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The Cost of the 'Water Risk' Component of Climate Change

Author: David Restaino

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The Securities and Exchange Commission (SEC) has released a guidance document regarding the disclosure of climate change implications in corporate disclosures. While most climate change issues have focused on air emissions, the SEC Guidance (pdf) also addresses water risks – such as water scarcity – within the suite of negative impacts that should be reported to the commission.

Disclosing water risks is different from quantifying other types of contingent liabilities. For example, the "risks" will differ for facilities located in water-scarce areas as compared to those in water-rich areas.

Particular water risks include:

- The quality and quantity of available water, which may implicate private-to-local or state-to-state water agreements and water purveyors that "ratchet down" supplies.
- The impact of groundwater recharge and, as a result, the recharge implications of stormwater permits.
- A review of both salt-water intrusion risks and the potential impacts that a rise in sea level could have on water intakes.

- The amount of water discharged from operations.

- Whether changes in discharge regulations – such as the growing concern about pharmaceuticals in wastewater – might impact the treatment and discharge of wastewater.

The burdens that the new guidance might place on business sectors will not end with those entities subject to SEC regulation. Instead, covered businesses can be expected to impose data gathering and reporting requirements upon their suppliers and distributors. In part, such disclosures will be made within the general requirement that covered corporations disclose material events under existing SEC rules, as more broadly interpreted by the new guidance. Such disclosures also can be viewed under the increasingly relevant topics of social responsibility and sustainability. In this vein, at least one large corporation is requiring its suppliers to sign an agreement on social and environmental responsibility. Whether this practice will be adopted remains to be seen.

Addressing the SEC Guidance will be no small undertaking for both major corporations and their contractors, but compliance will cut across many sectors of the economy. Companies will need to make assessments and analyze their own water issues. Water purveyors may be asked to address the supply of water expected to be available in future years, and consulting firms may be asked to assist in these processes.

Disclosing water risks also will be different because the "claim" is a much broader concept than normal disclosures, in which there is both a known claim and a specified request for damages. In addition, disclosure will be subject to different interpretations across different business sectors and geographic areas.

In 2011, corporations will likely increase their activity in climate change from the sustainability side. The International Organization for Standardization is in the final stages of adopting a Guidance on Social Responsibility, designated ISO 26000, with an October 2010 target publication date. This guidance – if adopted – would apply to both public and private sectors and distill the concept of social responsibility into some core goals, including:

- Develop a consensus on *social responsibility* – which is defined as the contribution of an organization to environmental protection, social progress and economic development.

- Broaden the inquiry to an organization’s sphere of influence, i.e., external entities with which an organization has a relationship allowing it to affect behavior. Consider the supply chain to include not only suppliers but also customers and consumers.

- Promote the principles of environmental risk management, life cycle thinking, sustainable procurement and “the polluter pays.” With respect to water, specifically seek the conservation of water, rational use of water, and consistent access to water. Climate change is specifically addressed.

In the absence of a standard, the public and investors already are taking notice of corporate activity in this risk arena. A report, co-authored by Ceres, UBS and Bloomberg, found that water-related risks were under-reported and singled out each of the 100 corporations. Risk disclosure also may provoke inquiries by third-parties, such as government agencies.

How costly can disclosure be? As the concept of water risk develops, to what degree will governments and non-profit environmental groups use disclosure information? Will those insurance carriers that underwrite a corporate portfolio question their potential insureds about water risks in an effort to better establish accurate premiums? Will banks or private investment funds expand the due diligence process? Only time will tell.

Most certainly, raw material suppliers will begin to see changes in the way corporations transact business. The inquiries initially may be collegial and simply involve processing information to provide a summary of the water risks inherent in making a raw material. In time, however, supply-chain contracts will begin to specify the data and ill-equipped suppliers may lose market share.

Such approaches to water risk can be expected to move beyond the supply side. Finished goods are both stored and distributed, and each activity has a water impact. Warehouses usually consist of paved areas and rooftops that can impact stormwater production and groundwater recharge. Likewise, motor vehicles that transport goods will, at a minimum, need periodic washing.

In today’s litigious society, we can predict that the information gathered to prepare SEC disclosures also would be fodder for discovery in future litigation. If scientific predictions are correct and adverse climate incidents occur, there may be a rush to blame those corporations that have failed to adequately disclose and/or respond to water risk.