By Gabriel L. Olivera and Nicole Molner

Climate Change: A Consideration for the Next Generation

Gabriel L. Olivera
O'Melveny & Myers LLP
New York

Nicole Molner
O'Melveny & Myers LLP
New York

Gabriel Olivera is a counsel with O'Melveny & Myers LLP in New York and is a 2023 ABI "40 Under 40" honoree. Nicole Molner is an associate in the same office.

It is undeniable that climate change will cause — and, in fact, has *already* caused — cataclysmic events around the planet.[1] These disasters, from wildfires and unprecedented storms to devastating floods and drought, are difficult to predict, but that does not mean that they are unanticipated, and one foreseeable consequence of climate change is an avalanche of corporate bankruptcies.

No business begins with the intention of filing for bankruptcy. However, just as environmental scientists need to evaluate the risks associated with climate change, lawyers need to identify, analyze, and advise their clients on the risks that climate change poses for their clients' businesses.

As we stand at the crossroads of environmental upheaval and economic uncertainty, it is imperative for young bankruptcy lawyers to comprehend the intricate ways in which climate change can impact businesses. This requires a keen understanding of not only the legal dimensions but also the environmental and economic factors at play. The effects of climate change are far-reaching, encompassing a range of economic and financial consequences that can affect households and businesses alike.

This article underscores the urgent need for an evolution in how restructuring lawyers approach the risks associated with climate change. Traditionally, the focus in bankruptcy law has been on financial mismanagement or market shifts, but as demonstrated by the bankruptcies of Pacific Gas & Electric (PG&E) and Basic Water Co. (BWC), climate change has emerged as a significant and direct threat to corporate stability.

Bankruptcy professionals must understand the legal implications of climate change on businesses and educate themselves about environmental trends and their effect on various industries. They must be equipped to advise clients on how to navigate climate-related challenges, including regulatory changes, physical asset vulnerabilities and volatile market dynamics. Restructuring lawyers must now consider climate change not as a distant possibility but as a devastating reality.

Factoring in Climate Change in Financial Risk Assessments

Climate change is a systemic issue intersecting with all aspects of a business's operations. When people consider environmental risk, they often think of rising sea levels, intensifying storms, water scarcity and wildfires. A company's vulnerability to these risks is influenced by location, transportation and supply chains, and other factors, including how significant an operational site is to a company's overall profitability.

For example, the 2018 wildfires in Northern California had significant ramifications for the state's economy. The total cost of the wildfires was estimated to be $148.5 billion, with $102.6 billion in damages in the state of California alone.[2] The services industry in California suffered 45.1 percent of indirect losses within the state.[3] Not only did the wildfires destroy infrastructure, but the air pollution that was produced also caused substantial burdens on the health care system, which led to reduced productivity and affected supply chains in and outside of California.[4]

This escalating vulnerability to climate-related disasters, as vividly demonstrated by the catastrophic effects of the Northern California wildfires, is a clear indication that environmental factors are increasingly critical in assessing financial stability and credit risk. Reflecting this trend, Moody's now incorporates a range of environmental risk categories — physical climate risks, carbon transition, waste and pollution, water management and natural capital — in its assessment of borrowers, highlighting how environmental concerns are becoming integral to understanding and evaluating credit implications.[5]

Moody's recently noted that the company's rated debt "held by sectors with high or very high environmental credit risk now exceeds $4 trillion."[6] To put that number in perspective, only six countries have a larger gross domestic product (GDP) at purchasing power parity: China, the U.S., India,

1 "What Is Climate Change?," United Nations, *available at* un.org/en/climatechange/what-is-climate-change; *see also* "Climate Change: A Threat to Human Wellbeing and Health of the Planet. Taking Action Now Can Secure Our Future," Intergovernmental Panel on Climate Change Press Release (Feb. 28, 2022), *available at* ipcc.ch/report/ar6/wg2/downloads/press/IPCC_AR6_WGII_PressRelease-English.pdf (unless otherwise specified, all links in this article were last visited on Jan. 2, 2024).

2 Kate Corry, "Full Cost of California's Wildfires to the U.S. Revealed," Univ. Coll. London (Dec. 7, 2020), *available at* ucl.ac.uk/news/2020/dec/full-cost-californias-wildfires-us-revealed.

3 *Id.*

4 *Id.*

5 Ram Sri-Saravanapavaan, "Trillions of Dollars in Global Sectors' Debt Highly Exposed to Environmental Risks," Moody's Investors Serv. (Nov. 28, 2023), *available at* moodys.com/web/en/us/about/insights/data-stories/2023-environmental-credit-risk-exposure.html.

6 *Id.*

Japan, Germany and Russia.[7] Indonesia, the world's seventh-largest economy, has a GDP of about $3.24 trillion.[8] It is clear that a significant portion of the global economy faces increased risk in their debt-repayment capabilities due to environmental factors.

In the past, climate change meant new government regulations, and that was what many companies were concerned about.[9] Today, businesses recognize the direct effect of climate change on their fundamental assets and liabilities and their need to address it.[10] A pivotal moment that likely influenced this shift in perspective was PG&E's bankruptcy.

In re PG&E Corp. and Pacific Gas & Electric Co.

PG&E's bankruptcy has widely been called the first major climate change case.[11] The company is a large investor-owned utility, providing electric and gas services to approximately 16 million customers in Central and Northern California.[12]

PG&E filed its bankruptcy case in January 2019 as it faced billions of dollars in damages from the 2017 and 2018 California wildfires.[13] The company's significant liability was a consequence of California's inverse-condemnation doctrine.[14] This legal principle imposes strict liability on private utilities when their equipment contributes to private property damage, leaving them financially responsible for any losses.[15]

While PG&E's poorly maintained power lines certainly contributed to the fires,[16] climate change made the wildfires more severe,[17] which increased PG&E's exposure to damages. Research by Park Williams, a hydroclimatologist at Columbia University's Lamont-Doherty Earth Observatory, shows a notable increase in California's average summer temperatures over the last 127 years.[18] Since the late 1800s, average summer temperatures have risen by over 3 degrees Fahrenheit. A significant increase has occurred just since the early 1970s, which correlates with a dramatic escalation in wildfires in the state.

From 1972-2018, there has been a fivefold increase in the area burned by wildfires every year — with an 800 percent increase in summer forest fires. Williams' research points to rising temperatures, a reduction in autumn rainfall and intensifying winds, which all lead to extremely dry conditions ideal for fires.[19] Dana Nuccitelli of Yale Climate Connections has compiled various studies that affirm the influence of climate change on exacerbating California's wildfire conditions.[20]

These facts, and the resulting PG&E bankruptcy, demonstrate that climate dynamics have the potential to precipitate a financial crisis in every sector of a company's business. Adapting to and mitigating climate risks must become integral parts of corporate planning and legal strategy. This evolution in business risks calls for a deeper comprehension of climate dynamics and their potential to precipitate financial crises in unsuspecting sectors.

In re Basic Water Co.

The *BWC* case[21] is another example of climate change driving a company into bankruptcy.[22] For many years, BWC stood as the exclusive water provider for Henderson, Nev., pumping water from Lake Mead into the city.[23] However, a 23-year drought eventually forced BWC to file for bankruptcy relief.[24]

The turning point came in 2021 when Lake Mead's water levels, affected by a drought that began in 2000, dropped to a critically low level.[25] This prevented BWC from fulfilling its water-delivery obligations. Despite efforts to expand its intake system in Lake Mead, concerns about aging infrastructure and escalating costs led BWC to explore other options, including selling the business to the City of Henderson and the Southern Nevada Water Authority,[26] but these efforts were unsuccessful. The situation evolved into a crisis on July 1, 2022, when Lake Mead's levels fell to a point where the intake structure could no longer function, forcing the company to rely on an unsustainable interim solution and ultimately leading to its bankruptcy filing.[27]

The direct impact of climate change on BWC's financial stability is undeniable. Its bankruptcy — driven by drought and the ensuing depletion of water resources — serves as a stark example of how climate change can destroy a once-successful company. Bankruptcy lawyers now need to foresee the wave of climate-related disruptions and help clients mitigate the risks to their financial well-being.

Conclusion

The urgency of addressing climate change cannot be overstated. As we advance into an era where environmen-

7 "Country Comparisons: Real GDP (Purchasing Power Parity)," *The World Factbook*, *available at* cia.gov/the-world-factbook/field/real-gdp-purchasing-power-parity/country-comparison.

8 *Id.*

9 Russell Gold, "*PG&E*: The First Climate-Change Bankruptcy, Probably Not the Last," *Wall St. J.* (Jan. 18, 2019), *available at* wsj.com/articles/pg-e-wildfires-and-the-first-climate-change-bankruptcy-11547820006 (subscription required to view article).

10 *Id.*

11 *In re PG&E Corp.*, No. 19-30088 (Bankr. N.D. Cal. Jan. 29, 2019).

12 "Company profile: Fast Facts About PG&E," *available at* pge.com/en/about/company-information/company-profile.html.

13 Declaration of Jason P. Wells in Support of First Day Motions and Related Relief, *In re PG&E Corp.*, No. 19-30088, ECF No. 28.

14 *Id.* at 3.

15 *See* Cal. Const., art. I, § 19(a) ("Private property may be taken or damaged for a public use and only when just compensation ... has first been paid to ... the owner."); *Barham v. S. Cal. Edison Co.*, 74 Cal. App. 4th 744, 753 (1999) (holding that privately owned electric utility is public entity for purposes of inverse-condemnation claim).

16 Ivan Penn, "PG&E, Troubled California Utility, Emerges from Bankruptcy," *N.Y. Times* (July 28, 2020), *available at* nytimes.com/2020/07/01/business/energy-environment/pge-bankruptcy-ends.html (subscription required to view article); *see also* Ivan Penn, Peter Eavis & James Glanz, "How PG&E Ignored Fire Risks in Favor of Profits," *N.Y. Times* (March 18, 2019), *available at* nytimes.com/interactive/2019/03/18/business/pge-california-wildfires.html.

17 John J. MacWilliams, Sarah La Monaca & James Kobus, *PG&E: Market and Policy Perspectives on the First Climate Change Bankruptcy* 9-10, Columbia Univ. Ctr. on Global Energy Policy (August 2019), *available at* nergypolicy.columbia.edu/wp-content/uploads/2019/08/PGE-CGEP_Report_111722.pdf.

18 *Id.*; Kevin Krajick, "Study Bolsters Case that Climate Change Is Driving Many California Wildfires," Columbia Univ. Faculty of Arts & Scis. (July 15, 2019), *available at* science.fas.columbia.edu/news/study-bolsters-case-that-climate-change-is-driving-many-california-wildfires.

19 MacWilliams, *supra* n.16, at 10; Daniel L. Swain, Baird Langenbrunner, J. David Neelin & Alex Hall, "Increasing Precipitation Volatility in Twenty-First-Century California," Nature Climate Change (May 2018), *available at* nature.com/articles/s41558-018-0140-y.epdf.

20 MacWilliams, *supra* n.16, at 10; Dana Nuccitelli, "The Many Ways Climate Change Worsens California Wildfires," Yale Climate Connections (Nov. 13, 2018), *available at* yaleclimateconnections.org/2018/11/the-many-ways-climate-change-worsens-california-wildfires.

21 *In re Basic Water Co.*, No. 22-13252 (Bankr. D. Nev. Sept. 10, 2022).

22 Omnibus Declaration of Stephanne Zimmerman in Support of Debtors' Petitions, First-Day Motions, and Related Relief, *In re Basic Water Co.*, No. 22-13252, ECF No. 7.

23 *Id.* at ¶ 18.

24 *See id.* at ¶¶ 43-55.

25 *Id.* at ¶ 48.

26 *Id.* at ¶ 47.

27 *Id.* at ¶ 52.

continued on page 52

from page 15

tal considerations are not just peripheral but central to legal strategy, bankruptcy lawyers face a paramount challenge. They must navigate a constantly shifting landscape where traditional approaches to assessing financial risk and distress must be re-evaluated and redefined in light of environmental concerns.

Young bankruptcy lawyers in particular must equip themselves with a comprehensive understanding of how climate change impacts businesses in order to guide clients through this new and uncharted territory, as climate change will increasingly pervade their practice. This will mean assessing the viability of long-term investments in light of climate change risks and guiding companies through the complex web of regulations that govern environmental issues.

Bankruptcy lawyers also must be familiar with the evolving jurisprudence around climate change; the *PG&E* and *BWC* cases are just the beginning. As bankruptcy courts all over the U.S. start to see cases filed due to climate-related issues, the legal precedents set will have significant implications for businesses and their bankruptcy strategies.

In essence, the role of bankruptcy lawyers is expanding. Their expertise is crucial in helping businesses adapt and thrive in this new reality, where environmental sustainability and financial prudence go hand in hand. As the world grapples with the impacts of climate change, the bankruptcy sector is uniquely positioned to drive positive change. By embedding environmental awareness into their practice, bankruptcy lawyers can play a pivotal role in steering businesses toward a sustainable and resilient future. This shift is not just a professional responsibility but a societal imperative — one that calls for a deep and committed response to the challenges posed by our changing planet. abi