

# Does sustainability collaboration in finance, investment, and insurance breach competition law? Not necessarily...

CGI Climate Governance initiative

Global FS Hub Webinar for financial sector Non-Executive Directors

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Cleary Gottlieb Steen & Hamilton LLP    October 31, 2023

# Overview

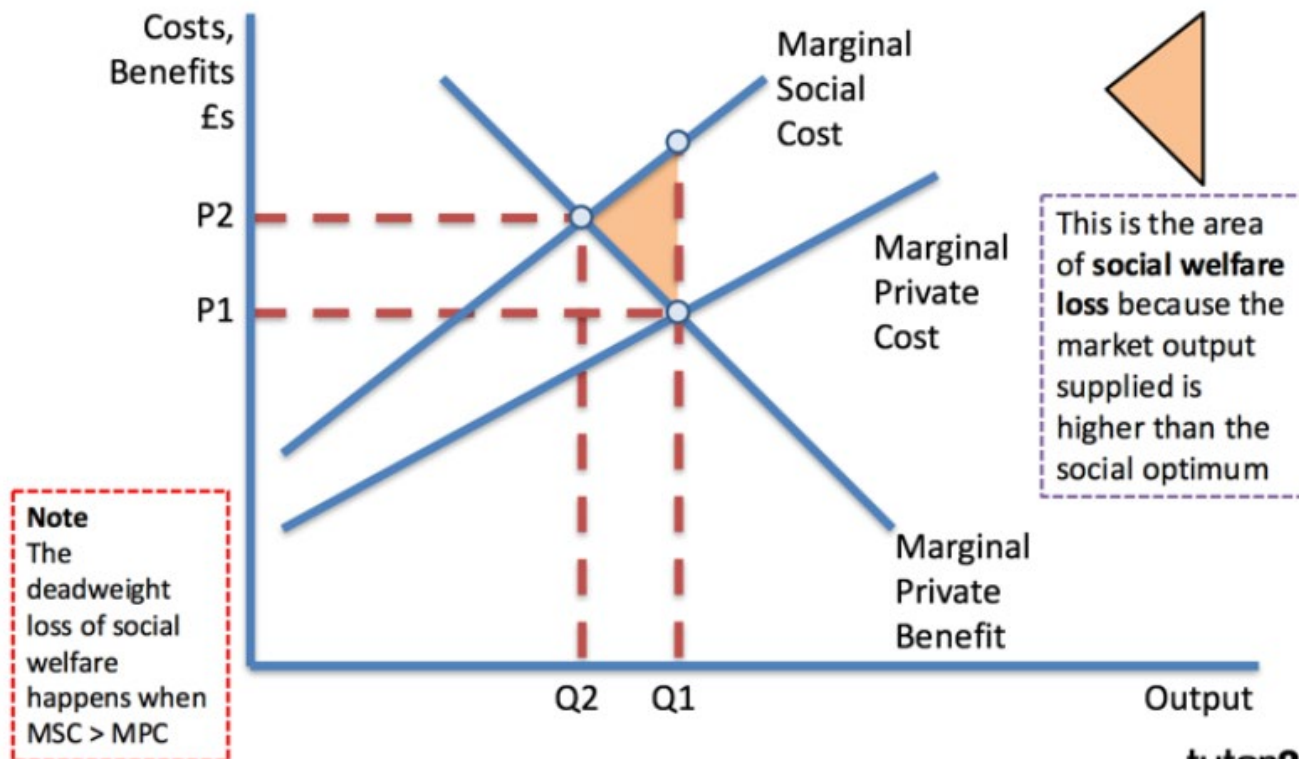


- Externalities and market failure leading to climate change
  - Cost to society and to our companies
    - Disclosures and reporting
    - Risk for other financed, insured, owned assets
    - Litigation and long-term risk (stranded assets, regulatory risk)
    - Fiduciary duties
- Private sector cooperation as a solution to collective action problem
- Antitrust analysis of cooperation (EU, UK, US)
  - Permitted agreements,
  - Exemptible agreements
  - What not to do
  - The US situation
- Conclusion:
  - cooperation is necessary and, in many cases, allowed

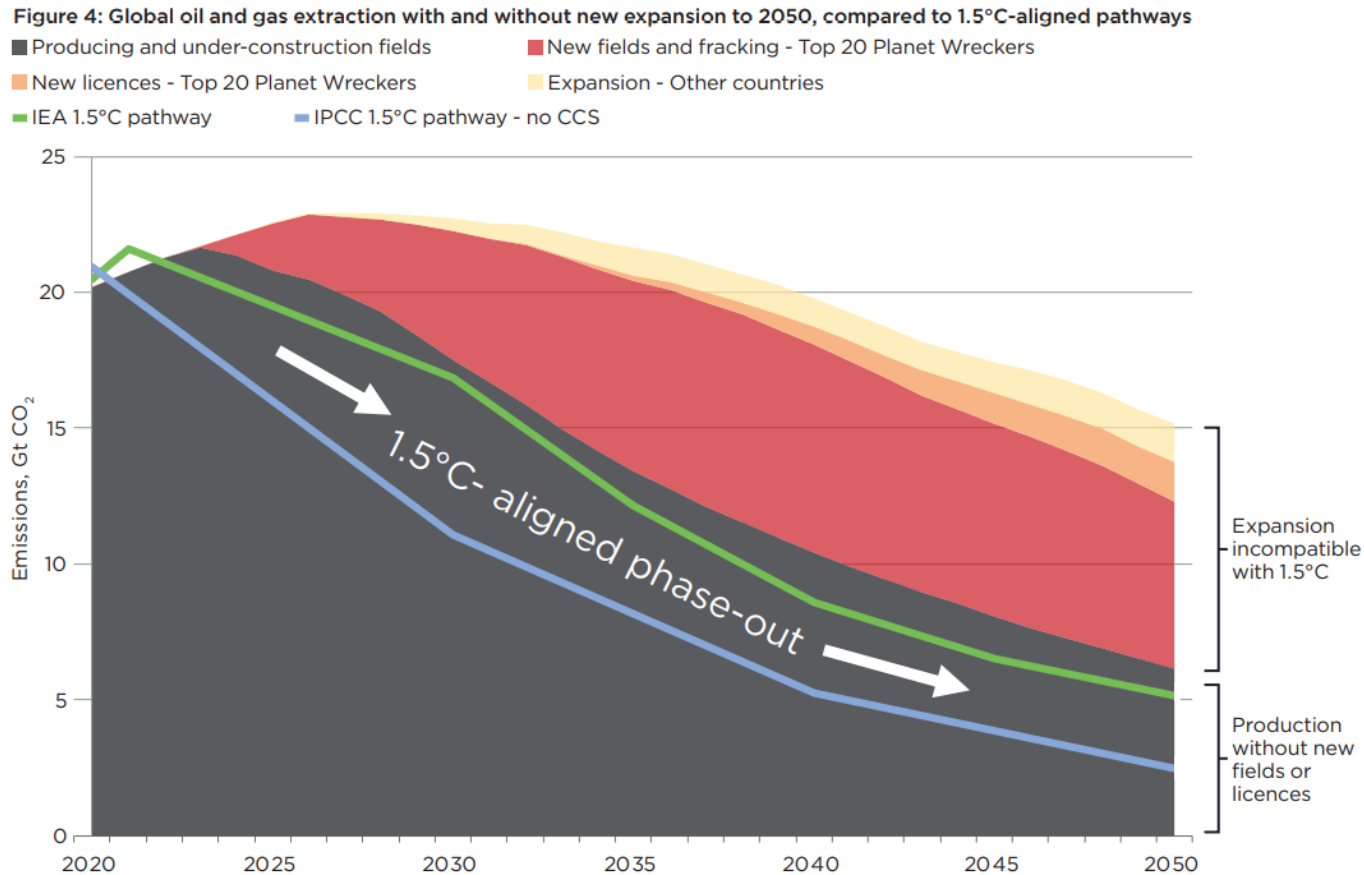
# Cost of climate crisis is not included in price/ROI

## Negative Externalities – The Social Welfare Loss

Market failure happens when prices do not reflect social costs



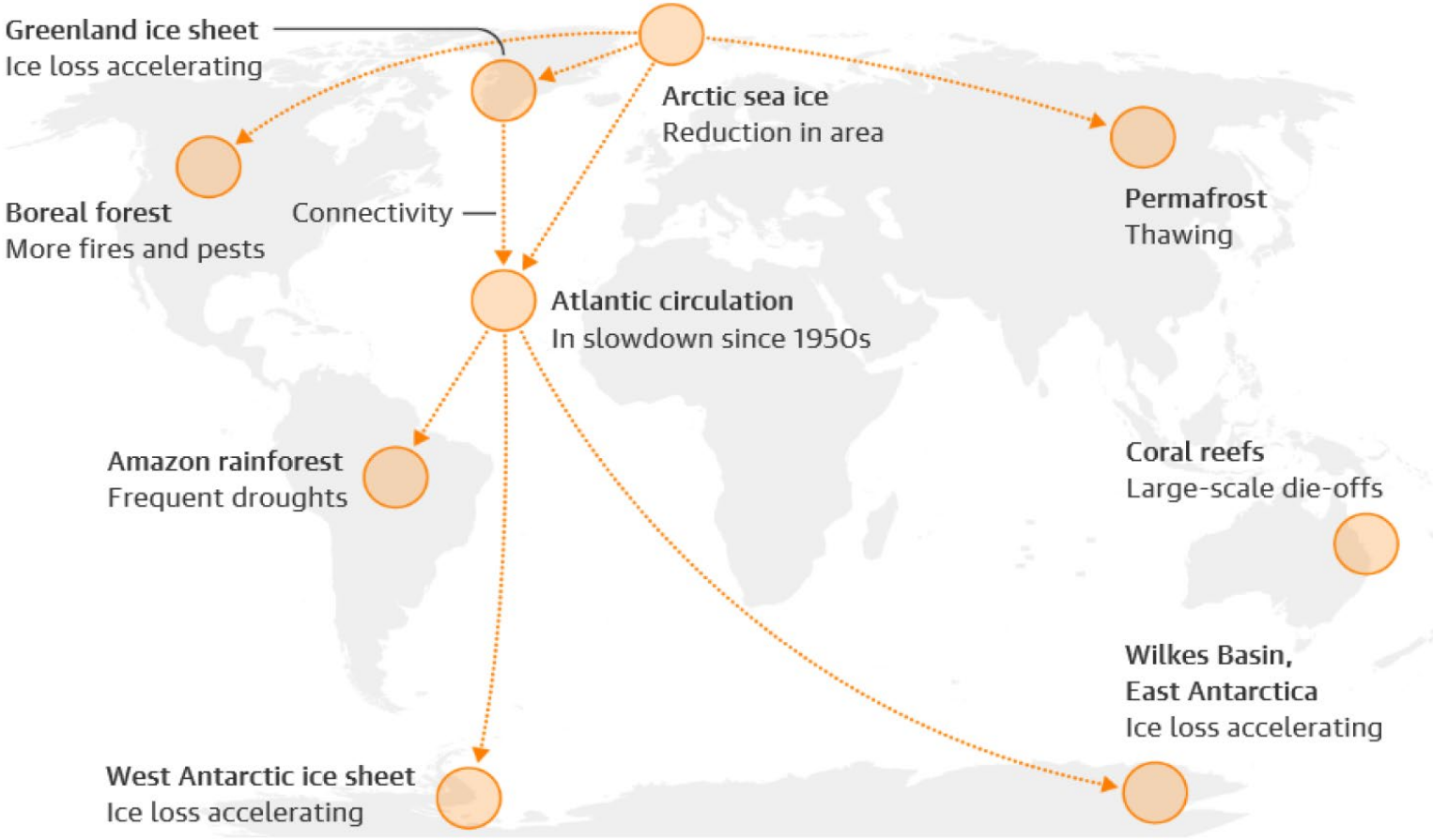
# The carbon budget leaves no room for new fossil fuels



Source: Oil Change International analysis of data from Rystad Energy (January 2023), IPCC AR6 Scenarios Database hosted by IIASA,<sup>36</sup> IEA<sup>37</sup>

In fact, this is already outdated: See [Assessing the size and uncertainty of remaining carbon budgets](#) | Nature Climate Change 30-10-2023

# Scientists' warning: a cascade of climate tipping points is possible



Guardian graphic. Source: Lenton et al, Nature, 2019

Table 3: The Great Carbon Arbitrage.

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Further temperature increase – on top of 1.1 °C already observed – prevented **	2.14



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# “This is a Big Big Deal”: Climate Leaders Praise California’s Lawsuit to Hold Big Oil Accountable

Published: Sep 18, 2023

NEW YORK – After Governor Gavin Newsom and Attorney General Rob Bonta [announced Friday that California is suing Big Oil](#) for more than 50 years of deception, cover-up, and damage, climate leaders across the country have shared their support.

**“The fifth-largest economy on earth is suing the five biggest oil companies for their climate lies.**

**This is a big big deal.”**

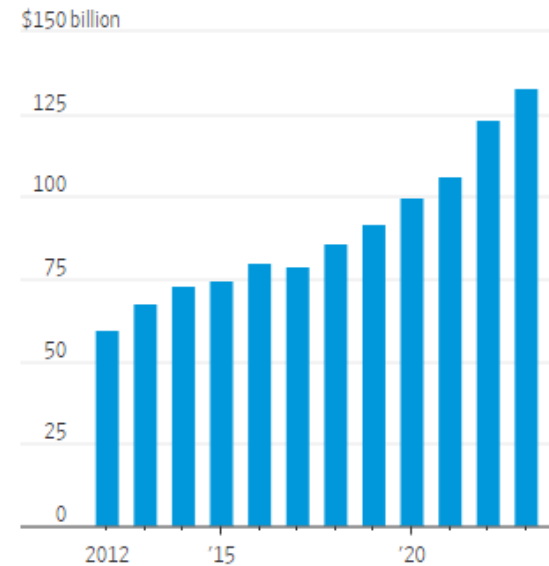
*Bill McKibben, environmentalist and founder, 350.org*

# First signs of existential risks:

## State Farm General Insurance Company®: California New Business Update

State Farm General Insurance Company®, State Farm's provider of homeowners insurance in California, will cease accepting new applications including all business and personal lines property and casualty insurance, effective May 27, 2023. This decision does not impact personal auto insurance. State Farm General Insurance Company made this decision due to historic increases in construction costs outpacing inflation, rapidly growing catastrophe exposure, and a challenging reinsurance market.

Global insured average annual catastrophe-loss estimates



Source: Verisk Analytics

TWSJ: Climate risk is becoming uninsurable.  
Better forecasting can help (30/10/2023).



# Dutch Corporate Governance Code, principle 1.1.

*The management board is responsible for the continuity of the company and its affiliated enterprise and for sustainable long-term value creation by the company and its affiliated enterprise. The management board takes into account the impact the actions of the company and its affiliated enterprise have on people and the environment and to that end weighs the stakeholder interests that are relevant in this context. The supervisory board monitors the management board in this regard*

See also the Dutch Shell Climate case (on appeal).

Also: 2014 Cancun case and Article 2:8 Civil Code

- See also the French Loi Pacte 2019 (Article 1833 French Code Civil); Afep-Medef, Corporate Governance Code of Listed Companies, 2018.
- In the EU, this is reflected in regulation including the Corporate Sustainability Reporting Directive, and the Corporate Sustainability Due Diligence Directive (CSDDD).

# Section 172 of the UK Companies Act 2006

## 172 **Duty to promote the success of the company**

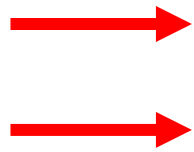
- (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
  - (a) the likely consequences of any decision in the long term,
  - (b) the interests of the company's employees,
  - (c) the need to foster the company's business relationships with suppliers, customers and others,
  - (d) the impact of the company's operations on the community and the environment,
  - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
  - (f) the need to act fairly as between members of the company.
- (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
- (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

## **UK Court (Shell case)**

it is for the directors to determine how best to promote the success of a company for the benefit of its members. “Marginal review” -- *balancing* of multiple factors

# IEA “Net Zero by 2050 – A Roadmap for Global Energy”

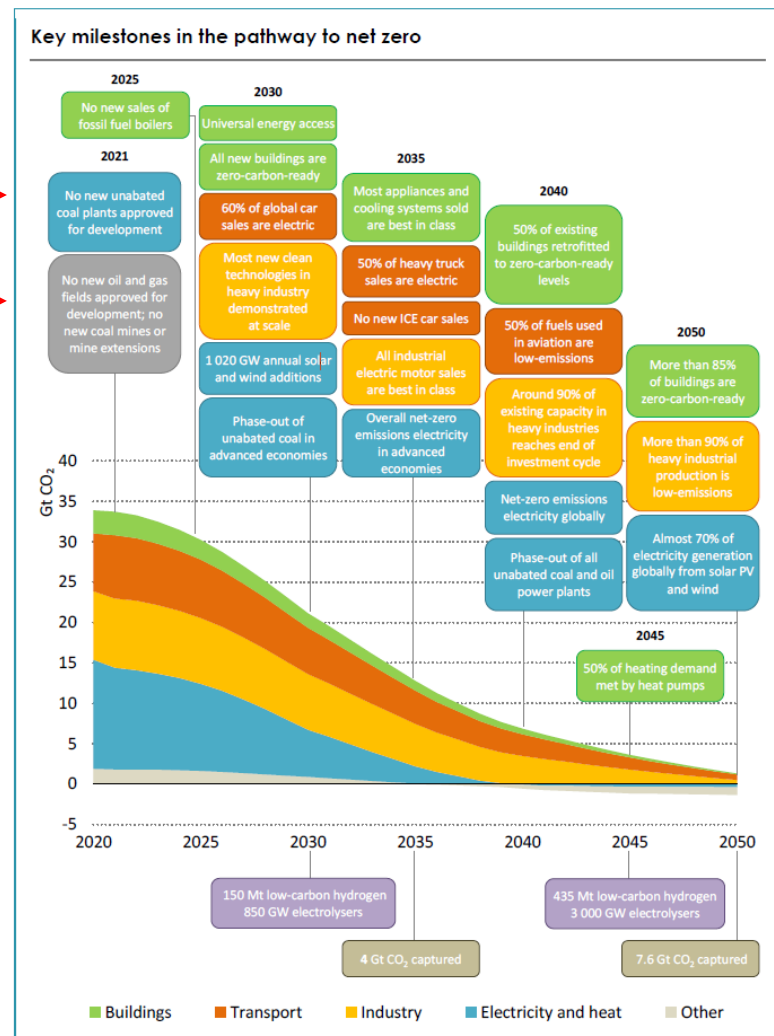
IEA key milestone: “Beyond projects already committed as of 2021, there are no new oil and gas fields ... and no new coal mines or mine extensions”



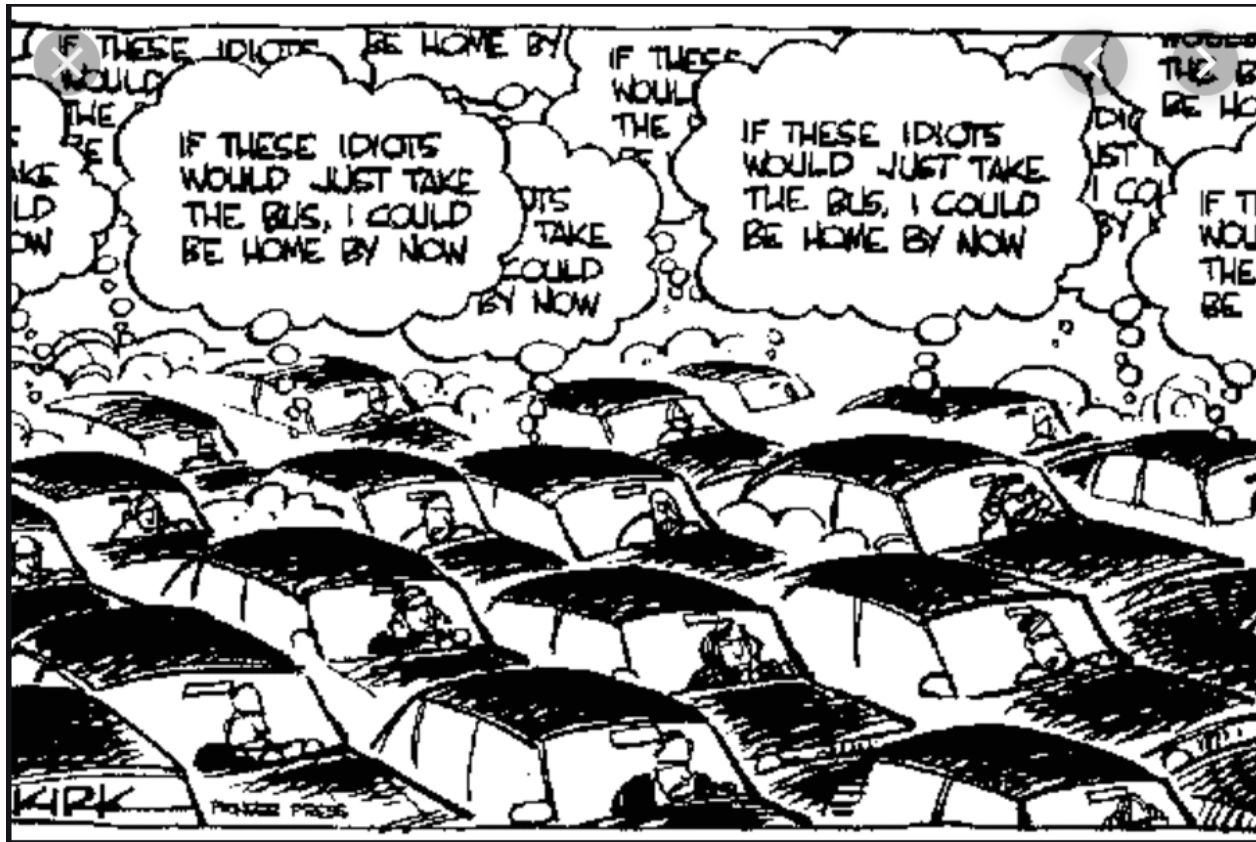
⇒ No or few banks and insurance companies will forego funding or insuring new unabated fossil fuel projects unless all of them do so.

⇒ Net Zero Agreements are necessary to resolve market failure

(May 2021)



# Collective action problems require cooperation



*Ajit Niranjana, The Guardian:*

Banks pumped more than \$150bn in to companies running 'carbon bomb' projects in 2022

# But political opposition using antitrust



**ERIC SCHMITT**  
MISSOURI ATTORNEY GENERAL

## Missouri Attorney General Leads 19 State Coalition in Launching Investigation into Six Major Banks Over ESG Investing

Oct 19, 2022, 11:16 AM by AG Schmitt

JEFFERSON CITY, Mo. – Missouri Attorney General Eric Schmitt announced today that his office and 18 other attorneys general have served six major American banks with civil investigative demands, which act as a subpoena, asking for documents relating to the companies' involvement with the United Nations' (UN) Net-Zero Banking Alliance. The banks under investigation include Bank of America, Citigroup, Goldman Sachs, JP Morgan Chase, Morgan Stanley, and Wells Fargo. NZBA-member banks must set emissions reduction targets in their lending and investment portfolios to reach net zero by 2050. Missouri, Arizona, Kentucky, and Texas are leadership states on this investigation.

“The Net-Zero Banking Alliance is a massive worldwide agreement by major banking institutions, overseen by the U.N., to starve companies engaged in fossil fuel-related activities of credit on national and international markets. Missouri farmers, oil leasing companies, and other businesses that are vital to Missouri’s and America’s economy will be unable to get a loan because of this alliance,” **said Attorney General Schmitt.** “We are leading a coalition investigating banks for ceding authority to the U.N., which will only result in the killing of American companies that don’t subscribe to the woke, climate agenda. These banks are accountable to American laws - we don’t let international bodies set the standards for our businesses.”

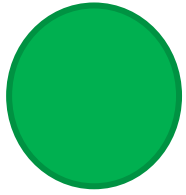
<https://ago.mo.gov/home/news/2022/10/19/missouri-attorney->

# EU 2023 Guidelines on Horizontal Agreements

## -- Chapter on Sustainability Agreements

see also UK 2023 Guidance

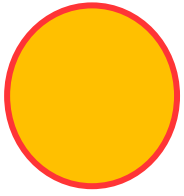
- 519. ... individual production and consumption decisions can have negative effects ('**negative externalities**'), for example on the environment, that are not sufficiently taken into account by the economic operators or consumers that cause them. This type of **market failure can be mitigated or cured by collective action**, primarily through public policies or (sector- specific) regulation, and secondarily through cooperation agreements between undertakings that promote sustainable production or consumption.
- 520. Where such market failures are addressed by appropriate regulation, for example, mandatory Union pollution standards, pricing mechanisms, such as the Union's Emissions Trading System ('ETS'), or taxes, additional measures by undertakings, for example through cooperation agreements, may be unnecessary. However, **cooperation agreements may address residual market failures that are not or not fully addressed by public policies and regulation.**



## Examples of sustainability cooperation -- generally allowed under Guidelines

- Coordinated internal initiatives – limiting printing, waste, etc
- Joint lobbying on sustainability / joint policy advertising
- Industry-led training program
- Agreements to comply with laws and regulations
- Voluntary codes of conduct
- Emissions targets leaving implementation free
- Standards meeting “soft safe harbour” criteria
- Objective lists of (un)sustainable practices, suppliers, inputs
- Joint R&D (pre-competitive or within block exemption)
- Activist shareholder coordination (macro stewardship initiatives) so long as no hub-and-spoke exchange





## Examples of sustainability cooperation that may need *ad hoc* assessment under Guidelines

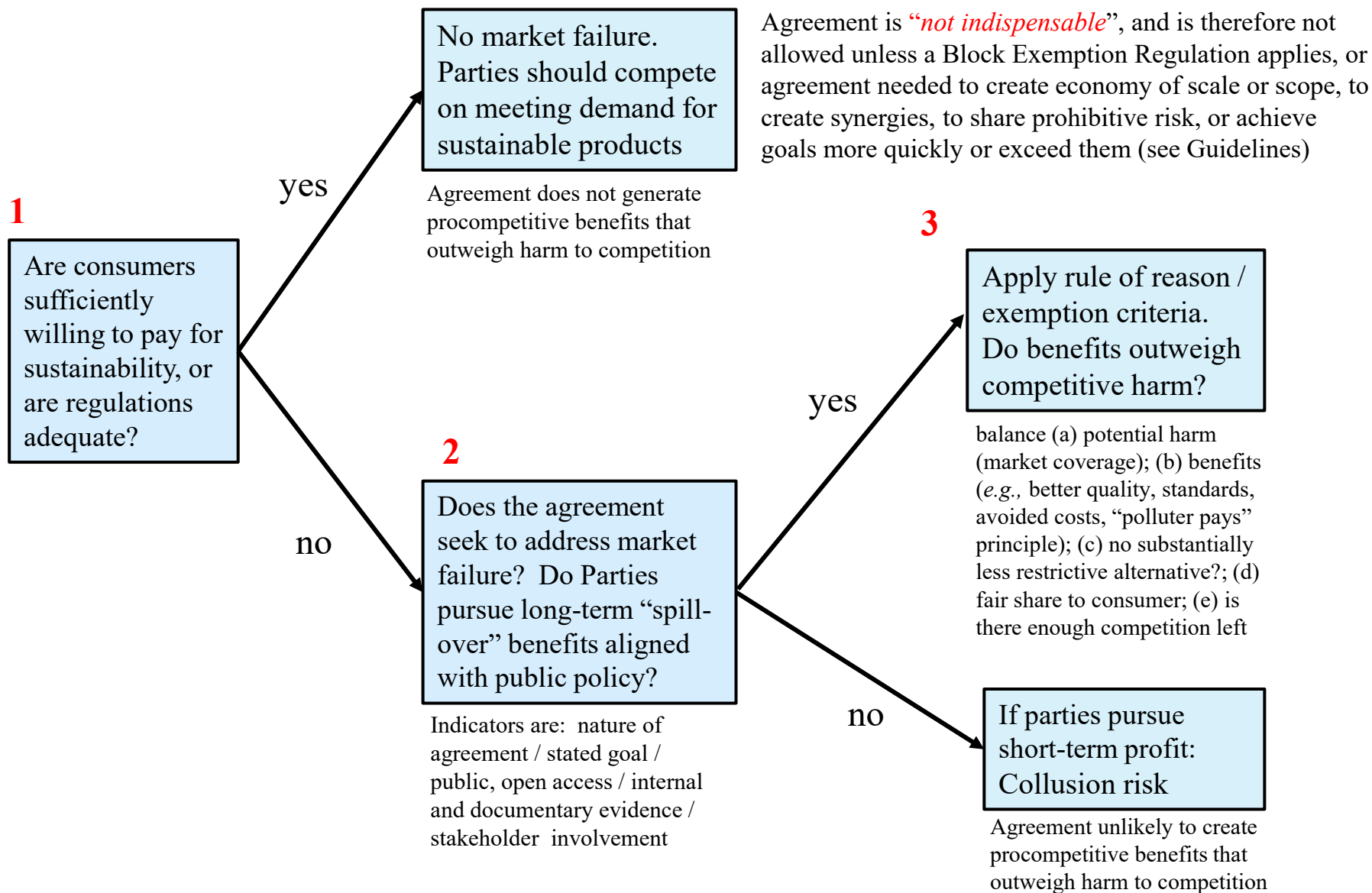
Agreements to:

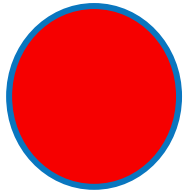
- Phase out of unsustainable input / products / practices
- Binding joint codes of conduct for supply chains
- Joint purchasing of sustainable / new input
- Joint production of sustainable / new products
- Activist shareholder joint divestment
- Agreements not to finance / insure high-emissions activities, unabated coal/fossil fuels
  - “no new unabated coal projects”
  - “no new fossil fuel fields”





# Decision Tree for assessing restrictions in climate/sustainability agreements





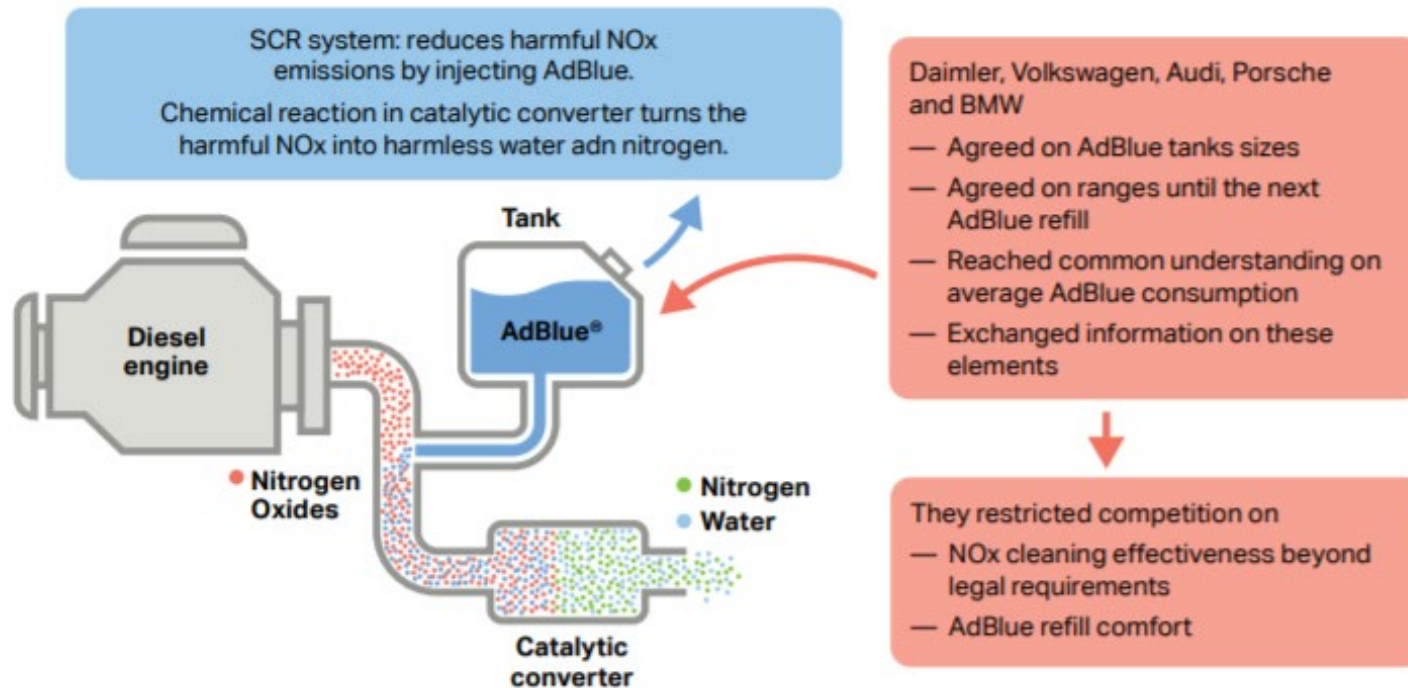
## Examples of sustainability cooperation -- not allowed (unless exceptional justification)

- Price fixing / output limitations
- Market allocation
- Agreements to pass on cost of emission reductions, or costs of emissions trading rights
- Limiting innovation
- Agreeing not to go beyond existing regulation
- Undermining regulation (*Adblue* case)
- Information exchanges not necessary for legitimate goals (on prices, volumes, future competitive plans, etc)



# Example of action against greenwashing collusion: *AdBlue*

Figure 1 - The Commission's Findings In AdBlue Cartel



Source: European Commission

See also “*Colluding Against Environmental Regulation*” (Jorge Ale-Chilet, Cuicui Chen, Jing Li and Mathias Reynaert) TSE Working Paper 1204, April 2021

## US rule of reason: market failure as justification

*“procompetitive justification analysis entails three steps. First, the defendant must identify a specific **cause of market failure**. ... high transaction costs, free-rider problems, downstream market power, information asymmetries, or another well-established cause of market failure ... Second, the defendant must prove that the relevant **market actually failed** (or would have failed) absent the challenged restraint. ... Third, the defendant must prove that the challenged **restraint actually alleviated the market failure.**”*

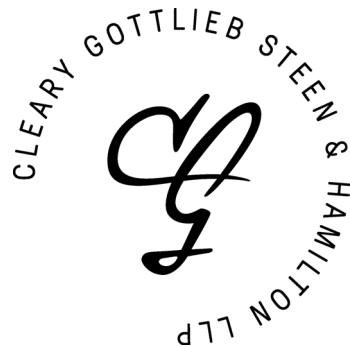
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# Conclusion

We have a choice

- Doing nothing and saying nothing
  - leading to climate risks, damage, litigation, and even existential risks
- Doing little while creating green impressions
  - leading to reputation damage, greenwashing litigation
- Take action
  - Lobby for regulation, emissions tax or effective emissions trading rights, to create level playing field
  - Cooperate within the guardrails of antitrust --- reducing risks to shareholders, customers, business
  - Coordination is necessary and normally allowed
  - Turn the risk into opportunity



Thank you

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