

10 Minutes on Climate Change*

What you need to know about emerging topics essential to your business. Brought to you by PricewaterhouseCoopers.

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Why climate change matters today

Highlights

- Stimulus packages for low-carbon technologies and a federal cap-and-trade system to reduce greenhouse gas emissions are proposed for legislative action in the United States.
- If enacted, these proposals will affect how the US produces energy—bolstering the efforts of a growing number of regional initiatives to combat climate change and stimulate clean technology investments.
- Investors and other stakeholders are increasingly requesting information from companies on how they will adapt.
- Although standards will continue to evolve, understanding current expectations and producing reliable information around performance should be priorities today.

The new administration promises both climate and energy policies will work together to breathe life into the economy, strengthen national security, and protect the environment.

Proposals include a federally sponsored cap-and-trade system that would progressively reduce the volume of greenhouse gases each company is allowed to emit—typically, the carbon dioxide that results from burning fossil fuels. At the same time, stimulus packages would encourage capital markets to invest in new technologies that would help companies reach emissions reduction targets.

CEOs who have been watching market signals in this area are gearing up. PricewaterhouseCoopers' work with the 2008 Carbon Disclosure Project shows that nearly 80% of CEOs among the S&P 500 are anticipating the business risks related to climate change, while just as many also see related opportunities.

What is the right response for the times?

- 1. Merging economic and environmental concerns.** Most companies can realize short-term cost savings through energy efficiency and waste reduction. Many will benefit from tax breaks for green investments or from creating new products or business relationships to meet changing needs. Carbon trading programs combined with investments in reducing greenhouse gases and adapting to new technologies will drive future efficiencies.
- 2. Anticipating future scenarios.** Broad thinking brings both the risks and the opportunities to light. Improving energy performance can reduce operating costs, while diversifying sources of energy can provide a natural hedge against price volatility in any one category.
- 3. Collaborating effectively with stakeholders.** Understanding how consumers, investors, policy makers and other key stakeholders view sustainability issues, including climate change, will further refine objectives and strategies.

At a glance

Climate change moves from a niche concern...

Until recently, the corporate response to climate change has been limited due to:

- A debate about the science behind climate change but often no clear economic rationale to contribute to a solution
- Few viable alternatives to carbon-intensive practices
- Limited demand by investors, consumers, and other stakeholders that companies respond
- Relatively little need to optimize the use of natural resources, including fossil fuels

...to a strategic opportunity

Corporate attitudes have shifted due to:

- Broad acceptance that greenhouse gases are causing climate change with potentially significant costs
- The likelihood that regulation will limit the amount of greenhouse gases that businesses are allowed to emit
- Investing trends that give new promise to cleaner fuels and more energy-efficient technologies
- Expectations that companies work to slow climate change and disclose risks and opportunities along the way
- Recognition that corporate performance and long-term viability rely on efforts to adapt to environmental change

Why it's an executive-level concern

The ongoing complexity of climate change has prompted many companies to name either a board member or a corporate-level executive to be responsible for its governance. Key issues include:

Regulatory compliance

Many companies already operate under regulated efforts to reduce greenhouse gas emissions. In the US, efforts among the states to create reporting registries and reduction programs have outpaced federal action, but federal action now seems likely.

While energy-intensive industries have been the first to participate in most cap-and-trade programs, all companies should consider how a change in the requirements to report greenhouse gas emissions, the lowering of caps over time, or even a federal carbon tax could impact the business environment.

Investor scrutiny

Institutional investors who foresee climate change posing material risk are making direct and meaningful requests for corporate disclosure. The 2008 proxy season alone saw a record 57 shareholder resolutions related to climate change.

This was nearly double the number of resolutions just two years earlier and about half the number in one of the most popular categories: executive pay.¹

Sustainable cost reduction

Meanwhile, environmental and economic needs continue to merge. A full 95% of US CEOs surveyed by PricewaterhouseCoopers say they are working to reduce energy costs through efficiency programs as part of an overall response to climate change.²

Employee and consumer expectations

Consumers are also raising their expectations that companies will do their part to combat climate change and provide sustainable yet affordable products. And they're not the only ones with expectations. Of PwC's own new hires, 40% say a prospective employer's policy on climate change is an important consideration when they decide whether or not to go to work for that employer.³

¹ CERES, "Investors Achieve Major Company Commitments on Climate Change" (August 2008), www.ceres.org.

² PricewaterhouseCoopers, 12th Annual Global CEO Survey (January 2009), www.pwc.com/ceosurvey.

³ PricewaterhouseCoopers, Managing tomorrow's people: Millennials at work (December 2008), www.pwc.com/managingpeople2020.

How to define the corporate response

As business conditions change, all CEOs will need a clear understanding of their companies' climate exposure. This is not exclusive to carbon; it also includes water and other natural resource constraints, changes in consumer demand, demographic shifts, and even changing weather patterns that could result in physical risks.

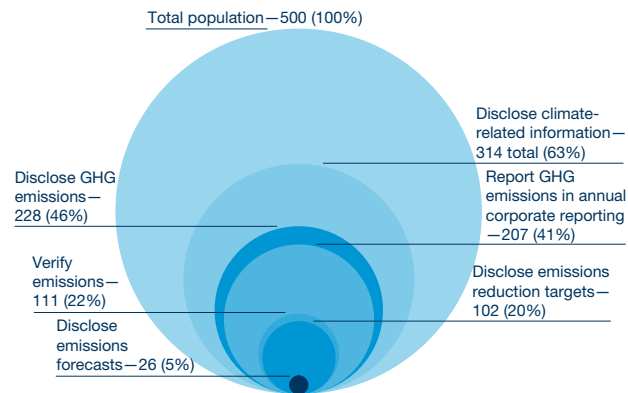
While each company has unique conditions, the challenge of how to integrate environmental thinking into the overall management approach is generally similar.

Corporate actions should be based on an evaluation of four key areas:

- **Strategy**—including shifts in consumer demand or an increase in demand for lower-carbon technologies and services
- **Operations**—including impacts to capital plans, efficiency programs, and possible supply chain disruptions due to demographic shifts or the availability of raw materials, water, or clean and affordable fuels
- **Reporting**—including accuracy of greenhouse gas emissions data and an understanding of the financial reporting or tax implications related to buying, selling, or banking emissions allowances
- **Compliance**—including the costs of regulatory compliance or legal proceedings related to a company's environmental impact

Where to encourage accountability

The S&P 500 increasingly sees the importance of climate-related disclosure and reporting



GHG = greenhouse gas
Source: Carbon Disclosure Project, 2008

Although standards will continue to evolve, the following areas warrant particular attention today.

Greenhouse gas emissions

More companies are now taking stock of their emissions as part of an overall effort to manage climate-related risks.

While guidance on how to measure and what to report helps companies anticipate future requirements, clarity has yet to form for some aspects, and accuracy can be a concern. Special attention to process design, systems support, and internal controls are required for verifiable measurements now and into the future.

Emissions allowances and carbon offsets

In the carbon markets, new questions are surfacing about how to measure emissions and offsets and account for the value of allowances. The International Accounting Standards Board and the Financial Accounting Standards Board have jointly recognized that increasingly, those allowances are financially material, and the two boards are working together to develop the appropriate models to account for them.

Tax incentives

Carbon trading also poses many novel tax issues that have yet to be addressed in legislation or administrative guidance. Tax incentives for green investments can make a positive impact on the bottom line but can also be difficult to navigate.

Financial reporting

US companies have no specific requirement from the Securities and Exchange Commission to disclose climate-related risk, yet general guidance can be viewed as requiring it. As such, some companies, particularly those in energy-intensive industries, now disclose climate risk in their Form 10-K filings, and others may soon follow. Many other companies view disclosure as a requirement for communicating with a broader group of stakeholders, and they address that need with sustainability reports.

Transactions

Where transactions are concerned, a growing number of assets and liabilities associated with climate change are now considered as part of certain transactions, calling for a more robust due diligence process.

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What to consider now

A holistic focus on both risk and performance today will set the right direction for the way a company will be able to operate in the long term.

Although many companies start with a risk, cost, and compliance approach, stopping there can result in ignoring innovation, missing market shifts, or failing to see new business opportunities.

An effective business response requires answers to several questions, including:

- What are the ongoing local, regional, and global risks and opportunities in short- and long-term climate change? How important are those risks and opportunities to the overall business? How might they impact the supply chain?

- How will the company decide which actions to take? How does governance of climate-related issues differ from other corporate governance responsibilities?
- What role should the company take in engaging policy makers on climate change?
- How much rigor is required to measure and manage greenhouse gas emissions?
- What information do internal and external stakeholders expect? How should such information be disclosed so that it is valued and gets used?

For more about the business response to climate change, visit www.pwc.com/sustainability.

Upcoming 10Minutes topics:

Finance and accounting (F&A) shared services

Until recently, companies expected F&A shared services centers to reduce F&A costs by 20% to 40% over three to five years. Faced with the current crisis, however, executives can't wait. 10Minutes explores a number of downturn-capitalizing strategies for companies with centers either in place or under development.

Realizing enterprise resource planning (ERP) value in a downturn

Across industries, at one level or another, enterprise applications (and whether they're agile, efficient, and cost-effective) sit at the core of a company's ability to weather the current economic downturn—or capitalize on it. 10Minutes discusses how economic downturns can be the best times to undertake a wide range of ERP-related actions.

Top concerns for boardroom directors

As a year of unprecedented challenge and change draws to an end, directors are revisiting their oversight of risk management and corporate culture. 10Minutes looks at how the ongoing credit crisis affects these and other corporate governance issues, sizing up the potential impact on your business.

Bolstering corporate liquidity

As the cash crunch continues, companies can shore up liquidity with both cash management strategies and tax mitigation techniques. 10Minutes explores how corporate managers—even while using these short-term tools—also need to think about the long-term implications of a fundamental re-pricing of credit.

How PwC can help

To have a deeper discussion about sustainability issues, including climate change, please contact:

Tell us how you like 10Minutes and what topics you would like to hear more about. Just send an email to:
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