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MIKE LIVERMORE: Welcome to the *Free Range Podcast*. I'm your host, Mike Livermore. This episode is sponsored by the Program on Law, Communities and the Environment at the University of Virginia School of Law. With me today are my colleagues at UVA Law, Quinn Curtis and Mitu Gulati, along with Mark Weidemaier, a law professor at UNC Chapel Hill.

All three are experts in the law and regulation of financial markets. And me too and Mark host the *Clauses and Controversies Podcast* on that subject. Today we'll be discussing ESG investing and their new paper *Green Bonds, Empty Promises*. Hi, Quinn, Mark, and Mitu, thanks for joining me today.

MARK WEIDEMAIER: Hey, Mike. Thanks for having us.

MIKE LIVERMORE: So you have a new paper together that you've put out recently. *Green Bonds, Empty Promises* is the name. And it's critical of certain types of ESG, environmental, social, governance finance.

One of the nice things about this paper is that you really get into the nitty gritty. You actually look at the legal documents underlying some of these instruments to figure out what they do and do not say. And I want to get into the results of your research.

But maybe we can just start with some basics about green bonds and the bond market more generally. So first off, we're talking about debt here. So, Mitu, in this context, who is borrowing from who?

MITU GULATI: So there is a wide range of institutions who are borrowing. And they're borrowing largely from the investing public. You might think that green bonds are instruments where issuers are borrowing from the subset in the world of tree huggers, let's say.

But that's not quite the case. These are garden variety investment instruments that big financial institutions around the world are purchasing primarily because of the financial returns that they provide, although this is something that we could discuss. But the world of green bonds, to contrast it, is very different from, say, a war bond that a country at war might raise capital from its population to support a war of the type the US issued lots of bonds during World War II or World War I that were advertised as ways of protecting the country.

The green bond market, to my mind, and Quinn and Mark might have different views, is a different kind of market in that all sorts of investors of the typical investing type are purchasing these.

MIKE LIVERMORE: Got it. So those are our buyers. And who's the seller here, Mitu?

MITU GULATI: So the sellers run the gamut. They are corporates. They are muni issuers, so our local Virginia institutions. They are sovereign. So countries find these bonds very popular.

And they are supranationals, which are institutions like the World Bank or the Asian Development Bank. So everybody's in on this party of issuing green bonds or, more broadly, ESG bonds to supposedly help improve the environment.

MIKE LIVERMORE: OK, great. OK. So it's a pretty robust market. We've got lots of buyers, a lot of, presumably, a lot of institutional buyers, pension funds, and the like, but others as well. And then it sounds like pretty much anybody who issues bonds, corporations, municipalities, sovereigns, countries are in the game.

So again, just to provide some context, legally, a bond-- these instruments that we're talking about are fundamentally about promises, right? The borrower promises to repay the loan with interest. So, Mark, what other kinds of promises do borrowers make in a typical bond? Let's set aside the green bond context.

And just in a regular bond, what else is in there other than just the promise to repay? And what kinds of things happen if the issuer doesn't deliver on the promise?

MARK WEIDEMAIER: So here, it depends really on who the issuing entity is. The promises vary, to some extent, depending on who's issued the bonds. But across all contexts, all of these promises reflect the underlying problem the investor has, which is once the investor gives the money, there's really nothing to do for the investor but to sit around and worry that you're not going to be repaid.

So basically, the promises fall into two buckets. There's a bucket of promises. And again, the nature of these promises varies across corporates and sovereigns and so forth. But there's a bucket of promises that are designed to maintain the investor's ranking relative to other creditors or to provide the investor with some informational rights or to limit opportunistic kinds of behavior by the borrowing entity.

And then the second bucket-- so those are sort of investor protective kinds of promises to limit the need to worry while you're sitting there, waiting to get paid. And then the second bucket is sort of the enforcement bucket. What happens if maybe the sovereign starts to lose its credit worthiness, if it starts to behave in ways that suggest opportunism.

And those from the kind of simplistic perspective involve a set of rights that are not necessarily promises, but the investor has the right often to accelerate the loan to get their money back to demand to be paid immediately and then a set of promises that relate to enforcement. So promises to submit to the jurisdiction of particular courts in the sovereign context to waive sovereign immunity and so forth so that the investor, in the event they don't get paid, has some legal recourse. That's what one would expect in a bond, pretty much regardless of the issuer.

MIKE LIVERMORE: Got it. Great. So these are kind of the garden variety of things that make sense in an economic context borrowers want. The lenders want assurances, and the borrowers are kind of willing to make these promises in order to get access to this capital.

OK. So now with those kind of moving parts on the table, there's the green side of all of this, the ESG, environmental, social, governance, side. So, Quinn, maybe you could just give us a quick snapshot of the state of ESG investing generally. And I know it's a really big domain. But what are we talking about when we talk about ESG investing? And then how do green bonds fit into that or that overall picture?

QUINN CURTIS: Sure. So ESG investing is a little bit hard to characterize because there's not a lot of agreement on what ESG means. But the starting point is that it stands for environmental, social, and governance issues. And over the last several years, the idea that you need to consider the environmental impact of your business operations, the social impact of your business operations, and corporate governance issues as part of how you invest, one way or another, whether that means which securities you choose to purchase or how you're going to vote your proxy if you're a stockholder.

Lots of major, major investors have at least publicly subscribed to the notion that we need to be considering ESG as part of how we manage our portfolios. We've seen a rise of mutual funds that specialize in ESG investing that they say exclude oil companies from their portfolios, or they seek out companies that have particularly strong environmental records. There's an entire ecosystem, a metaphorical ecosystem around evaluating the ESG exposure of various companies.

And this has become big business and probably the most discussed aspect of investing in academia and in the business world too, the notion of how are we going to incorporate these considerations into investing. And what I think is important for our paper is to contrast how that plays out when we're talking about stocks equities and the bond market.

And so if we're talking about stocks, I might think that it's just a good idea to invest in companies that are ahead of the curve on adapting to the impacts of climate change, whatever I think that means. They're investing in making their operations more energy efficient, that they've located their facilities in areas that are going to be not vulnerable to sea level change or extreme weather events.

And I think the market's sort of missing this. And I'm going to invest in companies that are doing that. And that's just the right way to invest. That's an ESG investment thesis.

And I might think, if I buy stock in those kind of companies, that that stock's going to beat the market. And I'll do well. And not only will I do well financially, but maybe by steering my capital that way, I'm putting a thumb on the scale for companies to be more pro-social and to reduce carbon emissions and so on.

In the bond market, it plays out a little bit differently, right? So if I'm buying stock, the stock value is going to adjust to incorporate all this information about how firms are behaving. But as Mark said, if I buy a bond, I'm going to get paid back or not. And what I'm going to get paid back is contractually set on the day I purchase it.

So I may well think that buying the bonds of a green company is a good idea because that company is going to perform better, and maybe I'll be more likely to be paid back. But that doesn't necessarily make green bonds bonds that incorporate a specific green project more attractive. Because the ordinary bonds of a green company and the green bonds of that same company are either going to get paid back or not.

And so I might be an ESG investor who thinks that ESG is important as a financial consideration. But even that's not necessarily going to make me think that green bonds are somehow a more valuable instrument. There's got to be something else going on that makes those bonds attractive.

And that was kind of the mystery, I think. What is it about promising to finance a specific project that makes these bonds, in some sense, attractive to investors?

**MIKE
LIVERMORE:**

Great. Yes, and it's a really interesting question as you set it up. Just to reiterate the point that you just articulated, there's a big difference between-- I mean, there's many differences, but there's a couple particularly relevant differences between investing in equity, buying shares of a company.

You can't really buy shares of a sovereign, of course, or a municipality. But at least in the corporate world, you can buy shares of companies, publicly-traded companies. Those same companies can issue bonds. Those are debts, right?

So you don't get to vote at the shareholder meeting. And you get paid back a fixed rate of return, as you noted, rather than getting a piece of the profits going forward.

And they can be for specific projects. So a company ABC can, say, issue bonds for, I don't know, a factory, or something like that, or to make some kind of specific investment rather than just issuing bonds in the company in general, right?

QUINN CURTIS: So, yeah, it's sort of characteristic of these green bonds that they are associated with a particular project to build a lead-certified transit hub if I'm a municipality, for example. And I'm using the word "associated" sort of advisedly because I think what we found is that these bonds, though they are associated with that project, aren't making strong legally enforceable promises to actually use the proceeds for that project.

MIKE LIVERMORE: Right. Great. So that gives us a preview of the findings. There's an association, in some sense, between-- but the bonds, well, actually, that's an interesting question. So in general, are corporate bonds or bonds that sovereigns issue typically associated with a specific project or are they just general like, we're ABC corporation. We're issuing bonds. Presumably there's some of that.

But is there also and then a sovereign can do that, Argentina, or whatever, could say, we're just issuing bonds in general, but then there's also project-specific bonds. So I'm just wondering how-- again, putting aside the green stuff for a moment, is it a common thing to issue debt that's tied to particular projects?

MITU GULATI: It's quite unusual, at least in the research that I've done. Much of it is with Mark on sovereign issuances and quasi sovereign issuances, like a state-owned company. Usually, there will be a use of proceeds section, which I've always thought of as some kind of historical artifact.

Because in the late 1800s, early 1900s, these were used a lot. And I'll give you a sense of why they were used then. But today, usually, they just say, the use of proceeds sections will say, these are bonds whose revenues will be used for general purposes.

And so if you just looked at a bond today, you'd wonder, why the hell do they even have this section? But in the old days, say take a railroad bond from the late 1800s when lots of these kinds of instruments were issued. You would specify where the money is going, in part, because the promise to pay you was from the revenues of the railroad.

And so these were, in a sense, collateralized instruments or you had a promise to pay from a particular revenue source so that stream of payments was tied to your being repaid. And so you cared a lot about where your money was going. But for whatever reason, we rarely do that today, except maybe some kind of toll road financing or something like that.

So specifying in a general bond of the type Quinn described where your money will be used, I've never seen it in a general bond, other than this new creature, the green bond.

MIKE LIVERMORE: Yeah, no. That's very interesting. And then in a-- it may be worthwhile separating out the green bond from kind of normal market transactions or typical market transactions. So you talked about general bonds. If you did want to issue debt that wasn't exactly collateralized, but it was kind of associated with a specific project in private markets-- put aside the sovereign for a moment-- we can do that through-- and we're getting, this is in my area. But there's things like special purpose vehicles and other forms that one might take in order to accomplish that goal. Is that broadly right?

MITU GULATI: Yeah. I mean, I think that's exactly right. So you and I have talked, Mike, in the past about investments by the Nature Conservancy and, say, a particular country where they're loaning money for a particular project. And then they have all sorts of bells and whistles to make sure that the right kind of environmental impact occurs.

Now that sort of project-- or you could imagine a development finance project where USAID is providing financing or some institutional institution like that. Those kinds of projects are very tailored to the particular goals in question. And they're expensive to set up.

But you have a high degree of assurance that the project will actually happen. And the money will be used for the purposes that you want it to be used. And the criticism of those projects is that just too many administrative costs usually.

These things are very different in that the money is just given. And then you say a prayer and hope it's used. But it's a far cry from the type of targeted financing, particularly in the developing world, we were used to.

MIKE LIVERMORE: OK. Good. So there is a way to structure the financings, where they are oriented towards specific projects. And that's one category of, say, bonds or debt transactions. But there's another category that you all are interested and that you're studying.

So how do you define the object of inquiry of the paper? So if we're going to-- I take it that we're actually excluding the kind of projects that you just described, the kind of project-specific financings maybe where there's a special purpose vehicle or there's some kind of really special one-off element to it. And that the world that we're describing is-- maybe what is it exactly?

How do we define the circle here of what counts as a green bond the way you guys define it? Mark, maybe you could take a crack at that.

MARK WEIDEMAIER: So the initial cut-off data included the kinds of project financing bonds that you're talking about. So we started with a big cut of bonds flagged with the green label over the last decade. But after excluding the project finance related bonds that we had included in that initial cut, we wound up focusing on what are often called the use of proceeds bonds.

And so we're using green bond loosely to refer to what people in the field would frequently call a use of proceeds bonds. And so here, basically the difference from a regular bond is simply that there's-- or at least one would expect there to be a promise restricting the sovereign's use of proceeds to projects that meet certain predefined criteria, often called eligible projects. But the shorthand way of thinking about them is just that the issuer is supposedly promising to do green stuff.

So those bonds are structured in different ways. Sometimes the issuer tells the investor that it will use the actual proceeds of the bond issuance for certain purposes. Sometimes it just promises to devote an equivalent amount of money equivalent to the proceeds to these eligible projects. But the core of the trade is that the investor gives the money and gets some assurance that the money is going to be devoted to environmentally-beneficial projects.

MIKE LIVERMORE: OK. Great. So this is quite helpful to me, anyway, in understanding the domain that we're talking about. So have in this world kind of project finance style bonds that may or may not be green. They could actually be very non-green. We shouldn't be heard to be arguing that all project finance is green, but there could be bonds that are associated with some specific project like a hydrogen production facility that relies on solar power, right?

So the idea they're making green hydrogen, and they're going to get financings. And it's a company, and there's a specific financing associated with that. OK, that's different.

What we're talking about here is a more general bond that's issued by a sovereign, or a company, or whatever that isn't just for, well-- and this is the heart-- this is the tricky question. So legally, what's going on here is that the bond is not associated with a particular project. But there's a section in the bond that says that we might call the use of proceeds section.

There's some language in the bond that says, we're going to use these proceeds for green things. And that's the language. So do you happen to have an example or you kind of come up with off the top of your head of the types of language that you would see in one of these use of proceeds? What would they say? They wouldn't say green things, obviously. They would say something a little bit more specific.

MARK WEIDEMAIER: Well, so now we're starting to get into both the details, but also the problems. And so basically, what they say is that the issuer-- I'm going to skip over some of the complexities here. Let's assume the issuer wants to make an actual promise.

So then the language says, the issuer will devote an amount equivalent to the loan proceeds to eligible projects, the defined term. And then typically, that's defined with reference to some set of green principles, often called a green bond framework or something of that nature, that the issuer has promulgated and that has a long list of definitions and descriptions of what types of projects fall into that list of eligible projects.

And one of the issues that we encounter is that those definitions are so broad and so vague that virtually any kind of project could be justified as satisfying the issuer's obligation. So just as a broad example, anything designed to improve energy efficiency, for example, might be one of the categories. And there's a query whether it's possible to tell whether any given project actually satisfies that criteria.

MIKE LIVERMORE: Yeah. OK, good. So it's very interesting, right, because you get into the nitty gritty. And there's all these kind of details about how these things work. So say in the example right-- so then it kind of says, all right, in the use of proceeds sections, we're going to use this for eligible projects that's defined elsewhere. And eligible project, there's a long list of definitions.

Presumably, some of those are fairly green sounding, but then there's others that are more open ended. So whose job is it to evaluate these things, to look at it and say, OK, this is green? OK, this is-- oh, this doesn't look very green. Is it up to the individual buyer or-- in the who's in the-- whose job is it to figure out whether this gets to be called green or not? Quinn, maybe you could give us an answer to that.

QUINN CURTIS: Yeah. So there's a couple ways that that can be done. So some of these bonds are going to be certified. So there are some third-party organizations. The Climate Bonds Initiative is one.

There are also some companies like Standard and Poor's that construct indices, where inclusion in the index is a representation that the bond is a green bond. And so they would sort of evaluate the greenness of the proposed commitments made by the bond as a third party. So those third parties themselves aren't often the ones-- CBI doesn't actually go out and verify the specific project. There's actually another set of verifiers that the bond issuer might contract with to assess the proposed project that's being undertaken, decide whether it meets certain standards for inclusion as a certified green bond.

And then some of them are just sort of asserted by the issuer to be for green purposes. And they're not going to be subject to that kind of verification. And then in that case, I suppose it's up to the investor to decide whether they think that the project or potential projects associated with that offering are sufficiently green to meet their goals as an investor, whatever those might be.

**MIKE
LIVERMORE:** OK. That's very interesting. All right. Now we're going to get into your-- these are kind of in preliminaries. But now we can kind of dig into the study that you guys actually did.

But directly follows from Quinn's response there, so how did you guys decide what was and was not green? Presumably, it was anything that was counted by these third-party certifiers. Was it just anything that included green stuff, like green marketing materials in the marketing materials? What counted as a green bond when you surveyed this world? And then we'll talk about the nitty gritty. But what was in, what was out when you compiled your sample?

MITU GULATI: So this is a crucial question. And the world provided us with a nice neat answer. So as Quinn had described, there are lots and lots of institutions, pretty much every major financial institution, that buys these instruments. OK, maybe exceptions for the state of Florida and the state of Texas, and a couple of others that are barred from buying these institutions, these instruments.

But because there is so much demand in the market, there are nicely-defined categorizations of green bonds. And so issuers of all these green bonds will specify, my bond is green. Maybe they'll have a little green color. Maybe some pretty trees on the front page.

But they will be then categorized by the databases that we would look at. So if you look on Bloomberg, or Filings Expert, or one of the other major databases, and you want to buy green bonds, there's something you can click on that will give you a listing of all the green bonds. And then you can see all the prices.

And so for our paper, what we did was to look at the stuff that was officially categorized as green and then looked at the kinds of promises that were made in this officially categorized set of instruments. Now, as you said, Mike, there could be other bonds that are out there.

Let's say there's a bond issued by some Native American tribe that's all about protecting the environment, but they didn't put a label on it that says we're really green, and we're protecting the environment. My sense is that would not be categorized as green. And in fact, nobody would buy it because of its green stuff because then you don't get credit for having invested in green stuff.

Maybe I'm being too cynical, and Quinn will correct me. But this is how we set up the project. We didn't categorize it. They were officially categorized.

MIKE And by officially, this is officially in like the Bloomberg.

LIVERMORE:

QUINN CURTIS: Yeah, in market terms. We used a database called Filings Expert, which has not just the legal and financial terms, but also has the categorization that industry people use, but almost every financial database because this is such a big market and because the categorization is important will tell you which new bonds have been issued that are green, or blue, or yellow, or whatever.

MIKE Just so that I can-- it's so interesting because it really gets to the heart of the project and the heart of this market.

LIVERMORE: So is this like I can just click a little box if I'm the issuer and say I'm green? Or in order to become officially green in the sense that in this database, it will show up as green?

I am in control of that? So like our Native American tribe, they could click green on the little box? Or this is the database themselves, like look at the marketing material. Who actually makes this decision about whether the little box is clicked next to green in this database?

MITU GULATI: So my impression is that for the most of the databases, they just let the issuer designate, which is why-- and Mark and I have done some work on Native American bond issues. We've always been puzzled because if you read their materials, they're super green, but they don't categorize themselves. And so the market doesn't give them any credit for this.

But the databases might categorize you as green and not green. But then there are also other institutions like the Climate Bonds Initiative or rating agencies that might then say you are super green, or you're just light green or dark green. There are institutions that then give you more fine-tuned categorizations of your degree of greenness. I don't know if Quinn or Mark wants to correct me on this. Please do.

MIKE Well, not hearing any corrections. It sounds like we're going to let that one stand. OK. So we've got our
LIVERMORE: databases. And then there are kind of the higher-level certifications that some of these other entities offer.

It sounds like generally speaking, for purposes of the databases, the issuers are the ones that get to choose whether they're categorized as green or not. OK. So then maybe one more step before we get into the results. Why does it matter whether this box is checked in this database?

Why would anybody check or not check this box? Mitu, you mentioned that maybe there are some states that actually limit your ability to invest if the box is checked. So why is this a consequential thing? And maybe Quinn you could give us an answer to this. Why is this a consequential thing whether in this database an instrument is marked as green or not?

QUINN CURTIS: So there are kind of two possibilities there. One is there's a notion that bonds that are identified as green might carry a lower interest rate, which is to say that's attractive if I'm an issuer of the bond, if I'm borrowing the money because I'll pay less interest. And so that's referred to as the "greenium," a green premium for bonds.

But its existence is kind of controversial. We kind of bracket the issue. It's really hard to pair up bonds that are absolutely identical, except for the Green aspects and determine their exact price difference. The finance people have looked long and hard at that.

And the consensus seems to be to the extent it exists, it's very small, something like 0.06% basis points. So that's not nothing, but it's close to 0. And so one possibility, though, one we kind of discount is, hey, maybe you're getting a better interest rate.

MIKE And this would be due to demand, right, that people demand these things. They demand green. They like green.

LIVERMORE: And so they're willing to essentially pay a little bit more in order to get the green bond.

QUINN CURTIS: Maybe if I'm an investor who's not just attracted to green as a financial play, but believes strongly in it as a matter of social value. I will accept a lower interest rate in order to support your green project. But that's a little intention with the idea that there's a big financial players who are major movers in this market.

We don't expect them to be the ones to take a discount on their investments. But what's unequivocally clear is that there is huge demand just in terms of the size of the market for these bonds. That doesn't necessarily translate into much of a greenium. But what we hear again and again and I think we see in the market is that if you can identify a bond as green, you're going to tap a larger and more liquid market to place those bonds.

And you're going to have more confidence those bonds are going to be in place. And your investors are going to have more confidence that there's going to be an after market for those bonds. And so this is very much a phenomenon that's driven by the investor side.

We have an appetite for these kinds of instruments as investors. Please give them to us. And that seems to be one of the key drivers of the green bonds market.

MIKE Yeah. So this was something that was in the paper, this distinction between the green premium or the greenium.

LIVERMORE: I have to admit, I'm not a humongous fan of that portmanteau. So the idea of that green premium, i.e. Investors are willing to pay more for these if you have the green label. And then the idea is if it exists, it's very small. We don't really see much of that.

But on the other hand, there's this liquidity reason, right? It's like, oh, you can then sell it to way more people. And way more people want to buy it and therefore, you have more confidence in the instrument going forward in secondary markets, all the stuff that you said.

But I'm having a very hard time separating out those two things in my mind. Because I have a thing. It would be very strange if I was like, I have this thing, and if I improve it a little bit, a lot more people are going to want to buy it. But no one's going to be willing to pay any more for it. It just strikes me like a contradiction.

QUINN CURTIS: Yeah. And as an economist creates a little bit of tension for me too. But one underlying detail here is a lot of these investors have some incentive to show their clients. Hey, look, we're involved in ESG. We're taking it seriously. We're bringing green assets into our portfolio. Clients want to see that.

But clients also want to see returns, right? There's no doubt about that. And the extent to which clients are going to accept actual lower returns might be extremely limited, which would, I think, explain a small greenium.

The other thing is a lot of these investors are going to be under binding fiduciary duties not to explicitly trade off returns for their beneficiaries in order to get some social benefit, that any ERISA plan is going to be bound by more or less that fiduciary duty.

MIKE Just for the listeners, these are pension-related plans.

LIVERMORE:

QUINN CURTIS: Yeah. Yeah, sorry. Yes, the pension funds, mutual funds would all be very uncomfortable if the greenium got to be very substantial. And so it's possible that there's precisely this dynamic that there's a lot of demand in the sense that investors would prefer that asset managers showed this type of green exposure. But both from a legal perspective and the other aspect of investor demand perspective, the returns aspect, their ability to sacrifice a material amount of money to get that is going to be very limited.

MIKE That's very interesting. I almost want to say that the word "demand" is the wrong word there if you're not willing to pay anything for it. But, yeah, so in any case, it's an interesting dynamic. There's clearly something, a desire of some kind to put these green-labeled things into your portfolio, even if you're not willing to pay much for it. OK.

LIVERMORE:

Now, at some level, we've just been kind of setting things up and setting the stage and explaining the stakes. But now maybe we can get into your findings. So, Mark, maybe you could give us a little intro here.

You went out. You actually identified a sample of these green bonds. You read the damn things. These are the things that were labeled green in the database that firms seem to have some kind of desire to put into their portfolio to show the commitment that they're adhering to their ESG commitments. And what does it turn out that these bonds actually look like?

MARK So it turns out that they look like vanilla, regular, ordinary bonds. So remember that the difference between a green bond, a use of proceeds bond, and just a regular bond issued for general corporate purposes purports to be that the issuer is restricting its policy flexibility. It's got to use the funds equal to the proceeds or the proceeds themselves to fund one of a series of eligible projects.

WEIDEMAIER:

And so if that's the nature of a green bond, we would expect to see a commitment to actually use proceeds for those purposes and then some mechanism by which investors could enforce that commitment. And the shortest way to describe our findings is that we see neither of those. Green bonds typically involve a representation that the issuer at the time of the bond issuance intends to spend money on green stuff, but no promise whatsoever to do that so the issuer is perfectly free to change its mind and to spend the money on a new coal-fired power plant.

And bondholders would have no basis whatsoever for objecting if it did that. Certainly no legal basis. And even if by some quirk of magic or luck a bond holder was able to point to some kind of actual commitment language really restricting the issuers use of proceeds, there's no mechanism for enforcing that. Typically, if the issuer violates a covenant, the investor can accelerate the loan and exit the transaction. The investor might be able to sue.

None of those rights are triggered by the issuer's failure to use proceeds for green purposes. And what we find too is that this is all perfectly clear in the documents. And in fact, it's become clearer and clearer over time.

So that a green bond basically says now, hey, look, we think we're probably going to do some green stuff with your money. But just to be clear, we have no obligation to do that whatsoever. And if we don't do it, if we change our mind, you have no rights whatsoever against us. I think I'd like to impose my summary that this is just a big, fat, giant scam.

MIKE Yeah. I was going to ask you, actually what your quick take was.

LIVERMORE:

MARK WEIDEMAIER: A scam implies lying. And one thing that seems clear is that at least to the sophisticated investors who are buying these, there are no lies. There's just a label and nothing underneath the label. But it's quite clear that there's nothing underneath the label. Sorry, I'll shut up now.

MIKE LIVERMORE: Yeah. No, no, that's interesting. And one of the bits of research that you did for this project is to talk to some investors and some folks who buy these things, some folks who structure these things, the lawyers who write the documents. And yeah, me too. What was their take? Were they like, yeah, this is a big scam? Or were they deluded about what was actually going on? What was the situation when you actually talked to the folks engaged in this market?

MITU GULATI: So again, the three of us talked to lots of people together. And you know from doing this kind of interview research, different people read different things. And I'm such a deep cynic that I came away from the interviews-- and we did over 50 interviews. And since the project, we've talked to more people.

My view of what they were saying was, yeah, you guys think it's a scam based on the legal language. And you're asking us for, oh, is the legal language going to improve? Is this the way it is just because the market is starting out this way?

And they said, come on. This is really just PR. So don't expect it to improve. And right now, there's a whole bunch of people in the market. So these are the people I see as being scammed, people like me who want their pension funds to invest in green stuff because I want to feel good at my home that I'm doing something for the environment.

They say, all these people want this to happen so investment managers have to go out and find green stuff. But they don't want lower returns. And companies have to produce stuff that will satisfy the investment managers because they know that somebody cares about it.

And so that's why we have this market, but it might just be a temporary thing. Might expand even further. But it isn't based on anything real.

I mean, one of the things that really drove me up the wall in terms of myself being scammed by these is where folks in companies or countries would say, look-- and this was a way of reassuring my dismay. They would say, look, we had this cool green project.

We had signed up with the Paris Accord to do all this stuff. And so we were doing it anyway. And then the investment bank said, well, why don't we do a green bond and say you're doing all this good stuff And so we can raise some money? But that dismayed me because I thought the green bond is promising to do extra green stuff, not just you getting credit for stuff that you were doing because of Paris.

MIKE I mean, that's interesting. Although for me, to be honest, that raises a different set of questions because that's the additionality question, which is which shows up actually in lots of different contexts in environmental law. How do you structure incentives so that people are changing their behavior? And that can be quite difficult.

But it sounds like there's something even deeper here, which is just they can do whatever they want with the money. They can go build coal-fired power plants if they want. And that strikes me as even more serious problem than the additionality, which is serious, no doubt, but is a little kind of more complicated to solve.

Whereas if you have legitimate promises that say, look, we're going to use this to build solar, or we're going to use this to improve wetlands and carbon sequestration. That seems like if there are real promises, at least plausibly valuable. What do you think, Quinn?

I mean, is this a big scam? Is it just PR? Is it greenwashing? That's a word that gets used. Who benefits, who loses from this current state of affairs?

QUINN CURTIS: It's strange. I even resist the greenwashing label because there are dynamics in this market that I don't even think quite square up with the idea of greenwashing. And to be clear, I'm probably the least cynical among the three of us. It's kind of been my role in the project.

But I'm looking at a bond that is from a US Realty company, \$425 million financing it's a Green bond and the promise is they're going to use the proceeds of that bond to construct buildings that meet LEED environmental certification standards.

And it comes with a letter from a third-party verifier that lays out the way that they're going to check the plans of the buildings and the HVAC of the buildings, all these details about how they're going to ensure that the buildings meet the LEED certification standards. This feeds back into certification for the bond as a green bond. They meet those standards.

And then sure enough, you get to the bottom of all this, and there's a disclaimer that none of this is legally enforceable. It's not actually part of the agreement. And so it's not-- greenwashing is a thin veneer of green. It's a relabeling, right?

This has a infrastructure around it that has some reality to it, but it's not the reality that I think a bond purchaser would or at least a sort of retailer, us, coming into this asking what it's about. The expectation would be that this ought to have some legal enforceability to it.

Right until you read that paragraph of text at the bottom, that's where you assume this is all headed. And so to me, there's something even deeper than just greenwashing. It's a very strange market.

It's like a conventional bond with this overlay that why does it even need to be part of the bond market documents? That's what I get hung up on. Why does this green aspect-- if this same real estate company said, hey, we're committed to building LEED certified buildings, and we're going to build this many thousand square feet over the next 10 years.

You should lend us money. Here's our conventional bond, right? And I'm an investor committed to seeing those buildings get built. I might want to buy that conventional bond.

But somehow, slapping-- and I'd understand that that's not legally enforceable, that it's just an aspirational promise they're putting on their website. But they put it in the bond document, right? And that's what I'm troubled by.

Because I can't think of any reason to put this purely aspirational stuff in the bond document other than to create the impression for someone somewhere that it's a part of the promise that is represented by the bond. And it's really not.

**MIKE
LIVERMORE:** That's interesting. And maybe this is worth thinking about for a second. So as lawyers, just a bunch of lawyers talking to each other. We would assume that the reason you would put language in a debt instrument, which is a contract of a particular kind, is that you want to make a promise.

You don't put your PR marketing materials into your contracts. That would be weird. Look at your assurance contract. It's not like State Farm puts a bunch of stuff about how State Farm is awesome in the actual contract that you sign, right? That's in their marketing materials.

And that is very strange, although one of the peculiarities of this that we've been kind of unpacking a little bit earlier this little box that gets checked in the database. And it sounds like if you don't put something in the bond itself, right, even if you kind of intend to use the funds for particular purposes. You're just a very green kind of institution. The box doesn't get checked.

So is that what it is? It's just a matter of like if you put the marketing material in the bond, then you get the check box. But if you don't put the marketing material in the bond, then if it's just on your website, then you don't get the check box. Quinn, is that what's going on?

QUINN CURTIS: That's really true, right. If this were just a plain vanilla bond for a company that was sincerely committed to building LEED-certified buildings, it's not going to be a green bond. And it's not going to accrue whatever advantage is this real estate company feels it gets by issuing green bonds.

**MIKE
LIVERMORE:** That's very interesting. So this just puts us in a peculiar position. So maybe, let's just imagine if we're being generous, that there is a difference. There's firms that they genuinely want to agree-- they don't want to agree to anything.

They genuinely want to engage in some investment in things that are green, but they don't want to be bound by a formal, legally enforceable promise. But they want to communicate to the market their genuine intent to spend money in particular ways. And part of the reason they want to communicate this is because there are market actors who, again, kind of in the same vein, want to fund entities that genuinely want to engage in funding green activities.

But actually, the investors don't want binding enforceable promises because that can cause all kinds of costs, like situations change. Once you are bound by these promises, you're really bound by them. And an investor could come in who doesn't care one lick about green things. And maybe the investor-- or sorry, the borrower needs to make some moves in order to deal with different market conditions.

And a sharp practice investor could buy up some bonds and threaten to bring some kind of lawsuit against the borrower and then extract some wealth from them. So is that part of the story here? Is that we're worried about sharp practice by kind of hedge funds or something?

So in any case, you can imagine that the market wants to operate on this kind of intention, but not legally enforceable promise basis. And the peculiarity is that it's happening at the level of actual bonds rather than just in marketing materials. But that's just like a weird artifact of how this stuff gets tracked in financial databases. I mean, is that possibly be the story or does it is it necessarily-- is that too rosy of a picture?

QUINN CURTIS: It strikes me as a little bit rosy for the following reason. So you could imagine that this real estate company is concerned. Suppose I put in my bond document that you'll be able to accelerate the debt if I don't build the LEED-certified building. And then the building is 90% finished.

And the LEED certification requirements change a little bit. In some way, that's relatively trivial. But I realize I'm committed. I'm not going to be able to get the certification that I thought I was going to be able to get anymore.

And as you say, maybe some investor comes in, just a pure interest rate play, swoops in, get some of the bonds, and sues me and accelerates the debt. And all of a sudden, I'm in a terrible position, not because I breached anything that would be important to an environmentalist, but because I've set myself up for an opportunistic investor. And I want to avoid that.

That kind of worry surely goes into the decision how much do I want to legally commit to this. But in a market where my counterparty, the purchaser wants to see legal enforceability, you would expect some sort of negotiated set of terms. I mean, the bonds, it's not going to literally be the buyer and seller sitting across the table.

But the terms we see in the bonds are one sided, right? We're not going to make a legal promise at all. And that doesn't strike me as an outcome from a process where we have sincerely concerned purchasers of the bond who want to see some credibility and sincerely motivated sellers of the bond who are willing to give some credibility, but are worried about opportunistic behavior.

What we see is these bonds, taking legal enforceability entirely off the table. And that, I think, it's not going to be explained just by the risk of opportunism, though I imagine that's a part of it.

MIKE LIVERMORE: OK. Good. Yeah, that makes sense to me. And there is the problem of the end purchaser, in some sense, the person who someone is demanding of some other entity typically, that that entity has received some kind of ESG commitment. And so that's the worry is that the Mitus of the world who want to invest in good things, things that they think will make the world a better place, will end up with a bunch of bonds in their portfolio that aren't actually accomplishing what they think they would accomplish.

So OK. So we have just a few minutes left now that we understand the problem. What is the way to address this? You guys talked about upgrading certifications, more disclosure.

Can the market sort this out? Do we just need to let people that the green bonds are kind of not worth-- the greenness isn't worth anything right now? And then presumably, people would look to these higher quality certification entities.

Do we need government regulation? What do you think? Maybe we can start with Mark, and we'll go through. And this will probably be where we wrap up.

MARK WEIDEMAIER: I mean, I think there are two directions that one can go. The direction that you're suggesting, which is either making certifications more robust or maybe building legal enforceability in some sense into these bonds I think will have the effect of making this something like an affinity bond market, which, to my mind, is contrary to the reasons why almost everybody wants these things to exist.

A set of enforceable commitments to genuinely do real stuff so that the die-hard, committed investors like Mitu will be all in. That to my mind is almost by definition a smaller market where bonds are actually not liquid. They're quite illiquid among other reasons, because they're no longer fungible.

They can't be viewed by less motivated investors as essentially equivalent to the issuer's regular bonds. So that's one direction, though. One can view these as affinity bonds, and one can build in some enforceability into them.

The other alternative, frankly, is just to kill the market. It's not clear to me that there would be much of an effect. Issuers can brand themselves as green every bit as much as they attempt to do now.

The people who care about supporting issuers who appear to have commitments to do green stuff can easily identify green issuers and invest in those entities. And we eliminate the risk that at least some investors wind up being duped by the label.

MIKE LIVERMORE: So just to be clear, that would mean making it illegal to claim to be green or--

MARK WEIDEMAIER: So I don't I don't envision this as an actual regulatory intervention. But one of the things that we frequently hear from the folks in the market that we interviewed is that the market will die if you try to build legal enforceability into these instruments. And my reaction-- I suspect Quinn and Mitu's reaction too has been, in part, like, well, who cares?

If the market can only survive if these promises are effectively meaningless, then it's not clear why we need the market to exist at all. As far as I can tell, issuers are able to finance their green projects. And if the market simply got wise and did away with these green labels, then it's not clear to me anybody would be worse off as a result.

MIKE LIVERMORE: Quinn, what do you think?

QUINN CURTIS: What I think is some low hanging fruit to at least try to improve this market because there's so much infrastructure around certification and verification and third parties who are involved in sorting these bonds. And to go back to this company bond, this is a bond whose certification is based on its commitment to have someone come out and verify the energy efficiency of these buildings.

Yet oddly, this certification document, which runs about 50 pages in length and sets out all the standards for what it takes to be called a certified green bond by this particular certifier, says nothing about the legal enforceability. And so it strikes me as a completely reasonable place to start is to ask the certifiers to say, if you want to be a certified green bond, you have to have some measure of legal enforceability.

And perhaps we have some tiers of what that means. It doesn't have to go straight into default. We could have some intermediate consequences if you fail on the green aspects of it. And then we'll see what happens.

If some of the folks are right and that sort of modest nudge causes the market to collapse, then maybe there was nothing there to begin with. And maybe as you said, Mike, the demand isn't really demand. It's demand and scare quotes.

But maybe it's robust to that. And suddenly, we see that these bonds become more credible. And the market might be a little bit smaller. But a little bit smaller, more credible market seems like a positive change to me.

The other thing that's on the horizon is the SEC is looking at disclosures for ESG mutual funds who are some of the purchasers of these bonds. And that's the interlink between the consumers who say they care about green assets and the assets themselves and to ask those funds to say, do you have any internal standards for what it means to be a green bond?

What's your position on legal enforceability? And perhaps that could feed back into the consumer market and connect people's stated desire to see some green assets in their portfolios with a mechanism that might actually lead to some legal enforceability for those assets.

So I think to the extent there's good news here it's that there's a lot of infrastructure in place that could be turned in a useful direction. The outstanding question is sort of how sincere this demand is.

MIKE LIVERMORE: And so Mitu, we'll end with the most cynical potential take. What do you think the right way to address this situation is?

MITU GULATI: So if I knew, I would have started with that. But let me at least point in what I think is-- well, I think there are two relevant directions here. One is the direction of this market.

We as a group may have been disappointed with the kinds of promises that are being made, the kinds of disclosures, where despite Quinn's little bit of optimism, we're generally on the pessimistic side about this. On the other hand, the reality is this market is booming.

I thought it was sort of dying, but it's back, and it's going gangbusters. And more and more money is being spent on infrastructure. It's not going anywhere.

So you are right to push us on how it's going to be made better because it's not dying, even if we think it should die. Now, in terms of how you make it better, I think we need to think seriously about what's going on in these bonds that, at least from an academic point of view, should be super interesting, which is that they're not just market transactions.

They are combining a market transaction, for want of a better word, almost a gift. So the green part of it is, give us a gift of your money, and we will not promise to do anything specific with it. But trust us because we're good guys. But then also give us your money because we'll pay you a return on it.

Normally, we don't think that these things combine. You either get a charitable contribution, or you get a gift. And then you get the investment.

But here you have a booming market that is combining these things that I had always thought could not and should not be effectively combined. So from that perspective, it's kind of like the stuff is happening, and I didn't think it could happen. And maybe it's just a matter of figuring out how this works.

But maybe we should take the perspective that this is just really cool, and it will evolve towards something better. But, Mike, I mean I'm very curious into as to what your perspective is because you know the environmental world so well. And you know institutions like the Nature Conservancy, and you care deeply about making the world a better place. So what do you come away from all of this with?

MIKE Yeah. I think I'm on the skeptical side. I think there's not much there. It seems like some PR. And to the extent
LIVERMORE: that people are being fooled. That's a bad thing. Because they are-- we don't like that.

We want our markets to work. And I'm fairly skeptical that anything kind of pro-environmental will come out of this all of this other than-- I guess my take is that the kind of ESG movement generally is helpful in that inasmuch as it raises general awareness about the importance of environmental issues and could lead to political change. But I ultimately think that especially on issues like climate change, all of the action is on policy.

And private markets aren't going to really deliver much for us other than, again, helping to facilitate the cultural change that might then lead to a better politics around these issues. So that's my quick take for what it's worth.

MITU GULATI: Well, thank you so much for having us. This was great fun.

MIKE Yeah. No, it's been great to have you all. I appreciate you taking time. It's a really interesting project. I think it
LIVERMORE: gives us a lot of insight into what's going on in this or not going on in this market. So thanks for the project, and thanks, everyone, for joining me.

QUINN CURTIS: Thank you.

MARK Thanks, Mike.

WEIDEMAIER:

MIKE And, listeners, if you enjoy this episode, let us know. You can give us like, a rating, subscribe to the podcast and
LIVERMORE: follow us on social media. It'd be great to hear from you. Till next time.

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