The Cost of Environmental Non-Compliance – Does the Polluter Really Pay?

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Abstract

Awareness about the environmental impact left in the wake of companies and their operations has been spreading rapidly and is starting to become the biggest talking point in this era of climate change. This article attempts to examine the extent to which this emergent environmental consciousness influences investor decisions. To this end, the hypothesis to be tested herein is "the price of shares of a company is influenced by the publication of environmental compliance/non-compliance on its part". This involves a study of market behaviour, emerging trends, and ideas - both Indian and international - as well as the success of these movements. Upon undertaking a critical analysis of the reasoning and thought process behind investment decisions in this context, this article makes certain recommendations in order to expedite the growth of sustainable investing as the norm rather than the exception. Therefore, the present research paper attempts to analyse the polluter pay principle in the international as well as national domain.

I. Introduction

It has long been the norm for investors to painstakingly analyse companies in depth for past, current, and speculative future risks before making a commitment with their money. While this analysis has traditionally been restricted to financial performance, in the current era of climate change, environmental awareness, and increased scrambling for natural resources, it has been noticed that companies are often distinguished not only by the numbers they churn out, but also the effect they have on the environment. It seems that investors are starting to account for environmental impact as one of the many factors to be evaluated before making investment decisions.[2] However, to properly examine the truth of this assertion, this article seeks to examine the relationship between a company's environmental (non)compliance, and the market price of its shares. Today's globalized, liberalized economy is structured so as to directly reward companies which can produce the most wealth for their shareholders, and operates on the premise that this wealth creation will benefit the economy as a whole.[3] However, an issue of rising prominence is that due to advanced industrialization, manufacturing processes in almost every industry exploit resource and necessarily leave an environmental impact. The larger the scale of production, the larger the environmental impact. The bottom line of this observation is that short-term wealth creation, while rewarded and (arguably) encouraged by the current economic system, is not sustainable and will inevitably cause unimaginably serious issues in the long run.

To reconcile the interests of corporations with those of the planet as a whole, a dedicated army of environmental activists, NGOs, and average citizens have been working to spread as much awareness about the impending climate crisis as possible and force governments into action. It would appear that their efforts have borne fruit. The past few decades have seen a significant

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[2] Denis Cormier & Michel Magnan, Investors' Assessment of Implicit Environmental Liabilities: An Empirical Investigation, 16 J. ACC. & PUB. POL'Y 215, 2177 (1998).

[3] Frank Scrimgeour, The Impact of Corporate Environmental Performance on Market Risk: The Australian Industry Case, 132 J. BUS. ETHICS 347, 348 (2015).

escalation in environmental regulatory regimes around the world, and companies are finding that governmental interference in the environmental impact of their operations is an unavoidable part of doing business. Governments and NGOs are not the sole participants in this global increase in awareness about the environment, however. Investors, both individual and institutional, have also begun insisting upon a higher standard of environmental compliance. Doubtless, an argument may be made that this insistence operates hand in glove with the truism that any company with a holistically sustainable method of doing business is bound to be a better investment option than an unsustainable counterpart. Therefore, the logical progression in a foray to arrive at the truth is to determine whether the increased emphasis on environmental compliance manifests in an empirical, quantifiable variation in share price.

II. International Position

a. United Nations Principles for Responsible Investment (UNPRI)

Perhaps the most significant international development in terms of uniformity has been a United Nations supported initiative – the United Nations Principles for Responsible Investment (UNPRI) – which was launched in April 2006. Drafted by institutional investors for institutional investors, the UNPRI is a set of 6 Principles which illustrate the practice of "responsible investment". The UNPRI guidelines on responsible investment recommend the incorporation of environmental, social and governance (hereinafter "ESG") factors into investment decisions, to mitigate risk and ensure sustainable returns.[4] In a minor departure from the norm with UN programs, the signatories to the UNPRI are organizations, which fall into one of the following three categories:

1. Asset Owners

Organizations that represent the holders of long-term retirement savings, insurance, and other assets. Examples include pension funds, sovereign wealth funds, foundations, endowments, insurance and reinsurance companies, and other financial institutions that manage deposits.[5] This is the principal category of signatory.[6]

2. Investment Managers

Organizations that administer or run investment funds, on their own accord or at the behest of others, provided they have ownership of less than half of these funds.[7]

3. Service Providers/Professional Service Partners

Organizations which provide products or services to the above-mentioned organizations.[8]While these companies do not act as stewards/managers of assets themselves, they exercise considerable influence over the manner in which their clients' approach ESG issues.[9]These organizations undertake a commitment to promoting, providing and developing services which facilitate their clients' realization of the Principles.

There are currently over 2,300 signatories to the UNPRI.[10] To become a signatory to the UNPRI

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[4]UN Principles for Responsible Investment, at https://www.unpri.org/pri/what-is-responsible-investment.
[5]Id.
[6]Id.
[7]Id.
[8]Id.
[9]Id.
[10]Id.

program is to demonstrate one's commitment to publicly follow and advocate for the 6 Principles it espouses. Therefore, each of these organizations takes it upon itself to integrate ESG considerations into investment analysis, decision-making strategy, management decisions; cultivate acceptance and application of the Principles, and provide regular updates towards the implementation of these Principles.[11]

General Market Behaviour

It is indisputable that the UNPRI has had significant success in its effort to harmonize the standard of ESG norms to which organizations should adhere vis-à-vis its signatories. ESG-based investing has been an emerging trend across the globe, with 26 per cent of all investing being done on the basis of ESG norms.[12] On the subject of the performance of ESG Funds around the world and the proliferation of the idea among a global investor base, Sivananth Ramachandran, Director, New Product Development (Indexes), Morningstar India summarized the position in the following manner:

> "Sustainable funds have performed well in the last few years. According to 2018 Morningstar US ESG landscape report, sustainable funds, on average, outperformed on a relative basis in 2018. A full 63 per cent of sustainable funds finished in the top half of their respective categories, including 35 per cent in the top quartile. Only 37 per cent finished in the bottom half, including just 18 per cent in the bottom quartile. For equity funds alone, the percentages were about the same, and there were no significant differences between ESG consideration, ESG integration, and impact funds. On the strength of last year's returns, 57 per cent of sustainable funds now rank in the top half of their categories over the trailing three years. For the trailing five years, 58 per cent rank in their category's top half. In Europe, at the end of 2018, returns of 32 per cent of sustainable funds landed in the top quartile of their respective Morningstar Categories, and 62 per cent finished in the top half. By contrast, the returns of only 17 per cent placed in the bottom quartile. In the Indian context, Morningstar India Sustainability Index, a broad and diversified portfolio of Indian companies which targets the top half of Indian market by market cap out-performed on a 1-year and 5-year basis."[13]

While this is commendable in its own right, the global position regarding non-signatories is far from uniform. An abundance of literature and surveys on the subject reveal that while the reasoning and details may vary, the overarching theme of the result is consistent.

Traditionally, expenditure on environmentally sound practices such as waste management or effluent treatment is considered non-productive.[14] It simply viewed environmental expenditure as having no gain or return. This is perhaps because at the time, the environment was viewed as a limitless resource incapable of depletion. Therefore, there was no "cost" to consuming resources.

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[11]Id.

[12] Kiran Kabtta Somvanshi, Why India is Turning into ESG Funding Hotspot, ECONOMIC TIMES, Feb. 11, 2019, http://www.businessworld.in/article/ESG-Is-The-Fastest-Growing-Investment-Approach-Globally-Chirag-Mehta-Quantum-AMC/13-07-2019-173281/ (May 16, 2020) [hereinafter ESG funding hotspot].

[13] Larissa Fernand, What Indian investors need to know about ESG, MORNINGSTAR, June 14, 2019, at https://www.morningstar.in/posts/53130/indian-investors-need-know-esg.aspx (last visited May 16, 2020).

[14] K. Palmer et al., Tightening Environmental Standards: The Benefit–Cost or the No-Cost Paradigm, 9 J. ECON. PERSP. 119, 132. (1995)

When a company is of the view that there is no cost to a certain proposition, it is perhaps too much to expect it to refrain from exploiting the situation to the fullest. In hindsight, it is unsurprising that it is this mentality that has led to a severe global environmental crisis today.
Perhaps the earliest and most widely quoted study which presented a differing view on the subject is one conducted by Porter and Van Der Linde,[15] in which they argued from a micro-economic perspective that relying on polluting practices results in mounting costs and is inefficient when compared to spending more on clean practices that are sustainable. They advocated for the framing of investment decisions in terms of "resource productivity" (the ability to produce more per unit of resource consumed) and asserted that this increases the economic value of the entire enterprise.[16]

Since then, a growing movement has been arguing that companies with environmentally sound policies (e.g., to reduce harmful by-products, reuse raw material, etc.) consequently have efficient production chains, resulting in a strategic advantage.[17] Firms with sound environmental profiles have lower risk of incurring "compliance costs" and are therefore safer investments. Put simply, if a company is not flouting the regulations, it faces no threat of action against it, and does not need to worry about potential legal costs, fines, penalties, etc. From a narrow, accountant's point of view, this is one less liability for the company to have to fret about. Apart from this, the declaration of a positive environmental conduct or funding cleaner technologies may have a beneficial impact on investment, as it leads to lesser scrutiny by regulators and communities, greater access to international markets, etc.[18] Regulators and investors have limited resources as well and there is a clear advantage to any company which can freely disclose material information to show that it is environmentally compliant, and not put the onus on the investor/regulator to have to investigate and verify such facts.

On this point, Klassen and McLaughlin[19] concluded that that public recognition of positive environmental conduct such as a nomination for a "clean company" award led to positive abnormal returns, while negative publications such as false disclosures of pollution levels caused abnormal negative returns. An earlier study by Karpoff[20] reached a similar conclusion.

A separate study by Hamilton[21] in the wake of the EPA's Toxic Release Inventory Program showed that companies suffered abnormal negative returns upon declaration of Toxic Release Inventory (hereinafter TRI) emissions when first disclosed in 1989. This seems to suggest that the large body of investors was unaware of the pollution profile of the companies in which they were investing. Once the exact figure came to light, it was easier to make an informed decision and avoid investing in such companies. This study is especially important, as it demonstrates in clear terms the importance of such information being publicly accessible.

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[15] M. E. Porter & C. Van Der Linde, Toward a New Conception of the Environmental Competitiveness Relationship,9 J. ECON. PERSP. 97, 118 (1995).
[16]Id.
[17]Id.
[18] R. D. Klassen & C. P. McLaughlin, The Impact of Environmental Management on Firm Performance, 42 MGMT. SCI., 1199, 1213 (1996).
[19] Id.
[20] J. M. Karpoff & J. R. Lott Jr., The Reputational Penalty Firms Bear from Committing Criminal Fraud,36 J. L.& ECON. 757, 802 (1993).
[21] J. Hamilton, Pollution as News: Media and Stock Market Reactions to the Toxics Release Inventory Data, 28 J. ENV'T ECON. & MGMT. 98, 113 (1995).

Konar and Cohen[22] studied the same issue 2 years later and observed that companies which suffered from the aforementioned negative abnormal returns also had the highest reduction in TRI emissions in subsequent years. This is equally important as it shows that the companies understood that it was their polluting practices which had discouraged investment and actively worked to correct the same. Thus, there is clear evidence of market forces working to compel companies to adopt better environmental practices without regulator intervention. This is quite encouraging as it depicts an ideal situation in which the dissemination of information is enough to spur the investor base and the company to act towards achieving compliance for mutual benefit.

The above-mentioned studies all attempted to cover a broad, global investor base. However, it is apposite to take into account studies which focus on investor behaviour in specific regions/countries. Accordingly, studies which focus on older, more well-developed economies as well as their counterparts which focus on younger, less-developed economies have been selected in an effort to give equal representation to both sides.

III. Global Position at a Glance

a. Well developed Economies

Specifically for the US market, it has been noted that although the regulatory regime impacts the holding period returns and its correlation with environmental performance, the measure of regulatory climate and the measure of environmental performance showed no such demonstrable correlation.[23] While proactive action towards environmentally sound policy does not directly affect financial performance, there exists a positive impact on regulatory climate.[24]A study of publicly traded S&P 500 firms showed that after accounting for extraneous variables which affect a firm's financial performance, mediocre environmental performance significantly negatively affects the value of intangible assets, both economically and statistically.[25]The same result has been observed in Canada as well, where studies observe that the declaration of negative environmental news leads to a decrease in market value of a firm.[26]
In both Romania[27] and China,[28] a similar conclusion was drawn, albeit with the mention that the inherent decrease in production costs for industries in the energy sector was also relevant to an increase in share price. It should also be noted that Romania has been considered a well-developed economy by virtue of its EU membership and resultant association with economic powerhouses of the region.[29]

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[22] S. Konar & M. Cohen, Information as Regulation: The Effect of Community Right to Know Laws on Toxic Emissions, 32 J. ENV'T ECON. & MGMT. 109, 124 (1997).
[23] Greg Filbeck and Raymond Gorman, The Relationship between the Environmental and Financial Performance of Public Utilities, 29 ENVTL & RESOURCE ECON. 137, 140 (2004).
[24]Id.
[25] S. Konar& M. Cohen, Does the Market Value Environmental Performance? 83 R. ECON. & STAT. 281, 289 (2001).
[26] B. Laplante & P. Lanoie, The market response to environmental incidents in Canada: A theoretical and empirical analysis, 60 S. ECON. J. 657, 672 (1994).
[27] Elena Dobret et al., The Influence of Environmental and Social Performance on Financial Performance: Evidence from Romania's Listed Entities, 7 SUSTAINABILITY 2513, 2553 (2015).
[28] X. Pan et al., Relationship between Corporate Social Responsibility and Financial Performance in the Mineral Industry: Evidence from Chinese Mineral Firms, 6 SUSTAINABILITY 4077, 4101 (2014).
[29]Indermit Gill, Romania has a great advantage on developing countries: it is part of the most important economic

In Japan, a slightly different relationship was observed - wherein for the "environmentally friendly" industries, the financial performance as indicated by Return on Equity and Return on Assets did not show statistically significant relationship. The "polluter" industries on the other hand showed an inverse relationship between Return on Assets and greenhouse gases.[30]

b. Less-developed Economies

A comprehensive study on 4 countries of this description viz. Mexico, Philippines, Chile, and Argentina concluded that contrary to popular belief comparatively weaker regulatory regimes which cannot control pollution effectively through conventional ways such as fines and penalties do not act as obstacle to pollution management and control.[31] Per contra, the study argued that the spread of information is enough for investors to make well-reasoned decisions and shun non-compliant companies, thereby punishing them more effectively than a regulator. The study also observed that announcements of compliance with environmental regulations when recognized[32] by the authorities lead to an increase in market value of over 20 per cent for the event window, while negative changes were observed upon publication, and prior to the actual imposition of any fine or liability.[33]These findings are largely consistent with investor behaviour in well-developed economies.

Nigeria – An Exception to the Norm

On the other hand, a study in Nigeria[34] revealed that there was no relationship between environmental expenditure and a firm's market valuation. The study further observed that environmental expenditure is not affected by a firm's market valuation.[35] Therefore, the twin conclusion is that companies which are guilty of environmental non-compliance do not face any loss of value, and companies which spend more on environmental compliance do not increase in value. This study represents the only deviant conclusion, which is most likely attributable to the extremely under-developed nature of Nigeria's economy, when compared to the other regions that were studied. One can quite easily imagine that investor sentiment in this region would value financial performance to the exclusion of all else, unlike the better-developed regions studied.

Thus, with the exception of Nigeria, the overall international position indicates that investors do not take kindly to news of environmental non-compliance and make investment decisions accordingly. Further, this effect can be inferred in quantifiable terms from a noticeable drop in the share price of such errant companies on the day such news/disclosures become generally available to the investing public. A few of these cases are discussed below:

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club in the world, the EU, WORLD BANK, June 24, 2013, https://www.worldbank.org/en/news/opinion/2013/06/24/romania-has-a-great-advantage-on-developing-countries-it-is-part-of-the-most-important-economic-club-in-the-world-the-eu May 16, 2020).

[30] H. Itawa& K. Okada, how does environmental performance affect financial performance? Evidence from Japanese manufacturing firms, 70 ECOLOGY ECON. 1691, 1700 (2011).

[31]Nlandu Mamingi, Capital Market Responses to Environmental Performance in Developing Countries, WORLD BANK DEVELOPMENTAL GROUP (1997).

[32]Id.

[33]Id.

[34]Omoike Amiolemen et al., Corporate social environmental reporting and stock prices: an analysis of listed firms in Nigeria, 15 INV. MGMT. & FIN. INNOVATIONS 318, 328 (2018); A. Solomon et al., Effect of Corporate Social Responsibility Performance (CSR) on stock prices: Empirical Study of Listed Manufacturing Companies in Nigeria, 16 J. BUS. MGMT. 112, 117 (2018).

[35]Id.

The Volkswagen Example

In terms of international examples of a company's investors reacting badly to news of environmental non-compliance, one would be hard pressed to find a more high-profile instance than the Volkswagen diesel emissions scandal. From an Environmental Protection Agency investigation in 2015, it came to light that Volkswagen, in a bid to become the largest automobile manufacturer in the world, had been systematically cheating emissions tests on its diesel vehicles in the USA. The method by which it did this was incredibly sophisticated and involved installing smart software in the engine of its diesel vehicles which prompted the engine to run at a reduced capacity in laboratory testing situations to limit emissions. When on road, the engine ran at a higher capacity and therefore produced up to 40 times more emissions than the permissible limit under the USA's Clean Air Act.

Upon the so-called "defeat devices" being discovered, the news spread like wildfire and Volkswagen saw its reputation shattered overnight. It should be kept in mind that at this point, no actual fines had been imposed, and no recall of non-compliant vehicles had been announced. Yet, the share price of Volkswagen took a big hit in the market and the company saw 25 per cent of its market value erased. Its shares dove down 23 per cent to 125.40 Euros, decreasing its market value by 15.6 Billion Euros.[36] These figures represent the most quantifiable form of investor displeasure and augured just how much backlash Volkswagen would face as a result of its admission. The company has not yet left the scandal behind, and is likely to face further fines and penalties in the USA alone.

The Deepwater Horizon Example

Another example is the explosion of British Petroleum's Deepwater Horizon oil drilling platform operating off the Macondo Prospect in 2010, causing the biggest oil spill in the history of the United States. Approximately 772 million litres of crude oil were pumped into the Gulf of Mexico before the spill was contained. The rig was found to have flouted several regulations and safety requirements, which lead to the explosion and subsequent sinking of the entire platform. The cost of the clean-up was immense, and cost around USD 24 billion. As a result, British Petroleum's share price plummeted 55 per cent from $59.48 on April 19, 2012 to $27 per share on June 25, 2010.[37] It need hardly be stated that this drop was meteoric.

However, British Petroleum founded the 20 billion dollars 'Deepwater Horizon Oil Spill Trust Fund' to defray the foreseeable costs and claims arising out of the incident and could fund the entire amount from cash and cash equivalents it already possessed. Therefore, in strict financial terms, BP ceased to feel the monetary effects of the incident within a couple of years. Nonetheless, its share price did not recover. This disparity between share price and actual financial impact can be attributed squarely to the loss of reputation suffered by BP, and the growth of a more well-informed investor base. This can be seen in contrast with the 1989 Exxon Valdez oil spill which, despite being the most expensive oil spill at the time, only saw a drop of 3 per cent in ExxonMobil's

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[36] Naomi Kresge and Richard Weiss, Volkswagen Drops 23 per cent After Admitting Diesel Emissions Cheat, BLOOMBERG, Sept. 21, 2015, https://www.bloomberg.com/news/articles/2015-09-21/volkswagen-drops-15-after-admitting-u-s-diesel-emissions-cheat May 16, 2020).

[37] Yogita Khatri, Companies with higher ESG score are better investment picks, ECONOMIC TIMES, Dec. 26, 2016, https://www.moneycontrol.com/news/business/stocks/tata-motors-lakshmi-vilas-bank-zenith-fibres-among-10-stocks-which-moved-the-most-last-week-3774711.html (May 16, 2020) [hereinafter Companies with higher ESG].

share price.[38]

IV. Indian Position

Much like the above examination of the international position, the study of the Indian market will be divided into 2 major portions – the growth of ESG investing, and general market behaviours independent of specific ESG norms.

The Growth of ESG Investing

While the Indian market has not taken to the concept of ESGs as readily as its western counterparts, the idea has undoubtedly gotten its foot in the door. However, in recent years, there have been significant steps from various investors towards encouraging sustainable and environmentally conscious investing, summed up as follows:

a) Kotak Mahindra Asset Management Co. Ltd. became the first Indian Asset Management Company signatory to the UNPRI in April 2018;
b) In February 2019 India's first ESG Equity Fund – Avendus India ESG Fund was launched by Avendus Capital Public Markets Alternate Strategies, the alternate asset management arm of Avendus Capital;
c) In June 2019, Quantum Asset Management Company Pvt. Ltd. launched an ESG Fund – the Quantum ESG Fund.[39]

The SBI Magnum Fund, instituted in 1991, also recently adopted the ESG norms as criteria for investments.[40]

As per Sivananth Ramachandran, "sustainable investing" has become a major trend in recent years, as it emphasizes on how firms handle ESG risks, which is especially significant for growing markets such as India wherein the environmental and labour regulations, standard of corporate governance, and the extent of transparency are not at par with those of developed markets.[41]

In India, ESG Indices displayed greater performance as well as equal or less volatility in the long run when contrasted with the Nifty, resulting in higher profits, once adjusted for risk.[42] To illustrate this, the Morgan Stanley Capital India (MSCI) ESG Leaders Index which covers thirty-five companies with relatively high ESG performance fared better than the approximately eighty-member MSCI Index during the period spanning September 2007 - January 2019. In a similar vein, Morningstar's Sustainability Index showed returns of 14.8 per cent from 2012 - 2016, as opposed

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[38] Sara Murphy, 25 Years on From Exxon Valdez: What We've Learned, What We've Ignored, THE MOTLEY FOOL, Mar. 24, 2014, https://www.fool.com/investing/general/2014/03/24/25-years-on-from-exxon-valdez-what-weve-learned-wh.aspx (May 16, 2020).
[39] ESG funding hotspot, supra note 12.
[40] Ibid.
[41] Companies with higher ESG, supra note 37.
[42] Aniruddha Bose, ESG is the Fastest Growing Investment Approach Globally: Chirag Mehta, Quantum AMC, BUSINESS WORLD, July 12, 2019, http://www.businessworld.in/article/ESG-Is-The-Fastest-Growing-Investment-Approach-Globally-Chirag-Mehta-Quantum-AMC/13-07-2019-173281/ (May 16, 2020).

to 13.7 per cent returns for Morningstar's India Index.[43]

These results are consistent with the intuitive position, as ESG Funds tend towards low risk, high quality stock, which should remain stable and perform well in the long- term. Therefore, it is quite clear that ESG investing is a fast-growing investment trend globally, with 25 per cent of institutional investment already branded ESG.[44] It stands to reason that, given the size and potential of the Indian market, ESG investment should have taken it by storm. While it has been gaining popularity, progress has been slow, with only the four aforementioned recognized ESG Funds operating at the moment and three more[45] in the pipeline.

Reasons for Slow Growth

This paper advances three possible reasons for the slow growth of ESG investing as a concept in India, to be discussed as follows:

i) Misleading classification:

The first possible reason for this phenomenon is that, due to the current classification criteria, ESG investing is considered "Thematic Investing". Thematic Investing is described as an investment scheme that is usually open ended and follows a certain theme.[46] It may traverse several sectors, as long as the theme remains consistent. SEBI describes Thematic Investment as the riskiest form of investment, as investors have to be well versed with the theme in question in order to make informed investments.[47] This is quite unfortunate, as it has led to the misconception that ESG investment is a risky proposition, while nothing could be further from the truth. ESG Investment is thematic only so far as high compliance with social, environmental, and governance standards cannot be restricted to any particular sector or industry. There is no special knowledge an investor requires in order to make good ESG investment decisions. However, as ESG investing comes under the larger blanket of Thematic Investing, plenty of casual/novice investors would be deterred from attempting it.

ii) **Lack of incentive/regulation to disclose**

When companies attempt to access capital markets to raise funds, they have to adhere to, inter alia, the SEBI Listing Obligations and Disclosure Requirements (LODR), 2015. Regulation 30 when read with Schedule III of the LODR, stipulates events which a company must reveal as "material disclosures", as well as a list of events which are deemed to be material. Environmental

[43]ESG funding hotspot, supra note 12.
[44]Ibid.
[45]Draft Scheme Information Document, ICICI Prudential ESG Fund, t https://www.sebi.gov.in/filings/mutual-funds/jul-2019/icici-prudential-esg-fund_43602.html; Draft Scheme Information Document, Quantum Swachh India ESG Equity Fund, https://www.sebi.gov.in/filings/mutual-funds/feb-2019/quantum-swachh-india-esg-equity-fund_42000.html; Draft Scheme Information Document, BNP Paribas India ESG Fund, https://www.sebi.gov.in/filings/mutual-funds/jun-2019/bnp-paribas-india-esg-fund_43248.html.
[46] Item 9, Annexure A, Categorization and Rationalization of Mutual Fund Schemes, Securities and Exchange Board of India, SEBI/HO/IMD/DF3/CIR/P/2017/114 (2017).
[47]Understanding SEBI's new fund categories, FUNDS INDIA, June 4, 2018, https://www.fundsindia.com/blog/mf-basics/investment-definitions/understanding-sebis-new-fund-categories/13708 (May 16, 2020).

compliance/non-compliance does not feature in this list in any shape or form. As a result, barring an actual regulatory action/ongoing dispute, a company is not mandated to disclose any environmental information at all. The only circumstance under which such information would be disclosed is if the Key Managerial Person appointed by the Board of Directors for such purpose were to decide, of their own accord,[48] that environmental compliance is a material event. Thus, there exists no method to compel such disclosure under the regulatory framework. In the absence of credible information about the company's environmental profile, it is a futile task to properly rank and invest in environmentally sound companies.

iii) **ESG Norms being entirely voluntary**

The BSE[49] and NSE[50] have both released guidance papers on the subject of ESG investing. While this is undoubtedly a positive step, both papers laboriously state in explicit terms that while ESG investing is the only sustainable form of investment and is the best method of building Long Term Sustainable Value (LTSV), it is entirely voluntary. This is perhaps too soft an approach for a market like India, more so as the NSE Guidance Paper itself notes that trends in India suggest that there is a lack of innate reporting culture in businesses and therefore regulators play a larger role in eliciting disclosure.[51] Given that this is so, it seems rather ineffective to merely advocate for ESG investing, without doing anything to incentivize/reward its adoption.

General Market Behaviour

ESG norms aside, the shares of companies in the Indian market also demonstrate price variations consistent with the international position i.e. upon publication of an environmental non-compliance, share prices tend to drop. This is evinced from the following instances: The shares of Birla Corp dropped by 14 per cent to Rs. 485 after the NGT ordered them to cease mineral extraction inside Chittorgarh municipal limits, within a 10 km radius of Bassi Wildlife Sanctuary, or inside an Eco-Sensitive Zone in the region.[52]SRF Ltd.'s shares slipped 5 per cent to Rs. 2281 on the Bombay Stock Exchange after the Gujarat Pollution Control Board ordered the closure of an industrial plant on allegations of flouting provisions of the Water Act, 1974.[53]Similarly, Graphite India's shares slipped by 3 per cent in response to the Karnataka Pollution Authority's closure of its Bangalore manufacturing operation.[54]One day after the Maharashtra Pollution

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[48] Regulation 30(5), Listing Obligations and Disclosure Requirements, Securities and Exchange Board of India, SEBI/LAD-NRO/GN/2015-16/013 (2015).
[49] Guidance Document on ESG Disclosures, Bombay Stock Exchange, https://www.bseindia.com/downloads1/BSEs_Guidance_doc_on_ESG.pdf (May 16, 2020).
[50]Umakanth Varottil, Environmental and Social Reporting by Indian Companies, National Stock Exchange, https://www.nseindia.com/research/content/QB_January_2019.pdf (May 16, 2020).
[51]Id. at 5.
[52]Birla Corp slips 14 per cent on NGT order to stop mining at Rajasthan unit, BUSINESS STANDARD, Mar. 11, 2019, https://www.business-standard.com/article/markets/birla-corp-14-on-ngt-order-to-stop-mining-activities-of-rajathan-unit-119031100125_1.html (May 16, 2020).
[53]SRF slips 5 per cent as Gujarat pollution board orders shutdown of Dahej plant, BUSINESS STANDARD, Apr. 1, 2019, https://www.business-standard.com/article/markets/srf-slips-5-as-gujarat-pollution-board-orders-shutdown-of-dahej-plant-119040100150_1.html (May 16, 2020).
[54]Graphite India slips 3 per cent as KSPCB orders shutdown of Bengaluru plant, ECONOMIC TIMES, FEB. 19, 2019, https://economictimes.indiatimes.com/markets/stocks/news/graphite-india-slips-3-as-kspcb-orders-shutdown-of-bengaluru-plant/articleshow/68059042.cms (May 16, 2020).

Authority closed its Thane plant, the shares of Huhtamaki PPL fell 7 per cent on BSE.[55]Radico Khaitan's shares plunged for eleven consecutive trading sessions from 8th Feb to 21st Feb, 2019, in response to the Central Pollution Control Board's shutting down of its Rampur plant. The total drop in share price amounted to 20 per cent, finishing at Rs. 349.[56]

The above-mentioned examples indicate that there exists a relationship between investor sentiment and environmental compliance. To further illustrate this, there are several instances wherein the share price of a company has increased as a result of positive/favourable environmental news. Such instances are set out below: On 3rd July, Excel Crop Care's stock increased by 6 per cent after the Gujarat Pollution Control board suspended its order to close Excel's Bhavnagar plant for three months in response to the company submitting an action plan.[57]Vedanta's stock rallied 6 per cent after the order of the National Green Tribunal (NGT) allowed Vedanta to reopen the Thoothukudi copper plant and directed Tamil Nadu authorities to renew their consent and restore electricity within 3 weeks.[58]Rallis India's stock rose 1.17 per cent to Rs 156.25 in response to the company's declaration that Gujarat Pollution Control Authority had reconsidered its earlier direction to cease activity at Dahej plant.[59]Hyderabad-based pharmaceutical company Everest Organics reported that the Telangana State Pollution Control Board had, upon inspection of its facility, permanently revoked its earlier closure order, leading to a share price surge of 36 per cent.[60]

Thus, one can quite easily infer that the general position of the average Indian investor is to regard environmental non-compliance as bad news and either reduce or avoid investing in errant entities. This is therefore largely consistent with the international position.

V. Greenwashing

As unsavoury as the practice is, the establishment of "greenwashing" as a widespread phenomenon in the Indian market indicates that companies are also of the opinion that environmental news (credible or otherwise) has a significant impact on their share performance. "Greenwashing", a term introduced in 1986 by environmentalist Jay Westerveld, refers to the phenomenon of

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[55]Huhtamaki PPL cracks 7 per cent on directive to shut Thane plant, ECONOMIC TIMES, Nov. 22, 2018, https://economictimes.indiatimes.com/markets/stocks/news/huhtamaki-ppl-cracks-7-on-directive-to-shut-thane-plant/articleshow/66745122.cms (May 16, 2020).

[56]Radico Khaitan shares crack after pollution regulator directs closure of Rampur plant, CNBC TV18, Feb. 21, 2019, https://www.cnbctv18.com/market/stocks/radico-khaitan-shares-crack-after-pollution-regulator-directs-closure-of-rampur-plant-2362541.html (May 16, 2020).

[57] Excel Crop Care jumps 6 per cent after Gujarat Pollution regulator withdraws closure order, MONEY CONTROL, July 3, 2017 https://www.moneycontrol.com/news/business/markets/excel-crop-care-gujarat-pollution-control-board-4164691.html (May 16, 2020).

[58]Vedanta gains 6 per cent after NGT orders reopening of Sterlite copper plant, BUSINESS STANDARD, Dec. 17, 2018, https://www.business-standard.com/article/markets/vedanta-gains-6-on-favorable-ngt-order-on-sterlite-copper-plant-118121700116_1.html (May 16, 2020).

[59]Rallis India firms up after GPCB revokes closure order, BUSINESS STANDARD, July 12, 2019, https://www.business-standard.com/article/news-cm/rallis-india-firms-up-after-gpcb-revokes-closure-order-119071200671_1.html (May 16, 2020).

[60] Rakesh Patil, Tata Motors, Lakshmi Vilas Bank, Zenith Fibres among 10 stocks which moved the most last week, MONEY CONTROL, Apr. 7, 2019, https://www.moneycontrol.com/news/business/stocks/tata-motors-lakshmi-vilas-bank-zenith-fibres-among-10-stocks-which-moved-the-most-last-week-3774711.html (May 16, 2020).

companies making exaggerated claims of positive environmental policy as a marketing tactic.[61] The fact that several successful companies[62] indulge in greenwashing drives home the point that companies also understand that investor perception of their environmental compliance matters enough to spend millions of dollars on. While greenwashing is practiced by a relative minority of companies, it is hoped that the underlying understanding regarding environmental compliance and share performance is shared by more ethical companies which spend on actual compliance.

This conclusion appears to have been adopted *in toto* by the policy makers who drafted the Indian Companies Act, 2013 as well. The Act took a positive step towards inculcating responsible investment by imposing a Corporate Social Responsibility obligation (of which environmental obligations form a large part) on Companies via the introduction of Section 135, specifically Section 135(5). While this section is the subject of an amendment vide the recently passed Companies (Amendment) Act, 2019 and the Companies (Amendment) Bill, 2020, the changes have yet to be notified. The exact nature and scope of the amendment will be discussed presently. Section 135(5) as it stands currently, till the amendment is notified and the bill is passed, is extracted hereunder:

> "The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy: Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities: Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount. Explanation - For the purposes of this section 'average net profit' shall be calculated in accordance with the provisions of section 198."

A plain reading of the Section reveals that, despite the use of the word "shall", which creates the impression that the Section is mandatory, the only obligation it imposes is to ensure that the specified amount is spent, or to disclose the reasons for the failure thereof. It is absolutely crucial to note that it does not specify any sort of penalty for such failure, as long as reasons are provided. While this appears counter-intuitive at first blush, a background examination of the intention of the drafters leads one to the conclusion that the Section contemplates that in the event that a company fails to meet its CSR obligations, forcing a mere disclosure of the same (as well as the reasons therefor) is a sufficient penalty, as one would assume that the market would react badly to such news.

This view is confirmed by a Report submitted by the High-Level Committee (to suggest measures for improved monitoring of the implementation of CSR policies) dated 22.09.2015, which states in para 4.4. of its Recommendations that:

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[61] Bruce Watson, the troubling evolution of corporate greenwashing, THE GUARDIAN, Aug. 20, 2016, https://www.theguardian.com/sustainable-business/2016/aug/20/greenwashing-environmentalism-lies-companies (May 16, 2020).

[62] Dr. Sanjay Katait, Green washing in India an alarming issue: misleading and deceptive environmental claims in advertising, 3 INT'L J. COM. & MGMT. RES. 91. 94-97 (2017); Greenwashing is an elusive CSR attempt, FINANCIAL EXPRESS, Oct. 1, 2018, https://www.financialexpress.com/opinion/greenwashing-is-an-elusive-csr-attempt/1332364/ (May 16, 2020).

> "4.4. The Committee is, prima facie, of the view that the existing provisions of the Act and Rules based on general principles of 'Comply or Explain' are for the time being sufficient for ensuring compliance of the law. This view has also been taken by the Parliamentary Standing Committee on Finance in its 21st Report".[63]

Therefore, it is plainly obvious that the drafters of the legislation themselves rely entirely on the assumption that investors will react negatively to a disclosure of non-compliance and consider this to be an adequate method to compel companies to meet their CSR obligation.

This fact is extremely relevant to the current proposition, as while most jurisdictions are mulling over the question of whether it is better to regulate through rules and regulations or allow market forces to operate freely, the Indian regulators have decided to combine the two and regulate through reliance on market forces. This also means that, as far as the Government is concerned, the negative reaction of Indian investors to environmental non-compliance is a foregone conclusion.

VI. Conclusions and Recommendations

The clear inference to be gleaned from the above analysis is that news of compliance results in a rise in share price while news of non-compliance leads to lower share price of the given company. Therefore, the hypothesis has been tested and has been affirmed as true by this article. The affirmation of the hypothesis also suggests the following inferences:

- Investors value the environmental compliance of companies when making investment decisions, and do not do so only to the extent of the financial cost of such non-compliance.
- The spread of clear and comprehensive information regarding the compliance levels of various companies influences investment decisions.
- The growth of ESG investment reflects an increased emphasis on sustainability as opposed to short-sighted profitability. The growth of green-washing as a method of attracting investment affirms this.

Investors are interested in practicing and promoting environmentally-conscious investing. Companies are understanding this and in some cases are beginning to modify their business profile to adhere to this change of sentiment. In fact, the only party that has not yet hopped aboard the environmental investing train is the Government and its regulatory bodies. As a result, this paper recommends the following:

- Clarification and reclassification of ESG investment
  It is absolutely crucial for the general public to be informed on what exactly ESG investing is. As mentioned earlier, ESG investing is not Thematic Investing *simpliciter*, and it is misguided for SEBI to classify it under the riskiest category of investment. The best remedy to this conundrum is for SEBI to simply create a separate category for ESG investment and rank its risk profile accordingly. This would result in clarity to the public as well as streamline the process of ESG investment.
- SEBI Regulations making ESG Ratings mandatory
  The lack of SEBI regulations on the subject leaves a gaping hole that one would be hard-pressed to solve. This should definitely be the first order of business in encouraging the

[63] Report of the High-Level Committee (to suggest measures for improved monitoring of the implementation of Corporate Social Responsibility policies), Ministry of Corporate Affairs, Sept. 22, 2015 at https://indiacorplaw.in/wp-content/uploads/2015/10/HLC_report_05102015.pdf.

rise of environmentally-conscious investing. Additionally, it would be a welcome step to make it mandatory for companies which seek to source capital from the public to obtain an ESG rating from a credible assessment agency. This system could function in a manner similar to the current regime of mandatory credit ratings when floating IPOs, and ESG ratings can be provided by ESG rating Agencies which would function exactly like Credit Rating Agencies currently do. The ESG rating would require periodic renewal in order to keep abreast with changes in environmental rules and compliances. Since the most effective way to introduce these changes is through a notification/regulation, this is the necessary first step and is long overdue already.

- Mandating additional disclosures
  As explained earlier, the current CSR regime only requires companies to disclose the causes for their failure to comply with CSR obligations in the Annual Report under Section 134 (3) (o). Given that the larger investing public i.e. potential future investors are likely to account for environmental compliance when making investment decisions, it is important that they be informed of the same as well. A proposed amendment to the CSR policy has been passed by Parliament and is pending notification in the Gazette, which mandates that companies pay the deficit/shortfall amount of stipulated CSR expenditure into a state-run fund, as well as proposing fines and imprisonment for the company and errant officials, respectively. While this is a positive step, it still does not solve the basic issue i.e. future investors will not be informed of the company's compliance with CSR obligations. Since the current regulatory framework does not provide for this, it is suggested that a provision to the effect that any non-compliance with CSR obligations ought to be disclosed to the Stock Exchange which lists the company’s shares be introduced in addition to the company’s existing disclosure obligations.

Thus, the bottom line is quite simply that investors care about the environmental impact of their investment decisions and are enabled in decision-making by the dissemination of information regarding compliance levels. Keeping this in mind, it is not an overstatement to say that the Indian (and global) economy stands on a knife edge. Large-scale commercial production is undoubtedly the leading cause of environmental degradation. Miraculously, without government intervention of any sort, there has arisen a global movement among investors themselves to persuade companies to switch to fewer damaging methods of doing business. What we are witnessing flies in the face of conventional market theory, which would presume that investors would care about wealth and wealth alone, leaving questions of sustainability to governments and isolated activists. The fact that this movement is spearheaded by investors themselves is an incredible opportunity to nurture it and watch it bloom on a global level, as investors and governments now have their interests aligned. The active involvement of the government is all that is necessary for this movement to take root and revolutionize reckless business practice that would, if left unchecked, encourage us to review our priorities as we are forced to choose between wealth creation and a habitable planet.