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Climate-Related Securities Suits May Increase With New SEC Standards

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Takeaways

- The SEC plans to issue new disclosure requirements regarding climate-related risks and opportunities, and the agency's recent actions suggest we have entered a new era of oversight when it comes to climate-related disclosures by public companies.
- Additional SEC disclosure requirements may increase litigation risk, as investors will scrutinize required disclosures along with other statements regarding climate issues, seeking potentially actionable misstatements or omissions.
- Past cases provide insight into how courts might treat future climate-related shareholder suits.
- If a company experiences adverse effects from climate change and a corresponding drop in stock price, federal securities suits may follow.

A New Era of Climate Disclosure Oversight

In 2010, the Securities and Exchange Commission (SEC) provided public companies with interpretive guidance on existing SEC disclosure requirements as they applied to climate change developments. The guidance did not alter disclosure requirements but suggested that, under the existing framework, companies might be required to disclose some climate-related risks and developments.

In March 2021, the SEC announced that, in response to investor demand it had established a task force within its Division of Enforcement whose mandate is to identify gaps in existing SEC disclosure requirements regarding climate and other ESG matters. The SEC also published a corresponding request for comment. Three-fourths of 550 letters subsequently submitted supported mandatory climate disclosure rules.

Then, in July 2021, SEC Chair Gary Gensler gave a speech suggesting that any new climate-related disclosure regulations are likely to be mandatory, noting that "it's with mandatory disclosures that investors can benefit from that consistency and comparability." Chair Gensler also explained that he asked SEC staff "to consider whether these disclosures should be filed in the Form 10-K [annual report], living alongside other information that investors use to make their investment decisions."

The new focus on ESG matters was evident again when, last September, the SEC released a sample comment letter that its staff may send to public companies regarding climate-related disclosures, or the absence thereof, in annual reports. (See our September 22, 2021, client alert "SEC Staff Issues Detailed Form 10-K Comments Regarding Climate-Related Disclosures.") The topics included the differences between the company's corporate social responsibility reports and its SEC filings, material climate-related litigation risks and indirect consequences of climate-related regulation or business trends. Those consequences could include decreased demand for goods and services that produce significant emissions, increased demand for goods that result in lower emissions and reputational risks resulting from operations or products resulting in material emissions, the letter indicated.

Taken together, the SEC's recent actions suggest we may soon enter a potential new era of oversight when it comes to climate-related disclosures by public companies.

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The Risk of More Climate-Related Securities Suits

The anticipated SEC rules also raise the prospect of a new wave of federal securities suits by private investors stemming from climate change disclosures. Such lawsuits could be either event-driven (*e.g.*, a drop in the stock price triggered by an adverse event affecting the company due to climate change) or proactive attempts to bring about corporate change through litigation.

Existing case law provides insight into how courts might treat future climate-related shareholder suits.

In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation (N.D. Cal.). Volkswagen bondholders alleged that the company violated securities laws by failing to disclose its emissions fraud. While Volkswagen had made statements in a bond offering memorandum and in corporate social responsibility (CSR) and sustainability reports that certain of its vehicles were environmentally friendly "clean diesel" vehicles, plaintiffs alleged the company had installed a device in those cars allowing them to evade emissions test procedures.

The court rejected the plaintiffs' claims based on the CSR and sustainability reports because the offering memorandum stated that investors should rely only on the information in that memorandum. However, the court allowed claims based on statements in the offering memorandum to proceed. The court noted that certain statements made by the company could lead a reasonable investor to conclude that Volkswagen "was committed to emissions-reducing technology," which could have been misleading.

Ramirez v. Exxon Mobil Corporation (N.D. Tex.). The court denied in large part a motion to dismiss a securities fraud complaint based on statements made by the company in a report titled "Energy and Carbon — Managing the Risks." While the company stated there that it applied a certain proxy cost of carbon in preparing its financials, the plaintiffs alleged that the defendant used a lower proxy cost internally. The court concluded that the plaintiffs had adequately alleged that the company made a material misstatement.

In re Vale S.A. Securities Litigation (E.D.N.Y.). After one of the defendant's dams in Brazil collapsed, plaintiffs alleged the company had made material misrepresentations in public filings and other statements relating to the safety of its dams, its sustainability practices and its compliance with safety standards. In that case, the court cited a sustainability report the company issued in connection with its general practices, and held the plaintiff adequately alleged material and actionable statements in that report because Vale "put the topic [of sustainability and safety] at issue such that [the Court] cannot say that, as a matter of law, investors would not find [certain] representations material."

See "Despite Last Year's Decline in Filings, Securities Litigation Will Likely Pick Up in 2022 Due to Plaintiffs' Continued Focus on SPAC Transactions and Event-Driven Litigation" and "Environmental Groups Have Sued Large German Companies To Reduce Their Products' CO2 Emissions."

Three Ways To Reduce Litigation Risk

In advance of the expected SEC requirements, companies may wish to consider the following actions to reduce litigation risk.

First, they should bear in mind that the new reporting rules may require more specificity as to the effects of climate change on the business's operations and results, which could make it more difficult for companies to argue in litigation that statements are merely aspirational or inactionable "puffery." When characterizing any climate-related information positively, companies should consider disclosure of any contrary material facts.

Second, general statements regarding a company's commitment to net-zero emissions or other climate goals may be deemed "material" to shareholders — at least at the pleading stage of litigation — even if those statements are relatively unspecific. Companies should ensure any forward-looking statements are identified as such and accompanied by adequate cautionary language.

Third, courts and plaintiffs will likely look at sustainability reports issued by the company, and not just SEC filings, as a source of potential alleged misrepresentations. Therefore, companies need to ensure the accuracy of all their statements about climate matters regardless of the document in which the statement appears, in addition to implementing appropriate disclosure controls and procedures regarding sustainability disclosures. (See our June 29, 2021, client alert "Enhancing Disclosure Controls and Procedures Relating to Voluntary Environmental and Social Disclosures.")