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Climate Risks Drive Investors Away From Carbon

By **Sean McLernon**

Law360, New York (August 14, 2013, 6:07 PM ET) -- With asset owners and managers increasingly worried about the financial implications of climate change, experts say corporate boards will feel new pressure to start taking low-carbon options more seriously as investors begin to shift away from resources like coal that are closely linked to global warming.

The Global Investor Coalition on Climate Change released a report last week revealing that 53 percent of asset managers either decided to not invest in or pulled out of listed entities because of climate change risks, which include existing and prospective regulatory changes and government support schemes in addition to physical impacts.

Asset owners are paying closer attention too, with 63 percent saying they are monitoring their managers on how climate change is integrated into their investment evaluations and 69 percent factoring climate factors into their fund manager decisions.

The net impact of the survey, which included a total of 84 owners and managers with collective assets topping $14 trillion, will likely be to nudge businesses away from reliance on fossil fuels and provide incentive for reducing their carbon footprints, according to Arnstein & Lehr LLP partner William J. Anaya.

“It’s going to open some eyes in some boardrooms,” Anaya said. “A lot of salaries are tied directly to stock, giving corporate managers a real incentive to respond to investment concerns.”

Environmental groups like 350.org are pushing their own ideologically motivated divestment movement, encouraging universities, states and localities, churches, and other groups to pull their money out of the 200 publicly traded companies that hold most of the world’s fossil fuel reserves.

While the activist-fueled campaign has started to receive more attention recently, those large companies may have more reason to be concerned about the investors who are moving their money elsewhere for purely financial reasons, as the Obama administration readies new greenhouse gas regulations and federal and state governments push cleaner energy options.

Coal companies are already starting to feel the heat, according to Akin Gump Strauss Hauer & Feld LLP partner Paul E. Gutermann. The industry could be facing serious new challenges in the coming months, with proposed carbon emissions standards for new plants coming in September and a rule for existing plants scheduled for rollout in June 2014.

The oil and natural gas sectors have yet to take much of an investment hit, Gutermann said, but companies across the board are paying much more detailed attention to climate risk factors than they used to.

“There is increased due diligence and an enhanced level of climate risk analysis being done,” Gutermann said. “The analysis is more sophisticated, not merely considering things like the next stage of the Kyoto protocol, but looking at industries that may be facing greater risk from changes in the environment.”

Events like record heat waves, droughts and devastating storms will keep climate change in the front of investors’ minds, according to Gutermann.

“There’s a trajectory of that being more highly considered,” Gutermann said. “When you have things like the hurricane in New York, there clearly is more concern about it and that will continue to trend upward.”

It all serves as a wake-up call for many companies, Anaya said, as the investment community is signaling that it may not be a good idea to invest in 20th century activities during the 21st century.

Greater consideration of climate risks doesn’t mean that the investment community is basing their decision on concerns about the state of the planet, however. It all comes down to cold calculations of how to get the best financial returns.

“They’re not actively pursuing the banner of climate change — they are just reacting to potential regulatory changes, government support schemes and other policies,” Anaya said. “That’s where they think the risk is. Investors could care less if the earth boils; they just want their investments to be secure.”

American Enterprise Institute energy and environmental policy scholar Benjamin Zycher doubts that an ideologically fueled divestment movement would be able to achieve its intended goals, pointing to the massive number of investors out there who are willing to fill the gap when other groups have pulled out.

“In principle, it can't have any effect at all in a world in which there are tens of thousands of competing asset managers and millions of investors competing for returns,” Zycher said. “All it could possibly have is a change in the identity of the investors. In terms of the number of dollars, the effect will be nonexistent.”

While Zycher said increased carbon emissions restrictions and other regulatory factors could lead investors to shift away from businesses linked to climate change, it’s hard to tell if such action is worth it until after the Obama administration has laid out specific plans.

Such regulatory uncertainty remains a primary concern for both energy companies and investors, according to Paul H. Dickerson, a former chief operating officer of the U.S. Department of Energy's Office of Energy Efficiency and Renewable Energy who is now of counsel at Mintz Levin Cohn Ferris Glovsky & Popeo PC.

“We have no idea what EPA will do as it relates to carbon,” Dickerson said. “I think we can safely say that Congress will fail to reach any agreement on any sort of program, but it is unclear what will happen with the EPA, whether it is good or bad.”

Even if strict regulation sharply increases compliance costs for industries that produce heavy amounts of carbon emissions, diversifying fuel portfolios will be more difficult for some companies than others, according to Brown Rudnick LLC counsel Paul Afonso. With many areas of the country still relying heavily on coal for electricity, some corporate boards won't have much flexibility to make significant changes in the short term.

“Boards of directors and their management always have to be responsible to their shareholders, but they also have to balance that with responsibility to the energy portfolio of the region and the reality of the system,” Afonso said. “It’s not something you can just switch on or off.”

Investors are still likely to move funds elsewhere, favoring other entities that receive more support from both the government and the market.

“Is this industry going to get whipsawed? Are they going to get dinged for more money? Will there be more government regulation? The market sees it as a risk, and that’s the point,” Anaya said.

--Editing by Elizabeth Bowen and Philip Shea.