Business and Governance

Green wash or green to the core?

Pushing the business world to take sustainability seriously

Abstract

Should Government be regulating business to encourage it to focus on issues of sustainability? Alternatively, should market forces decide whether a business will focus on sustainability?

Issues relating to sustainability appear almost daily in the media. Some businesses are addressing such issues, others are choosing to ignore them and still others are simply confused as to what it means for them.

Despite what might sometimes be the impression in the business world, Government in New Zealand has taken a relatively light-handed approach to regulating sustainability. 'Sustainability' appears as a concept in expected statutes, notably the Resource Management, Conservation, Biosecurity and Fisheries Acts. It is increasingly appearing in other statutes where sustainability has not played a major role, such as the Building, Civil Aviation, Maritime Transport and Gambling Acts. What sustainability means in these various statutes is able to be debated and interpreted in various ways. Whether, or by how much, the use of the word 'sustainability' is leading to sustainable outcomes is poorly, if at all, measured.

Perhaps more pressing for business is the change taking place in the market place. This change is being signaled perhaps most loudly by the so-called 'Carbon Disclosure Project 4', a questionnaire being sent to companies worldwide by multi-trillion dollar funds seeking information about businesses' carbon emissions footprint. The impact of CDP4 has not been felt strongly in New Zealand, but already there are home grown 'ethical' investment funds which will be directing their investment to those businesses which behave in sustainable ways.

This paper will explore these and other issues related to the pressures on business to behave sustainably. It will consider the impact of such pressures and consider whether anything more can or should be done to push businesses to behave sustainably.

Introduction

From Meridian Energy's focus on renewable energy generation to people selling 'organic' products at stalls in markets, greenness in one form or another is seeping into the language of business in New Zealand. There are many ways to be green and many shades of green. This paper uses the terms 'green' and 'sustainable' to cover all those various shades. It is not concerned with defining greenness but with the forces that are pushing business to become 'green'.

Although sustainability appears in a growing number of statutes, the New Zealand Government has not yet introduced legislation requiring businesses to focus on sustainability issues in all aspects of their daily operation. In particular, businesses are not required to report on sustainable matters.

What **is** putting pressure on businesses to take notice of sustainability is the market. Surveys, such as the Carbon Disclosure Project (**CDP**) which managers of multi-trillion dollar funds send to businesses, are seeking information in relation to a business' carbon footprint. Manufacturers are investigating their supply chain and questioning their suppliers, including small businesses, about the sustainability of their business practices. Consumers are seeking out environmentally friendly products. This market scrutiny has been growing in the past couple of years, without any signals that it will decrease.

Governments have adopted a range of different approaches across the world. In California, the state has put in place several world first laws in relation to climate change. In Australia, the decision has been made that regulation is not appropriate to encourage sustainability reporting by business. This paper explores the pressures on New Zealand businesses to behave sustainably. It will also consider whether anything more can or should be done to push businesses down a more sustainable path.

Key Points

- There is little regulation relating to the sustainability of businesses in New Zealand.
- Market pressures, especially in the international market, are real and growing.
- While most New Zealand business do not seem to understand these pressures, those that do have engaged in corporate social responsibility/triple bottom line (**CSR/TBL**) reporting over a number of years.
- Increasingly, being green on the outside may no longer be enough.

Discussion

The current statutory framework in New Zealand

The New Zealand Government in regulating for sustainability, especially as it effects business operation, has taken a light-handed approach. The concept 'sustainability' appears in several statutes in New Zealand. However, the emphasis of most of the statutes (examples of which follow) in which the concept features is resource use. While resource use may affect some businesses, sustainability is yet to feature in a New Zealand statute that relates primarily to business.

The Resource Management Act 1991

The core purpose of the RMA is to promote 'sustainable management' (section 5). The definition of the term includes protecting natural and physical resources so that communities can provide for their social, economic and cultural wellbeing, while meeting the reasonably foreseeable needs of future generations.

This purpose guides the decision making of local authorities and the Environment Court under the RMA (*Independent News Auckland Ltd v Manukau CC* EnvC A103/2003). This includes the development of policies and plans and the assessment of applications for resource consent. The purpose is regularly cited in decisions to provide context for the decision making process (see *Estate Homes Ltd v Waitakere CC* [2006] NZRMA 308, at para 102; *Westfield (New Zealand) Ltd v North Shore CC* [2005] NZRMA 337, at para 9). However, the Court has recognised that in reaching an integrated outcome, a complicated balancing act of often competing factors is required (*Trio Holdings v Marlborough DC* [1997] NZRMA 97).

Industrial or manufacturing businesses will most likely require resource consents to operate. An application for resource consent must address issues relating to sustainability (that is, social, economic and environmental effects) in order to inform the consent authority of an activity's effects. It is common that a resource consent will impose ongoing monitoring or reporting requirements thereby ensuring, within the purview of the RMA, the continued 'sustainability' of that businesses operations.

Local Government Act 2002

Local government is required to play a role in the social, environmental, economic and cultural wellbeing (known as the four wellbeings) of the community, and to take a sustainable development approach (section 3).

During the development of the LGA there was discussion about how best to express the concept of sustainability. It was decided 'sustainable development' was the best term to use as it provides a link from the Act to a key objective of central government: international initiatives in relation to sustainable development.

The LGA and the RMA use different terms. Sustainable development was not used in the RMA as it was thought the word 'development' would be interpreted as meaning 'pro-development' whereas sustainable 'management' was thought to have a more balanced connotation. Sustainable management is a concept capable of interpretation so it can accommodate at least some non-anthropocentric values. This is seen as extending the traditional sustainable development approach (John Mulligan, *Adopting Sustainability? Sustainability, sustainable development and sustainable management*, Butterworths Resource Management Bulletin 4(15) Oct 2002: 173-178). Sustainable development is the presently preferred term but it is not necessarily inconsistent with 'sustainable management'.

Under the LGA, taking a sustainable development approach includes taking into account the four well-beings and the reasonably foreseeable needs of future generations (section 14). This longer term approach is encouraged throughout the Act, for example, through the development of Long Term Council Community Plans. These are 10 year plans which must be audited to ensure that the financial requirements for the Council and community are met over that 10 year period.

Whether the inclusion of sustainability concepts in the LGA will lead to sustainable development has not been measured. Indeed, its measurement may be problematic.

Reporting Requirements

In relation to business reporting, current legislation is facilitative rather than directive.

The Financial Reporting Act 1993 requires that companies add information to their financial statements outside of generally accepted accounting practice if the statements, of themselves, do not give a true and fair view of the company's position. That requirement and the definition of 'generally accepted accounting practice' is broad enough, in appropriate circumstances, to include issues of sustainability. That is not to suggest reporting on such matters takes place or is required to take place now. A change in the business community's view of sustainability, perhaps brought about by the voluntary reporting of such matters by an increasing number of companies, may alter that.

On the other side of the coin, the Fair Trading Act 1986 could be used against anyone misleadingly describing their business or property as 'sustainable' or 'green'. Specifically in relation to buildings, the Act makes it an offence to make false or misleading representations concerning 'the existence or availability of facilities associated with the land'.

Other statutes

Sustainability of fishing resources has played a large role in the development of case law around sustainability. The Fisheries Act 1996 has an entire Part devoted to measuring and ensuring the sustainability of a fish stock in the fishing quota system. 'Ensuring sustainability' is defined by the Act as:

> Maintaining the potential of fisheries resources to meet the reasonably foreseeable needs of future generations; and avoiding, remedying, or mitigating any adverse effects of fishing on the aquatic environment.

Other legislation that makes reference to sustainability includes the Conservation, Biosecurity, Building, Civil Aviation, Maritime Transport and Gambling Acts.

External pressures on business

Sustainability in the form of concern for climate change and corporate social responsibility as discussed below is being pressed on business by the wider market place.

Carbon Disclosure Project

The Carbon Disclosure Project is the world's largest institutional investor collaboration that questions business implications of climate change. Information has been gathered for the CDP through an annual survey sent to companies around the world. This survey requests the companies to disclose information on their greenhouse gas emissions and their stance on the risk related to climate change. The survey sent out in 2006 was called CDP4. This survey had the backing of investors with more than 31.5 trillion dollars in assets, and was sent out to over 1,900 companies worldwide. The response rate in 2006 was the highest ever at 72%, up from 47% in 2003. Of those companies that responded, 87% indicated that climate change was a commercial risk and/or opportunity; 48% of companies which considered climate change to present a commercial risk to their business had implemented a greenhouse gas reduction programme.

Awareness of CDP is growing. The Prime Minister of the United Kingdom, Tony Blair, has publicly acknowledged the project and, in a letter to CDP, states that no industry can now afford to ignore the climate change issue. In the 2006 annual City of London's Liveable City Awards, CDP was awarded the overall winner. The judging panel praised CDP for effecting a tangible impact on global efforts to combat climate change (Carbon Disclosure Project, *Livable City Awards 2006 Press Release,* www.cdproject.net/viewnewsitem.asp&id=48, viewed on 15/09/06). Recognition has also been given to the CDP in the United States. The Trustee of the New York State Common Retirement Fund is quoted as stating 'the Carbon Disclosure Project is a quiet, mature, expert way to raise the consciousness of CEOs who are under pressure to provide immediate profits for the next quarter's reporting. It is a way to give them a sense that looking at the long term is really the smart and sensible way to go'.

Companies answering the survey can choose to have their responses made available on the CDP website. Investors can look at these survey results and assess whether or not they want to invest in the company. The responses from companies can be quite telling. Responses in the CDP3 survey from the overseas parents of companies operating in New Zealand included BP, Westpac, Vodafone and ANZ. All of these companies currently have some focus on sustainability in their marketing in New Zealand. The survey answers provide an illustration of the depth of knowledge these companies have in relation to sustainability and the action they are taking behind what they are saying. The survey responses show that both BP and Westpac are deeply involved in the sustainability issue and see climate change as a real threat, whereas ANZ and Vodafone provide responses that are more light-weight.

The responses to the 2006 survey (CDP4) have recently been released. 2006 was the first year that New Zealand companies were specifically included in the survey. Thirty-two New Zealand companies were asked to participate in CDP4. Of these thirty-two, only one company answered the survey and made those answers available on line. Four companies answered but did not make the information available, while the remaining twenty-seven declined to participate or did not respond. This low response rate is either indicative of a lack of comprehension about climate change or lack of understanding of the far-reaching nature of the CDP project.

CDP4 also analysed the financial implications of greenhouse gas regulation on the companies involved in the project. Conclusions were reached that the best positioned company in this survey would have had windfall revenues yielding US$298m . The worst positioned company could lose 25% of its earnings due to regulatory compliance costs. Another important point coming out of the project was that greenhouse gas reduction was less costly than expected. At a fixed cost of $25 per ton many businesses could reduce emissions to 10% below their 2005 levels for less than 1% of their earnings.

These findings and the financial backing and worldwide significance of CDP should make it a very real pressure on businesses.

Other major institutional initiatives, similar to CDP, exist worldwide. Recently, European investors managing more than US $1.6 billion agreed to put pressure on governments and companies to reduce climate change (*Institutional investors pledge action on climate change*, Environmental Finance, 5 October 2006, page 5). These signatories will actively consider climate change in their investment analysis and also engage with companies they invest with to ensure they are minimising risks and maximising opportunities presented by climate change and climate policy.

The Investor Statement on Climate Change sets out the views of The Institutional Investors Group on Climate Change, a forum for collaboration between pension funds and other institutional investors on issues related to climate change. It will work to influence government to adopt policies incentivising the reduction of greenhouse gases.

CSR/TBL reporting

Focus on corporate social responsibility is increasing and has seen companies adopt triple bottom line reporting which expands the scope of a company's reporting from simply profit and loss to include consideration of broader impacts of the business on the economy, the environment and society. TBL reports provide a clear picture of an organisation's social, economic and environmental performance. The reports are designed to enhance transparency and provide a vision of how organisations are to improve their development overall. A good report also includes a managerial response to the performance of the organisation and information about how the organisation contributes to society.

The push to undertake such reporting and generally for companies to become good corporate citizens is coming from all directions: consumers of the company's products, investors, shareholders and employees. As an example, in New Zealand, socially responsible investments have recently become available (For example, Asteron (formerly Royal Sun Alliance) Socially Responsible Investment Trust Fund). Such investment funds will begin to demand that the companies in which they invest exhibit good corporate citizenship.

Large companies throughout New Zealand have been issuing sustainability reports for a number of years. These companies include BP Oil New Zealand Limited, Hubbard Foods Limited, The Warehouse Group Limited, and Land Care Research.

Those involved in such reporting have found that the process has evolved to drive internally focused improvement programmes across all aspects of the company. The reports also provide a more long term vision for the company and an outward expression of the company's understanding of its impact on those matters included in the triple bottom line.

Consumers' interest in sustainability

Consumer pressure for companies to provide environmentally friendly products is increasing. Several surveys have looked at consumers' environmental concerns and how that is reflected in their purchasing habits. In the past, perceptions of inferior product quality and difficulty in identifying green products may have turned consumers off buying environmentally friendly products (Aceti Associates, Barrier/Motivation inventory *Why consumers buy green; why they don't*, 25 November 2002, http://www.mass.gov/dep/recycle/reduce/whygreen.pdf). However, anecdotally there is now a wider range of products that are easily identifiable as environmentally friendly and it is more widely accepted that the products are of the same level of quality.

A recent report on consumers shows companies can cash in on environmental products. Ecover, a Belgian company that makes ecological washing and cleaning products, states that sales are growing at a rate of 20% per year, reaching US$66 million last year. Also, major American brands are now buying into ecologically or environmentally friendly products. These companies include General Electric, Wal Mart, and Unilever. Products and services marketed by GE under its Ecomagination brand have risen from US$6.2 billion in 2004 to US$10.1 billion in 2005 (Financial Times, *Companies cash in on environmental awareness*, 14 September 2006, www.ft.com).

Governmental Approaches

The New Zealand Government approach - no regulation

As discussed above, there are limited regulatory requirements to operate sustainably imposed on New Zealand businesses.

At a non-regulatory level, a move towards sustainable industry is being driven by the Ministry for the Environment and its Sustainable Industry Group. That Group focuses on encouraging and rewarding businesses with sustainable practices rather than regulating or punishing business that do not comply with sustainability practices.

More broadly, the Ministry for the Environment has several sustainability initiatives relating to business. Most of these initiatives involve taking a partnership role in promoting sustainable business practices. These partnership roles include, for example: working with Fonterra to achieve eco-efficiency; working with Government agencies to improve the sustainability of their activities through Govt[3]; working with the New Zealand screen industry to contribute to greener film and TV productions; negotiating a New Zealand packaging accord; developing a New Zealand waste strategy; working on product stewardship; investigating options for special waste; and working with six regions within New Zealand on sustainable tourism.

The Ministry has also developed a web-based tool for people interested in sustainability called 'Simply sustainable: tools and resources'. This is developed to help turn sustainability concepts into practical application tools and resources. Information provided relates to eco-efficiency, waste management, triple bottom line reporting and product design.

While it is applaudable that the Ministry is working in partnership with business and providing these tool kits, there is little evidence of whether these voluntary approaches provide a sound basis for achieving sustainability within industry and/or business.

California - groundbreaking legislation

California is the 12th largest emitter of carbon in the world. On the 27th of September 2006, California's Governor Schwarzenegger signed a Bill that established a programme of regulatory and market mechanisms to reduce greenhouse gases. The California Global Warming Solutions Act of 2006 requires a statewide greenhouse gas emissions cap for 2020 based on 1990 emissions. It also requires the adoption of mandatory reporting rules for significant sources of greenhouse gases by January 1st 2009. Additionally, it requires the adoption of regulations by January 1st 2011 to achieve the maximum technologically feasible and cost effective reductions of greenhouse gas. This includes provisions for using both market mechanisms and alternative compliance mechanisms. Celebrations of this move to regulate emissions occurred nationally and internationally. British Prime Minister Tony Blair, the Governor of New York, and Sir Richard Branson all applauded the Governor's leadership. The Japanese Prime Minister also sent a letter of support of the legislation.

Australia - reviewing legislative requirements

The Australian Parliamentary Joint Committee on Corporations and Financial Services published a report on CSR in June 2006. This report was in response to the growing popularity of CSR reporting which was said to stem from both a growing interest in sustainability globally and the growing interest in company governance generally.

The Committee considering the matter reviewed the drivers and principles of CSR and the existing legislative framework. The Committee favoured an 'enlightened self-interest' approach, considering that careful and appropriate corporate responsibility was in a company's interest and able to be pursued voluntarily by companies under the current legislative framework.

The Committee rejected amendment of the legislation to make reporting compulsory. Compulsory reporting would give rise to a compliance culture rather than a true commitment to CSR within companies. A recommendation for the Australian Government was that it continue to monitor the uptake of regulatory frameworks around the world and provide the business community with advice on how to apply any global reporting initiatives.

UK - Companies Act to be amended

In direct contrast to the Australian approach is the development of company law in the UK.

The Companies Bill is currently awaiting the final Royal assent before becoming law in the United Kingdom. This Bill has been the subject of much consultation and discussion in Britain over the past 8 years. One of the objectives of the Bill has been to create a long-term investment culture. Whether that is achieved remains to be seen. What it will do is modify the way British businesses operate. In particular in relation to sustainability it introduces new requirements: there is an extension of director's duties requiring them to consider the impact of the company's operations on the community and the environment; directors must also report on environmental matters, employees and social and community issues as part of their business review reporting; and there is an increase of Auditors' powers in relation to sustainability reporting.

Is New Zealand green on the outside or green to the core?

New Zealand has included reference to sustainability in several pieces of legislation. Most of these Acts, including the RMA and the LGA, relate to considering sustainability in decisions relating to resource allocation. There may be consensus that some reference to sustainability in legislation is appropriate. However, the pressure on businesses to act in a sustainable manner from legislation remains weak.

For example, current business reporting requirements do not prevent sustainability disclosures but neither do they mandate them. A small number of businesses in New Zealand are voluntarily reporting on cultural, social and environmental issues. However, there are currently no statutorily imposed standards or auditing regimes to check the assertions made in these reports.

At this stage, the main pressures on businesses within New Zealand to consider or act on sustainability are coming from the market. Indicative of this pressure and of international importance is the Carbon Disclosure Project directing the placement of $31.5 trillion dollars of investment funds based on businesses response to climate change. The information gathering survey prompted by the CDP only reached New Zealand companies for the first time in 2006 and the lack of response among such companies is startling. This and other similarly focussed investment philosophies will increasingly put pressure on companies to take such sustainability issues seriously.

What is clear is that presently the majority of New Zealand businesses are currently some way off being green to the core and something needs to be done to change that. Although there may be some validity in the Australian finding that CSR reporting should not be made compulsory, there are other actions that the Government could take. Mandating standards and requiring compulsory auditing of sustainability reports would provide greater certainty for businesses choosing to use sustainability reports. Requiring an annual declaration of any environmental, social or cultural offences committed by businesses may also assist in raising the profile of such issues.

Whether steps are taken voluntarily or through legislative change, what is important is that New Zealand businesses are better informed about and prepared to deal with sustainability issues as they become increasingly relevant for local and global investors and for consumers in local and global markets. Being green on the outside may no longer be enough.

James Hassall
Senior Associate
Phillips Fox
PO Box 160
Auckland

Tel +64 9 300 3801
Fax +64 9 303 2311
Mob +64 27 688 4004

james.hassall@phillipsfox.com

Lucie Drummond
Lawyer
Phillips Fox
PO Box 160
Auckland

Tel +64 9 300 3862
Fax +64 9 303 2311
Mob +64 21 466 996

lucie.drummond@phillipsfox.com

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