Recognising Climate Change as Insolvency Risk

PG&E's Chapter 11 filing in 2019 is widely recognised as the first climate-related insolvency in the United States, highlighting the link between climate change and insolvency. Hawaiian Electric (HECO) could now face a similar situation to PG&E as a result of the deadly wildfires on Maui in August 2023. While European countries have the strongest and most modern environmental and climate laws, research on the impact of climate change on bankruptcy and restructuring proceedings is still in its infancy. Against this background, my presentation will focus on two aspects:

The first part provides an overview of climate change-related risks that may contribute to or exacerbate the risk of insolvency. These risks include:

1. Physical risks: Natural disasters such as droughts, floods and storms are predicted to become more frequent and severe as a result of climate change. These events have the potential to severely impact supply chains, real estate, and infrastructure, resulting in loss of life, financial losses and potential insolvency for affected businesses.
2. Transition risks: To mitigate the physical risks of climate change and the transition to a low-carbon economy, governments and regulators are implementing an increasing number of regulations and policies. These regulations and policies may have adverse ancillary impacts, lead to stranded assets and corporate uncertainty.
3. Litigation risks: As of December 2023, over 2,500 climate change lawsuits have been filed in 54 jurisdictions. These lawsuits, based on a variety of legal grounds, are expected to become more frequent and successful. Academics warn that existing climate risk assessments do not take litigation risks into account, despite the fact that climate change liability can cause significant financial and reputational damage.
4. Market risks: As consumer preferences, investment concerns, and stakeholder demands for sustainable and environmentally responsible operations shift, markets are being reshaped. Companies that fail to adapt to these changing dynamics risk losing competitiveness, market share, and revenue streams.

1. Insurance risks: While insurance plays a critical role in mitigating the economic impact of the materialisation of physical climate risks, only a fraction of the economic losses caused by extreme weather and climate-related disasters in Europe are insured. This so-called "climate insurance gap" is estimated at 65%, leaving companies exposed to uncovered losses that can seriously affect their liquidity, balance sheet, and asset value.

The second part of the presentation will examine how insolvency laws could be amended to recognise climate change-related risks with the aim of improving risk management, promoting greater transparency for creditors, investors, lenders, and other stakeholders, and making restructurings more robust.