
CLIMATE CHANGE, CORPORATE STRATEGY, AND CORPORATE LAW DUTIES

*Perry E. Wallace**

INTRODUCTION

Although greenhouse-gas (“GHG”) management now ranks among the world’s great challenges, this status did not obtain instantly—or easily. Today, however, reservations about the validity of global warming as a major threat are fading.¹ They are fading, appropriately, as rapidly as some ice sheets and glaciers are melting.² Indeed, the steady flow of new, compelling evidence joins an already considerable base of scientific, economic, and other certainties about the subject.³

The result of this evolution in climate-change certainty has been major change of global dimensions. In notable ways, the structures and the functions of governmental, economic, and social institutions around the world are now being revised. Moreover, these revisions typically derive from one model or another of a carbon-constrained planet.⁴

Corporations, because of their past and continuing roles in creating the problem, will be substantially affected by emerging market and regulatory cultures. “The consequences [of these market and regulatory dynamics] are not confined to ‘obvious’ sectors such as power generation, transport and heavy industry;

* Professor of Law, Washington College of Law at American University. Director, JD/MBA Dual Degree Program. JD, Columbia University, 1975. B.Eng., Vanderbilt University, 1970.

1. UNITED NATIONS ENV’T PROGRAMME, UNEP YEARBOOK 2009, at 21 (Catherine McMullen & Thomas Hayden eds., 2009) (“Climate change has long since ceased to be a scientific curiosity It is the major, overriding environmental issue of our time . . .”).

2. See, e.g., Press Release, Nat’l Aeronautics & Space Admin., Satellites Show Arctic Literally on Thin Ice (Apr. 6, 2009), http://www.nasa.gov/home/hqnews/2009/apr/HQ_09-079_Sea_ice_thins.html (“In recent years, Arctic sea ice has been declining at a surprising rate.”).

3. UNITED NATIONS ENV’T PROGRAMME, *supra* note 1, at 22 (“[S]carcely a week passes without new research appearing in peer-reviewed literature and news reports that adds to the story.”).

4. See NICHOLAS STERN, U.K. TREASURY, THE ECONOMICS OF CLIMATE CHANGE: THE STERN REVIEW (2007); see also EUR. COMM’N, EU ACTION AGAINST CLIMATE CHANGE: THE EUROPEAN CLIMATE CHANGE PROGRAMME (2006), available at http://ec.europa.eu/environment/climat/pdf/eu_climate_change_prog.pdf (describing European Union actions to address climate change).

virtually every company's activities, business models and strategies will need to be completely rethought."⁵

This Article explores the question of whether corporate- and securities-law duties⁶ can (or will in the future) play a role in influencing the rapidly growing movement toward corporate strategic planning for GHG management. Part I of the Article discusses corporate strategic-planning methodologies for GHG management. This Part describes the basic features of corporate approaches to developing and implementing strategies, policies, and practices. Important here are the risks, and also the opportunities, facing corporations and their stewards. Part II then evaluates the potential applicability of corporate- and securities-law provisions that might appear to be implicated in climate-change corporate strategic planning and implementation.

I. STRATEGIC PLANNING FOR CORPORATE MANAGEMENT OF GREENHOUSE GASES

A. *Corporate Strategy Development for GHG Management: The Central Role of Risk*

Understanding the wisdom of timely action, some corporate leaders have developed their own strategies for GHG management, and certain common features are emerging. One highly respected approach, for example, is the one set forth in Andrew J. Hoffman's *Carbon Strategies*.⁷ Reflecting basic features common to other formulations, *Carbon Strategies* presents a road map consisting of three interactive stages that altogether comprise eight specific steps.

"Stage One" of the method requires that the company develop a "climate strategy." This includes (1) assessing the emissions profile, (2) gauging risks and opportunities of GHG impacts, (3) evaluating action options for addressing these impacts, and (4) setting goals and targets.⁸ "Stage Two" of the method requires that the company focus inwardly by (1) developing financial mechanisms and (2) engaging the organization.⁹ "Stage Three" of the method requires that the company focus outwardly by (1) formulating policy strategies and (2) managing external relations.¹⁰

In the initial assessment, a company must ascertain whether a scientifically demonstrated *general* risk is in fact actual, or at least

5. Rory Sullivan, *Introduction to CORPORATE RESPONSES TO CLIMATE CHANGE* 2, 3 (Rory Sullivan ed., 2008); *see also* ANDREW J. HOFFMAN & JOHN G. WOODY, *CLIMATE CHANGE: WHAT'S YOUR BUSINESS STRATEGY?* 1 (2008).

6. The term "corporate law" will generally refer to both state corporate law and federal securities law, unless one particular body of law is expressly made the subject of discussion.

7. ANDREW J. HOFFMAN, *CARBON STRATEGIES* (2007).

8. *Id.* at 10–32.

9. *Id.* at 33–47.

10. *Id.* at 48–62.

imminent, and substantial as to that *specific* company. Where the answer is in the affirmative, the company must then decide what to do.¹¹ The following discussion focuses on specific material climate-change risks posed for certain industries, based on available information and assessments.

B. Specific Actual or Imminent Risks Facing Certain Industries: Opportunities and Competitive Advantage

Of the various risks that attend climate change, physical, regulatory, and litigation risks are the most plausible candidates for potential applicability of the corporate and securities laws.

1. Physical Risk

Companies may face physical consequences of climate change. These include weather-related events such as increased storms, floods, droughts, strong winds, heat, forest fires, variations in water availability, and damage to vulnerable properties on coastlines.¹²

Such impacts create the potential for destruction of property, increased insurance premiums, asset devaluation, heat-related illnesses and diseases, enforced relocation, and increased commodity prices. Affected companies would need to conduct thorough risk assessments as well as invoke adequate risk-management techniques and devices.¹³

2. Regulatory Risk

Climate change is increasingly viewed as a *serious market failure* that requires government intervention. These interventions may consist of (1) traditional measures (such as permit or energy-efficiency requirements) or (2) market-based measures (such as carbon taxes, emissions-trading schemes, and fuel tariffs).¹⁴ Ironically, what is clearer to most nonexperts than the validity of the science is the inevitability of regulation. Nevertheless, this inevitability poses one threshold choice for companies: not *whether* to prepare, but *when* and *how* to prepare. Indeed, the corporate-strategy questions, because of the still-pervasive ignorance about climate change (not to mention political dynamics), are being driven

11. *See id.* at 10–32.

12. *See* Petition for Interpretive Guidance on Climate Risk Disclosure, No. 4-547, at 7, 28–32 (Sept. 18, 2007), *available at* <http://www.sec.gov/rules/petitions/2007/petn4-547.pdf> [hereinafter SEC Petition]; Tom Walsh, *Climate Change: Business Risks and Solutions*, RISK ALERT, Apr. 2006, at 1, 2–6, *available at* <http://global.marsh.com/risk/climate/climate/documents/climateChange200604.pdf>.

13. *See* Walsh, *supra* note 12, at 14–31.

14. *See, e.g.*, Nathaniel O. Keohane et al., *The Choice of Regulatory Instruments in Environmental Policy*, 22 HARV. ENVTL. L. REV. 313, 313–18 (1998).

most by the spectre of comprehensive regulation.¹⁵

3. *Litigation Risk*

With increased certainty about climate-change science and impacts, and with an expanding field of regulatory mandates, litigation is becoming more of a credible threat. At the same time, the question of the risks created by climate-change litigation is complex. Numerous variables render attempts at describing these risks a “precarious venture.”¹⁶ Nevertheless, litigation is a dynamic that corporate planners must include in their strategic-planning calculus.

II. CORPORATE AND SECURITIES LAW

A. *Fiduciary-Duty Law*

Many environmental advocates now assert that substantial certainty about the climate-change threat imposes a “fiduciary duty” on corporate directors and officers to take aggressive ameliorative action. The following discussion examines these contentions through the prism of Delaware case law.

1. *The Fiduciary Duty of Oversight and Monitoring*

a. *The Legal Framework: Is the Framework Evolving?*
Corporate directors can be held personally liable for “an unconsidered failure . . . to act in circumstances in which due attention would . . . have prevented [a] loss.”¹⁷ Thus pronounced the Delaware Court of Chancery in *In re Caremark International Inc. Derivative Litigation*.¹⁸ *Caremark* is generally viewed as having set forth not only a narrow, fiduciary-protective standard of review (“bad faith”) but also an expanded scope of fiduciary oversight responsibility.¹⁹ The court enlarged the scope of director responsibility beyond the more minimalist “red flag” test of *Graham v. Allis-Chalmers Manufacturing Co.*²⁰ The *Caremark* opinion endorsed information and reporting systems and controls as

15. See, e.g., Nicholas DiMascio, Note, *Credit Where Credit Is Due: The Legal Treatment of Early Greenhouse Gas Emissions Reductions*, 56 DUKE L.J. 1587, 1587–90 (2007).

16. See discussion *infra* Part II.B.2.c.

17. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (emphasis omitted).

18. *Id.*

19. See CORPORATE LAW STORIES 331–46 (J. Mark Ramseyer ed., 2009).

20. See *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 129–31 (Del. 1963); see also Donald C. Langevoort, *Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's "Duty of Care as Responsibility for Systems,"* 31 J. CORP. L. 949, 953 (2006); Hillary A. Sale, *Monitoring Caremark's Good Faith*, 32 DEL. J. CORP. L. 719, 752–53 (2007).

oversight tools (and defenses).²¹

Nevertheless, liability in any particular instance is not a given: “[O]nly a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.”²² A claim of this type, therefore, is “possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.”²³

The Delaware Supreme Court, in *Stone v. Ritter*, approved the chancery court’s *Caremark* decision, including the latter court’s endorsement of information and reporting systems.²⁴ The *Stone* court held that such a “conscious disregard for their responsibilities” of oversight and monitoring amounts to a breach of the directors’ duty of loyalty, at least to the extent they did not act in “good faith.”²⁵ In such instances, as other courts have noted, the directors must have been “conscious of the fact that they were not doing their jobs.”²⁶ They must have acted with “bad faith—because their indolence was so persistent.”²⁷

Notwithstanding these difficulties of pleading and proof posed by the law governing a claim of oversight failure, some commentators have wondered whether certain developments over the years may cause courts to hold directors to a higher level of scrutiny:

(1) The *Caremark* court itself noted the Delaware courts’ increasing emphasis on the importance of the board function,²⁸ commented that the requirement of a fully informed board is so basic as to be “elementary,”²⁹ and spoke approvingly of the emphasis on corporate information and reporting systems in the federal sentencing guidelines.³⁰

(2) The impact of the Sarbanes-Oxley Act (“SOX”) increased the scrutiny on public companies and their fiduciaries. While *technically*, of course, SOX is federal law, many perceive a follow-on effect at the state-court level—as *Caremark* itself illustrates/symbolizes.³¹

21. *Caremark*, 698 A.2d at 969–70.

22. *Id.* at 971.

23. *Id.* at 967.

24. *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006).

25. *Id.* at 370.

26. *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003).

27. *Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007); *see also In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006).

28. *Caremark*, 698 A.2d at 970 (citing *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); *Paramount Commc’ns Inc. v. QVC Network Inc. (In re Paramount Commc’ns Inc. S’holders’ Litig.)*, 637 A.2d 34 (Del. 1994)).

29. *Caremark*, 698 A.2d at 970.

30. *Id.* at 969–70.

31. *See* Marc Gunther, *Boards Beware!*, FORTUNE, Nov. 10, 2003, at 171,

(3) Numerous experts believe that “[i]n the context of the current global financial crisis and the swooning global economy . . . boards and companies must be mindful of the possibility that courts will apply new standards, or interpret existing standards, to increase board responsibility for risk management.”³²

The following discussion considers both factual and legal considerations in analyzing the fiduciary duty to respond to climate-change business risks.

b. *Monitoring GHG Impacts and Regulatory Developments: What Facts and Events Could Trigger a Duty of Oversight? And Is Corporate Law Really Evolving?* Recent Delaware case law hardly bodes well for the prospect that the courts will be driving strict corporate-governance oversight of climate-change business risks. *In re Citigroup Inc. Shareholder Derivative Litigation* aptly supports this point.³³

In *Citigroup*, shareholders sued derivatively, charging certain current and former directors and officers with failure to perform their oversight and management duties relative to the company’s involvement in the subprime-mortgage market. The company’s dealings in complex financial instruments through its Securities & Banking Unit had led to significant losses that in turn plunged the company into financial crisis.³⁴

The plaintiffs asserted that the fiduciaries should have acted in the face of several “red flags” that posed significant business risk. These included (1) specific, negative developments in the housing and subprime-credit markets, (2) predictions of doom in these markets by eminent experts such as economist Paul Krugman and organizations such as the Financial Accounting Standards Board, (3) specific instances of substantial distress or failure on the part of firms engaged in similar market activities, and (4) specific instances of substantial distress or failure of financial derivative instruments linked to those markets.³⁵

In ruling on the defendants’ motion to dismiss the derivative

176 (“It would not be unreasonable to assume that the Delaware courts are responding to the Enron and WorldCom headlines and the intrusion, so to speak, of the federal government into the internal governance of corporations.” (quoting former Delaware Chancellor William Allen)); see also Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors’ Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 415–20 (2005) (“[T]here is evidence that Sarbanes-Oxley may play a role in increasing director liability by altering the manner in which state courts view exculpatory statutes.”).

32. Martin Lipton et al., *Risk Management and the Board of Directors*, 42 BANK & CORP. GOVERNANCE L. REP. 150, 150 (2009).

33. *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009).

34. *Id.* at 111–15.

35. *Id.* at 114–15, 127.

suit, the court was not kind to the plaintiffs. First, and especially pertinent to climate-change issues, the court took a dim view of “business risk” as a suitable triggering context for fiduciary responsibility. *Caremark* and *Stone*, observed the court, involved losses deriving from serious employee misconduct or corporate violations of law, not from business risk.³⁶ The court opined:

To the extent the Court allows shareholder plaintiffs to succeed on a theory that a director is liable for a failure to monitor business risk, the Court risks undermining the well settled policy of Delaware law by inviting Courts to perform a hindsight evaluation of the reasonableness or prudence of directors’ business decisions.³⁷

In elucidating this duty, did the *Caremark* court and the others referred to in *Citigroup* focus largely on serious employee misconduct and corporate violations of law *simply* because this was the factual context of those cases? Did *Caremark* actually contemplate a broader scope of responsibility, one embracing business risk as well as violations of law? For example, the *Caremark* court spoke of the need for directors to be sufficiently knowledgeable that they can “reach informed judgments *concerning both the corporation’s compliance with law and its business performance.*”³⁸ Is this what the *Citigroup* court had in mind when it observed that “it may be possible for a plaintiff to meet the burden under *some set of facts*”?³⁹

At least *technically*, the *Citigroup* and *Caremark* courts allowed that a plaintiff could successfully demonstrate a culpable failure to monitor business risk “under some set of facts.” On the other hand, the *Citigroup* court’s main message was largely in the negative, to the point of describing business risk as “fundamentally different” from employee misconduct and legal violations.⁴⁰

Essentially, the *Citigroup* court conflated the duty-of-care/business-judgment-rule analysis with the duty-of-loyalty/bad-faith analysis. Characterizing the case as actually a duty-of-care case, although analyzing the matter under both duties, the court talked largely about business-judgment “decisions” and business

36. *Id.* at 123–24.

37. *Id.* at 126. The court’s discussion of the business judgment rule and the duty of oversight together reflected its view that “one can see a similarity between the standard for assessing oversight liability and the standard for assessing a disinterested director’s decision under the duty of care when [as here] the company has adopted an exculpatory provision pursuant to § 102(b)(7).” *Id.* at 125.

38. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996) (emphasis added).

39. *Citigroup*, 964 A.2d at 126 (emphasis added).

40. *Id.* at 131.

risk.⁴¹ In this regard, the judicial-restraint rationale of the business judgment rule predominated in the discussion. This meant that imposing liability based on a failure to monitor business risk would undermine the purposes of the business judgment rule in protecting the type of risk taking that lies at the heart of the free-enterprise system.⁴² Delaware law was not meant to make directors liable for “failure to predict the future and to properly evaluate business risk.”⁴³ At best, the court’s acknowledgement of the possibility of demonstrating a culpable failure by directors to monitor business risk was noncommittal and skeptical.

If fiduciary liability is possible, in theory at least, the *Citigroup* court gave no explicit positive guidance about what facts would support a successful claim. Identifying what the court said the plaintiffs did wrong and what the company’s directors did right, however, is a logical place to start.

For example, the court characterized the plaintiffs’ allegations as insufficient in that they were “conclusory” and not “particularized.”⁴⁴ They “[did] not even specify how the board’s oversight mechanisms were inadequate or how the director defendants knew of these inadequacies and consciously ignored them.”⁴⁵ It also appeared to be significant that “Citigroup had procedures and controls in place that were designed to monitor risk,” with a rather active and engaged committee that worked with management and key outside advisers.⁴⁶

Without express guidance, it is not discernible whether establishing procedures and controls directed by an active and engaged committee would be an indispensable requirement or merely a factor to consider. But a prudent board seeking to avoid adverse legal consequences in the future would do well to consider establishing a similar arrangement as the GHG regulatory web becomes more complete or as physical impacts of climate change become more specific and substantive.

2. *Fiduciary Duty and Decision Making About Climate Change*

a. *The Legal Framework.* The fiduciary duty of oversight is typically distinguished from the fiduciary duty of care on the basis, among other things, that the latter controls liability for “decisions”

41. *See id.* at 123–31.

42. *Id.* at 130–31.

43. *Id.* at 131.

44. *Id.* at 127. The court also noted that *American International Group, Inc., v. Greenberg (In re American International Group, Inc., Consolidated Derivative Litigation)*, 965 A.2d 763 (Del. Ch. 2009), provided a “stark contrast” between the allegations presented in *Citigroup* and allegations that are sufficient to survive a motion to dismiss. *Citigroup*, 964 A.2d at 130.

45. *Citigroup*, 964 A.2d at 128.

46. *Id.* at 127.

made by a board. Directors are protected from liability for such decisions by the process-oriented business judgment rule⁴⁷—a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”⁴⁸

b. *Applicability.*

i. *Decisions Whether to Take Strategic Action on Climate Change.* The basic approach of the business judgment rule, focusing on the decision makers’ process rather than the substance of their decision, provides considerable discretion. In that sense, directors, to the extent they use a rational, informed decisional process, may pretty much take (or not take) whatever action they choose regarding corporate policy and practice on climate change.

Perhaps the most revealing language about the attitude of the Delaware courts on the subject comes from *Caremark*:

[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through “stupid” to “egregious” or “irrational”, provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests.⁴⁹

Though strongly worded, this expression does not exaggerate the scope of discretion accorded fiduciaries.⁵⁰

ii. *Must Companies Adopt “Best Practices”?* Environmental advocates, along with corporations taking a proactive leadership posture on climate change, typically urge corporate adoption of high-quality standards of GHG management. They note the competitive advantages and reputational benefits of such a practice, and they believe that, in the long term, the benefits will far outpace the initial and ongoing costs.⁵¹

On the other hand, many corporate leaders and policymakers balk at this notion, defending their position on the ground that the

47. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967–68 (Del. Ch. 1996) (“[T]he business judgment rule is process oriented and informed by a deep respect for all *good faith* board decisions.”).

48. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

49. *Caremark*, 698 A.2d at 967.

50. *See* MODEL BUS. CORP. ACT § 8.31 cmt. note on directors’ liability 4 (2007).

51. *See* Steven Mufson, *Push to Reduce Greenhouse Gases Would Put a Price on Emitting Pollution*, WASH. POST, Mar. 13, 2009, at D1 (describing competing views about imminent legislation on climate change).

increased costs related to achieving such a high standard entail significant negative consequences. They assert that these harmful consequences would occur at company-specific, industry-sector, and ultimately macroeconomic levels. Further, they would add, the huge capital investments required initially could turn out to be inappropriate when the ultimate comprehensive regulatory scheme is established.⁵²

State corporate law, because of the considerable discretion accorded to directors, does not require that they adopt best practices for GHG management. As the Delaware Supreme Court stated in *Brehm v. Eisner*:

Aspirational ideals of good corporate governance practices for boards of directors that go beyond the minimal legal requirements of the corporation law are highly desirable, often tend to benefit stockholders, sometimes reduce litigation and can usually help directors avoid liability. *But they are not required by the corporation law and do not define standards of liability.*⁵³

Hence, state corporate law, in the absence of positive climate regulation, is not really an actor in the debate and discussion about climate-change strategy. Corporate planners should, however, monitor emerging law carefully, as best-practices standards are virtually always among the proposed regulatory models.

iii. *Would Adoption of Best Practices Violate Fiduciary Duties?* While the question remains whether fiduciary-duty law, unaccompanied by any legal-compliance strictures, requires directors to adopt best-practices standards, proactive adoption of such standards would not appear to be a real problem.

A shareholder complaining about adoption of (presumably more costly) best-practices standards might claim that directors caused the company to “waste” corporate resources. “To prevail on a waste claim . . . the plaintiff must overcome the general presumption of good faith by showing that the board’s decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation’s best interests.”⁵⁴

Following this standard, the *Citigroup* court dismissed the plaintiffs’ waste claims based on the company’s subprime-related investments, noting that “[t]he test to show corporate waste is difficult for any plaintiff to meet.”⁵⁵ On this analysis, given that a

52. *See id.*

53. *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000) (emphasis added), quoted in *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 745 n.399 (Del. Ch. 2005).

54. *White v. Panic*, 783 A.2d 543, 554 n.36 (Del. 2001).

55. *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 136 (Del.

corporate strategic decision in favor of a more costly, higher GHG-management model would likely be the result of a thorough and considered process, fiduciaries should not be in danger of incurring personal liability.⁵⁶

B. *Securities Law*

Assertions that state corporate law applies to climate change also have counterparts in federal securities law. But unlike the views about state law, those about federal securities law and climate change tend to be the subject of major initiatives. These initiatives aim to pressure public companies into making more forthcoming disclosures to the federal Securities and Exchange Commission (“SEC”) and to the public.

The discussion below describes several prominent initiatives, analyzes specific, potentially applicable disclosure provisions, and then speculates about the future disclosure environment. Important here is the fact that advocates are not just seeking immediate action by public companies. They are also attempting to influence and shape legal interpretations of existing law in their favor. While strikingly few companies are currently making disclosures, these initiatives, combined with evolving knowledge and values about climate change, will gradually create a quite different legal culture for affected companies.

1. *Major Initiatives to Increase SEC Disclosure About Climate Change*

a. *Legal Actions by the New York Attorney General: The Xcel and Dynege Settlements.* In September 2007, New York Attorney General (“NYAG”) Andrew M. Cuomo initiated an inquiry, pursuant to Executive Law Section 63 and General Business Law Section 352,⁵⁷ centering on the Xcel Energy (Xcel) and Dynege companies, among others. The Xcel inquiry concerned the adequacy of the company’s disclosures to investors, including in its SEC filings, on the “expected impact of climate change and the regulation of [GHG] emissions on Xcel Energy’s operations, financial condition, and plans to construct a new coal-fired electric generating unit.”⁵⁸ The

Ch. 2009). *See generally id.* at 135–38 (analyzing plaintiffs’ waste claims).

56. *See generally* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (1994); William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264–77 (1992).

57. N.Y. EXEC. LAW § 63 (McKinney 2002) sets forth the general duties of the New York Attorney General and includes subsection 15, which provides authority to accept “assurances of discontinuance” in settlement of matters initiated by the Attorney General. N.Y. GEN. BUS. LAW § 352 (McKinney 1996) provides certain authority to the Attorney General with respect to the investigation of “fraudulent practices in respect to stocks, bonds and other securities.”

58. Assurance of Discontinuance Pursuant to Executive Law § 63(15), *In re*

Dynegy inquiry was similar.⁵⁹

Xcel and Dynegy ultimately agreed to settle, without admitting or denying any violation of law or wrongdoing, by agreeing to expand or continue relevant disclosures made in their annual Form 10-K filings with the SEC.⁶⁰ The four-year Xcel agreement (Xcel Discontinuance) and the four-year Dynegy agreement (Dynegy Discontinuance) both included the following disclosure requirements:

(1) *Analysis of Financial Risks from Regulation* (present and probable future laws regulating GHG emissions).⁶¹

(2) *Analysis of Financial Risks from Litigation* (“any” climate-change litigation that will “likely” have a “material financial effect” on the company).⁶²

(3) *Analysis of Financial Risks from Physical Impacts of Climate Change* (including “increase[s] in sea level and changes in weather conditions, such as increases in extreme weather events, changes in precipitation resulting in drought or water shortages, and changes in temperature”).⁶³

(4) *Strategic Analysis of Climate-Change Risk and Emissions Management* (extensive disclosure regarding the company’s position on climate change, GHG emissions data, management strategies and practices (and their results and expected future effects), and relevant corporate-governance policies and practices).⁶⁴

From the wording of the Xcel Discontinuance, Xcel may have been suspected of disclosing *significantly less* about climate-change matters in its SEC disclosures than in its voluntary disclosures. For example, the Xcel Discontinuance noted particularly the disclosures the company made in response to a 2006 questionnaire from the Carbon Disclosure Project (CDP) and in other non-SEC disclosures.⁶⁵

Indeed, those disclosures provided information that essentially *framed* the nature and scope of the NYAG’s inquiry.⁶⁶ After the

Xcel Energy Inc., AOD # 08-012, at 1 (Aug. 26, 2008), *available at* http://www.oag.state.ny.us/media_center/2008/aug/xcel_aod.pdf [hereinafter Xcel Discontinuance].

59. *See* Assurance of Discontinuance Pursuant to Executive Law § 63(15), *In re* Dynegy Inc., AOD # 08-132, at 1 (Oct. 23, 2008), *available at* http://www.oag.state.ny.us/media_center/2008/oct/dynegy_aod.pdf [hereinafter Dynegy Discontinuance].

60. *Id.* at 2–5; Xcel Discontinuance, *supra* note 58, at 2–5.

61. Dynegy Discontinuance, *supra* note 59, at 3; Xcel Discontinuance, *supra* note 58, at 3.

62. Dynegy Discontinuance, *supra* note 59, at 3; Xcel Discontinuance, *supra* note 58, at 3–4.

63. Dynegy Discontinuance, *supra* note 59, at 3–4; Xcel Discontinuance, *supra* note 58, at 4.

64. Dynegy Discontinuance, *supra* note 59, at 4–5; Xcel Discontinuance, *supra* note 58, at 4–5.

65. Xcel Discontinuance, *supra* note 58, at 1–2.

66. *Compare id.* at 1 (discussing, in paragraph A, the nature and scope of

NYAG's initial intervention, Xcel "provided more detailed information about climate change risk in its SEC filings than in previous filings."⁶⁷ The Xcel Discontinuance memorialized the parties' ultimate agreement about appropriate disclosures.

In this regard, the NYAG's inquiry may have been addressing a typical pattern that has emerged in recent years. That is, many companies reap the *reputational benefits* of appearing enthusiastic and forthcoming about climate change in *voluntary* settings. But those same companies may become discernibly more restrictive in their SEC disclosures—wherein, of course, fuller disclosure could have adverse market and liability potential.

This practice is apparently widespread. For example, it was described in a review of SEC and other disclosure practices by the law firm McGuireWoods LLP.⁶⁸ The firm reviewed the 2008 10-K filings of approximately 350 companies included in the S&P 500, S&P MidCap 400, and S&P SmallCap 600 indices across all ten industry sectors represented in these indices. First, generally, the review found that "very few companies outside the energy and utility industries were making any type of climate change . . . disclosures in their SEC reports."⁶⁹ And as to disparate disclosures, it appears that in non-SEC venues many companies go as far as identifying climate change as posing "commercial risk," having a "likelihood of 'significant impact,'" or being a "potential material risk." Yet these same companies' SEC disclosures do not address these critical, obviously "material" subjects.⁷⁰

Initiatives such as those of the NYAG put pressure on companies to make fuller SEC disclosures. This is obvious from the considerable publicity accompanying them. For example, NYAG Cuomo announced the Dynegy settlement at a press conference joined by former U.S. Vice President Al Gore. The settlement, Cuomo said, will help "protect investors by ensuring disclosure of potential financial risks that climate change may pose . . . [and will] raise the bar in the industry."⁷¹

the NYAG's inquiry), *with id.* at 2 (using identical language, in paragraph E, to describe the information disclosed by Xcel to the CDP and in other non-SEC disclosures).

67. *Id.* at 2.

68. JANE WHITT SELLERS ET AL., MCGUIREWOODS LLP, CLIMATE CHANGE DISCLOSURE: OUT WITH THE OLD; IN WITH THE NEW? (2009), <http://www.mcguirewoods.com/news-resources/publications/climate%20change%20disclosure.pdf>.

69. *Id.* at 1.

70. *Id.* at 8.

71. Press Release, Office of the Attorney Gen. of N.Y., Attorney General Cuomo, Joined by Vice President Gore, Announces Agreement with Major Energy Company, Dynegy, Inc. (Oct. 23, 2008) (emphasis added), *available at* http://www.oag.state.ny.us/media_center/2008/oct/oct23a_08.html.

b. *SEC Petition.* On September 18, 2007, a coalition of nongovernmental organizations, state governmental officials and entities (including state treasurers, comptrollers, and state retirement pension funds), and others filed a petition with the SEC entitled Petition for Interpretive Guidance on Climate Risk Disclosure (“SEC Petition”).⁷² The SEC Petition “request[ed] that the [SEC] issue an interpretive release clarifying that material climate-related information must be included in corporate disclosures under existing law.”⁷³ Notably, the SEC Petition sought an “interpretation” of “existing law,” thus reflecting the petitioners’ position that present law was a sufficient basis for requiring the desired climate-risk disclosures and no new laws were necessary. Accordingly, the petitioners used this position as the basis for the following points:

- (1) Current law requires public companies to disclose material information about climate risk.⁷⁴
- (2) The changing regulatory and physical environments related to climate change are creating significant business risks for public companies.⁷⁵
- (3) Climate risk is increasingly important to investors.⁷⁶
- (4) Currently, climate risk is not being adequately disclosed.⁷⁷
- (5) The SEC should clarify corporate obligations to disclose climate risk.⁷⁸

The NYAG settlements and the SEC Petition reflect substantial advocacy by major actors. Certainly, the power wielded by these actors, which is both political and economic, will weigh heavily on the state of emerging attitudes, policies, and practices on climate change in the corporate sector. From a legal standpoint, however, the question whether federal securities law, by itself, *compels* the sought-after action has not been decided authoritatively. The following discussion offers some pertinent points for any analysis leading to such a decision.

2. *Analysis of Pertinent Provisions*

The SEC Petition identified several SEC disclosure provisions that typically arise in discussions about climate change. In most of

72. SEC Petition, *supra* note 12. On June 12, 2008, the petitioners made a supplemental filing with the SEC, reporting on recent developments pertinent to the original petition. Letter from Cal. Pub. Employees’ Ret. Sys. et al., to Florence E. Harmon, Acting Sec’y, U.S. Sec. & Exch. Comm’n (June 12, 2008), available at <http://www.sec.gov/rules/petitions/2008/petn4-547-supp.pdf>.

73. SEC Petition, *supra* note 12, at 2.

74. *Id.* at 13–21.

75. *Id.* at 21–34.

76. *Id.* at 34–44.

77. *Id.* at 45–51.

78. *Id.* at 51–56.

these provisions, whether disclosure is required depends on the extent to which a climate-change impact is sufficiently *specific, certain, and substantial* to be important to investors. A close look reveals that increased certainty about climate change—particularly as reflected in express statements by some companies—may be increasing the prospect that disclosure is legally required *in certain instances*. In other situations, however, a substantial burden remains to demonstrate the presence of sufficient specificity, certainty, and substantiality to trigger legal disclosure requirements.

a. *Accounting for Contingencies (Under Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards No. 5)*. Accrual of a loss contingency for financial-statement purposes depends on whether a liability or asset impairment is “probable” and the amount of the loss can be “reasonably estimated.”⁷⁹ To the extent the facts warrant it, climate-related liabilities or asset impairments may arise as a result of (1) violation of, or required compliance with, an existing climate-change law; (2) damage to someone else’s property, such as damage because of weather-related climate-change events; (3) obligations triggered by climate-change events, such as company obligations based on insurance, guaranty, or other hedging transactions; or (4) damage to a company’s own property by climate-influenced weather events.⁸⁰

The challenge for this disclosure requirement is similar to that for litigation disclosure, in that such elements as materiality, damages, and causation (including *specific* demonstration and attribution to the company) remain problematic in many instances.⁸¹

b. *Description of Business (Under Item 101 of SEC Regulation S-K)*. Item 101 would require disclosure of the “material effects” that compliance with environmental law “may have upon the [company’s] capital expenditures, earnings and competitive position” as well as disclosure of “any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material[.]”⁸²

Obviously, once a valid regulatory measure exists, as is true in an increasing number of cities, states, and countries, disclosure is

79. ACCOUNTING STANDARDS: ORIGINAL PRONOUNCEMENTS, Statement of Fin. Accounting Standards No. 5, para. 8 (Fin. Accounting Standards Bd. 2004). To be “probable,” an event must be “likely to occur.” *Id.* para. 3(a). Even where the test for accrual is not met, disclosure in the financial-statement notes may be required. *Id.* paras. 9–12.

80. *See id.* para. 4.

81. *See* discussion *infra* Part II.B.2.c.

82. 17 C.F.R. § 229.101(c)(1)(xii) (2008).

required.

c. *Legal Proceedings (Under Item 103 of SEC Regulation S-K)*. Item 103 of Regulation S-K requires disclosure by public companies of major legal proceedings that could have a significant financial impact on the company.⁸³ The provision applies to major environmental proceedings.⁸⁴

“Materiality” and the size of the potential financial impact are the formal elements in a company’s analysis here. Pivotal in that analysis—and a typical weak link in climate-change litigation cases, both in regard to standing and on the merits—is the question of causation. Accordingly, a company may take the position that disclosure of pending climate-change litigation is unwarranted because a tenuous basis of causation makes a victory on the merits unlikely. Alternatively, a company may disclose the litigation but then characterize it as weak.

Notwithstanding the increased activity and prominence in the area of climate-change litigation, it has been said that “[g]auging the prospects of . . . pending climate change [litigation] is a precarious venture.”⁸⁵ Thus observed a report prepared by the Congressional Research Service entitled *Climate Change Litigation: A Growing Phenomenon* (“CRS Report”). The CRS Report notes further:

In the conventional sense of the term, plaintiffs’ successes have been rare in cases seeking relief *directly from GHG emitters*. A court may be reluctant to impose expensive measures to address a global problem on a defendant that is a proportionately minor contributor (which almost all defendants are, given the vast number of GHG emitters), using statutory provisions or common law principles that were not formulated with global problems in mind, against a backdrop of scientific uncertainty as to the precise consequences (if not the general cause) of climate change.⁸⁶

As noted earlier, causation is often a major problem, whether in the context of legal standing or the merits. An “intractable problem in environmental law [generally has been convincing courts to impose] liability for harms that are remote in time and place from the pollution sought to be abated, particularly where the pollution comes from multiple sources.”⁸⁷

83. *Id.* § 229.103 (requiring disclosure of “material pending legal proceedings, other than ordinary routine litigation incidental to the business”).

84. *Id.* § 229.103 instruction 5.

85. ROBERT MELTZ, CONG. RESEARCH SERV., *CLIMATE CHANGE LITIGATION: A GROWING PHENOMENON* 33 (2008), available at http://www.communityrights.org/PDFs/Warming%20Law/CRS_4_7_08.pdf.

86. *Id.*

87. *Id.* at 34; see RICHARD J. LAZARUS, *THE MAKING OF ENVIRONMENTAL LAW*

In contrast to the previous genre of cases, pro-environmental litigation seeking *governmental* remedies has tended to be more successful. “In a much-publicized string of 2007 decisions under the Clean Air Act, Energy Policy and Conservation Act of 1975, foreign policy authority of the United States, and [the National Environmental Policy Act], courts have shown increased willingness to authorize or require government consideration of climate change.”⁸⁸ From a corporate perspective, these victories can have potentially significant impacts.

For example, in *Center for Biological Diversity v. U.S. Department of the Interior*, the U.S. Court of Appeals for the District of Columbia vacated a five-year federal Interior Department oil- and gas-leasing program for failure of the government to consider environmental impacts properly.⁸⁹ And although the court remanded the case to the agency for proper environmental analysis,⁹⁰ and probably ultimate completion of the program, potential business lessees suffer from costs related to the delay. Additionally, the plaintiffs could well exacerbate the delay through continued litigation initiatives.

d. *Management’s Discussion and Analysis of Financial Condition and Results of Operations (Under Item 303 of SEC Regulation S-K).*⁹¹ The overall objective of the Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is well reflected in its title. It is to give investors “an opportunity to look at the [company] through the eyes of management by providing a historical and prospective analysis of the [company’s] financial condition and results of operations.”⁹² This objective, especially given the MD&A’s “particular emphasis on the [company’s] prospects for the future,”⁹³ makes it perhaps the most potent climate-change disclosure provision *at this juncture*. What

5–15 (2004); *see also* *Ctr. for Biological Diversity v. U.S. Dep’t of the Interior*, 563 F.3d 466, 478 (D.C. Cir. 2009) (“Petitioners’ substantive theory of standing [to sue about climate-change impacts] fails because [they] have not established either the injury or causation element . . .”).

88. MELTZ, *supra* note 85, at 33–34 (citing *Massachusetts v. EPA*, 549 U.S. 497 (2007); *Ctr. for Biological Diversity v. Nat’l Highway Traffic Safety Admin.*, 508 F.3d 508 (9th Cir. 2007); *Cent. Valley Chrysler-Jeep, Inc. v. Goldstene*, 529 F. Supp. 2d 1151 (E.D. Cal. 2007); *Green Mountain Chrysler Plymouth Dodge Jeep v. Crombie*, 508 F. Supp. 2d 295 (D. Vt. 2007)).

89. *Ctr. for Biological Diversity v. U.S. Dep’t of the Interior*, 563 F.3d at 489.

90. *Id.*

91. 17 C.F.R. § 229.303 (2008).

92. Management’s Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,436 (May 24, 1989).

93. *Id.*

remains to be seen is whether the SEC will choose to require companies to live up to the express language of the provision, as well as the SEC's own interpretations of it, on climate-change matters.

More specifically, in the MD&A, companies "must *identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect* on financial condition or operating performance."⁹⁴ Moreover, "forward looking information is required where there are known trends [or] uncertainties . . . that are reasonably likely to result in . . . a material impact on the company's liquidity, capital resources, revenues and results of operations."⁹⁵

That this provision applies to "business risk" as much as legal compliance is clear from its language. Additionally, this fact was affirmed early on by the SEC in *Caterpillar Inc.*⁹⁶ In *Caterpillar*, the SEC found that the company had failed to make disclosures about events deriving from economic policy changes that could in the future have a material negative financial impact on the consolidated company.

In 1989, the company's Brazilian subsidiary, CBSA, had reported disproportionately high net profits (compared to other subsidiaries). But a significant component of those net profits consisted of nonoperating items tied directly to Brazil's troubled economic environment.⁹⁷ When Brazil's new president "immediately instituted sweeping economic and monetary changes," Caterpillar failed to disclose this development and its implications.⁹⁸ The SEC concluded that Caterpillar's disclosures "should have discussed the future uncertainties regarding CBSA's operations, the possible risk of Caterpillar having materially lower earnings as a result of that risk and, to the extent reasonably practicable, quantified the impact of such risk."⁹⁹

The SEC Petition expresses the view that "information about the scope of the challenges climate change poses to a specific company, and whether its management is adequately prepared to face those challenges, is precisely the type of information that the

94. Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056, 75,057 (Dec. 29, 2003) (emphasis added).

95. DIV. OF CORP. FIN., U.S. SEC. & EXCH. COMM'N, SUMMARY BY THE DIVISION OF CORPORATION FINANCE OF SIGNIFICANT ISSUES ADDRESSED IN THE REVIEW OF THE PERIODIC REPORTS OF THE FORTUNE 500 COMPANIES (2003), www.sec.gov/divisions/corpfin/fortune500rep.htm.

96. See *Caterpillar Inc.*, 50 S.E.C. 903, 912 (1992).

97. *Id.* at 904.

98. *Id.* at 905-08.

99. *Id.* at 912.

market is now demanding about climate risk.”¹⁰⁰ The SEC’s view appears to be similar, at least in general, when it observes that companies “should identify and discuss key performance indicators, including non-financial performance indicators, that their management uses to manage the business and that would be material to investors.”¹⁰¹ Thus, the language of the MD&A is clear, and so are the SEC’s interpretations of it. When the SEC and the courts begin to consider the question of climate-change disclosure in SEC filings, MD&A disclosure will probably be the most difficult one to reject.

3. *Implications for Corporate Strategic Planning*

As to the applicability of the securities laws to climate change, the discussion above suggests that specific disclosure provisions may or may not be relevant at this time. Over time, more of these provisions will likely become applicable. But the real question is what attitude the SEC and the courts will take about disclosure.

To the extent that they approach cases with a healthy but inquiring skepticism, they will probably chart a gradual course toward increasingly demanding disclosure. But if the ignorance and unfounded skepticism about climate change that have hamstrung progress in this area for many years carries the day, those asserting claims will meet with real difficulty. A more rational consideration that may play a role, whether or not it is expressly articulated, is the quite legitimate concern about the economic impact of corporate action. Always an element in the debate and discussion, and frequently only a mere political stratagem, this concern looms even larger than ever during the present global economic and financial crisis.

Yet it is not this latter scenario of reluctance in legal enforcement that will determine the future of corporate climate-change strategy. To the contrary, an influential community of advocates, boosted by an ever-growing consensus about the need for action, will continue its leadership role in setting the ground rules for corporate policies and practices in this area. Securities law, by contrast, will likely have an increasingly greater impact on corporate action, but how much so will depend on the political will of government and the advocacy of plaintiffs. The “take away” message for the corporate community, therefore, is that it should prepare for a new world of demanding climate-change standards, whatever the source of the pressure animating the change.

100. SEC Petition, *supra* note 12, at 18.

101. Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056, 75,057 (Dec. 29, 2003).

CONCLUSION

Climate change has emerged as an important consideration in corporate planning today, and its profile appears likely to increase. Because of its potential adverse impacts on companies, whether through physical phenomena, regulation, or litigation, corporate planners are being forced to act.

Whether corporate and securities law will play a role in this emerging drama remains to be seen. The analysis in this Article points to a minimal likelihood of state corporate-law significance in the near future. Federal securities law—because of the Sarbanes-Oxley Act, and perhaps boosted by substantial advocacy and reactions to the present financial crisis—is likely to play a much greater role. In the meantime, nonlegal forces, emanating from politics, economics, and advocacy-driven public consciousness, will provide the main impetus for corporate action.