

## Climate Change, Fiduciary Duty & Shareholder Value

“In terms of climate policy, the Australian government is fast becoming public enemy number two among environmentalists” (Out of the Greenhouse, Page 40, Environmental Finance 2002). Although Australia has been set a reasonably manageable greenhouse target of a reduction of 8% by 2010, from the 1990 baseline levels, in comparison to its counterparts, it has been standing by the United States in its stance of not ratifying the Kyoto Protocol. One of the key issues that the government has argued is the uncertainty relating to land clearing figures that help form the 1990 baseline. Whilst the federal government has not provided any indication that it will ratify the Kyoto Protocol, it has put forth the National Greenhouse Strategy. State governments and industry have been making a variety of inroads into reducing greenhouse emissions, recognising that the potential ratification of the Protocol may otherwise have significant economic consequences, including private sector business risks. The New South Wales government, for example, recently announced that electricity retailers would be mandated to reduce emissions by 5% from the baseline levels, by 2007. Accordingly, a confounding issue for the private sector relates to the potential risks faced by investors. A recent report by Innovest Strategic Value Advisors, Inc titled Value at Risk: Climate Change and the Future of Governance (April 2002), addresses this exact concern.

The report argues, from a US perspective, that investor negligence of risks associated with climate change is neither prudent nor responsible, and is probably the first study to show clear links between climate change, fiduciary duty and shareholder value. The report suggests that investment risks are two-fold: (1) the economic/financial risk from the damages and remediation due to climate change itself (directly to companies and indirectly through general socio-economic disruptions in the US and abroad), and (2) exposure to the costs of greenhouse gas emissions in any regime to mitigate climate change.

The bottom line, as this report documents, is straightforward: climate change represents a potential multi-billion dollar risk to the US private sector. The report claims, it should therefore command the same level of attention and urgency as any other business risk of this magnitude. But what, precisely, must institutional investors do to carry out their fiduciary duties in a responsible and prudent fashion in light of the economic threats posed by climate change?

Institutional investors have a legal duty to act prudently and solely in their beneficiaries’ best interests. As the report suggests, embedded climate risk is a serious long-term threat to the preservation of investment value. The report recommends that institutional investors, so as to fulfill their fiduciary duties, must:

- Seek expert advice on climate risk.
- Undertake a portfolio-wide assessment of risk exposures.
- Incorporate climate change considerations into overall investment strategies.
- Request – and if necessary, demand – greater disclosure of climate risks by companies wishing to be considered as investment candidates.
- Encourage best practice among their portfolio companies.
- Explore the commercial potential of new, “climate-friendly” investment products.
- Channel more investment capital into “clean energy” opportunities.
- Promote the universal adoption of the Greenhouse Gas Reporting Protocol recommended in the Global Reporting Initiative’s reporting guidelines.
- Support collective industry initiatives promoting a lower carbon economy.

The Australian investment community is faced with similar issues. The level of awareness of the potential effects of climate change is severely lacking. As engineers, we have a duty to increase this level of awareness and to bridge the gap between the technical field and the uninitiated investment community so as to address what perhaps is the most significant global environmental threat.

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