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Study Assesses Cost of Climate Litigation on Shareholder Value

May 30, 2023

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A **working paper** from the London School of Economics and Political Science that looked at over 100 climate-related lawsuits between 2005 and 2021 found that the filing of a climate-based litigation claim or corresponding unfavorable court decision reduced the market capitalization of the defendant company by about 0.41%, on average.

Broken out by incident, the study found that the mere filing of a climate-related lawsuit could decrease a company's market valuation by 0.35%, while an actual court decision finding liability on the company reduced the defendant company's market capitalization by 0.99%.

According to the working paper, the losses were not evenly distributed across all companies and sectors. The paper found a key distinction between "Carbon Majors" (*i.e.*, companies in the energy, utilities, and materials sectors of the economy) and non-Carbon Majors. For **Carbon Majors**, the filing of a case reduced market capitalization by 0.57% while an unfavorable court ruling impacted share price by 1.50%. But for non-Carbon Majors, the study found no statistically measurable impact on share price resulting from either initiation of a climate-related lawsuit or from an unfavorable decision.

Notably, the authors found that the vast majority of statistically measurable declines in share price occurred from litigation initiated after 2019. While the first recorded climate-related litigation dates back decades earlier, the study found that only in recent years have the capital markets responded significantly to climate-related lawsuits. The authors noted that by the mid-late 2000s, plaintiffs first began to develop novel climate-based litigation theories against large carbon emitters. In 2005, residents along the Mississippi Gulf Coast impacted by Hurricane Katrina sued an oil and gas company for damages. Three years later, in 2008, residents in

Alaska sued an oil and gas company seeking damages related to expected relocation costs on grounds that rising sea levels threatening their homes were caused by carbon emissions. Plaintiffs lost both cases and the study notes that climate litigation against large corporations quieted in response. But that gradually changed as governments globally increasingly took action to address climate issues, academic studies demonstrated stronger ties between carbon emissions and climate change and international consensus formed around the goals of the Paris Agreement. Since 2019, an unfavorable decision to a Carbon Major has resulted in a 1.55% decline in market capitalization.

While the percentage impact on share price seems small, the authors noted that an unfavorable decision to a company leads to a $360 million loss in shareholder value, on average. The paper acknowledged that these are averages and may be skewed by large cases. But even so, the dollar amounts may not even fully measure the impact of climate-related litigation on a company, or similarly situated companies, for a number of reasons. First, there is a small but statistically measurable anticipation effect in advance of a judicial decision. Accordingly, the resulting decline in share price after a decision is released may not fully account for the anticipatory impact on share price before judgment is rendered. Second, the long timeline of a litigation means that a company can slowly lose shareholder value from pre-judgment motion practice, news reports and preliminary decisions. Finally, cases brought against one company within an industry may impact others in the industry as well.

Taking the Temperature: In one sense, it is not surprising that the filing of a lawsuit or an adverse decision can negatively impact a company's stock price, depending on the significance of the litigation and market perceptions about the likelihood and magnitude of a potential pro-plaintiff judgment. More notable is that, according to the study, meaningful share price impact is a relatively recent phenomenon, coinciding, as the authors observe, with increasing general awareness of and legislative and regulatory activity around climate-related issues. Litigation is no exception. We comment frequently on the accelerating trend of climate-related litigation globally, as well as shareholder pressure on companies related to climate challenges. Directors and officers confronting this environment, as well as the "pro-ESG" and "anti-ESG" divide in the U.S., can best address these challenges by focusing on climate-related governance (*i.e.*, monitoring and assessing material risks and opportunities), data collection/assessment (including alignment with SBTi or other data standard setters) and disclosure (including necessary caveats or qualifications on articulated climate goals). Doing so can help reduce litigation exposure and, in that, preserve shareholder value. And, according to at least one recent study, "ESG activities have no strong negative correlations with financial outcomes; in fact, they are associated with encouraging revenue growth and EBITDA margins."