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Potential Climate Change Disclosure Obligations Under the Federal Securities Laws and State Law

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Introduction

Publicly traded companies face a changing landscape regarding their obligation to disclose costs relating to climate change and prospective climate change regulation. Growing scientific conclusions concerning the existence of climate change and increased executive and legislative attention given to the issue indicate that climate change regulation is increasingly probable. Regulations on the horizon are likely to alter company business plans, result in litigation, and impose additional costs on companies, to the detriment of investors.

Currently, the federal securities laws do not explicitly require companies to disclose costs or potential costs related to climate change. Rather, public companies must evaluate costs related to climate change and disclose such costs if the company deems them to be material. Historically, companies have held that costs associated with climate change are too attenuated and speculative to be material and to require disclosure. Nevertheless, the seemingly imminent nature of climate change regulation and movements on the part of investors to compel additional disclosure may result in heightened disclosure requirements in the near future.

Part I of this article provides background information regarding SEC disclosure requirements and discusses different materiality standards. Part II of this article discusses recent movements on the part of institutional investors to compel disclosure of climate change risk. Next, part III discusses portions of disclosure documents that are likely to reflect climate change costs in the future. Part IV of this article explains the proxy system and illustrates the way that shareholders may compel climate change disclosure through the proxy process. Finally, this article concludes with a discussion of the role that state corporate law may play in compelling officers and directors to disclose climate change costs.

I. SEC Disclosure Requirements & Materiality

Companies subject to SEC reporting requirements have extensive disclosure obligations pertaining to their costs and expenses.[1] The Securities Act of 1933 (“Securities Act”) and Exchange Act of 1934 (“Exchange Act”) emphasize corporate disclosure, in an effort to provide investors with enough information for them to make educated investment decisions.[2] The Exchange Act governs company disclosure requirements and § 13(a) requires companies to file periodic and annual disclosure

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[1] Not all companies are subject to SEC reporting requirements. This article will focus on publicly traded companies, which are subject to SEC reporting requirements. *See* Securities Exchange Act of 1934 § 13(a), 15 U.S.C. § 78m (2006) [hereinafter Exchange Act] (requiring any company registered on a national securities exchange to file quarterly and annual reports according to rules set forth by the Commission). Additionally, any company that has more than $1 million in total assets and more than 750 investors must register with the Commission and comply with Commission reporting requirements. Exchange Act, *supra*, at § 12(g).

[2] *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977) (stating the purpose of the Exchange Act is to “““substitute a philosophy of full disclosure for the philosophy of caveat emptor””” (citing Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 151 (1972), quoting SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963))).

documents with the SEC.[3] In this section, Congress granted the SEC authority to promulgate rules governing such disclosures.[4] Pursuant to this authority, the SEC promulgated Regulation S-K, which lists the items, which must be disclosed in quarterly and annual reports, and—in some instances—the manner in which information should be disclosed.[5] Generally speaking, information that must be disclosed in company reports is split into different "Items" and includes a description of business,[6] material legal proceedings,[7] financial data,[8] and a discussion of contingencies or other market risks that may affect the company's financial position.[9]

Companies are only required to disclose *material* information in their quarterly and annual reports.[10] Because information that is not material does not need to be disclosed, the definition of materiality is important. There are a number of different Items in Regulation S-K and the standard for materiality differs depending on the type of information disclosed. Most of the information in Regulation S-K is governed by the materiality standard applied in *Basic Inc. v. Levinson*.[11] In *Basic Inc.*, the court adopted an earlier standard which stated that to satisfy the materiality standard "'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"[12] The court also expressly authorized the use of a probability/magnitude test to determine whether information is material.[13] Therefore, to determine whether a contingent or forward-looking event is material, a company should

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[3] *See* Exchange Act, *supra* note 1, at § 13(a). *See* David S. Ruder, Yuji Sun & Arek Sycz, *The Securities and Exchange Commission's Pre-and Post-Enron Responses to Corporate Financial Fraud: An Analysis and Evaluation*, 80 NOTRE DAME L. REV. 1103, 1113–14 (2005) (emphasizing the comprehensive nature of the SEC's disclosure system).

[4] *See* Exchange Act, *supra* note 1, at § 13(a) (requiring corporate disclosure documents to comply with all rules and regulations set forth by the SEC). The SEC has promulgated extensive rules governing quarterly and annual disclosure. *See* 17 C.F.R. § 240.13a-13 (2009) (setting forth instructions for the filing of quarterly reports).

[5] 17 C.F.R. §§ 229.10–229.703 (2009).

[6] 17 C.F.R. § 229.101 (2009).

[7] 17 C.F.R. § 229.103 (2009).

[8] 17 C.F.R. §§ 229.301–308t (2009).

[9] 17 C.F.R. §§ 229.303, 229.305 (2009).

[10] *See* Milton v. Van Dorn Co., 961 F.2d 965, 972 (1st Cir. 1992) (holding that speculative information regarding a product line was not material in light of the total mix of information available to investors); Berg v. First Am. Bankshares, Inc., 796 F.2d 489, 496 (D.C. Cir. 1986) (requiring plaintiff to make specific allegations of falsity, rather than merely speculate that information was false and therefore materially misleading).

[11] *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988) (determining whether communications made in anticipation of a merger were material).

[12] *See id.* at 231–32 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)) (adopting the materiality standard set forth in *TSC Indus., Inc.* for actions brought under the anti-fraud provisions of the Exchange Act).

[13] *See Basic Inc.*, 485 U.S. at 238–39 (accepting the standard set forth by Judge Friendly in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1986), in which he stated that materiality "'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity,'" *Basic Inc.*, 485 U.S. at 238).

weigh the probability of harm or loss in light of the extent of the loss to determine whether a condition is material.[14]

Regulation S-K also specifies the types of information that should be included in financial statements that are incorporated into SEC disclosure filings. Regulation S-K does not specify how such information should be calculated. Rather, the SEC's accounting staff works with the accounting profession to establish methods of accounting for and disclosing financial information. The standard for determining whether information contained in financial statements is material is not the *Basic Inc.* standard used elsewhere in Regulation S-K.[15] Rather, Item 303 of Regulation S-K requires management to disclose "known trends . . . events or uncertainties" reasonably likely to have an effect on a company's capital, revenues or income.[16] To determine whether information is material under the Item 303 standard, management must determine whether a trend or contingency is *unlikely* to occur. If the contingency is *unlikely* to occur, management does not need to include the contingency in Item 303.

However, if management cannot determine that the contingency is *unlikely* to occur, management must disclose the existence of the contingency and the range of possible liabilities resulting from the contingency.[17] The SEC illustrated this inquiry in an interpretive release, using as an example the issue of whether an entity must disclose its status as a possibly responsible party (PRP) under the Comprehensive Environmental Response, Compensation and Liability Act (commonly known as the Superfund Act).[18] The SEC stated that if an entity is correctly designated as a PRP and management is unsure about the extent of liability and whether insurance coverage and/or contribution by other parties would cover their liability, management must disclose the entity's status as a PRP.[19]

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[14] *See Basic Inc*., 485 U.S. at 239 (listing board resolutions, the involvement of investment bankers, and the existence of actual negotiations as possible factors to consider in determining the probability that a merger will occur and the size of the two corporations and of the potential premiums over market value as factors to consider in determining the magnitude of the merger). For example, a contingent event with a 5% probability of occurrence, resulting in a $1 million liability would not be material. Likewise, an adverse event with a 90% chance of occurrence, resulting in a $100 liability would not be material. *See* Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45151 (1999) (emphasizing that materiality determinations involving accounting require a "quantitative" and "qualitative" analysis).

[15] *See* Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Exchange Act Release No. 33-6835 at n.27 (May 18, 1989), *available at* http://www.sec.gov/rules/interp/33-6835.htm [hereinafter MD&A Interpretive Release] ("The probability/magnitude test for materiality approved by the Supreme Court in *Basic, Inc., v. Levinson*, 485 U.S. 224 (1988), is inapposite to Item 303 disclosure.").

[16] *See* 17 C.F.R. § 229.303 (2009) (requiring the registrant to disclose information pertaining to known trends or uncertainties which would have an effect on a registrant's sale or liquidity).

[17] MD&A Interpretive Release, *supra* note 15.

[18] *Id*. The Comprehensive Environmental Response, Compensation, and Liability Act is codified at 42 U.S.C. §§ 9601–9675. *See also* Oxford Asset Mgmt., Ltd. v. Jaharis, 297 F.3d 1182, 1191 (11th Cir. 2002) ("As regards trends, we interpret this element to require an assessment of whether an observed pattern accurately reflects persistent conditions of the particular registrant's business environment.").

[19] *See* MD&A Interpretive Release, *supra* note 15. ("For MD&A purposes, aggregate potential cleanup costs must be considered in light of the joint and several liability to which a PRP is subject. Facts regarding whether insurance coverage may be contested, and whether and to what extent potential sources of contribution or indemnification constitute reliable sources of recovery may be factored into the determination of whether a material future effect is not reasonably likely to occur.").

On a related note, it is worth emphasizing the role that standards for financial accounting play in governing when potential climate change liabilities must be included in disclosure documents required by Regulation S-K. Financial statements included in Regulation S-K must accord with Generally Accepted Accounting Principles ("GAAP") and corporate officers are required to certify that documents included in Regulation S-K conform to GAAP requirements.[20] Because financial statements included within Regulation S-K must comport with GAAP, any changes in the GAAP standards for disclosure of environmental liabilities are relevant to determining liability under the securities laws. Going forward, changing attitudes regarding climate change risk and the potential for climate change regulation may alter the materiality determination under the *Basic Inc.* standard, the Item 303 standard, or financial accounting standards set by GAAP or the Financial Accounting Standards Board ("FASB").

II. Climate Change Risk is Likely Material to Investors

Earlier corporate determinations that climate change risk was not material can probably be attributed to past scientific uncertainty regarding the existence of climate change and the fairly recent nature of proposed climate change regulation. Due to such uncertainties, the effect of climate change on companies was (and still may be) largely speculative. Probably due to these uncertainties, disclosure of climate change risk received little attention from investors and investor groups in the past.

Despite investors' earlier indifference to climate change and climate change risk, it is likely that in the near future, investors will consider climate change risk to be material in making investment decisions.[21] To begin, scientific opinion supporting the existence and severity of climate change is widespread and supported by compelling empirical evidence.[22] Perhaps motivated by the growing consensus regarding the existence and attendant dangers of climate change, climate change regulation has been promoted at global, national, regional, state, and local levels.[23] A number of climate change bills have been proposed in Congress and the current administration has made climate change a priority.[24] Recently, the House passed a climate change bill,[25] which

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[20] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.). Sarbanes Oxley §§ 906(a)–(b) are the provisions requiring officer certification that the disclosures conform with GAAP requirements. 18 U.S.C. § 1350 (2006).

[21] *See* Elise N. Rindfleisch, *Shareholder Proposals: A Catalyst for Climate Change-Related Disclosure, Analysis, and Action?*, 5 BERKELEY BUS. L.J. 45, 47 (2008) (listing risks corporations face as a result of climate change, including: "physical risks, regulatory risks, litigation risks, competitive risks, and reputational risks").

[22] *See* Perry E. Wallace, *Climate Change, Fiduciary Duty and Corporate Disclosure: Are Things Heating up in the Boardroom?*, 26 VA. ENVTL. L.J. 293, 295 (2008) (discussing studies by the Intergovernmental Panel on Climate Change, NASA Goddard Institute of Space Studies, Potsdam Institute for Climate Impact Research, and Max Planck Institute for Meteorology as evidence of growing scientific consensus regarding the existence of climate change).

[23] *See* A.B.A. SEC. ENV'T, ENERGY & RESOURCES, GLOBAL CLIMATE CHANGE & U.S. LAW 21 (Michael B. Gerrard ed. 2007) [hereinafter Gerrard] (stating that the varying levels of international, regional, state, and local regulation have resulted in a regulatory construct of "three or even four dimensions—since it exists in time as well as in space—that continues to morph").

[24] *See generally* Steven Mufson & Juliet Eilperin, *How Obama has Made his Energy Platform 'Pop'*, WASH. POST, May 31, 2009, at A3 (describing President Obama's efforts to portray climate change as a way to create jobs and industry and to protect national security).

President Obama urged the Senate to pass.[26] A number of states have also enacted climate change measures and a number of these states have entered into regional climate change initiatives. The judiciary recently affirmed the right of states to regulate, and require other entities to regulate carbon emissions, giving added authority to measures passed by the states.[27] Perhaps most relevant to the topic of SEC disclosure requirements, one of the SEC Commissioners recently indicated that the SEC is poised to look very seriously at climate change disclosure in the near future.[28]

The costs that climate change regulation may impose on corporations are potentially great and may include changing demand for products, costs of compliance with climate change legislation, costs incurred in complying with demands of "green investors," changing accounting regulations, and potential suits for noncompliance with any climate change regulations.[29] Additionally, businesses face a number of physical risks associated with climate change, such as damage to facilities and processes for shipping goods as a result of potentially severe weather patterns.[30] Perhaps recognizing the high likelihood of costs associated with climate change risk, investors have initiated a movement to compel corporate disclosure of costs associated with climate change risk. For example, the Investor Network on Climate Risk (INCR) coordinates efforts to better understand the financial risks associated with climate change. The network, which currently represents a network of more than eighty investors (collectively managing more than $8 trillion in assets) urges corporations to disclose costs associated with climate change.[31] Recently, a number of investors associated with INCR wrote the SEC, requesting guidance on climate change disclosure requirements and asking the SEC to adopt greater reporting requirements pertaining to corporate governance issues.[32]

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[25] American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong. (2009) (as passed by the House, June 26, 2009).

[26] *See* Transcript, *Interview With President Obama on Climate Change Bill*, N.Y. TIMES, June 28, 2009, http://www.nytimes.com/2009/06/29/us/politics/29climate-text.html?pagewanted=1&_r=1&sq=interview%20with%20President%20Obama%20on%20climate%20change%20bill&st=cse&scp=*1* (statement by President Obama that he hoped cooperation in the House would propel cooperation in the Senate). The Senate has not yet presented its version of a climate change bill and key Democrats have stated that it is unlikely that a climate change bill will reach the Senate floor until 2010. *See* Ian Talley, *Climate Bill Likely on the Shelf for the Rest of the Year*, WALL ST. J., Nov. 11, 2009, http://online.wsj.com/article/SB125795001554343591.html?mod=WSJ_hpp_MIDDLENexttoWhatsNewsSecond (explaining the difficulties Senate Democrats face in reaching a consensus between the Environment Panel and Finance and Agriculture committees).

[27] *See infra* notes 50–54 and accompanying text (detailing state common law nuisance actions).

[28] *See* Evan Lehmann, *SEC Turnaround Sparks Sudden Look at Climate Disclosure*, N.Y. TIMES, July 13, 2009, http://www.nytimes.com/cwire/2009/07/13/13climatewire-sec-turnaround-sparks-sudden-look-at-climate-65102.html?scp=1&sq=SEC%20Turnaround%20Sparks%20Sudden%20Look%20at%20Climate%20Disclosure&st=cse (describing the SEC's efforts to meet with "top-level advocates of 'climate risk disclosure'").

[29] *See* PEW CENTER ON GLOBAL CLIMATE CHANGE AND PEW CENTER ON THE STATES, CLIMATE CHANGE 101: UNDERSTANDING AND RESPONDING TO GLOBAL CLIMATE CHANGE, *available at* http://www.pewcenteronthestates.org/uploadedFiles/Climate%20Change%20101,%20Business%20Solutions.pdf (noting that many businesses now deem regulation to be inevitable).

[30] *See id.* (listing the industries most likely to face physical risks associated with climate change).

[31] *See* INVESTOR NETWORK ON CLIMATE CHANGE, ABOUT INCR, http://www.incr.com/Page.aspx?pid=261 (describing actions taken by INCR on behalf of its investors).

[32] In addition to the number of institutional investors who signed the letter, a number of state and local comptrollers also signed onto the letter. Letter from Investor Network on Climate Risk, to Mary L.

Some investor groups have gone as far as suggesting specific reporting guidelines for companies to follow. For example, the Global Reporting Initiative ("GRI") urges companies to disclose corporate practices regarding a number of social issues, including climate change. The GRI has set forth ideal reporting guidelines, which shareholders, availing themselves of the proxy system, have referenced in urging companies to disclose climate change risk.[33] Additionally, the California Pension Employee Retirement System ("CalPers"), which invests all California pension funds, has issued guidelines that must be followed by the funds in which it invests. Among these guidelines, CalPers requires that funds provide "accurate and timely disclosure of environmental risks."[34]

In addition to actions taken by institutional investors, state treasuries, industry groups, and other relevant actors are monitoring potential climate change risk and potential climate change disclosure. Recently, the National Association of Insurance Regulators ("NAIR") made it mandatory for insurance companies to report to regulators the risks they face from climate change.[35] The Senate Subcommittee on Securities, Insurance and Investment ("Senate Securities Committee") has also addressed the issue and held a hearing to discuss climate change disclosure. Following the hearing, Senators Dodd and Reed wrote a letter to then SEC Chairman Chris Cox, encouraging the SEC to issue guidance on climate change disclosure requirements.[36] Additionally, the Government Accountability Office ("GAO") issued a report stating that the SEC should attempt to clarify and enhance transparency pertaining to environmental disclosure.[37]

Schapiro, Chairman, U.S. Sec. & Exch. Comm'n (June 12, 2009) (on file with author), *available at* http://www.incr.com/Page.aspx?pid=1107.

[33] GLOBAL REPORTING INITIATIVE, SUSTAINABILITY REPORTING GUIDELINES (3d ed. 2006), *available at* http://www.globalreporting.org/NR/rdonlyres/ED9E9B36-AB54-4DE1-BFF2-5F735235CA44/0/G3_GuidelinesENU.pdf. The SEC has held that GRI reporting guidelines are too vague to require companies to follow. The SEC has distinguished between shareholder proxy proposals which require a company to issue a "sustainability report" based solely on the GRI and proposals which compel corporations to issue a "sustainability report" and cite the GRI as useful guidelines. *See* Texas Indus., Inc., SEC No-Action Letter, 2007 WL 2188373, at *10 (July 27, 2007) (stating that Texas Industries may not exclude shareholder proposal from its proxy statements because the reference to GRI in the proposal was merely suggestive rather than mandatory).

[34] *See* CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM, GLOBAL PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE (Mar. 2009), *available at* http://www.calpers-governance.org/docs-sof/marketinitiatives/2009-04-01-corp-governance-pub20-final-glossy.pdf. CalPers also provides funds with the "Global Framework for Climate Risk Disclosure" checklist and asks the funds to use the checklist in evaluating and drafting an appropriate disclosure document. *Id*.

[35] *See* NATIONAL ASSOCIATION OF INSURANCE REGULATORS, INSURANCE REGULATORS ADOPT CLIMATE CHANGE RISK DISCLOSURE (Mar. 17, 2009), *available at* http://www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm (requiring insurers to report the ways in which they will alter their risk management models and investment strategies, if any, and the steps they are taking to educate policymakers and policyholders about climate change risks).

[36] *See* Letter from Christopher J. Dodd, Chairman, U.S. Senate Committee on Banking, Housing and Urban Affairs, to Christopher Cox, Chairman, U.S. Sec. & Exch. Comm'n (Dec. 6, 2007) (on file with author), *available at* http://dodd.senate.gov/multimedia/2007/120607_CoxLetter.pdf (urging the SEC to issue an interpretive release to "ensure greater consistency and completeness in disclosure of material information related to climate change and current and probable future regulation").

[37] *See* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, ENVIRONMENTAL DISCLOSURE: SEC SHOULD EXPLORE WAYS TO IMPROVE TRACKING AND TRANSPARENCY OF INFORMATION (2004), *available at* http://gao.gov/new.items/d04808.pdf (stating the SEC does not adequately track environmentally-related issues in corporate findings and thus does not have the ability to identify reoccurring issues).

The consensus regarding the existence of climate change has provoked strong responses from investors and other relevant industry actors. In the aggregate, these responses appear to indicate that investors consider climate change risk to be a material factor in determining their investments, or are likely to do so in the future.

III. Climate Change Disclosure Requirements Under the Federal Securities Laws

If climate change risk is considered material in making an investment decision, there are a number of places in corporate disclosure documents that Regulation S-K may mandate disclosure of climate change risk. To begin, Item 101 requires companies to disclose information relating to general business and product development. The information included in Item 101 usually serves as a broad overview of the company's business and emerging (or contracting) product areas and services.[38]

Importantly, Item 101 specifically requires companies to disclose material effects of compliance with environmental laws and regulations on the company's capital expenditures, earnings, and the competitive position of the registrant.[39] Regulation S-K requires that a company disclose estimated capital expenditures for the fiscal year of the report issued, the following year and any additional periods that the registrant deems material.[40] The SEC accounting staff has issued some guidance on environmental liability disclosure, specifying that potential expenditures for environmental liabilities must be listed separately on a company's balance sheet. The figure listed should not be reduced by any potential recovery on the liability, whether from insurance or contribution by another party.[41] The SEC has acknowledged that disclosure of capital expenditures pertaining to climate change regulation is complicated and includes costs incurred to comply with different international regulations.[42]

Particularly relevant to the discussion regarding capital-expenditures-for-climate-change disclosure obligations, are the current efforts by the FASB and the International Accounting Standards Board (IASB) to develop accounting standards to be used in assessing liabilities under different cap and trade credit schemes.[43] As regulatory schemes pertaining to climate change continue to develop, it is possible (and perhaps likely) that the accounting industry will promulgate rules governing disclosure of

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[38] *See* 17 C.F.R. § 229.101(a) (2009) (requiring a registrant to "describe the general development of the business").

[39] 17 C.F.R. § 229.101(c)(1)(xii) (2009). *See* Gerrard *supra* note 23, at 458 ("In times of major regulatory initiatives . . . resulting capital expenditures may be a company's most significant environmental disclosure."). The statute also requires companies to disclose material costs related to the construction or maintenance of environment control facilities for the companies' next two years of operation, at least. 17 C.F.R. § 229.101(c)(1)(xii).

[40] 17 C.F.R. § 229.101(c)(1)(xii).

[41] *See* SEC Staff Accounting Bulletin No. 92, 58 Fed. Reg. 32,843 (1993) ("The risks and uncertainties associated with a registrant's contingent liability are separate and distinct from those associated with its claim for recovery from third parties.").

[42] *See* Arthur M. Wharton Air Prods. & Chemicals, Inc., SEC No-Action Letter, Fed. Sec. L. Rep. ¶ 79,429 (May 9, 1973) (requiring disclosure of foreign regulation having a material effect on operations in the U.S.).

[43] *See* FINANCIAL ACCOUNTING STANDARDS BOARD, PROJECT UPDATES: EMISSIONS TRADING SCHEMES, http://www.fasb.org/project/emissions_trading_schemes.shtml (last updated Oct. 30, 2009) (recognizing there is little guidance regarding accounting standards for emissions trading schemes).

corporate assets and liabilities under an emissions trading scheme.[44] Because the SEC often works with the accounting profession to develop disclosure requirements for financial information, it is likely that accounting standards promulgated to address liabilities under a cap and trade scheme will impact any eventual disclosure requirements promulgated by the SEC.

Item 103 of Regulation S-K requires companies to disclose legal and administrative proceedings in which the company is a party, or otherwise involved.[45] This includes proceedings "known to be contemplated" by government and regulatory authorities, including the state attorneys general.[46] Disclosure of legal proceedings is only required if the proceeding is material.[47] Currently, the SEC holds that litigation incident to the ordinary course of business is not material.[48] However, the SEC has explicitly stated that environmental litigation does not qualify as litigation incident to the ordinary course of business, stating "an administrative or judicial proceeding . . . arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary (sic) for the purpose of protecting the environment shall not be deemed 'ordinary routine litigation incidental to the business.'"[49]

To the extent there is potential for companies to be sued under proposed and impending climate change regulations, such suits will likely be required disclosures under Item 103. By way of example, states and other interested parties have recently brought suits requiring companies to curb carbon emissions, on the theory that carbon emissions are a public nuisance.[50] Recently, the Second Circuit overturned the dismissal of a common law nuisance action, brought by a number of states, against a number of corporate defendants.[51] The Southern District of New York dismissed the complaint, holding that the case presented a non-justiciable political question.[52] Following a lengthy discussion of the political question doctrine, the Second Circuit reversed the district court decision, held that each plaintiff had standing and had stated a claim upon which relief could be granted and remanded the case to the district court for adjudication.[53] The Second Circuit recognized that although the debate regarding global warming has

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[44] *See* James M. Fornaro, Kenneth A. Winkelman, & David Glodstein, *Accounting for Emissions: Emerging Issues and the Need for Global Accounting Standards*, J. FIN. ACCT. (2009), *available at* http://www.journalofaccountancy.com/Issues/2009/Jul/20081312.htm (highlighting varying treatment of cap and trade assets and liabilities under diverse accounting practices).
[45] 17 C.F.R. § 229.103 (2009).
[46] *Id.* *See* Gerrard *supra* note 23, at 462 (recognizing that "the attorneys general . . . are clearly 'governmental authorities'" and listing different climate change suits brought by state attorneys general).
[47] 17 C.F.R. § 229.103.
[48] *See id.* at Instruction 5.
[49] *Id.*
[50] *See* Connecticut v. Am. Elec. Power Co., Inc., 406 F. Supp. 2d 265, 268 (S.D.N.Y. 2005), *rev'd*, 582 F.3d 309 (2d Cir. 2009) (plaintiffs' alleging that defendants' carbon dioxide emissions will cause irreparable harm); Comer v. Murphy Oil USA, Inc., No.,1:05-CV-436-LG-RHW, 2007 WL 6942285 (S.D. Miss., Aug. 30, 2007), *rev'd*, 585 F.3d 855 (5th Cir. 2009) (plaintiffs' arguing that climate change contributed to the force of hurricane Katrina).
[51] Connecticut v. Am. Elec. Power. Co., 582 F.3d 309 (2d Cir. 2009).
[52] S*ee Am. Elec. Power Co.*, 406 F. Supp. 2d at 274 (stating that resolution of the suit would require "'an initial policy determination of a kind clearly for non-judicial discretion'" (quoting Vieth v. Jubelirer, 541 U.S. 267, 278 (2004))).
[53] *Am. Elec. Power Co.*, 582 F.3d at 325, 392.

political ramifications, the abatement of public nuisances caused by global warming does not represent a non-justiciable political question.[54] The determination that common law nuisance suits can proceed against companies for their contributions to global warming illustrates that company's can (and likely will) be held liable for climate change.

Companies must also disclose a number of risk factors and contingent liabilities in their quarterly and annual reports. Risk factors, uncertainties and contingent liabilities are disclosed in Item 303 of Regulation S-K, in the Management Discussion & Analysis (MD&A). Item 303 requires companies to disclose "trends or any known demands, commitments, events or uncertainties" impacting liquidity and/or capital resources and also requires the company to provide information it believes "necessary to an understanding of its financial condition."[55] Again, specific disclosure requirements under Item 303 are partially governed by accounting principles set forth by GAAP and standards set by the Financial Accounting Standards Board (FASB).[56]

For purposes of Item 303 disclosure, if liability (or potential liability) for environmental contingencies is quantifiable, the SEC requires that the contingency be disclosed and charged to income.[57] If the contingency cannot be precisely quantified, it must be noted and "quantified to the extent reasonably practicable" in the underlying financial statements.[58] These financial statements are incorporated into the disclosure documents filed with the SEC, and corporate officers must certify that the financial statements are accurate and do not contain false or misleading statements.[59] Documents filed with the SEC that do not comport with financial accounting standards and/or that contain inaccuracies in the financial statements may violate the securities laws and render the company vulnerable to enforcement action brought by the SEC.[60]

The Sarbanes-Oxley Act of 2002 ("SOX") places great emphasis on the importance of officer and director involvement in verifying the accuracy of company financial statements. SOX requires corporate officers and directors to certify that all information contained in corporate reports is correct and imposes personal liability on the part of officers and directors if information contained in disclosure documents is false or misleading.[61] The statute also requires officers and directors to certify that they have

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[54] *Id*. at 332.
[55] 17 C.F.R. § 229.303(a) (2009).
[56] *See* discussion *supra* Part I (explaining different materiality standards).
[57] *See* FINANCIAL ACCOUNTING STANDARDS BOARD, STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 5: ACCOUNTING FOR CONTINGENCIES Paragraph 10 (1975), *available at* http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175818754616&blobheader=application%2Fpdf.
[58] *See* MD&A Interpretative Release, *supra* note 15 (explaining that hypothetical company which has correctly been designated as a "Potentially Responsible Party" by the EPA must approximate and disclose the extent of its potential liability).
[59] *See* Sarbanes Oxley Act of 2002 § 302(a), 15 U.S.C.§ 7241(2006) (requiring the CEO and CFO to certify that they have reviewed company filings). Section 302 specifically requires the CEO and CFO to certify that the financial statements "fairly represent in all material respects the financial condition and result of operations of the issuer. . . " 15 U.S.C. § 7241(a)(2).
[60] *See* Sarbanes Oxley Act of 2002 § 906(a), 18 U.S.C. 1350(c) (2006) (imposing criminal liability on officers and directors for false statement contained in a company's periodic reports); *see also* Ridgway M Hall Jr., *Quality Assurance in EHS Audits and Audit Programs: The New BEAC Standards*, 39 ENVTL. L. REP. NEWS & ANALYSIS 10594 (2009) (emphasizing the need for appropriate internal controls for monitoring environmental costs in order to ensure that corporate officers are not held criminally liable).
[61] *See* supra notes 59–60and accompanying text (describing officer liability under Sarbanes-Oxley).

implemented and maintained internal controls to ensure that material information properly comes to light and will be disclosed.[62] As a whole, SOX is indicative of lawmakers' willingness to impose substantial transparency-related obligations upon companies and their executives.[63] The personal nature of officer liability and repercussions stemming from such liability may serve as incentive for officers to err on the side of greater disclosure of effects attributable to climate change.[64]

In addition to the "trends or any known demands, commitments, events or uncertainties" companies must disclose in Item 303, companies must also disclose a number of risk factors in Item 503(c) of Regulation S-K.[65] The SEC has promulgated specific information regarding risk factors which must be disclosed and the method by which risks should be disclosed to investors.[66] Risk disclosure in Item 503(c) is particularly relevant for companies involved in industries most likely to be affected by climate change, such as the auto and coal industries.

Finally, as a general matter, the SEC favors extensive disclosure in the Management Discussion and Analysis and in periodic filings generally.[67] The SEC has issued a number of interpretive releases stating its preference for comprehensive disclosure and noting that "changes in business enterprise systems, communications and other aspects of information technology have significantly increased the amount of information available to management."[68] Other securities statutes enacted in recent years support the inference that the SEC favors substantial corporate disclosure. The 1995 Private Securities Litigation Reform Act ("PSLRA") provides companies with a safe-harbor for forward-looking statements contained in its filings.[69] In passing the PSLRA, Congress acknowledged that forward-looking information is material to investors.[70] Taken together, the SEC's stated preference for comprehensive disclosure, recent statutes mandating higher disclosure and increased pressure from investors requesting the SEC to

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[62] Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241.

[63] *See* Mitchell F. Crusto, *Endangered Green Reports: "Cumulative Materiality" in Corporate Environmental Disclosure After Sarbanes-Oxley*, 42 HARV. J. ON LEGIS. 483, 485 (2005) ("Sarbanes-Oxley represents a milestone in corporate disclosures from 'fuzzy' corporate disclosure standards to those promoting transparency.").

[64] *See* Gerrard, *supra* note 23, at 469 ("The certifications required by Sarbanes-Oxley put ongoing pressure on management to account for and disclose, in financial statements or otherwise, any material aspect of climate change risk that can fairly be said to be quantifiable.").

[65] *Compare* 17 C.F.R. § 229.303 (2009) *with* 17 C.F.R. § 229.503(c) (2009).

[66] 17 C.F.R. § 229.503(c).

[67] In fact, one author has argued that the extensive level of disclosure required by the SEC essentially amounts to SEC regulation of corporate governance issues. *See* Roberta S. Karmel, *Realizing the Dream of William O. Douglas – The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 88–89 (2005) (describing efforts by the SEC to regulate board composition and director independence through disclosure requirements).

[68] *See* Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release Nos. 33-8,350, 34-48,960 (Dec. 19, 2003) (Information disclosed should be "informative" and "transparent.").

[69] Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 77z-2–78u-5 (2006) (providing a safe harbor for forward-looking statements accompanied by appropriate cautionary statements).

[70] *See* H.R. CONF. REP. NO. 104-369, at 32, *reprinted in* 1995 U.S.C.C.A.N. 730–31 (stating the purpose of the safe-harbor as "to encourage issuers to disseminate relevant information to the market without fear of open-ended liability").

compel disclosure of climate change risk may serve as a strong indication that disclosure of climate change risk may soon be mandated at a federal level.

IV. Shareholders May be Able to Compel Corporate Disclosure of Climate Change Risk through the Proxy System

In public companies, shareholders elect the board of directors and have the ability to submit proposals to the board of directors, requesting changes to corporate policies.[71] Recent or potential changes in the way in which shareholders nominate directors and submit shareholder proposals may increase the role shareholders play in effecting changes in corporate governance in the future. The board of directors is usually elected at an annual shareholder meeting, but given the size of most public companies, most shareholders own only a small share of the company's securities and do not attend the annual meeting.[72] Therefore, the board of directors is typically elected through a proxy system. In this system, the corporation mails voting materials to each shareholder in advance of the annual meeting, listing the current board's recommendations for the slate of directors.[73] Typically, shareholders return the voting materials to the company, authorizing the company to vote their shares on their behalf and most often, checking a single box authorizing the company to vote for the entire slate of directors nominated by the current board.[74] Because the overwhelming majority of shareholders vote by proxy, any shareholder wishing to show up at the annual meeting and nominate his or her own director is likely to have little success, as most votes have already been cast.[75]

The SEC has promulgated a number of "proxy access" rules in an attempt to facilitate shareholders' access to the director nomination system.[76] As it stands, SEC Rule 14a-7 requires a registrant either: to allow a shareholder to include his or her director nominations in the proxy materials mailed by the company *or* to disclose to the

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[71] *See* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 680-81 (2007) (arguing that the shareholder franchise is especially important because there are few other options for shareholders to provide a check on directorial power).

[72] Incentives to attend the annual shareholder meeting may be greater for institutional investors. Institutional investors often own a far greater percentage of a company's securities and given these large ownership percentages, institutional investors may have a very real incentive to participate at an annual shareholder meeting. *See* STEPHEN M. BAINBRIDGE, SHAREHOLDER ACTIVISM AND INSTITUTIONAL INVESTORS 4–10 (UCLA School of Law, Law & Econs. Research Paper Series, Research Paper No. 05-20, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=796227&rec=1&srcabs=218650 (last visited Dec. 9, 2009) (defending the oft-cited maxim that "control is divorced from ownership" in public companies and concluding that shareholder voting rights should be an "accountability devise of last resort," *id.* at 9).

[73] *See* Thomas W. Joo, *A Trip Through the Maze of "Corporate Democracy": Shareholder Voice and Management Composition*, 77 ST. JOHN'S L. REV. 735, 753 (2003) (describing the shareholder voting process). A shareholder's right to submit his or her vote through the proxy system rests in contract law. *See generally* Laura Hunter Dietz, et al., 18 AM. JUR. 2D *Corporations* § 903 (2009).

[74] *See* Bebchuk, *supra* note 71, at 687 ("[R]ivals seeking to oust incumbents succeeded in gaining control in only eight companies with a market capitalization above $200 million during the decade.").

[75] *See* Mark A. Sargent & Dennis R. Honabach, PROXY RULES HANDBOOK § 5.2 (2008) (recognizing that shareholders must communicate with fellow shareholders individually prior to the annual meeting if the shareholder wishes to gain support for his or her proposal).

[76] These rules only apply to companies that are registered under § 12 of the Exchange Act, *supra* note 1. 17 C.F.R. § 240.14a-2 (2009).

shareholder the company's shareholder list, enabling the shareholder to mail his or her nominations to the entire roster of shareholders.[77] In addition to Rule 14a-7, Rule 14a-8 allows qualifying shareholders to submit proposals, which accompany the proxy materials regarding the election of directors.[78] Shareholder proposals usually request that the board take a specific action or adopt a particular policy. Once submitted, there are a number of ways in which a corporation can eliminate shareholder proposals from inclusion in the proxy statement.[79] If the proposal is ultimately included within the proxy materials, shareholders vote on the proposal at the same time that they vote on the board of directors.

Importantly, the SEC staff recently indicated that it is changing the way in which it has typically evaluated the exclusion of shareholder proposals relating to risk.[80] The Division of Corporate Finance staff cited an awareness that "the application of the analytical framework [pertaining to the exclusion of shareholder proposals requiring a company to analyze risk] may have resulted in the unwarranted exclusion of proposals that relate to the evaluation of risk but that focus on significant policy issues."[81] The staff stated that proposals submitted in the future will focus on the "subject matter to which the risk pertains," and "[t]he fact that a proposal would require an evaluation of risk will not be dispositive."[82] Proponents of greater climate change disclosure cite the revision of these guidelines as a victory, stating that the new guidelines ensure that matters of importance are put before shareholders.[83]

To date, the SEC's proxy access proposals have not been particularly effective in granting shareholders effective access to the proxy system. Currently, the rules require shareholders to bear the costs associated with copying and mailing their respective proxy materials and this cost has proved to be prohibitive.[84] The SEC has recently circulated proposed proxy access rule changes for comment that would substantially alter the proxy access process, making the process more affordable for shareholders.[85] The ultimate content of the prospective rule is unclear, but it is likely to include provisions *requiring* corporate reimbursement of shareholder costs incurred in waging a proxy fight and additional limitations on the corporation's ability to exclude shareholder proposals from

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[77] 17 C.F.R. § 240.14a-7 (2009).
[78] 17 C.F.R. § 240.14a-8 (2009). In order to avail themselves of one of these mechanisms, shareholders must meet certain requirements. For example, for at least one full year prior to submitting the proposal, the shareholder must have continuously held at least $2,000 in market value of the securities or 1% of the company's securities. *Id.*
[79] *See* 17 C.F.R. § 240.14a-8(i) (2009) (listing proposals that are improper under state law, such as those that encroach on the role of directors, as proposals which may be excluded from the proxy materials).
[80] SEC DIVISION OF CORPORATE FINANCE, STAFF LEGAL BULLETIN NO. 14E, SHAREHOLDER PROPOSALS (2009), *available at* http://www.sec.gov/interps/legal/cfslb14e.htm.
[81] *Id.*
[82] *Id.*
[83] Press Release, Ceres, Ceres Applauds SEC Decision Allowing Financial Risks in Environmental and Social Resolutions (Oct. 28, 2009) (on file with author), *available at* http://www.ceres.org/Page.aspx?pid=1145 (quoting Mindy Lubber, the president of Ceres).
[84] *See* 17 C.F.R. § 240.14a-7(e) (2009) ("The security holder shall reimburse the reasonable expenses incurred by the registrant in performing the acts requested . . . ."); *see also* Press Release, SEC, SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors, No. 2009-116 (May 20, 2009), http://www.sec.gov/news/press/2009/2009-116.htm (citing the expense for shareholders of mailing out proxies as one of the reasons why the proxy access rules need to be amended).
[85] Press Release, SEC, *supra* note 84.

inclusion in the proxy materials.[86] While the timetable for the passage of these rules (and their ultimate content) is unclear, it is clear that the SEC aims to increase the ability of shareholders to influence director elections and corporate procedure.[87]

Delaware has recently added provisions to its General Corporate Code which allow corporations to amend their bylaws in order to provide greater proxy access.[88] Consistent with what many consider the "permissive" nature of the Delaware corporate code, the legislature added Sections 112 & 113 to the charter, which allow, but do not require corporations to provide greater access to the proxy system.[89] These sections provide corporations with great flexibility to set their own rules and standards for shareholder access to the proxy system.[90] Given Delaware's prominence in corporate law, the effect these amendments have on the ability of shareholders to access the proxy system has important implications for the accessibility of the proxy access system generally.[91] If corporations find that allowing proxy access is optimal, or if investors are able to compel corporations to add such bylaws, investors will have greater ability to nominate directors and submit shareholder proposals under state law.[92]

The potential changes to the SEC's proxy access provisions and the amendments to the Delaware corporate code may make shareholder proposals a more effective tool for

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[86] *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29024 (proposed June 18, 2009) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249, 274), *available at* http://www.sec.gov/rules/proposed/2009/33-9046.pdf (providing the full text of the proposed rules).

[87] The SEC recently stated that proposed proxy changes would probably not be submitted to the commissioners until 2010. *See* Jesse Westbrook, *SEC to Delay Proxy-Access Rule, Giving Banks Reprieve*, BLOOMBERG, Oct. 2, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=a2ZCxme0W84Y (reporting that the large number of comments received by the SEC regarding the proposed rules may have influenced the decision to wait on submitting the rule to the commissioners).

[88] *See* Kara Scannell, *Policy Makers Work to Give Shareholders More Boardroom Clout*, WALL ST. J., Mar. 26, 2009, at B1, *available at* http://online.wsj.com/article/SB123802990560843399.html (discussing the Delaware amendments' passage through the Delaware legislature).

[89] *See* Michael Tumas & John Graussbauer, *Amendments to the Delaware Corporation Code*, The Harvard Law School Forum on Corporate Governance and Financial Regulation, Feb. 28, 2009, http://blogs.law.harvard.edu/corpgov/2009/02/28/proposed-amendments-to-the-delaware-general-corporation-law-2/ ("Consistent with Delaware's preference for enabling legislation and maintaining maximum flexibility, the amendments eschew mandates for corporate action.").

[90] For example, Section 112 allows corporations to adopt bylaws requiring a corporation to include shareholder nominations for directors within its proxy materials, but also allows corporations to condition such inclusion on a number of eligibility requirements. *See* 8 DEL. STAT. ANN. § 112 (2009) (listing requirements of beneficial ownership, informational requirements, and indemnification provisions among the possible conditions corporations may set on shareholder access to the proxy system). Section 113 permits corporations to adopt a bylaw that allows for the reimbursement of expenses shareholders incur in effecting a proxy contest and to condition repayment of these expenses on the shareholder proposal achieving a minimum level of success. *Id*. at § 113.

[91] *See* Int'l Ins. Co. v. Johns, 874 F.2d 1447, 1459 at n.22 (11th Cir. 1989) (recognizing that Florida courts often rely on Delaware corporate law when interpreting Florida corporate law).

[92] The SEC would mandate greater proxy access under federal law, while the amendment to state corporate codes would allow greater access under state law. Currently there is an important (and heated) debate regarding whether the federal securities laws should mandate access to the board of directors, an area traditionally governed by state law. *See* Jeffrey McCracken & Kara Scannell, *Fight Brews as Proxy Access Nears*, WALL ST. J, Aug. 26, 2009, at C1, *available at* http://online.wsj.com/article/SB125123103942758059.html (recognizing comments that the SEC's proposed proxy rules represent "'the biggest change relating to corporate governance ever proposed by the SEC'" (quoting attorney John Finley of Simpson, Thacher & Bartlett)).

effecting corporate governance changes in the future. Shareholders are paying increased attention to corporate governance issues (perhaps due to the very public, very costly corporate governance scandals involving Enron & WorldCom) and are submitting shareholder proposals in record numbers.[93] Shareholder proposals have been submitted regarding a variety of corporate governance issues and typically touch on areas such as executive pay and the composition of the board of directors.[94] However, in recent years, shareholders have also submitted a record number of proposals touching on corporate social responsibility issues, such as ethical workplace practices, product safety concerns and environmentally friendly operations.[95]

Shareholders' ability to gain access to company proxy statements is particularly relevant to climate change disclosure because a record number of shareholder proposals submitted in recent years focus on environmental law issues and requirements pertaining to climate change disclosure.[96] In fact, proxies seeking to compel climate change disclosure now "surpass[] social issues, such as fair employment, political contributions and CEO pay/golden parachutes" as the most prevalent subject of shareholder resolutions.[97] Recently, a climate change proposal received a majority vote from shareholders for the first time ever.[98] In addition to enabling a higher number of proposals regarding climate change disclosure and environmentally friendly corporate policies, increased access to the proxy system would enable investors to nominate and vote for directors who support climate change disclosure or emissions reduction principles.[99]

V. The Potential for State Action

A number of state actions and state laws may also affect climate change disclosure requirements. The recent settlement between Xcel Energy and the State of New York ("Xcel Settlement") illustrates the role that states can play in enforcing and

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[93] The SEC defines a proposal as, "[a] recommendation or requirement that the company and/or its board of directors take action." 17 C.F.R. 240.14a-8(a) (2009).

[94] For example, Cisco Systems, Inc. recently adopted a shareholder proposal giving shareholders a greater say regarding executive compensation. *See* Jonathan Stempel, *Cisco Shareholders OK Say on Pay Proposal*, REUTERS, Nov. 13, 2009, http://www.reuters.com/article/CMPSRV/idUSN1350197220091113 (noting that say-on-pay proposals have increased, likely in response to anger over Wall Street compensation).

[95] *See* Ian B. Lee, *Corporate Law, Profit Maximization, and the "Responsible" Shareholder*, 10 STAN. J. L. BUS. & FIN. 31, 43–45 (2005) (noting the debate between those who argue that a corporation's sole responsibility is profit maximization and those who hold that a corporation must act responsibly while seeking profits).

[96] *See* Rindfleish, *supra* note 21, at 48–49 (recognizing that shareholder proposals relating to climate change are submitted in record numbers and receive the highest percentages of support from shareholders).

[97] Gerrard, *supra* note 23, at 474–75 (citing the rising number of climate change proposals as evidence of a broader trend favoring socially responsible investing).

[98] *See* Conrad MacKerron, *Apple's Greenhouse Gas Reporting is a Welcome Step Forward*, GreenerComputing.com, http://www.greenercomputing.com/blog/2009/09/28/apples-greenhouse-gas-reporting-welcome-step-forward?page=0%2C1 (last visited Dec. 9, 2009) (describing Apple, Inc.'s efforts to perform a lifecycle assessment of its carbon emissions and noting that Apple's expanded disclosure was done in response to a shareholder proposal).

[99] *See supra* notes 85–87 and accompanying text (describing the SEC's proposed rules to facilitate shareholders' ability to nominate directors).

furthering climate change disclosure. In the Xcel matter, Attorney General Cuomo compelled five different energy companies to turn over their corporate filings, suspecting that the companies had not made adequate disclosure regarding their climate change risk.[100] After an investigation, the state of New York and Xcel Energy reached a settlement, whereby Xcel Energy agreed to make more extensive disclosures of climate change risk in the future.[101] The agreement between New York and Xcel energy has been deemed "'landmark'" and may serve as a model for other states in future actions against similarly situated companies.[102]

States may also influence corporate reporting of greenhouse gas emissions by enacting state "right to know" laws. Currently, five states have mandatory greenhouse gas disclosure statutes, requiring companies to disclose their levels of carbon emissions.[103] Some scholars argue that requiring disclosure of carbon emissions will promote a reduction in carbon emissions because such disclosure requirements will facilitate increased peer and government monitoring of emissions.[104] If state statutes requiring disclosure of carbon emissions standards become prevalent, the SEC may be more likely to require climate change disclosure on the part of all registrants because corporations would already have procedures in place to track this information.[105] Additionally, if additional states pass "right to know laws," the SEC may require disclosure of certain climate change regulation costs in an effort to ensure that disclosure remains uniform and that SEC filings remain the primary source of information for investors.

States may also play a role in defining corporate disclosure requirements by defining the fiduciary obligations of corporate officials. Corporations and the actions of corporate officials are governed by substantive state corporate law. Officers and

[100] *See* Nicholas Confessore, *Energy Firm to Specify Investor Risk*, N.Y. TIMES, Aug. 28, 2008, at C1 (describing efforts by New York's Attorney General to determine whether power companies adequately disclosed climate change risk associated with new coal plants).

[101] *See* Assurance of Discontinuance Pursuant to Executive Law § 63(15), *In re* Matter of Xcel Energy Inc, AOD #08-012 (2008), *available at* http://www.oag.state.ny.us/bureaus/environmental/pdfs/Attachment%20E%20--%20Xcel%20AOD.pdf (requiring Xcel to disclose: an "Analysis of Financial Risks from Regulation," an "Analysis of Financial Risks from Litigation," an "Analysis of Financial Risks from Physical Impacts of Climate Change," and a "Strategic Analysis of Climate Change Risk and Emissions Management").

[102] *See* Confessore, *supra* note 100 (recognizing that Attorney General Cuomo is able to bring suits against a number of power companies because of New York's Martin Act, which permits the New York Attorney General to investigate corporations whose securities trade on Wall Street). Recently, Attorney General Cuomo entered into a similar settlement agreement with AES Corp., requiring AES to disclose risks the company faces as a result of climate change. Chad Bray, *Update: AES Corp. to Disclose Climate-Change Risk*, WALL ST. J., Nov. 19, 2009, http://online.wsj.com/article/BT-CO-20091119-713519.html.

[103] Andrew Schatz, Note, *Regulating Greenhouse Gases by Mandatory Information Disclosure*, 26 VA. ENV'TL L.J. 335, 354 (2008). Currently, the states with mandatory reporting requirements are: Wisconsin, New Jersey, Maine, Connecticut, and California. *Id*.

[104] *See id*. at 339–40 (discussing the Toxics Release Inventory (TRI) and summarizing the contention of Bradley C. Karkkainen, *Information as Environmental Regulation, TRI and Performance Benchmarking Precursor to a New Paradigm?*, 89 GEO. L. J. 257 (2001) that the TRI changed corporate decision-making (which, in turn, improved the TRI) by motivating: "(1) self-monitoring by firms; (2) peer-monitoring among firms; (3) government and environmental group pressure; (4) community pressure; (5) market pressures and (6) mutually reinforcing behaviors by firms").

[105] Some argue that state statutes focusing on disclosure are more feasible than other types of regulation because disclosure is not "coercive." *See, e.g.*, Schatz*, supra* note 103, at 336.

directors manage the corporation and are required to act in the best interest of the corporation, as fiduciaries.[106] As such, bodies of state corporate and decisional law play an important role in defining the scope of officer fiduciary duties.[107] The decisions of officers and directors are usually given deference by the courts and reviewed under the business judgment rule.[108] The business judgment rule requires courts to review the process by which officers and directors make decisions but only permits review of the board's substantive decision if a plaintiff can establish that the board violated its fiduciary duties.[109] Resolving a matter long uncertain, the Delaware Supreme Court recently determined that corporate officers have the same fiduciary duties as directors do.[110]

While it is now settled—at least in the influential Delaware forum—that corporate officers have the same fiduciary duties as directors, it is uncertain what the scope of those duties are. Fiduciaries have a duty of care to the corporation, and commentators have speculated that corporate officers may have a higher duty of care than outside directors because their familiarity with the day to day operations of the company is greater.[111] This is particularly relevant after *In re Caremark International Inc. Derivative Litigation*,[112] in which the Delaware Court of Chancery stated that a director's duty of care includes the duty to assure that corporations have a proper monitoring system in place to ensure that corporate information indicating noncompliance with reporting or other requirements comes to light.[113]

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[106] *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (holding that deal protection devices which preclude the board of directors from exercising their fiduciary duties and coerce stockholder votes are unenforceable).

[107] *See* Jane J. Kim, *Fiduciary Duty Hits the Street – Sort Of*, WALL ST. J., Aug. 31, 2009, http://online.wsj.com/article/SB125150143646168267.html (discussing efforts to impose uniform fiduciary duty standards on investment advisors and noting that such federal regulation could preempt traditional state common law standards of fiduciary duties).

[108] *See* Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971) (noting the business judgment rule is premised on the notion that actions taken by directors are typically done "'in good faith'" and "'inspired for the best interests of the corporation'" (quoting Warshaw v. Calhoun, 221 A.2d 487, 492–93 (1966))). The business judgment rule is a very deferential standard of review and unless the plaintiff challenging an action can prove that the business judgment rule does not apply, the court will uphold the board's decision if it can be "'attributed to any rational business purpose.'" Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949, 954 (Del. 1985) (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (1971)). There are a number of situations in which a plaintiff can challenge the presumption of the business judgment rule. For example, if a director is "interested" in a transaction such that the director stands to personally benefit, plaintiffs may be able to rebut the presumption of the business judgment rule. *See Sinclair Oil Corp.*, 280 A.2d at 720.

[109] *See* Craig W. Palm & Mark A. Kearney, *A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part I)*, 40 VILL. L. REV. 1297, 1303–04 (1995) ("From a procedural perspective, the challenging shareholder has the initial burden to show that the board's decision was not proper because the board violated one or more of its three fundamental duties to the corporation.").

[110] *See* Gantler v. Stephens, 965 A.2d 695, 708-09 (Del. 2009) ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold.").

[111] *See* Shannon German, *What they Don't Know Can Hurt Them: Corporate Officers' Duty of Candor to Directors*, 34 DEL. J. CORP. L. 221, 257 (2009) (arguing that Delaware law "leave[s] room for the idea that corporate officers could be held liable for failing to fully inform the board of all material information in the officers' possession").

[112] 698 A.2d 959 (Del. Ch. 1996).

[113] *Id.* at 970.

One professor suggests that reading *Caremark*, SOX, and increased proxy access together evidences an overall trend towards imposing more stringent fiduciary duties upon officers and directors and suggests that these heightened fiduciary duties may include monitoring environmental disclosure responsibilities to ensure that corporations do not run afoul of SEC reporting requirements.[114]

Additionally, officers and directors in states with "responsible corporate officer" laws should be particularly vigilant in ensuring that their companies comply with state statutes enacted to combat climate change. A California appellate court recently used the responsible corporate officer doctrine as a basis for holding corporate officers personally liable in a civil suit for violations of environmental statutes that affect the public welfare.[115] The *Roscoe* decision is an important indication of continued judicial willingness to enforce state environmental statues and agency regulations.[116]

Conclusion

The SEC does not currently mandate disclosure of climate change risk and companies have not typically disclosed costs associated with climate change, often on the grounds that because climate change regulation and costs are speculative, such costs are not material to investors. Changing investor attitudes and an increased likelihood of federal regulation pertaining to climate change may alter the traditional 'materiality' determination and costs associated with climate change are likely to be material in the future. In addition to federal regulation of climate change, states and private investors may take action to compel climate change disclosure. If corporate disclosure of climate change is required, the question becomes: What disclosure is required and with what specificity should it be disclosed?

[114] Wallace, *supra* note 22, at 330–33.
[115] People v. Roscoe, 87 Cal. Rptr.3d 187 (Cal. Ct. App. 2008).
[116] See Client Alert, Paul Hastings, Corporate Officers Beware – California Court Revives and Expands the "Responsible Corporate Officer Doctrine" and Imposes Millions in Personal Fines (January 12, 2009), http://www.paulhastings.com/assets/publications/1136.pdf?wt.mc_ID=1136.pdf (listing judicial willingness to impose personal liability on officers as indication that it "legitimizes environmental agencies' use of [the responsible corporate officer doctrine] to impose administrative penalties on individual corporate officers").