Officers' and Directors' Fiduciary Duties and Corporate Disclosure Obligations

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The Current Picture: Trends and Events

The financial crisis and any economic downturn will change the landscape for the scope and timing of federal climate legislation.

Climate change continues to dominate shareholder resolutions on environmental matters. Environmentally conscious investors include high-profile entities such as CalPers, with significant market presence.

CERES' September 2007 SEC Petition is a prominent step towards mainstreaming climate change disclosure requirements, – physical risk; regulatory risk; GHG emissions; management strategy and governance.

The August 2008 Xcel settlement agreement and California SB 1550 sharpened the focus on the "ask" for climate disclosure.

The first RGGI auction, in September 2008, established the cost of carbon well above pre-established price floors in a regional cap-and-trade market, moving disclosure a step closer to quantification.

EPA missed the September 2008 deadline for a draft rule establishing a GHG emissions registry pursuant to the FY 08 Omnibus Appropriations Act registry. EPA must develop a final rule by June 2009.

A global voluntary disclosure platform is likely, but is several years away.

The Current Picture: Best Practices

Companies must rigorously reconcile their mandatory and voluntary disclosure.

Companies should monitor state and regional initiatives closely. The battle for leadership and ongoing federal inaction raise the stakes at this table.

Boards must require management to gather actively and evaluate intelligently all climate change information material to their businesses.

Fiduciary Duties

Loyalty

There can be no conflict between duty and self-interest. Guth v. Loft

Good Faith

Honesty of purpose and genuine care for fiduciary's constituents. Barkan, Stone

8 DGCL 102(b)(7). Corporation may eliminate or limit director liability except for breach of duty of loyalty or good faith.

Fiduciary Duties

Due Care

A prudent person acting in the interests of the corporation, considering all material information reasonably available. Integrated Health Services

An unconsidered failure to act may breach the duty, if sustained or systematic. Caremark

The content of a board decision is not, by itself, grounds for liability. Disney II

Available Material Information

The same diligence in gathering and considering material information as an ordinarily prudent person under similar circumstances. Hanson

Reasonable reliance on experts is warranted; unquestioning acceptance is not. Hanson, Nuveen

A belief, no matter how formed, must be rational. Navellier

Business Judgment Rule

A presumption that directors act on an informed basis and in the honest belief that their actions are in the best interests of the company and its shareholders. Aronson

An unintelligent or unadvised judgment is not protected. Van Gorkom

Presumption does not protect a fundamentally flawed process. In re Holly Farms

SEC Disclosure Regulations

10-b-5

Prohibits material misstatements or omissions.

Supreme Court: Material if a reasonable investor would view it as significantly altering the total mix of information made available.

SEC: Material if there is a substantial likelihood that a reasonable person would consider it important.

There is no bright line test of materiality. Both qualitative and quantitative factors must be used.

SEC Disclosure Regulations

S-K Item 101 – Disclosure of Capital Expenditures

- **Item 101(c)(xii): Requires disclosure of actual and contingent material effects that compliance with environmental law may have on capital expenditures, earnings and competitive position.**
  - **Time Frame: Current and following year, and far enough ahead to make disclosure not misleading.**
  - **Estimates: Set forth the source, assumptions, methods and extent of uncertainty necessary for the disclosure not to be misleading.**

SEC Disclosure Regulations

S-K Item 103 – Disclosure of Legal Proceedings

Item 103 requires disclosure of pending or contemplated material legal proceedings to which the registrant or any of its subsidiaries is a party or to which their property is subject.

Environmental legal proceedings must be disclosed if:

- The amount involved is material to the business or financial condition of the registrant.

SEC Disclosure Regulations

S-K Item 103 – (cont'd)

The amount exceeds 10% of the current assets of the registrant and subsidiaries on a consolidated basis; OR

A governmental authority is a party, and the proceeding involves potential monetary sanctions, <u>unless</u> the registrant reasonably believes that monetary sanctions, exclusive of interest and costs, will be less than $100,000.

SEC Disclosure Regulations

S-K Item 303 – Management Discussion and Analysis (MD&A)

- **Item 303 requires discussion of currently known trends, events or uncertainties that are reasonably expected to have a material impact on liquidity, capital, sales, revenues or income.**
  - **Is the event reasonably likely to occur?**
  - **Disclose unless a material effect is not reasonably likely.**
  - **Quantify to the extent reasonably practicable.**

The SEC's Y2K Template

Disclose if you have not assessed your risks.

Disclose without regard to countervailing or mitigating circumstances.

Address in meaningful and specific language:

- **General plans to address the issue**
- **Effects on business, finances, customers, suppliers and other constituents**
- **Timetable, budget and impacts**

(Staff Legal Bulletin No. 5, Revised 1/12/98)

The Xcel Settlement

In September 2007, New York Attorney General Andrew Cuomo subpoenaed Xcel and four other power companies for information on their disclosure of financial risks from climate change.

The subpoenas were issued under the Martin Act, which gives the Attorney General access to documents of firms doing business in the state. Executive Law § 63(12)

In August 2008, Xcel entered into an enforceable Assurance of Discontinuance ("AoD") in which it agreed to increase its climate change disclosure.

Xcel AoD Requirements

- Analysis of material financial risks of:
  - Present and probable GHG regulation and legislation
  - Climate change-related litigation
  - Physical impacts of climate change on operations
- Additional Disclosures
  - Current GHG emissions and expected emissions increases from planned coal-fired power plants
  - Strategies for reducing, offsetting or managing emissions
  - Corporate governance actions on climate change, including the role of the Board of Directors and whether environmental performance affects officer compensation

Credit for Past Disclosure (or Risk?)

The AoD notes several recent developments:

- **Xcel's 2006 Response to Climate Disclosure Project included the expected impact of climate change and GHG regulation on Xcel's operations, financial condition, and its plans to construct new coal-fired power plants**
- **Xcel's Form 10-K for 2007 contained more detailed disclosures on climate change risk than previous filings**
- **Xcel issued a corporate responsibility report based on GRI standards, and made climate change risk disclosure in various filings with state agencies and the SEC**

Implications of the AoD

Companies in the power industry now have an enforceable example of a disclosure template and may feel pressure to increase their climate change disclosure in the areas outlined by that template.

Increasing support for climate-related shareholder resolutions and possible resolution of the Ceres Petition to the SEC are part of the same picture.

The AoD may accelerate adoption – and heighten the credibility – of private disclosure templates.

California SB 1550

In February 2008, State Senator Florez introduced SB 1550, which would have required the Controller to develop a non-binding climate change disclosure standard, including:

- Historical direct and indirect GHG emissions since 1990
- Strategies for reducing, offsetting or managing emissions
- Corporate governance actions on climate change, including executive compensation linkage
- Assessment of physical and regulatory risks

On August 31, the last day for any bill to be passed, the Senate rejected Assembly amendments, and the bill died.

Appendix

Recent SEC-Driven Climate Disclosure

Regulatory Risk

Coal-fired Electric Co.

There have been a variety of unsuccessful legislative efforts to force mandatory control of utility emissions that allegedly contribute to climate change. If legislation is passed in the future requiring mandatory carbon dioxide emission reductions to address climate change, this could have a tremendous impact on all coal-fired electric utilities, including the Company's operations, by requiring the Company to significantly reduce the use of coal as a fuel source.

Regulatory Risk

Auto Co.

If significant increases in CAFE standards are imposed beyond those presently in effect or proposed, or if state greenhouse gas regulations are not overturned, we may be forced to take various costly actions that could have substantial adverse effects on our sales volume and profits. For example, we may have to curtail production of certain vehicles such as family-size, luxury, and high-performance cars and full-size light-trucks; restrict offerings of selected engines and popular options; and/or increase market support programs for our most fuel-efficient cars and light-trucks in order to maintain compliance.

Regulatory Risk

Oil Co.

Until an implementation plan is developed [for Kyoto] it is impossible to assess the impact on specific industries and individual businesses within an industry. It is generally believed that the oil and gas industry, as a major producer of carbon dioxide, will bear a disproportionately large share of the anticipated cost of implementation. Any required reductions in the greenhouse gases emitted from our operations could result in increases in our capital expenditures and operating expenses, which could have an adverse effect on our results of operations and financial condition.

Litigation Risk

Defendant Utility Co.

In July 2004, attorneys general from eight states, each outside of [our] service territory**,** and the corporation counsel for New York City filed a complaint in the U.S. District Court for the Southern District of New York. A nearly identical complaint was filed by three environmental groups in the same court. The complaints allege that the companies' emissions of carbon dioxide, a greenhouse gas, contribute to global warming, which the plaintiffs assert is a public nuisance. Under common law public and private nuisance theories, the plaintiffs seek a judicial order (1) holding each defendant jointly and severally liable for creating, contributing to, and/or maintaining global warming and (2) requiring each of the defendants to cap its emissions of carbon dioxide and then reduce those emissions by a specified percentage each year for at least a decade. Plaintiffs have not, however, requested that damages be awarded in connection with their claims. [We] believe these claims are without merit and note that the complaint cites no statutory or regulatory basis for the claims. In September 2005, the U.S. District Court for the Southern District of New York granted …the defendants' motion to dismiss these cases. The plaintiffs filed an appeal to the U.S. Court of Appeals for the Second Circuit on October 19, 2005. The ultimate outcome of these matters cannot be determined at this time.

MD&A / Opportunity

Industrial Co.

We offer wind turbines as part of our renewable energy portfolio, which also includes solar and geothermal technology. We are a worldwide supplier of gas turbines for Integrated Gasification Combined Cycle (IGCC) applications, having provided gas turbines for a significant number of the world's operating IGCC plants. IGCC systems convert coal and other hydrocarbons into synthetic gas that, after cleanup, is used as the primary fuel for gas turbines in combined-cycle systems. IGCC systems produce fewer air pollutants compared with traditional pulverized coal power plants. We continue to invest in advanced technology development that will provide more value to our customers and more efficient solutions that comply with today's strict environmental regulations.

MD&A

Multi-jurisdictional Company (U.S.)

The United States is not a party to the Kyoto Protocol. Instead, the U.S. greenhouse gas policy currently favors voluntary actions, continued research, and technology development over near-term mandatory greenhouse gas reduction requirements. Although several bills have been introduced in Congress that would compel carbon dioxide (CO_2) emission reductions, none have advanced through the legislature and presently there are no federal mandatory greenhouse gas reduction requirements. The likelihood of a federally mandated CO_2 emissions reduction program being enacted in the near future, or the specific requirements of any such regime, is highly uncertain. Several states have taken legislative or regulatory steps to manage greenhouse gas emissions, none of which will impact our operations. A number of U.S. states in the Northeast and far West are discussing the enactment of either state-specific or regional programs that could mandate future reductions in greenhouse gas emissions, or otherwise manage those emissions, although the outcome of those state discussions is highly uncertain. We support the enactment of U.S. federal legislation that would be in the form of a federal-level carbon tax or other market based mechanism that provides the policy advantages of a carbon tax approach and also applies to all sectors of the economy. Believing that it is in the best interest of its investors and customers to do so, [we are] actively participating in the evolution of federal policy on this important issue.

MD&A

Insurance Co.

We write a considerable amount of business that is exposed to U.S. hurricanes and windstorms. This volatility is compounded by accounting regulations that do not permit reinsurers to reserve for such catastrophic events until they occur. We expect that increases in the values and concentrations of insured property will increase the severity of such occurrences per year in the future and that climate change may increase the frequency of severe weather events. In 2005, three major hurricanes made landfall in the United States and caused substantial damage. Underwriting is inherently a matter of judgment, involving important assumptions about matters that are unpredictable and beyond our control, and for which historical experience and probability analysis may not provide sufficient guidance.

Additional Resources

http://www.abanet.org/environ/committees/environdisclosures/home.html

Global Climate Change and U.S. Law (Michael B. Gerrard ed., 2007)

Disclosure of Climate Change Risks and Opportunities, *The Review of Securities & Commodities Regulation*, **Vol. 41, No. 1**

Climate Change Disclosure: Moving Towards A Brave New World, *Capital Markets Law Journal*, **Aug. 2008**

Additional Resources

17 C.F.R. § 229.101-303

Staff Accounting Bulletin (SAB) No. 92, 58 Fed. Reg. 32843 (June 14, 1993)

SAB No. 99, 64 Fed. Reg. 45150

Mark A. Stach, *Disclosing Environmental Liabilities Under Securities Law* (Clark Boardman 1997)

C. Gregory Rogers, Financial Reporting of Environmental Liabilities and Risks after Sarbanes-Oxley (Wiley 2005)