Making Corporate Carbon Commitments Credible

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The problem

The importance (and urgency) of addressing climate change

Corporations (and others) are visibly advertising greater climate responsibility

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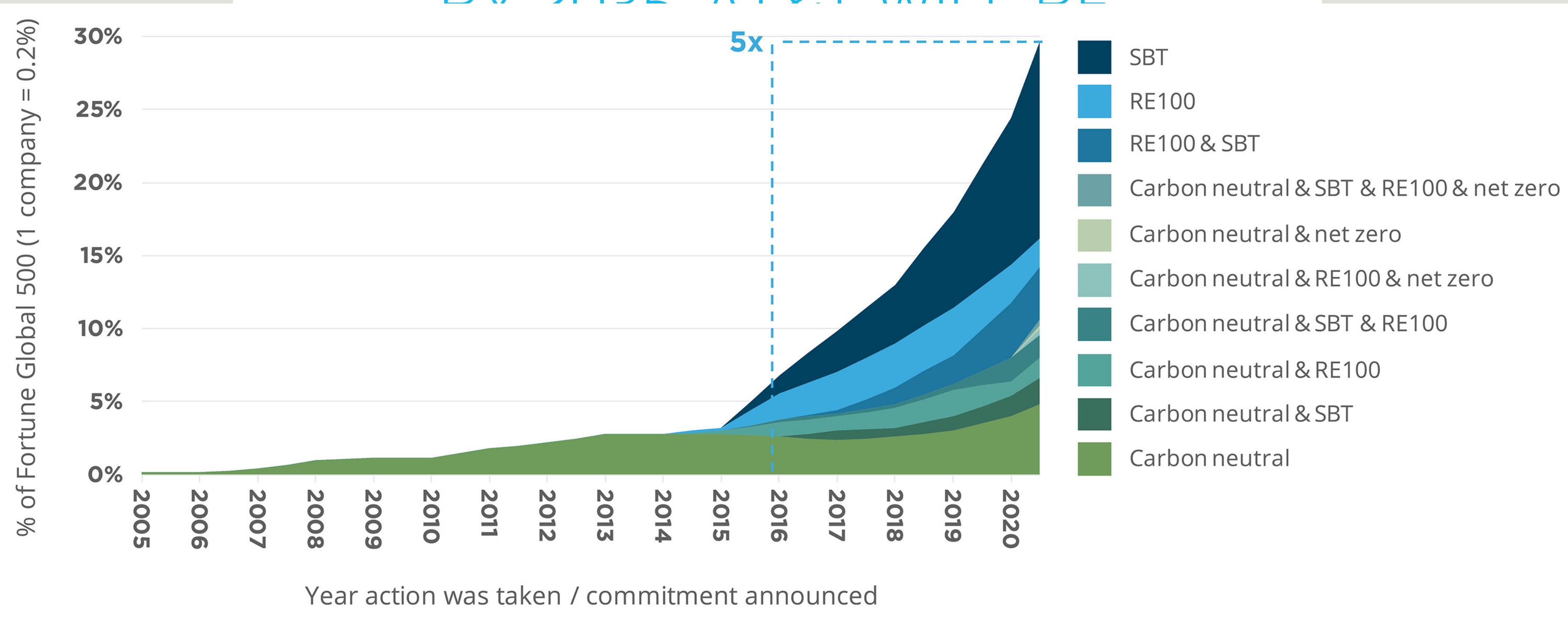

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AEW's approach

Focus on a specific issue – carbon pricing

High carbon pricing hurts brown companies but helps green companies

But carbon pricing is a function of corporate political activity – brown companies can lobby to reduce or delay carbon taxes

AEW demonstrate the resulting prisoner's dilemma

How can we prevent corporations from defecting?

		Green	
Brown		Don't lobby	Lobby
	Don't lobby	(0 , 0)	(-2 , 1)
	Lobby	(1 , -2)	(-1 , -1)

Two distinct problems

1. Coordination

How does BP prevent Exxon from defecting (by staying brown and lobbying)?

This may be the rationale for corporate public statements

- Not greenwashing but an attempt to bind industry participants
- With sanctions for defection that include a loss of political credibility and public shaming

Two distinct problems

2. Incentive compatibility

Officers and directors make strategic decisions about both operations and lobbying

AEW identify factors that might drive those decisions to brown

Stock price, fiduciary duties, takeovers, executive compensation

Particular concern that shareholders (with control over the board) will urge defection if it is profitable

Steven Davidoff Solomon and I identify a similar concern for public benefit corporations

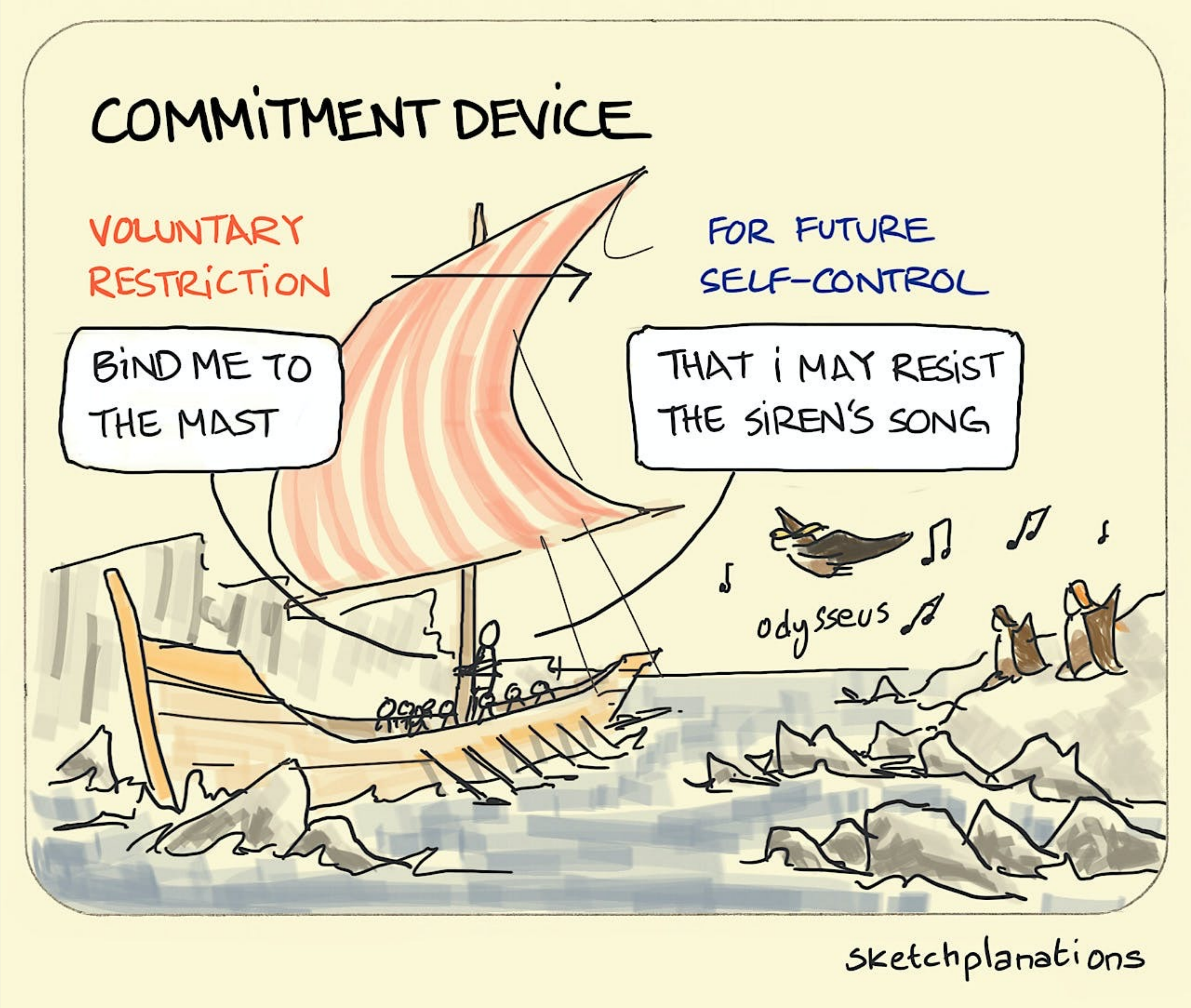
Solving these problems

Restructuring executive compensation

Reforming governance (climate committees)

Meaningful climate disclosure

AEW are skeptical that governance solutions will be effective and propose an alternative commitment device


COMMITMENT DEVICE
VOLUNTARY RESTRICTION
FOR FUTURE SELF-CONTROL
BIND ME TO THE MAST
THAT I MAY RESIST THE SIREN'S SONG
odysseus
sketchplanations

The Green Pill

The pill appears to be a type of voluntary carbon tax by private contract

It ties the firm's financing costs to achievement of climate goals

Financing costs more if firm fails to meet its climate commitments

AEW carefully address both legal and practical challenges

In particular – the risk of strategic behavior can be addressed by payment to non-investor third party (such as a charity)

Four questions

1. Would the pill be equally effective as a discount for green instead of a penalty for brown?

2. How is the size of the carrot/stick determined, and can it be sufficiently large to influence firm behavior?

3. What are the challenges of defining and evaluating success?
   - Role of KPIs
   - Long-term financing is particularly appropriate given the long-term nature of climate-related operational changes, but
   - How do these contracts accommodate changes in the world?

4. Legal issues
   - Is adoption of a green pill consistent with the board's fiduciary duties?
   - Dead hands and related problems (fiduciary outs?)

The Unanswered Challenge: The Business Case for Climate Change

What is the optimal outcome here?

Is green (with an appropriate carbon tax) better than brown for

- A specific corporation? (is it just a transition issue?)
- The industry?
- Society?

What level of carbon tax is appropriate?

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input?

In Conclusion

Great paper!

Original and potentially effective tool to increase corporate commitment to climate change

Thoughtful consideration of potential practical and legal impediments

Further development of

- Market-based support for green pills
- Relationship of private ordering to regulatory reform