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Shareholder Activists Set to Drill Oil Companies

BP's Gulf disaster pressures energy companies to disclose more about environmental and safety compliance. How to account for catastrophic risk?

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It may seem unthinkable that a company with so formidable a public image and financial track record as BP ([BP](#)) is fighting to save its reputation—and potentially, its very existence—less than two years after the oil industry logged its biggest-ever growth in profits. Reversals of fortune of this magnitude aren't as rare as we sometimes think. Recall how the tobacco giants wound up ceding enormous, profit-generating power to the U.S. government and how asbestos lawsuits forced such major industrial outfits as Johns-Manville into bankruptcy.

The common denominator linking BP with these companies is growing clear: They all failed to anticipate risks that could threaten their business foundations.

Now the tide has shifted with respect to how much thought mainstream investors are giving to environmental, social, and corporate governance (ESG) issues. Michael Passoff, senior program director for the Corporate Social Responsibility Program at As You Sow, a shareholder advocacy organization in San Francisco, has reviewed as far back as 1999 resolutions focused on corporate environmental issues that were being filed for the first time. "Nothing comes close to the support we're getting now," says Passoff.

A June 3 proxy vote that called on Layne Christensen ([LAYN](#)), a mining and production company, to produce a sustainability report drew support from over 60 percent of shareholders. Earlier resolutions regarding disclosures about coal ash at power producers CMS Energy ([CMS](#)) and MDU Resources Group ([MDU](#)) were supported by over 40 percent of each company's shareholders. Resolutions demanding greater disclosure by natural gas producers about their hydraulic fracturing practices have drawn supportive votes ranging from 26 percent to 41 percent of shareholders, five to six times what they've received in prior years, says Passoff.

He believes environmental sustainability issues had already begun to attract broader support before the Apr. 20 explosion of BP's Deepwater Horizon rig sent an estimated millions of barrels of oil gushing into the Gulf of Mexico. Passoff credits the change in consciousness to growing awareness of climate change issues. "Investors are seeing that environmental practices affect their bottom line. It's starting to become more commonly accepted," he says.

Environmental resolutions are drawing affirmative votes from pension funds such as the California Public Employees Retirement System (CalPERS) and from RiskMetrics, a proxy service that historically has tended to support management on ESG resolutions, says Passoff.

OTHER OIL COMPANIES FACE SAME RISKS

On June 11, MSCI, a provider of stock indices and portfolio risk analytics, announced plans to include nonfinancial factors such as ESG in its investment products. MSCI acquired RiskMetrics Group on June 1.

There's undeniable risk that BP could declare bankruptcy as a result of the Gulf oil disaster, says Nell Minow, editor and co-founder of the Corporate Library, an independent research group. That BP is on the spot doesn't mean other oil companies are doing any better at planning for environmental debacles, she adds.

"If large fiduciary institutional investors who are going to own a piece of every company for a long time don't understand that they need to do a better job of monitoring risk and getting boards of directors to monitor risk," investors are better off "putting [all their money] in T-bills," says Minow.

The Securities & Exchange Commission's greater receptivity toward requiring disclosures on various matters concerning climate change points to a push for more disclosure, not less, says Robert Graham, founder and head of the environmental law practice at Chicago-based Jenner & Block. He thinks this should motivate shareholders to require companies to disclose more thorough information in their public filings.

In the past, demands for risk disclosure tended to be viewed as hypothetical. In light of the Gulf disaster, Graham predicts that requests for such information will become more mainstream. "These issues are real and this disaster dramatically demonstrates how they impact a company's balance sheet," he says.

\$20 BILLION LIABILITY FOR MARSHLANDS?

Skeptics need look no further than the toll taken on BP's shares since Apr. 20, he says. (The stock has declined 44 percent.) It's also clear—from the thousands of lawsuits BP is facing as a result of the spill's health and safety effects, plus damages claims by many businesses operating in the Gulf—that the company is likely to be held accountable, Graham adds.

The plunge in BP's stock price over the past six weeks amounts to roughly \$83 billion in market capitalization erased, no small loss for shareholders. If BP bows to pressure from U.S. politicians to suspend its \$3.36 per ADR annual dividend, the pain will be compounded for BP investors. While the company has reportedly said it won't seek to limit payouts on legal claims to the \$75 million cap set by the Oil Pollution Act of 1990, the liability cap is likely to be thrown out if plaintiffs' attorneys can prove that the company's reckless behavior and lack of proper safety measures contributed to the disaster.

BP could be on the hook for as much as \$20 billion if a major public works project needs to be undertaken to save marshland around the Gulf, Douglas Brinkley, fellow in history at the Baker Institute at Rice University in Houston, told CNN ([TWX](#)) last week.

As of June 10, the company had received roughly 42,000 claims and paid over 20,000 claims totaling \$53 million, a spokesman in BP's Houston office told *Bloomberg Businessweek*.

It is inevitable, Graham says, that companies will be pressed by shareholders to disclose more information about safety practices, the kinds of fail-safe mechanisms they have in place for high-risk operations, and their plans and prospects. Companies will have to reconsider the insurance they've arranged to better gauge how much and what kinds of coverage they need to cover potential risks. They'll also need to figure out how much cash to set aside in reserve to cover unforeseen incidents that may cause environmental damage, he says. Shareholders will also start to insist on viewing companies' safety records, including any sanctions received from federal or state agencies regarding their operations.

DO SHORT-TERM INVESTORS CARE?

There will also likely be a bigger push for disclosure on what companies are doing to develop alternative energy sources and how much money they're investing in that area, relative to investments in fossil fuels, says Graham, which he notes would fit in well with disclosures on climate-related risks that the SEC began to require in February. In the long run, it may well encourage energy producers to put further research and money into developing less risky, climate-friendlier alternative energy sources such as solar and wind, he adds.

From one perspective, growing awareness among shareholders of environmental, social, and governance-related risks could be seen as a corrective to the general trend toward a relatively short-sighted view as investors' time horizons have shrunk. "If you're renting the stock, you don't care what happens next year," says Lloyd Kurtz, manager of the Wells Fargo Advantage Social Sustainability Fund

(WSRAX). "You don't care if the company has a litigation problem in two years because you'll be gone by then."

The prevailing short-sighted view of risk creates an opportunity for investors with longer time horizons, who are more inclined to look for problems that may crop up, he says.

Kurtz would prefer that the damages companies are required to pay for litigation and environmental destruction continue to come out of shareholder equity rather than out of cash reserves earmarked to cover such events. That's the only way to get investors to make it common practice to weigh environmental risks, along with other risk factors, when deciding whether or not to invest in a company, he says. He suspects that any attempt to assign a monetary value to such risks before they manifest would only enable companies to manage the reserves to help bolster or reduce their profits.

Minow at the Corporate Library agrees that investors need to consider such risks when researching companies to invest in. She would also like to see these risks accounted for on companies' balance sheets. Apart from what she says is BP's environmental negligence, the company embarked on a project "without any idea of how to handle it if things went wrong," something Minow calls "utterly indefensible." The fact that BP didn't have a backup plan in place speaks to sustainability issues, she adds.

She sees a clear parallel with the fate of Texaco, which—while still an independent company—was forced to file for bankruptcy in 1987 so it could continue operating while it figured out how to recover from a huge civil verdict stemming from its attempted acquisition of Getty Oil.

SHAREHOLDERS MIGHT WRITE IN DIRECTORS

The financial industry reform legislation that's now in conference committee between the U.S. Senate and the House of Representatives includes provisions for shareholders to propose their own board candidates on companies' proxy cards, which will put unprecedented pressure on individual directors, says Minow. She believes this—more than resolutions, which aren't binding—will be the focus of shareholder activism.

"[Primary attention] is going to be on replacing boards of directors and if the board of directors at BP didn't do a good-enough job of responding to problems, they'll be out," she predicts. If BP lacks directors with environmental credentials, some will have to be found and added, she says.

Coming as it did toward the end of proxy season, the timing of the Gulf disaster may seem unfortunate for activists, but Minow believes time will confer an advantage. By the time the 2011 proxy season comes around, she predicts that the financial reform legislation will have passed, opening fresh opportunities for activists to exert pressure on companies.

"There's a reason shareholders' resolutions have to be in by fall for meetings in the spring. It gives corporations a really good opportunity to get their acts together before shareholders start proposing resolutions," she says. "Partly for that reason, I suspect [BP chief executive officer Tony] Hayward will be out by the end of the summer."