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Blog Post

Four Key Steps to Assessing and Mitigating Climate Risk

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In a recent article series for Private Equity Law Report, Kirkland & Ellis attorneys Alexandra N. Farmer and Jennie Morawetz highlight four key steps to assessing and mitigating climate risk. While the articles are tailored to private equity firms, these takeaways are broadly applicable to any business that invests in, owns or manages energy and infrastructure assets. As BlackRock continues to remind companies in its latest July 2020 stewardship report: “climate risk is investment risk.”

1. **Consider Adopting a Formal Framework:** By joining investor groups focused on climate action and pushing voluntary frameworks such as the Task Force on Climate-Related Financial Disclosures, investors are increasingly demanding that businesses assess and mitigate climate risk. Businesses are responding, and those that have begun developing climate programs are finding that such programs offer several potential advantages, from improving resiliency to attracting and strengthening relationships with investors and customers.
2. **Report with Care:** Fully capitalizing on a climate program requires reporting, and businesses must take care to avoid reporting pitfalls. Specifically, businesses should be careful to avoid “greenwashing” (spending more time on the marketing of environmental programs than on minimizing environmental impact), frame future plans in a way that allows for flexibility, be clear about the scope of their climate programs and report carbon footprints and scenario analyses (i.e., quantitative or qualitative assessments of how a business will be affected by physical, legal, policy, market and/or other risks associated with different climate change trajectories) only after careful vetting. Auditing may be appropriate in certain cases.
3. **Start with Physical Risk:** In the early stages of developing a climate program, many businesses choose to focus on assessing and mitigating physical risk, particularly in the energy and infrastructure space, where not properly evaluating climate risk can result in unforeseen casualty losses due to environmental

impacts. A number of risk assessment tools now exist that allow businesses to model the impacts on particular assets or portfolios of increasing frequency and severity of extreme weather, such as floods and wildfires, as well as longer term climatic changes such as sea-level rise.

4. **Build a Resiliency Program:** Assessment alone is not enough. Use risk assessment results to build an effective resiliency program that mitigates any material physical climate risks with strategic adaptive capacity and robust crisis response capacity. Adaptive capacity refers to the ability of a business' assets to physically withstand and continue to operate in the face of climatic changes, and crisis response capacity refers to the ability of the business to mitigate through contracts and good management practices any remaining risk from such climatic changes. The former often facilitates the latter because reducing material physical risk provides leverage for negotiating more favorable terms in insurance policies.

Energy and infrastructure businesses and investors that tackle climate risk, potentially starting with physical risk, have a significant opportunity to create value by positioning themselves to take advantage of market changes that prioritize climate, in addition to mitigating risk to their investments and assets.

The Private Equity Law Report articles are available to subscribers: Part 1 and Part 2.

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