

# The Green Trap Door

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SEC rules have long required companies to disclose material information an investor should possess to decide whether to buy a company's stock. However, on January 27, 2010, the SEC issued interpretive guidance indicating disclosures must now include projected impacts of business and legal developments related to climate change.

The agency advised disclosures should include a consideration whether existing or pending laws, rules, and international treaties will have a material impact on their business. The regulator also told companies to consider the actual and physical impact of climate change. The rationale for such disclosure makes sense, at least on the surface. Investors have a fundamental right to know which companies are well-positioned for the future and which are not. This ensures that business risks of climate change will not be ignored.

One dissenter indicated, this release was unnecessary and the guidance was premature at best. For the reasons set forth below, this may well be a fair assessment. It likely marks the path to increased litigation for one simple reason. In most instances, the judiciary and legislative are currently unable to provide sound guidance regarding what businesses can expect vis-à-vis climate change concerns.

As an example of this, a couple landmark decisions have laid groundwork for great debates regarding what type of risks businesses can reasonably expect to confront. The first came on September 21, 2009, when the Second Circuit reinstated a public nuisance lawsuit brought by eight states, the City of New York, and three land trusts against six electric power companies in *Connecticut v. American Electric Power Company*. The Plaintiffs claimed Defendants were the largest emitters of carbon dioxide in the United States. As such, they were contributing to global warming, resulting in harm to human health and natural resources.

The District Court had originally dismissed these actions because the claims represented a non-justiciable political question which would require balancing of environmental and economic issues. The Second Circuit reversed stating:

Nowhere in their complaints do plaintiffs ask the court to fashion a comprehensive and far-reaching solution to global climate change, a task that arguably falls within the purview of the political branches. Instead, they seek to limit emissions from six domestic coal-fired electricity plants on the ground that such emissions constitute a public nuisance that they allege has caused, is causing and will continue to cause them injury... Well-settled principles of tort and public

nuisance law provide appropriate guidance...[to address these claims]... through principled adjudication.

On October 16, 2009, in *Comer v. Murphy Oil*, a Fifth Circuit panel likewise reversed a Mississippi District Court and revived a suit alleging global warming exacerbated damage caused by Hurricane Katrina. Adopting much of the Second Circuit's position, the Fifth Circuit ruled plaintiffs have standing to assert their claims and that these claims did not represent non-justiciable political questions. Of note, however, on February 26, 2010, the Fifth Circuit indicated this matter will be rescheduled for a rehearing en banc.

Even if the Fifth Circuit en banc adopts the initial panel's opinion, this issue remains far from resolved on several levels. For example, it is uncertain what impact this decision may have in jurisdictions where, unlike New York, emission standards have already been established.

California, who ironically was one of the Plaintiff states in the Second Circuit action, had the opportunity to provide a quick answer and may have indirectly done so. Nine days after the *American Electric Power* decision, in *Kivalina v Exxonmobil Corporation*, the Northern District of California addressed an Inupiat Eskimo village's attempt to bring federal nuisance actions against 24 energy and utility companies. The action sought both "monetary damages for defendants' past and ongoing contributions to global warming," and "damages caused by certain defendants' acts in furthering a conspiracy to suppress the awareness of the link between these emissions and global warming."

The District Court expressly rejected the Second Circuit's conclusion, instead finding the emission of greenhouse gases is fundamentally different from water and air pollution cases. Whereas the latter typically involve a discrete geographically definable area, it is impossible to similarly limit a claim based on global warming. The Court concluded it was not equipped to address the policy decisions inherent in these truly global environmental claims.

Businesses trying to assess risk are really left with more questions than answers from these decisions. Unfortunately, it does not appear legislation will be on its way to aid with assessments.

One of the challenges in appraising future costs and risk will be determining which legislative bodies will be at the forefront of any new regulations. Ultimately, that may well determine what standards must be met. Good money suggests there will not be any global agreement any time

soon. Rather, this appears to be an issue where policies will likely be implemented at regional levels first.

The 2009 United Nations Climate Change Conference was by most counts an unmitigated failure. Following negotiations from December 7 to December 18, there was not even agreement regarding what international goals should be. They varied from South Korea's suggestion that, by 2020, greenhouse gas emissions should be reduced by 4% from 2005 levels to Costa Rica's suggestion that all nations become carbon neutral by that same date. The result of the summit was an accord that was "taken note of," but not adopted by participating nations.

Of late, there seems to be some optimism of a national resolution. In February 2010, Senators Tom Carper and John Kerry each expressed hopes for new legislation by year's end. Carper indicated Congress may establish a cap-and-trade market this year. This would provide federal regulation of emissions from coal, oil, and natural gas, but allow businesses to buy and sell pollution rights. A similar bill passed the House of Representatives last year, but stalled in the Senate. Kerry was less specific, but indicated Congress was on track to enact a comprehensive measure including nuclear energy provisions.

In the meantime, California has already shown state governments are capable of setting meaningful goals. In 2006, Governor Schwarzenegger signed Assembly Bill 32. This landmark bill established a first-in-the-world comprehensive program to achieve quantifiable reductions of greenhouse gases. Using market-based incentives, California mandated a 25 percent reduction of carbon emissions to 1990 levels by the year 2020 and an 80 percent reduction of that amount by 2050.

Based on the above, real efforts are being made to move toward lower carbon emissions at all levels. However, creates problems for those charged with assessing risk. Because greater strides are initially being made at regional levels, there is a great risk of differing environmental standards across the geography in which each publicly traded business operates. In addition to these inconsistencies, there are a number of factors that may force the "local rules" to change. Obviously, federal law and international agreements will trump any state regulations with lower standards. There also may be certain political pressures to "keep up with the Joneses" and modify existing policies depending on legislative goals sister states later enact.

Notwithstanding this optimistic ap-

proach—that governments and business will continue to be ready, willing, and able to reduce pollution—the reality is that standards may also run a risk of loosening. California, who stood at the vanguard in 2006, has been one of the harder hit states by the economic decline over the past two years. It may be unrealistic to expect companies doing business in the state to have the funds and technology available to meet the 2020 targets and foolhardy to expect to attract any new manufacturing with the state's higher associated costs.

What is the net effect of this on a duty to disclose risks based on environmental factors? A true discussion of all these variables as they might apply to any company would require a short treatise. There appears to be an incredibly slender border between "speculation" and "risk" dividing a broad scope of issues.

For the time being, despite this "guidance" from the SEC, businesses will be left weighing for themselves the extent of disclosures they will make regarding potential risks and rewards associated with environmentally related issues. Obviously, whatever material information is known must be disclosed, but materiality will be adjudged by the probability of any event occurring. The more tentative information is, the less useful it will be to potential investors. The apparently ever-shifting sands make it difficult to project with more than speculation the likelihood any particular change in environmental policies and regulations will take place, let alone its impact. Nonetheless, it is apparent the SEC, from its interpretation expects businesses to make projections based on climate change issues. This leaves directors and officers making disclosure decisions at their own peril. By failing to disclose risks, they risk actions from stock purchasers, who well may be emboldened by the SEC's statement. To the extent stock holders believe disclosure reports overstate risk, they too may seek relief. The only thing that seems certain is that the SEC's new interpretation will guide many to the courthouse.



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