Sustainability Grows Up: From Aspiration to Accountability

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The discussion around corporate environmental, social, and governance (ESG) efforts and disclosures is often shaped — in fact, distorted — by high-profile announcements from large institutional investors or gossipy sustainability grades from proxy advisory firms.

In the glare of these spotlights, it is understandable that companies will respond in kind, issuing glossy corporate social responsibility reports proclaiming high-minded objectives, from sustainability, to diversity, to transparency. The legitimate purpose of ESG inquiry, however, is not to set off a virtue arms-race, but rather to understand how prepared a company is to manage the business risks it faces. Fundamentally, ESG analysis is all about threat assessment.

Existing Securities and Exchange Commission (SEC) guidance on climate change disclosure, issued in 2010, calls on all securities issuers to consider environmental risks on par with other business risks and reminds issuers that they are obliged to disclose risk information that a reasonable investor would consider material to the investment decision.

The SEC is on track to issue a new draft regulation addressing ESG disclosures this fall, and this regulation is expected to be much more granular and address not only environmental issues, but social and governance issues as well.

However, the resort industry needs not and should not wait until the regulation is published before beginning to assess its risks. Indeed, publicly traded resort companies already address many environmental risks in their SEC filings.

The first step to disclosure, of course, is to assess thoroughly the environmental risks facing the company.

The four main categories of environmental risk facing the industry are:

- Growth constraints
- Operating costs and losses
- Changing consumer behavior
- Regulatory requirements

While these categories often overlap, they offer a useful framework for considering the E in ESG. Growth constraints represent restrictions (often regulatory in nature) on resort expansion and new resort development. Resort operators are familiar with such limitations, as there long have been limits on development in sensitive natural environments, such as beaches and other aquatic lands.

However, the restrictive threats are multiplying. Evolving international agreements are increasing the number of nations that impose strict environmental controls. Droughts are posing both regulatory and economic challenges, and declining snowfalls pose special risks to winter-sports-centered resorts, including existing properties.

A California appeals court recently rejected as inadequate the environmental review for a planned Lake Tahoe resort, primarily due to a failure to plan for wildfire impacts. Large, damaging storms are growing more frequent, endangering valuable coastal resorts. These pressures are in tension with growing consumer interest in locations that are more wild, more remote, and more sustainable.

Regulatory risk associated with climate change concerns also continues to grow, impacting feasibility and cost (e.g., renewable energy mandates, vehicle charging requirements, water management demands). Resort operators must ensure that their risk assessment keeps pace with the very rapid regulatory and social developments around environmental risk, and must, as in the past, disclose risks that are material.

What's different today is that companies are responding affirmatively to the *reputational risk* associated with negative perceptions around their environmental profiles by taking control of their own ESG narratives. This risk applies equally to privately owned resort operators that are not subject to SEC disclosure requirements, as investors and lenders continue to focus on environmental risk in their portfolios, and consumers show an ever-growing desire to spend money with companies committed to reducing their environmental impact.

While glossy corporate social responsibility reports can appear self-congratulatory and self-serving, they are a response to reputational risk that can be material to the market value of the company. If several large institutional investors keenly interested in ESG performance exit a holding or initiate a proxy battle, it would be surprising if stock value was *not* adversely affected.

Companies are, therefore, understandably motivated to burnish their ESG reputations with the investment community. ESG reports are one way of doing that, but some companies also engage in targeted outreach to key investors and proxy advisory firms to identify concerns and, whenever possible, tout the company's progress. While necessary, though, this affirmative effort poses its own traps.

ESG reports, sustainability commitments, and similar communications are typically framed as aspirations and guarded by "forward-looking statement" disclaimers that warn these objectives may not be achieved.

However, there is great pressure today for companies to commit to a future course of action that can be quantified. The Paris Agreement on climate change and the subsequent U.S. withdrawal spawned many pledges by companies to "comply with" the Paris Agreement, a legally nonsensical notion because the Paris Agreement binds nations and not individual actors.

Nevertheless, those commitments were made, and the pace has only accelerated in the last two years. Each day, it seems that another company is pledging to be carbon neutral or to reach net-zero by 2050, or 2040, or even sooner. These and other sustainability terms are weighted with specific expectations in the investing community, and they have implications for a company's sustainability strategy.

More importantly, notwithstanding any disclaimer, it may be present-tense misleading to adopt a specific future goal with no realistic plan to achieve it. That is particularly the case when more and more investors, large and small, are attributing increasing importance — materiality — to ESG issues. Therefore, companies must exercise extreme caution and vigilance when making statements about ESG performance and aspirations.

Legal advisors who practice in the sustainability field and related ESG disciplines are essential to formulating an effective response to increased ESG awareness. The rapidly developing state and federal legal landscape demands subject-matter experts to apprise resort developers of emerging legal risks. Affirmative ESG statements must be carefully vetted by securities lawyers and other subject-matter experts to ensure that they do not create unintended expectations and that the statements align with business plans and policies. ■