ESG Decision-Making —What are the alternatives?

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ESG—environmental, social, and [corporate] governance—is the focus of socially responsible investing, reflecting the notion that corporations should serve the interests of not only their shareholders, but of all their stakeholders. This paper suggests NEPA's EIS process provides a possible go-by for corporate decision-makers to use in ensuring that their ESG policies consider the big picture--the cons as well as the pros of their ESG policies.

The NEPA process begins when an agency proposes to take action. The agency's next step is to determine the significance of that action's environmental effects and to look at alternative means for achieving the agency's objectives. NEPA requires the agency to analyze *the full range of direct, indirect, and cumulative effects of its preferred action and any reasonable alternatives*. The information provided by this process enables the agency to make an informed decision, but that decision need not be the environmentally preferred one.

Applying the NEPA EIS model requires corporate decision-makers to ask a series of questions. For a summary, see the table below. The first question is whether the focus is to be on sustainability as it relates to the environment or whether social and governance concerns are to be addressed as well.

If we focus on the E, the question then is what aspects of sustainability does the company wish to address, *e.g*., water use, waste generation, energy generation, and/or carbon production? Consider, for example a company wishing to become—and to market itself as—net zero carbon. What are the activities that collectively result in its carbon footprint? Next, what is the carbon footprint for each of those activities? Are scope 3 (upstream and downstream, supply chain) emissions as well scope 1 (direct, owned) and 2 (indirect, utility-related) emissions, to be considered?

Next, what alternatives are available for the company to achieve its net zero carbon objective, *e.g*., reductions of carbon emissions or obtaining offsets? If the alternative is to reduce carbon emissions say by shifting from using electricity produced by coal or gas to electricity produced by solar and wind, what are the carbon footprints associated with the extraction of necessary constituent metals and the manufacture, use, and disposal of solar cells and wind turbines as compared to those associated with the use of coal or gas? And, if the alternative is to reduce carbon generally--by effecting carbon offsets, e.g., by planting or maintaining forests or croplands, how are those offsets to be quantified and verified?

Next, what are the tradeoffs in achieving net zero carbon, *e.g*., what effect will the steps taken to achieve net zero carbon have on other aspects of sustainability such as water use? For example, if carbon is to be reduced by using biofuels or by planting or maintaining forests or croplands, how much more water might be required than if energy is derived from coal or natural gas? And if a switch to renewables means energy is less available or more costly, what effect might that switch have on other energy users whose access to that energy may be impaired? In developing countries, provision of energy may be weighted more heavily than addressing climate change.

At present, there is no common currency for quantifying and comparing the costs of different aspects of sustainability, yet alone for comparing environmental and other social costs. But there are go-bys. For example, there's a body of literature (and litigation) on the social cost of a ton of carbon--the monetized future harm resulting from the release of one additional ton of carbon dioxide. And if the desired reduction in carbon requires additional gallons of water, what is the cost of that additional water? There's literature too on the environmental and social costs of global water use as well as on the social costs of water pollution. And, to the extent there are social costs associated with the decision to go to net zero carbon, how are those costs to be quantified and compared?

Questions a NEPA EIS-type of alternatives analysis might ask

(1) What aspects of sustainability should be addressed, *e.g.*, waste generation or carbon production?

(2) What are the desired objectives, *e.g.*, zero landfill or net zero carbon?

(3) What activities produce the environmental and social impacts of concern, *e.g.*, what activities are necessary to produce the goods and services that result in landfill wastes or carbon?

(4) What is the scope of the activities to be addressed, *e.g.*, the production of the goods and services only or the entire life cycle producing the goods and services, including the activities of suppliers and end users?

(5) What is the magnitude of each impact?

(6) What alternatives would achieve the desired objectives?

(7) What are the environmental and social impacts of each alternative?

(8) What is the monetary value of each of those impacts?

There are further questions that need be asked. Assuming relative impacts of each alternative can be identified, quantified, and monetized, how then are those factors to be weighed in corporate decision-making and, more broadly, how are corporations that make those decisions to be judged by investors and other stakeholders. And what reporting should be required, so comparisons can be more readily made.

As noted, use of the EIS process does not compel a particular choice or result. However, if companies were to use such a NEPA EIS alternatives analysis, they should be better positioned to make informed ESG decisions as to which alternative best meets their objectives, and investors would have a better understanding of how sustainability has factored into that corporation's decision-making process.