The Price of New Risks in Financial Markets: Evidence from Climate Change Litigation*

Alison Taylor†

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Abstract

This paper is the first to study how investors respond to climate change litigation. I look at the effect of litigation on stock price returns, implied volatility and institutional holdings of defendant and peer firms. With most cases, the stock prices of defendant firms decrease after an announcement, but increase by 1.41% for cases about historical GHG emissions. This may indicate speculation and heterogeneous investor beliefs. There is also significant industry spillover for peer firms. Peer firm stock prices increase around securities lawsuits, but in other cases peers experience stock price declines, institutional holding divestment and an increase in implied volatility. Investors are heterogeneous by institutional type; investment companies divest both defendants and competitors, whereas investment advisors increase holdings of defendants. Institutional investors that divest defendant oil and gas firms buy more shares in other oil and gas companies in the same quarter, both within the same 4-digit SIC industry and in other industries. My results are inconsistent with a simple homogeneous investor model where an increase in litigation risk for a firm decreases the value of the firm and increases the expected future volatility. Consequently, models of the investor response to climate change information should incorporate heterogeneous investors and industry spillover effects.

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†Email: alisonkathleen.taylor@mail.utoronto.ca