

Financing Green: The Rise Of The Green Bond

Law360, New York (June 26, 2014, 5:47 PM ET) --

Once considered to belong strictly in the purview of international financial institutions, green bonds have now become an attractive financing option for corporates, including for some corporates operating outside the energy sector. The recent heightened interest among investors in green bonds could present not only a significant source of funding for companies looking to obtain financing, but it could also present a significant advance toward providing the sort of major infrastructure investment needed in order to make progress in reducing global carbon emissions.

Evidence of this sudden market interest in green bonds can be seen in a series of recent, high-profile green bond issuances. In November 2013, French energy company EDF raised \$1.9 billion for renewable energy projects. This was followed in 2014 by Unilever's issuance of £250 million in bonds to finance new factories designed to cut waste and emissions, Toyota Financial Services' \$1.75 billion issuance to fund consumer loans and leases for hybrid vehicles^[1], and Iberdrola's €750 million issuance for renewable energy and smart metering projects.^[2] As of March 2014, about \$6 billion in green bonds had been issued in 2014, roughly four times the amount for the same period in 2013.^[3]



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Green Bond Basics

One reason that the green bond market is poised for continued growth may be that green bonds — sometimes also known as climate bonds — can be tied to a surprisingly wide variety of projects or activities with environmental benefits. As expected, green bonds are often used to finance solar power projects, wind farms and other alternative energy projects. Green bonds are also used to finance projects for environmental mitigation efforts due to climate change, such as flood control measures.

However, the Unilever and Toyota issuances, noted above, are cases in which green bonds were used to finance typical business activities and investments for each company, even though neither company operates primarily in the energy sectors, and neither company is known primarily for selling “green” products. For Toyota, the issuance could be considered “green” because it was connected to hybrid vehicles. In the case of Unilever, as discussed further below, the issuance could be considered a green bond issuance because of clearly identifiable positive environmental impacts. Additionally, green bonds have sometimes been used to fund projects like organic farms or public parks that may not have clear carbon reduction impacts, but are nonetheless generally perceived as

being environmentally friendly.

Environmental Benefits

Given the wide range of projects that can be financed through green bonds, care must be taken to ensure that the projects can truly be considered “green.” This is especially the case since there may be technical challenges in evaluating environmental impacts; for example, determining the reduction in carbon emissions that would result from upgrading buildings and factory equipment, as was the case in the Unilever issuance. Issuers of green bonds therefore must be able to lend support to their “green” labeling by demonstrating the environmental results that would flow from the projects or activities to be financed. Likewise, green bond investors need to be ready to evaluate projected environmental impacts, lest they be seen as taking credit for making environmentally friendly investments while those investments fail to live up to expectations.

In order to ensure that green bonds actually deliver on environmental promises, the international financial institutions that pioneered the use of green bonds have put in place internal standards for the environmental impacts of their investments and activities. For example, the World Bank has at least two sets of environmental guidelines that projects intended to be financed by green bonds must meet: one guideline is a general environmental standard that all of the World Bank’s undertakings must follow[4], while another set of guidelines covers green bonds specifically.[5]

Companies that do not have existing standards for projects that may be financed through green bonds can employ outside environmental consultants to develop guidelines and ensure compliance. For example, Unilever employed DNV GL, a technical advisory firm in the energy sector, to develop criteria for emissions, water usage, and waste related to Unilever’s green bond-financed projects.[6] However, questions will naturally arise regarding the independence of consultants hired by the same companies they are being asked to evaluate, so the reputation and expertise of such consultants will be paramount.

Some efforts have also been made to establish independent guidelines for green bonds that are meant to be widely adopted by green bond issuers. The Green Bond Principles (the “GBP”), developed by a group of banks, set out recommendations on the use of proceeds, environmental evaluations, and continued reporting on projects. The GBP do not, however, set out specific environmental impact targets, nor do they impose limits on the categories of projects and activities that can be financed by green bonds.[7] Furthermore, the GBP are generally short on specific guidelines for issuers to follow, rather taking the role — at least for the time being — as an overarching framework for the green bond issuance process. Additional work therefore will be needed before the GBP can be considered a complete set of guidelines for green bonds. And while the GBP can serve as a baseline standard, green bond issuers should be aware of the need to take additional efforts to demonstrate the positive environmental impact of their projects.

Another example of independent green bond guidelines is the climate bonds certification process created by The Climate Bonds Initiative, a not-for-profit organization. This certification process goes further than the GBP and includes an evaluation as to whether a project meets certain technical criteria intended to ensure positive environmental impact.[8] But given the relative youth of green bonds in the market, it remains to be seen whether the certifications or ratings established by this or any other organization will gain widespread acceptance in the market as an independent standard for green bonds. The result of not having a generally recognized standard for environmental evaluations is that potential issuers currently without detailed internal green bond guidelines must consider carefully how they will justify their claims of being “green,” since a variety of options are at the table and a market standard has not yet settled into place.

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[1] Green Bonds: Spring is in the Air, The Economist (March 22, 2014), <http://www.economist.com/news/finance-and-economics/21599400-bonds-tied-green-investments-are-booming-spring-air>.

[2] Megan Darby, Utility Week (April 9, 2014), <http://www.utilityweek.co.uk/news/iberdrola-follows-edf-into-green-bond-market-with-%E2%82%AC750m-issue/997212>

[3] Green Bonds: Spring is in the Air, The Economist (March 22, 2014), <http://www.economist.com/news/finance-and-economics/21599400-bonds-tied-green-investments-are-booming-spring-air>.

[4] Performance Standard 1: Assessment and Management of Environmental and Social Risks and Impacts, The World Bank (July 1, 2012).

[5] Green Bond: Fifth Annual Investor Update 2013, The World Bank (Oct. 2013), at 4.

[6] Unilever Green Sustainability Bond: DNV GL Second Party Opinion, DNV GL (available at <http://www.unilever.com/images/DNVGLOpinion05March2014tcm13384846.pdf>).

[7] Green Bond Principles, 2014: Voluntary Process Guidelines for Issuing Green Bonds (January 13, 2014), available at <http://www.ceres.org/resources/reports/green-bond-principles-2014-voluntary-process-guidelines-for-issuing-green-bonds/view>.

[8] Climate Bond Standard, Climate Bonds Initiative, available at: http://standards.climatebonds.net/wp-content/uploads/2014/01/ClimateBondStandard_Text.pdf