Loeb was invited to speak as a faculty member at the Practising Law Institute on the topic of Establishing and Enforcing Corporate Green Technology Policies. He is a member of the Palm Beach County Green Task Force's governmental sub-committee, and also serves on the following boards, the School Choice Fund, Broward County Crime Commission and formerly the Florida Co-Chair for Rudy Giuliani's Presidential Campaign. He earned a Bachelor of Science in Management and Finance from the A.B. Freeman School of Busiess at Tulane University.

Introduction

Some companies are moving towards implementing a climate change strategy as part of their business model as sustainability makes their business more efficient, increasing the bottom line. "More than 30 Fortune 500 companies in the U.S. have set targets for greenhouse-gas reductions. Of these, 11 have already met them, and not a single one has lost money." (1) There is a tremendous amount of value companies can take advantage of by implementing a climate change or sustainability strategy into their business. The problem is that companies who recognize this often take the wrong approach and leave value on the table.

There are several challenges when discussing sustainability with businesses however most corporations do not have anyone dedicated to these initiatives or the ones that do have not created a full and complete strategy. Without setting up a complete firm wide strategy not only do companies miss out on value generation but also open themselves up to future risks. In order to address all the value propositions that can be derived from a sustainability strategy, a top down approach needs to be incorporated.

The reason most corporations have not implemented a successful climate change program and complete strategy is that they do not have anyone dedicated specifically to these initiatives. Most have left this task to someone in the divisions of corporate social responsibility (CSR), public relations, or in facilities. Hence, there is a distinct gap in what should be a meaningful sustainability strategy because of the lack of expertise within the company devoted to this task. CSR personnel typically care about value through marketing and communications, while a facilities manager is focused on engineering tasks directly related to energy savings and environmental impact. Even with a combination of both, a clear "carbon strategy" is lacking.

A strong carbon strategy generates potential carbon credits, such as voluntary emission reductions (VERs), renewable energy credits (RECs), and energy efficiency credits (also known as White Tags) through the active reduction or avoidance of greenhouse gases (GHG). Most corporate executives who understand the value of this strategy still have trouble creating a strong plan that encompasses all benefits without neglecting potential revenue streams.

This is because drivers to tackle climate change are multifold such as consumer behavior, brand image, early action (cost of carbon and future regulations), and energy reduction. This wait-and-see approach will clearly be detrimental to the companies who are becoming environmental leaders in their sectors.

Strategy Formulation

"Tackling climate change could create opportunities for a company to increase its value by up to 80%. Conversely it could threaten up to 65% of value if the company is poorly positioned." (2)

The largest problem for companies who see this potential value is having someone create a comprehensive carbon strategy to encompass all the potential benefits while reducing risks. We find that no one really understands the credit market and what it takes to generate credits. Most companies who have taken the lead on the reduction side are led by engineers who do not care or do not understand the commercialization process of generating credits. On the other hand, the companies who care about marketing with leadership from the CSR side do not understand the science and these efforts sometimes lead to "green-washing".

Green-washing is a buzzword that describes how some entities over exaggerate or falsely state their environmental claims in order to improve their brand image. Therefore, the most successful method for creating a comprehensive strategy that enables the best value generation for the company is to involve C-level executives who are able to manage, incorporate, and direct the implementation of a carbon strategy. This begins with a Chief Sustainability Officer appointed position.

The focus then shifts to the three main value generators for a company in regards to a successful carbon strategy: brand value, cost reduction, and credit generation.

Brand value is created by communicating to the public the projects a company is involved in which improve economic, social and environmental impacts. A good marketing tool for assuring brand value is CSR reporting.

Cost reduction is a result of the projects developed by the corporation to reduce greenhouse gasses. These can be directly related to energy, fuel, and waste reductions. Project examples include lighting/HVAC retrofits, renewable energy, energy management, fuel alternatives, and even recycling programs.

Credits can be generated by implementing a project which changes the business-as-usual scenario of a company compared to the basic carbon footprint. These credits are renewed every year and examples include emission reductions, renewable energy, and energy efficiency.

Strategy Development

Before an overall carbon strategy is developed, a company must take certain steps to identify where they stand as a steward to the environment. The most recognized term for this first step is the "Carbon Footprint." A carbon footprint is a baseline measurement of the impact that an organization has on climate change also known as a greenhouse inventory. As you cannot manage what you don't measure, a company must take certain steps in order to perform the required due diligence before developing a full carbon strategy and moving forward with its implementation.

Step 1: Creating a baseline Just as a person on a diet should first begin a weight-loss regimen by stepping on a scale, a company should first create their baseline carbon footprint before all else. Furthermore, before an organization can create extra revenue from reduction projects it must first complete their greenhouse gas inventory that can stand up to third party verification. Third party verification is a quality assurance process conducted by an independent third party auditor which determines the validity of the presented data set from a carbon footprint.

It is often observed that companies implement environmental and/or energy saving practices without establishing a baseline. Although this process may save money in the short-term, this will be problematic once a company wants to publicly report their reductions and they may fail to generate credits.

There are many examples throughout the world where companies have been scrutinized in the media and in the worst case scenario lose consumer

confidence based on green washing accusations.

Companies that may now or in the future fall under federal, regional or state climate change legislation, and do not establish a baseline early, will have difficulty reaching reduction targets. This could even increase costs if a company has to purchase credits to make up the difference. Collecting historical data to create a baseline post project implementation is difficult and not always accurate, and the results will likely have trouble standing up to third party verification.

Companies can take advantage of increasing their brand value by publicly reporting their emissions. This effort needs to be executed in a thoughtful way where credibility and transparency become paramount. Reputable registries include The Carbon Disclosure Project or The Climate Registry.

Step 2: Reducing greenhouse gases

Once the carbon footprint is completed and verified, companies can now identify their most significant emission sources and pinpoint the areas with greatest emission reduction potential. The latter usually stems from energy and fuel consumption and corporations tend to target these reductions first. As previously stated, the biggest mistake often made is when corporations implement reduction projects without first constructing a complete carbon strategy. A carbon strategy is developing a plan to tackle these reductions by making the case for the need for credits which has to include meeting additionality.

The term additionality in the climate change space refers to greenhouse gas emission reductions which are done above and beyond business-as-usual. This implies that any emission reduction project would not have happened in the absence of carbon credits generated to help finance the project itself. This is an essential concept when implementing a successful carbon strategy.

Whether a company changes light bulbs, implements a recycling program or uses methane for energy, a carbon strategy must be put together which outlines the financing plan and addresses how greenhouse gases will be reduced. This is a prerequisite to qualify for any future credits a company may

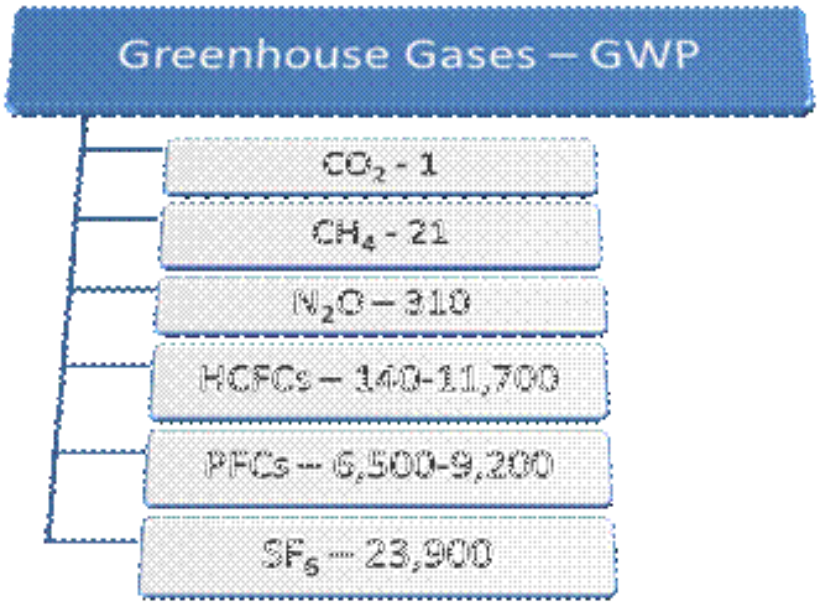
create and meeting additionality is a requirement in order to get credits certified.

It is also important to understand that a company will not be able to generate credits if it will be affected by a mandated emission reduction or if it has already set public targets, unless it can reduce in excess of the mandate or target. Furthermore, the company cannot go backwards and get credits from reduction projects already in place or get credits in the future for these projects. What is a carbon credit?

Carbon credits and greenhouse gases are calculated in metric tons of carbon dioxide equivalent (Mt CO2e). For example, one voluntary emission reduction (carbon credit) equals 1 Mt CO2e. The international Kyoto Protocol, agreed on by the United Nations, identified six greenhouse gases which are the major gases that affect global warming.

- CO2 (Carbon Dioxide)
- CH4 (Methane)
- N2O (Nitrous Oxide)
- HFC (Hydrofluorocarbons)
- PFC (Perfluorocompounds)
- SF6 (Sulfur Hexafluoride)

In order to compare concentrations from various greenhouse gases, the global warming potential (GWP) is used as a comparison index. Methane (GWP = 21), for instance, is 21 more times potent than carbon dioxide and therefore one metric ton of methane would equate to 21 metric tons of CO2e, hence 21 carbon credits.



Carbon credits are not tax credits but more like commodities that are created through the reduction of CO2e. Credits are generated when CO2e is reduced while meeting additionality. Prior to market certification, GHG reductions need to be verified by an approved 3rd party and must be registered. It is expected that "Carbon will become the biggest of any derivatives product in the next four to five years. And that would of course mean overtaking T-bills and any contract that is out there right now." (3)

Carbon credits are generated as an annuity. Once the reduction is made above and beyond business-as-usual, it changes business-as-usual compared to the baseline and this difference is realized annually. For example, if a company is emitting 100 MT CO2e annually, which equals it's baseline footprint, and replaces its incandescent light bulbs to fluorescent, it may hypothetically reduce its carbon footprint by 10 MT CO2e. The company would then be emitting 90 MT CO2e annually and therefore generate 10 carbon credits a year. Note that 3rd party verification is needed to certify these credits every year.

The following three examples show how companies that are unfamiliar with the carbon market often negate the prospect of carbon credit generation.

First, when company representatives are asked if they are interested in generating credits from their future reductions, a common response is, "we are going to keep the credits as we may need them for future compliance." However, if a company has not developed a strategy including a comprehensive baseline, it cannot create any credits even if it considers the necessity to prepare for future mandates and plans for internal credit usage. There is a distinct lack of understanding among companies about the commercialization process of carbon credits especially when it relates to additionality.

This point cannot be stressed enough if the company wants to keep the credits, it has to create them first; it cannot simply go back and receive them after the onset or completion of the reduction project. There is also a large knowledge gap when it comes to carbon markets, especially regarding energy efficiency projects. Companies will incur competitive risk and increase their business exposure in the future when competing with those who have acquired a superior knowledge of carbon markets from the beginning.

The second argument companies cite for refraining from setting up a carbon strategy is that they prefer to wait for respective legislation and often have been advised to do so by their attorneys. This ill-guided advice could hinder a company from generating credits when emission caps in business sectors become business-as-usual and therefore cannot meet additionality from the reduction process. The best time to begin implementing carbon strategies in any larger-scale business is now.

Lastly, corporations have often been told or believe that there is no market for credits in the United States which does not reflect the reality of what is true. To this end,"Volume in the over-the-counter (OTC) market nearly tripled in 2007, to 42 million tonnes of carbon credits. Combined with the 23 million tonnes transacted on the CCX in 2007, a confirmed total volume of 65 million tonnes was transacted in the voluntary carbon market in 2007." (4) Furthermore; this impressive growth in the US market was already surpassed by the middle part of 2008. It is clear; a robust US domestic carbon market already exists and will only continue to grow.

Step 3: Communicate

Developing a Corporate Social Responsibility (CSR) report should not only incorporate environmental value but also social and economic. CSR can be a great tool to communicate a company's actions to the public but should not be the only focus when related to climate change. Most CSR executives lack understanding of greenhouse gas calculation protocols, reduction measurements, and/or carbon credit creation. If CSR reports are not communicated properly, they can backfire and lead to a decrease in the public trust. There has been a rapid growth in consumer demand for CSR which is the primary value driver today; there are still many problems as to how this is communicated and marketed to the public. This is not necessarily the fault of the company but due to the lack of uniform standards, as the public does not truly understand the company's green communication tools. The Federal Trading Commission (FTC) has yet to set clear climate change marketing guidelines, often leading to over exaggerated or false claims o reductions. On the other hand, we have seen many environmentally friendly firms not brand the company or their products as 'green' and the consumer is thus unaware of the company's real sustainable efforts.

It is therefore paramount to follow a process where a meaningful carbon strategy is accompanied with high quality and transparent measurements prior to reporting. This process should be done for each project or until all projects are implemented so one can properly measure against the baseline and accurately report. Only a verifiable project can lead to transparency and creditability and will avoid claims of green washing. Note, if the credits generated are then sold to a third party, the company cannot claim these reductions anymore since environmental attributes were passed onto another entity.

Conclusion and Obstacles

The best carbon strategy is incorporated into the business model by a C-level executive who wants to generate as much value as possible.

After establishing a comprehensive and verified baseline, greenhouse gas emissions can be communicated to customers, consumers, or shareholders by

using CSR reporting, public relations and/or public reporting through reputable registries such as The Climate Registry. Yet, any future reduction targets should not be made public, as to keep the integrity of trying to meet additionality for any of the company's planned reduction projects. On the other hand if a company created a strategy prior to setting the target that incorporates additionality, it may publicly report. This means their target is conditional on needing credits to meet that target. Note: As previously stated: once those credits are sold, corporations cannot use those reductions to meet that target.

At Carbon Solutions America we see countless companies set random public targets with many different organizations as part of their reporting scheme. This is a misguided strategy, set up by professionals who are inexperienced in the carbon markets and mainly care about marketing and/or branding.

Once a public reduction target is set by a corporation, additionality claims are essentially lost since the target then becomes part of business-as-usual. It is rather recommended that companies set internal goals since the value of credits will far outweigh the future value of public reporting of targets. If a corporation wants to do both and still be able to generate credits, it should incorporate public targets as part of their overall carbon strategy while putting together a case for additionality that is needed to meet those targets.

A carbon strategy also needs to address the project's potential to mitigate climate change and highlight the need for credits to finance the reduction project. Obviously, reduction of costs is going to be the biggest driver for most of the projects. As an example, if savings are created through reduction in waste or energy as with fuel and utility costs, this serves as a great benefit to corporate greenhouse gas reductions; however, this should not be the driver in your carbon strategy as it makes additionality harder to prove.

In summary, companies should also identify which projects can create maximum credits as these revenue streams can become significant. Once the strategy is implemented and the project is verified, the CSR team may be allowed to communicate and market its company's reduction as it then can accurately measure it against its reported baseline.

Carbon Solutions America (CSA) is an independent climate change consulting and project management firm. We specialize in conducting carbon footprints, overseeing the design and implementation of greenhouse gas reduction and sustainability strategies, and managing the generation of carbon, energy efficiency and renewable energy credits. CSA is partners with the Florida Center for Environmental Studies, a Founding Reporter of The Climate Registry and registered with the World Bank Carbon Finance Unit.

(1) The Pew Center for Research, 2008

(2) The Carbon Trust and McKinsey Report Analysis 2008 - Climate Change a Business Revolution?

(3) The Honorable Bart Chilton, Commissioner US Commodity Futures Trading

(4) "State of the Voluntary Carbon Markets 2008" by The Ecosystem Marketplace Team

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