CLIENT ALERT

The Widening Circles of the Exxon Mobil Climate Disclosure Investigation and Its Implications for Energy Companies

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New York State Attorney General Eric Schneiderman's recent announcement that his office will be using the powerful and expansive provisions of New York State's securities statute, known as the "Martin Act," to investigate Exxon Mobil's public statements and internal research concerning climate has put an exclamation point on a chorus of calls by congressmen, senators and presidential candidates for investigation of Exxon Mobil's private knowledge and public statements dating back 30 years. It might also open the door to broader scrutiny under federal securities laws.

In some respects, there is little new here. The Schneiderman investigation draws from a decade-old playbook, and much of it is grounded in basic principles of environmental disclosure that have been debated in the courts for over 30 years. This debate has intensified with investor interest over the past few years but remains linked to actual or alleged discrepancies between private knowledge and conduct, on the one hand, and public disclosure on the other.

Similarly, the New York Attorney General is using the same subpoena powers that were used in 2007 to give one of his predecessors access to documents of publicly-traded electric utilities doing business in New York, to test a simple principle: Were the companies providing the investing public with all material information they knew about the effects of climate change on their business and the consequences of their greenhouse gas (GHG) regulations on their business? In 2007 and 2008, then Attorney General (now Governor) Andrew Cuomo used his Martin Act powers to subpoena, and then negotiate enforceable Assurance of Discontinuance (AoD) agreements with the utilities. The utilities agreed to increase their climate change disclosure to include analysis of material financial risks of GHG regulation and legislation; climate change-related litigation; and the physical impacts of climate change on their operations. The companies also agreed to make disclosure about their current GHG emissions and the expected emission increases from planned coal-fired power plants; their strategies for reducing, offsetting or managing emissions; and the role of their Boards of Directors in establishing climate change policy.

What may prove to be the longest lasting consequences of the investigation extend beyond the reach of liability under state law, however. The 2008 AoD agreements, for example, created what became a recognized template for climate change disclosure by public utilities. This template was then reinforced by the SEC's February 2010 climate change disclosure guidance document, which treated many of the same substantive areas in the context of Reg. S-K. The power of a Martin Act investigation, and its relationship to a company's disclosures to investors, can also be seen in Peabody Energy Corp's agreement yesterday to increase its climate change-related disclosure to resolve the New York Attorney General's allegations made in 2013 under the Martin Act.

The Exxon Mobil investigation could prove even more complex, and the results more far-reaching, because of the long history of the company's own research into climate-related issues and its own public disclosures (including SEC filings) on the topic. The public utilities that were the subject of the 2007/8 investigation had said little or nothing publicly. By contrast, in addition to the information likely to be yielded by the scope of the Martin Act subpoenas, the Exxon Mobil public record has already been enhanced by two widely reported independent private investigations by news organizations, including a joint Los Angeles

Times/Columbia University School of Journalism study, which describes in detail Exxon's climate research in the Arctic and the company's corresponding statements to, and omissions from, the investing public about the perceived business threat from climate change.

The Broad Reach of the Martin Act

Under the Martin Act, New York's Attorney General has the exclusive responsibility for investigating and enjoining "fraudulent practices in the marketing of stocks, bonds and other securities within or from New York," using broad investigatory powers. At trial, he is not required to demonstrate scienter or intent to deceive in making out a claim for "fraudulent practices." Although the Martin Act does not afford a private plaintiff the right to institute actions to enforce the statute itself, in 2011, New York's highest court ruled that private plaintiffs had the right to bring common law claims separate and distinct from Martin Act obligations. The Martin Act investigation may also generate private federal securities litigation, which will be subject to the more exacting substantive and procedural requirements of the Private Securities Litigation Reform Act of 1995, which, among other things, requires particularized pleading of a "strong inference" of scienter.

The detailed analysis required in such cases arising against the backdrop of high profile environmental matters can be seen in the Ninth Circuit's recent ruling in *Reese v. Malone*, in which the complexities of a publicly-traded oil company's responsive positioning to a crisis are also in full view. In *Reese*, the Ninth Circuit allowed shareholder damage suits to continue after examining the discrepancies between BP's public and private records concerning leaks in two areas of BP's Alaskan pipeline system, one of which spilled 200,000 gallons of oil in March of 2006 and the other, five months later, in a different transit line. Both leaks were the product of pipeline corrosion that had been caused by several forces and exacerbated by what BP subsequently admitted were substandard corrosion detection protocols.

The first spill prompted an extensive investigation by the Pipeline and Hazardous Materials Safety Administration (PHMSA), which issued a Corrective Action Order that contained several findings and questions which, as events unfolded, contrasted markedly with certain of BP's public statements about the events, as well as with the company's corporate protocols. The second spill, which resulted in a temporary shutdown of BP's Prudhoe Bay oil field, prompted investigations by both the Senate and the House. At these hearings, testimony both from regulatory authorities and private sector pipeline maintenance executives also contrasted unfavorably with BP's own public statements.

In their securities fraud case, the plaintiffs in *Reese* focused on three types of statements that they alleged to be false or misleading: (1) press statements by BP's senior executive in charge of the Prudhoe Bay pipeline project, one of which was general in nature and two of which related specifically to the larger, March spill; (2) the general statement by BP's CEO to the press that the March spill had occurred notwithstanding "BP's world class corrosion monitoring and leak detection systems;" and (3) statements in BP's annual reports, one concerning management's belief about BP's material compliance with applicable environmental laws and regulations and one touting BP's "environmental best practices."

The Ninth Circuit found all but the CEO's general statement actionable under the federal securities laws. Employing a point-by-point analysis to demonstrate the adequacy of plaintiffs' pleadings under the exacting federal "scienter" requirements, the Ninth Circuit found that plaintiffs had adequately pled knowing material falsity.

The final facet of the Court's opinion, which took BP to task for what many would consider standard boilerplate disclosure in its Annual Report, the type of boilerplate that Exxon Mobil itself has used in the climate change context in its 10-K's may turn out to have the longest-lasting ramifications and the further-reaching consequences.

The language in question stated that "Management believes that [its] activities are in compliance in all material respects with applicable environmental laws and regulations." The district court had found that these statements were too "vague and ambiguous" to support an allegation of falsity. Similarly, the district court found the phrases "management believes" and the use of the qualifier "material," to be significant.

The Ninth Circuit took a sharply differently view. In the Court's view, the egregious nature of the violations, all of which had occurred before the annual report was formally issued, the ongoing discussions with PMHSA in the context of violations of the Corrective Action Order, and BP's comparatively poor performance compared to industry norms belied the assertion of "material compliance."

As to scienter, the Ninth Circuit reasoned that, in light of the prominence of the violations and their magnitude, it would be absurd to suggest that top management was unaware of the compliance issues that rendered the annual report statement misleading. Not satisfied with simply tearing through the veil of these standard qualifiers, the Ninth Circuit also contrasted the specific statement with BP's broad boilerplate language concerning general environmental risks facing the company. Placed in the context of these broad risks, BP's statement concerning management's belief that there had been general compliance effectively misdirected shareholders from the very specific problems that BP was actually facing as a result of the corrosion of its Alaska pipelines and the resulting leaks. Rather than providing general cover, according to the Court, these two elements of the annual report compounded the falsity of the statements for purposes of analyzing the securities fraud pleadings. A similar analysis, using similar methodology, appears to create risk for Exxon Mobil and other publicly-traded energy companies under federal securities laws.

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