

Proposal for a transition reserve and transition investment plans for large polluters

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Background

Research by Friends of the Earth shows that even in a climate conscious country such as the Netherlands, none of the 29 highest polluting companies have a sufficiently good climate transition plan. Not only is this a problem for society, but also for the companies themselves. The green transition poses outsized risks to high-emission firms in carbon-intensive industries. This stems from the unsustainability of their current business models and the inevitability that a failure to transition will leave stranded assets sitting on their balance sheets. Where transition risks go unaddressed, high-emission firms face eventual bankruptcy. This comes on top of all other catastrophic impacts of a major climate disaster.

Current financial and corporate legal structures prioritise short-term profit distributions, doing little to incentivise long-term investments in the sustainability transition. At the same time, taxpayers foot the bill through government support to large polluters for this transition. This is exacerbated by the implicit guarantee that ‘too big to fail’ companies will receive government bailouts where they fail to transition. The result is that profits of polluting activities are allocated to shareholders and executives, whilst the costs are borne by society.

Proposal: transition reserve & transition investment plans

This policy proposal aims to address the transition risks faced by high-emission firms whilst internalising the cost of the transition. To this end, it proposes two new legal obligations for large emitters. First, the requirement that large emitters establish a mandatory **transition reserve**. This would ensure they keep enough money on their balance sheets to finance the costs of transition.

Second, the requirement that large emitters develop a **transition investment plan**. This would outline the necessary steps required to achieve successful transition and provide costing estimates. Beyond simply setting numerical targets for reducing CO₂ emissions, the transition investment plan will detail the specific investments the company will make to achieve these objectives.

Implementation

These two proposals can be implemented within the framework of national (and mutatis mutandis European) company law. The Transition Reserve should take the form of a **legally required statutory reserve**. This would oblige companies to keep a certain amount of cash on their balance sheets for a specific purpose: the sustainability transition. The size of the reserve is to be determined by reference to the actual costs of transition.

The transition investment plan should be formalised and legally binding for at least the largest polluters. These objectives and obligations would be much more robust than companies' current climate plans, aiming to fundamentally change their business models. The obligation to develop a transition plan would become part of company directors' duties.

Impact

These proposals have several intended benefits. First, they require large emitters to finance the costs of their own transitions through non-tax measures. This reduces the 'moral hazard' of relying on public bailouts. Second, they foster a movement away from industrywide short-termism by encouraging firms to future-proof their operations and take responsibility for their environmental and societal impacts. This is in line with current developments in European Union law. Third, they increase the transparency of and credibility of climate plans by mandating companies to disclose the cost of transitioning their business models. In doing so, these proposals increase the transparency of big polluters vis-à-vis their shareholders and the government. This enables greater parliamentary and regulatory oversight, and better permits investors to make choices based on companies' transition plans.



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