Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=0f41fd7c-6cc7-4d6d-86ed-f5ddc5223ed0

MORRISON | FOERSTER
CLEANTECH GROUP

CLEANTECH UPDATE

June 2009

Public Companies in All Sectors: Now's a Good Time to Look at Climate Change-Related Disclosures (and D&O Coverage)

by Mia Mazza

Recent and upcoming developments underscore the need for public companies, and their directors and officers, to consider whether they may have exposure to a newly emerging source of disclosure-related litigation.

There is a growing, organized effort on various fronts to get every public company to voluntarily disclose information about its "carbon footprint" and about the other ways in which climate change may affect its business in the future. As discussed below, not only are significant investor groups demanding this information, but the peer pressure to make voluntary climate change-related disclosures is also becoming strong enough to get the attention of public companies across all sectors. If your company is beginning to discuss the possibility of making voluntary disclosures, or is already making them, there are potential liabilities — and directors' and officers' liability insurance coverage issues — to consider.

WHY EVERY PUBLIC COMPANY IS POTENTIALLY AFFECTED.

Investors are becoming increasingly interested in understanding the "carbon footprint" of each of their investments, sometimes for altruistic reasons and always for financial ones. A company's "carbon footprint" typically includes the total set of greenhouse gas emissions caused directly *and indirectly* by its operations. Investors are concerned that future developments in the government regulation of greenhouse gas emissions will have a significant financial impact not only on companies that emit large amounts of greenhouse gases, but also on those who do business with large emitters.

For example, if new government regulation causes the price of coal-based electricity to increase substantially, that regulation might have a substantial financial effect on a company that has traditionally relied on the low price of coal-based electricity to run its

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=0f41fd7c-6cc7-4d6d-86ed-f5ddc5223ed0

operations profitably. By comparison, a company that has become more energy efficient, or that has moved to renewable sources of energy such as solar and wind, may be in a better position. Moreover, the future physical effects of global warming, such as an increased scarcity of water resources, could bring substantial financial risk to companies that neither emit nor do business with emitters.

In light of the Obama administration's June 16, 2009, release of a scientific report on climate change that argues for fast action against global warming,[1] and the upcoming December 2009 United Nations summit on climate change in Copenhagen, Denmark, it seems likely that some kind of new regulation is on the way.

AN INCREASING DEMAND FOR VOLUNTARY DISCLOSURE.

On June 12, 2009, 41 leading global investors sent a letter to President Barack Obama's new Chairman of the U.S. Securities and Exchange Commission, Mary L. Schapiro, urging the SEC to take steps to improve public companies' disclosure of climate change-related risks in securities filings.[2] The letter's signatories, representing approximately $1.4 trillion in assets under management, include treasurers, comptrollers, controllers, asset managers, and institutional investors such as the California Public Employees' Retirement System (CalPERS), the American Federation of State, County, and Municipal Employees (AFSCME), and the New York City Employee Retirement System (NYCERS).

This June 2009 letter is the latest development in an accelerating effort, by interest groups like those signing on to the letter and others, to promote an increase in climate change-related disclosure. On May 26, 2009, a working group that includes the International Federation of Accountants and all of the "big four" global accounting firms released an Exposure Draft of a Global Reporting Framework for climate change-related disclosure.[3] This framework, proposed by the recently-formed Climate Disclosure Standards Board (CDSB) (a non-governmental organization), is intended for "voluntary" use by all companies in compiling their "mainstream financial reports."[4] The CDSB Exposure Draft, and proposals from these other interest groups,[5] suggest that every public company provide information on a wide variety of topics, for example:

- Direct and indirect energy consumption, and energy saved due to conservation and efficiency improvements;
- The company's actual direct and certain indirect emissions of carbon dioxide and other greenhouse gases, expected future increases in emissions, strategies the company is taking to reduce and/or offset emissions, results of those strategies to date, and the expected effect of those strategies on future emissions;
- The company's stance on whether climate change is a company priority and whether the company has a responsibility to address the issue;
- Corporate governance actions taken to address climate change;
- Financial risks the company faces because of the physical impacts associated with climate change; and
- Significant actions the company is taking to maximize opportunities associated with climate change.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=0f41fd7c-6cc7-4d6d-86ed-f5ddc5223ed0

TO VOLUNTARILY DISCLOSE OR NOT? NO "RIGHT" ANSWER.

Today, U.S. public companies are not necessarily required to make these disclosures in their regular inancial reports.[6] As a result, many companies may decide to say nothing about climate change in their financial reports or otherwise; after all, "silence, absent a duty to disclose, is not misleading" under the federal securities laws.[7] A company that makes a voluntary disclosure on a climate-related topic could be opening itself up to a future claim that the disclosure was somehow misleading.[8] Non-disclosure is a particularly appealing strategy in light of the lack of unified standards for disclosure, or even for the measurement of carbon footprints.

But the pressure for public companies to make "voluntary" climate change-related disclosures is increasing, and will continue to do so over time. Companies that make no disclosure at all may find that their investors believe them to have insufficient awareness of climate-related risks or even to be hiding something. This is particularly the case for companies whose competitors do elect to make some disclosure. The likelihood of a poor comparison is increased by the fact that many companies voluntarily report certain information about their respective carbon footprints in venues other than their periodic securities filings, such as a separate "Corporate Social Responsibility" report, or in the annals of various non-governmental organizations such as the Carbon Disclosure Project (CDP).[9] Indeed, on June 15, 2009, NASDAQ introduced a "Global Sustainability 50 Index" (Nasdaq:QCRD), which tracks the performance of "companies that are taking a leadership role in voluntarily disclosing sustainability performance information," including carbon footprint and energy usage.[10]

Of course, with disclosure — especially disclosure in the absence of a commonly-used framework — comes the specter of future litigation against a company and its directors and officers for material misrepresentation. Shareholder plaintiffs will be all too eager to sue if a company's stock price happens to drop at the same time that the company increases or recalculates its reported carbon footprint, reports an increase in regulatory exposure related to climate change, or even makes a first-time disclosure that is significantly higher than what the market would have guessed. Even the most frivolous case will inevitably give rise to significant legal fees and pressure to settle the case to avoid costly discovery.

D&O INSURANCE RAMIFICATIONS.

Directors' and officers' liability insurance is the safety net that companies rely upon to protect them in the case of disclosure-related shareholder litigation. Unfortunately, many existing D&O insurance policies will not respond if the subject of the disclosure at issue is climate-related risk.

The normal concerns about a D&O policy — such as the accuracy of the application and whether misstatements in it may give a carrier cause to rescind a policy — exist for climate-related disclosure suits too. It is typically the case that a company's periodic securities law disclosure is part of the application for D&O insurance. As a result, a serious concern would be whether evolving standards of disclosure in publicly-filed documents could lead to the situation of earlier-filed documents later seeming to be misleading in light of new standards and norms.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=0f41fd7c-6cc7-4d6d-86ed-f5ddc5223ed0

In addition, D&O insurers have long included what they would refer to as a standard "pollution exclusion" in their policies. To be sure, a D&O insurance policy is not intended to respond directly to an actual pollution claim. However, all too often a D&O policy's pollution exclusion is drafted so broadly that there may be a dispute as to coverage for typical disclosure-related securities class action suits if the subject of the disclosure relates to climate risk. Indeed, a typical pollution exclusion begins to look particularly ominous, vis-à-vis potential climate-related disclosure suits, in light of the U.S. Supreme Court's ruling, in *Massachusetts v. EPA*, 549 U.S. 497 (2007), that greenhouse gases are "air pollutants" covered by the Clean Air Act.

A skilled insurance broker will help a company negotiate language that provides coverage for disclosure-related claims concerning climate risk. A prudent insurance buyer will ensure that the company's broker has done just this. In addition, it is worth discussing program structures that might provide coverage for climate disclosure-related litigation where a company's primary D&O insurance carrier refuses to do so. For example, this may be a reason to purchase Side A Difference in Condition D&O policy. Finally, care should be taken to ensure that whatever gains in coverage are negotiated for a company will apply to suits brought outside the United States, including through locally-admitted D&O policies.

OTHER ACTIONS TO CONSIDER.

Here are some additional proactive steps that you can take, if you haven't already done so, in starting to consider whether and to what extent your company should make voluntary disclosures on climate change-related issues:

1. Determine what disclosures your company is already making about climate change. You may find that you are disclosing more today than you would have anticipated. Of course, you may want to review the company's SEC filings, website, and official Corporate Social Responsibility reports. But beyond those venues, you may find disclosures elsewhere, such as the CDP website, which contains a number of different reports in which hundreds of public companies have made disclosures regarding their respective carbon footprints. If the company has an internal group in charge of "sustainability" or "corporate responsibility," be sure to find out what kinds of disclosures they have been making, and to whom.

2. Understand what kinds of voluntary climate-related disclosures might be appropriate for your company. There may be simple, non-controversial disclosures you can make comfortably to avoid giving a false impression that your company is hiding something or out of touch. Reviewing the disclosures of your competitors and companies listed in CDP reports or the NASDAQ QCRD index, and looking at suggestions made by organizations in which your company's largest institutional shareholders are members, can be helpful in this regard.

3. Initiate a discussion with your board of directors regarding what level of commitment, if any, the board thinks is appropriate for the company with respect to climate change and environmental issues. Discussions of this sort may fall within a board's fiduciary duty obligations. In addition, good documentation of these discussions may be helpful to a board's defense if the board is later accused of breaching its fiduciary duties in this regard.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=0f41fd7c-6cc7-4d6d-86ed-f5ddc5223ed0

4. Think about starting to measure. Even if your company doesn't plan on disclosing anything at this time, it may still be wise to start the process of measuring the company's "carbon footprint." Keep in mind, however, that you may become obligated to disclose the results. If you don't have a group in charge of taking a look at these issues, consider starting one. Or, a consultant may be useful in helping you to scope out a plan for a future measuring effort. If you do start measuring your carbon footprint, keep an eye out for near-term financial benefits that can be gained — for example, you may find pockets of energy inefficiency that can be addressed quickly and easily to reduce costs.

5. If you do decide to make voluntary climate change-related disclosures, be sure to work with your attorneys, accountants, and environmental experts to make sure those disclosures are accompanied by appropriate caveats and specific information about methodology. For example, you may decide to tell investors the precise basis for any statements the company makes, and about the many uncertainties affecting the company's ability to make any accurate measurements or predictions at this time.

6. Even if you don't decide to make climate change-related disclosures, consider incorporating climate-related information into your risk factors. This will increase the likelihood that, if sued, your company will fall within the safe harbor that applies to forward-looking statements that are accompanied by meaningful cautionary statements.[11] ■

[1] Mooney, Alexander, "White House Report Warns of Climate Change Effects" (June 16, 2009).

[2] CERES press release, "Investors with $1.4 Trillion in Assets Call on the SEC to Improve Disclosure of Climate Change and Other Risks" (June 12, 2009).

[3] *The Climate Disclosure Standards Board Reporting Framework, Exposure Draft* (May 2009).

[4] "Mainstream financial reports" is defined as including a company's "collective primary financial statements, along with notes," as well as the "management discussion and analysis or MD&A" that typically accompanies those statements. *Id.* at 15.

[5] *See, e.g.*, Global Reporting Initiative, *Sustainability Reporting Guidelines* (2006); CalPERS Global Principles of Accountable Corporate Governance (2008); American Society for Testing and Materials (ASTM), *Financial Disclosures Attributed to Climate Change* (2008); *see also In the Matter of Xcel Energy Inc.*, Attorney General of the State of New York, Assurance of Discontinuance Pursuant to Executive Law § 63(15) (Aug. 26, 2008).

[6] Current SEC rules and accounting standards, such as Reg S-K and FASB Statement No. 5, may already require some companies to make certain climate change-related disclosures in their SEC filings. The question whether and when those *existing* standards *require* you to make climate change-related disclosures should be discussed with your accountants and attorneys and is outside the scope of this article. Also outside the scope of this article is the U.S. Environmental Protection Agency's proposed mandatory greenhouse gas reporting rule for major sources of emissions (74 Fed. Reg. 16,606, published April 10, 2009).

[7] *Basic v. Levinson*, 485 U.S. 224, 239 n.17 (1988).

[8] *See* Securities Exchange Act of 1934, section 10(b) (15 U.S.C. § 78j(b)); SEC rule 10b-5 (17 C.F.R. § 240.10b-5).

[9] http://www.cdproject.net/. CDP's Carbon Disclosure Leadership Index includes companies in both "carbon-intensive" and "non-carbon-intensive" sectors.

[10] NASDAQ press release, "NASDAQ OMX and CRD Analytics Launch New Index Tracking Corporate Sustainability Performance" (June 15, 2009).

[11] *See* 15 U.S.C. § 78u-5.

This legal update was co-authored by Priya Cherian Huskins, Esq., a partner at Woodruff-Sawyer & Co., a full-service insurance brokerage. Priya specializes in D&O liability and insurance issues and can be reached at phuskins@wsandco.com or (415) 402-6527.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

©2009 Morrison & Foerster LLP. All Rights Reserved.