ARE SECURITIES LAWS EFFECTIVE AGAINST CLIMATE CHANGE? A PROPOSAL FOR TARGETED CLIMATE RELATED DISCLOSURE AND GHG REDUCTION

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ABSTRACT

The New York Attorney General filed a lawsuit against Exxon Mobil on October 24, 2018, claiming the company committed securities fraud in order to prop up the value of the company by publicly disclosing a higher proxy cost—or projected future cost—of climate change regulation than the internal cost used. Following this lawsuit, a federal class action was filed utilizing the same legal theory on the same facts. These lawsuits should be viewed as part of the larger history of lawsuits against large fossil fuel companies for climate change-related harms. Public nuisance theory largely captured a set of lawsuits against these companies, before being nullified as an actionable federal claim by AEP and Kivalina on displacement grounds.

There are several issues with using securities fraud to address climate change. First, securities laws suffer from circularity, as harmed investors are recouped by other stakeholders and the corporation, thereby also harming the shareholder group, and leaving no net gain. Second, quantifying proxy costs poses a challenge, as future regulations are not yet in existence. Third, climate change disclosure is not mandated by the SEC, which leads to a range of disclosure, often inadequate, from the use of varied accounting frameworks or the lack of disclosure entirely. Finally, securities law fails to address the societal cost of climate change, instead focusing on reimbursing the internal harmed shareholder group while excluding externally harmed groups. This Note proposes a legislative solution through comparison to the Dodd-Frank Wall Street Reform Act of 2010 as a societal-focused law. Through the proposed legislation, this Note seeks to help

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refine securities fraud as a tool to combat climate change-related financial fraud to capture negative externalities.

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INTRODUCTION

The effects of climate change continue to worsen as the global rise in temperature approaches 1.5 degrees Celsius. The frequency and intensity of hurricanes, wild fires, droughts, heat waves, and other extreme weather events are increasing, while glacier melt and sea level rise continue unabated. Climate change has conclusively been attributed to anthropogenic greenhouse gas (GHG) emissions. Recently, the Climate Accountability Institute reported that if fossil fuels continue to be extracted at the same rate over the next twenty-eight years as they were between 1988 and 2017, “global average temperatures would be on course to rise by 4 degrees Celsius . . . by the end of the century.” This temperature rise has dire consequences, including extensive “species extinction . . . and global food scarcity” risks. The report further calculated that one hundred companies are responsible for 71 percent of all global emissions. Exxon Mobil is responsible for 2 percent of all global GHG emissions from 1988–2010. This makes it the fifth highest emitting entity globally, and the first overall non-nation-state-owned company. It ranks behind a nation state, China, and three nationally owned oil and gas companies—Saudi Aramco, Gazprom, and National Iranian Oil Company. It is thus not surprising that Exxon Mobil and other large fossil fuel emitting companies have been the target of climate change laws.
change litigation. The use of securities laws for climate change litigation is, however, a relatively new phenomenon.\(^\text{10}\)

To understand the current use of the securities laws to address climate change, it is important to discuss the recent climate change litigation history. A decade prior to New York’s lawsuit, federal public nuisance theory was used against large fossil fuel companies.\(^\text{11}\) However, in 2011 and 2012, two rulings heralded the demise of federal public nuisance under the displacement theory.\(^\text{12}\)

The more recent phenomenon is the use of “proxy cost” in climate change securities disclosure litigation.\(^\text{13}\) Proxy cost is defined as the present financial cost of future governmental regulatory action.\(^\text{14}\) According to New York’s lawsuit, it affects present day value of the company, including its investment decisions, business planning, assets, and estimates of future demand for oil and gas.\(^\text{15}\) New York’s lawsuit alleges differing internal and publicly represented proxy costs.\(^\text{16}\) However, proxy cost suffers from the challenge of quantification, as the regulation nor its cost exist.\(^\text{17}\)

Scholars argue that securities litigation in general suffers from circular wealth transfers.\(^\text{18}\) They argue that when a secondary purchaser of securities successfully claims that the company has made false or misleading material representations causing an inflated purchase price,


\(^\text{12}\) Am. Elec., 564 U.S. at 424; Native Vill., 696 F.3d. at 857 (stating that “[w]hen Congress has acted to occupy the entire field, that action displaces any previously available federal common law action”) (citation omitted). Displacement theory refers to when a federal statute addresses the same issue and offers a remedy for an overlapping federal common law right, therefore rendering the common law right void.

\(^\text{13}\) Summons & Complaint, supra note 11, at 27.

\(^\text{14}\) \textit{Id.} (stating that “Exxon has repeatedly and falsely assured investors that it has taken active and consistent steps to protect the company’s value from the risk that climate change regulation poses to its business.”).

\(^\text{15}\) \textit{Id.}

\(^\text{16}\) \textit{Id.} at 27–28.

\(^\text{17}\) See Summons & Complaint supra, note 14, at 27.

the shareholders—who are forced to bear the recovery—are usually innocent of any wrongdoing. In addition, “neither the defendant corporation nor its continuing shareholders ordinarily benefit from the plaintiffs’ purchases,” as they are sold on a secondary market. This occurs because the class is certified by the period in which the securities were bought, thereby leaving the rest of the shareholders to bear the brunt of the penalties brought against the corporation. If they remain shareholders, the harmed shareholder group is penalized, along with the corporation.

Thus, damages would not be adequately apportioned to address the external costs of climate change in a securities disclosure lawsuit. The cases brought by New York and the federal class in Ramirez are based on similar theory and facts, and both seek to reimburse the shareholders who purchased securities on the secondary market. Therefore, the outcome of the lawsuits effectuates a circular wealth transfer and inadequately addresses any externalized harm.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) serves to prevent and mitigate risks to the stability of the American financial system. Dodd-Frank was developed and passed as a response to the 2008 Recession, where the collapse of mortgage-backed securities triggered a bank liquidity crisis. This Note delves into the requirements for Significant Financial Institutions (SIFIs)—the largest financial institutions capable of causing systemic economic harm, and proposes new climate-related securities disclosure laws in order to remedy external, climate change-related harms. Specifically, this Note

19. Coffee, Jr., supra note 18, at 1556.
20. Id.
21. Id. at 1557.
22. Id.
23. See id.
25. See generally id.
27. The Act seeks to prevent the societal risks that come from the financial distress or failure of large, interconnected financial institutions, which include large scale job loss, foreclosure, and lack of ability to secure credit. Dealbook, Obama Moves to Limit ‘Reckless Risk’ of Banks, N.Y. TIMES (Jan. 21, 2010), https://dealbook.nytimes.com/2010/01/21/obama-moves-to-limit-reckless-risks-of-banks/?searchResultPosition=4 [https://perma.cc/6QYM-XFUM].
proposes using the SIFI “stress tests,” or periodic disclosure of liquidity and compliance, and the SIFI liquidity requirement itself, as models for the creation of a mandated environmental, societal, and governmental (ESG) reporting framework for climate change disclosure. The proposal also uses an extension of the U.S. Securities and Exchange Commission’s (SEC) “fair fund” authority under the Sarbanes-Oxley Act (Sarbanes-Oxley) as a legal basis to recoup societal losses from climate change.

This Note assesses whether securities laws are an effective mechanism to combat climate change, with a focus on harm and remedies. Part II discusses the recent use of the federal and state securities laws in the climate change disclosure context, with a focus on the use of proxy cost. Part III centers on the challenge of quantifying future proxy cost and discusses the criticism of shareholder security fraud lawsuits as a circular wealth transfer. Part IV uses the SIFI regulation created under Dodd-Frank as a tool of comparison to propose a new framework for climate change regulation that realizes external costs.

I. THE RISE OF THE SECURITIES LAWS AS A MECHANISM TO COMBAT FRAUDULENT CLIMATE CHANGE DISCLOSURE

A. FAILED PUBLIC NUISANCE ATTEMPTS

Many climate change lawsuits against large fossil fuel-emitting companies used federal environmental statutes, like the Clean Air Act (CAA) or the National Environmental Policy Act, or federal common law tort public nuisance theory. Federal environmental statutes have limited remedies for private claimants, and the doctrine of displacement has effectively extinguished climate change claims under public nuisance theory.

In *American Electric Power Co. v. Connecticut*, the U.S. Supreme Court ruled that the Environmental Protection Agency (EPA) has the authority to regulate GHG emissions under the CAA, thereby displacing

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any claim for injunctive relief under public nuisance theory for climate change.31 Shortly thereafter, in *Native Village of Kivalina v. Exxon Mobil Corp.*, the Ninth Circuit extended the displacement holding in *American Electric* to claims for monetary damages,32 even though the damages sought in *Kivalina* in this action were not available to it under the CAA.33

Along with displacement, it is challenging to show *prima facie* climate change-caused damages.34 For example, in *Kivalina*, the District Court found there was no way to determine whether Exxon Mobil and the rest of the defendants’ emissions could be attributed to the plaintiff’s environmental damage suffered.35

Ultimately, the current New York lawsuit was initiated to recoup investor loss.36 However, this Note assumes that New York State also seeks to combat the negative effects of climate change through securities litigation.37

### B. THE 2008 SETTLEMENT

A decade before the current New York lawsuit against Exxon Mobil commenced, New York used the Martin Act to subpoena multiple utility and energy companies.38 The New York State Attorney General sought

32. *Kivalina*, 696 F.3d. at 857.
34. *Id.* at 142.
35. *Kivalina*, 696 F.3d. at 868; *see infra*, Part II.B. It is argued that proxy costs potentially suffer from a similar causal disconnect.
information about whether these companies’ investors were receiving adequate information about the financial liabilities of carbon dioxide emissions, citing potentially misleading reporting. The investigations resulted in settlement agreements, most notably with two companies, Dynegy and Xcel. The settlements required the inclusion of material financial risks of GHG emissions in relation to climate change, including stranded or impaired assets. The 2008 settlements’ success likely played a role in the decision to initiate the current lawsuit against Exxon Mobil.

C. THE CURRENT LAWSUITS

New York’s securities fraud lawsuit was filed against Exxon Mobil on October 24, 2018. The lawsuit is the culmination of more than two years of investigation under the Martin Act. The investigation commenced in November 2015, after articles from Inside Climate News and The Los Angeles Times alleged the company covered up its own...
climate change research for over thirty years.\textsuperscript{45} Eric Schneiderman—New York’s Attorney General at the time—initiated the investigation, alleging the company did not disclose its own conclusive knowledge of climate change to investors.\textsuperscript{46}

By summer 2017, Eric Schneiderman narrowed the scope of the investigation to focus on how Exxon Mobil had two separate financial calculations for the proxy cost of future regulatory action related to climate change: an internal, lower or non-existent proxy cost, and a publicly represented, higher proxy cost.\textsuperscript{47}

The lawsuit contains several allegations, most importantly, that Exxon Mobil failed to apply the proxy cost it represented to the public.\textsuperscript{48} In its place, the company used a lower, undisclosed proxy cost contained in internal corporate guidance, a further lower cost based on a static number, accounting for existing regulations held flat for decades into the future, or no cost associated with GHG emissions.\textsuperscript{49} Additionally, in projecting demand for oil and gas, Exxon Mobil did not apply its public proxy cost to the transportation sector.\textsuperscript{50} It also did not apply proxy costs to its GHG emissions for long-term assets before 2016.\textsuperscript{51}

The federal class actions brought against Exxon Mobil by pension funds over the past two years rest on similar theories of proxy cost fraud.\textsuperscript{52} Ramirez \textit{v. Exxon Mobil Corp.} alleges Exxon Mobil failed to disclose the actual proxy cost of carbon it used and failed to use when calculating

\begin{itemize}
\item \textsuperscript{46} Gillis & Krauss, \textit{supra} note 44.
\item \textsuperscript{47} Emily Flitter, \textit{NY Prosecutor Says Exxon Misled Investors on Climate Change}, REUTERS (June 2, 2017), https://www.reuters.com/article/usa-climatechange-exxon-idUSL1N11Z0O4 [https://perma.cc/Q4RE-WB5R].
\item \textsuperscript{49} \textit{Id.} at 28.
\item \textsuperscript{50} \textit{Id.} at 80.
\item \textsuperscript{51} \textit{Id.} at 8.
\end{itemize}
capital expenditures and other business and investment decisions. Although dismissed, *Fentress v. Exxon Mobil Corp.* alleged Exxon Mobil and several of its executives knew the prices of oil reserves and other assets were overvalued because it did not adequately address the known cost of climate change before writing them down. Part III.A. compares these lawsuits in further detail.

II. **Climate Change Disclosure Fraud Suits Analyzed: Do They Accomplish Their Goal?**

A. **Can Proxy Cost Be Trusted?**

The outcome of *Fentress* demonstrates that securities fraud lawsuits based on proxy cost misstatements are challenging to prove in court. The Southern District of Texas stated the price of future reserves were more likely to have been written down because the price of oil dropped precipitously. The Court also stated that competitors declared impaired reserves in 2014 through 2016, rather than realizing the failure to account for a more accurate future climate change regulatory cost. The Court also determined that even if Exxon Mobil did not effectively publicly divulge the climate change information, investors knew of the risks of climate change. Because publicly available information existed during the class period, the Court ruled the market incorporated this information into the price.

The Court also noted that because fossil fuels are likely to remain the majority of the global energy supply before 2040 based on information provided by the Energy Information Agency, allegations of stranded assets due to climate change regulation and the transition away from fossil fuels are “conclusory and inconsistent” with the reports. The Court concluded its analysis by stating that securities fraud did not provide a mechanism to address the questionable “ethical norms for a company to

55. *See generally id.* at 587.
56. *Id.* at 573.
57. *Id.* at 579.
58. *Id.*
59. *Id.* at 578–79.
60. *Id.* at 578.
know that its business contributes to global harm and at the same time to expect to continue to profit from that business.\textsuperscript{61}

The plaintiff pension fund in \textit{Ramirez} used the same approach, yet focused on the exact communications proving a different internal cost used by the CEO and other executives, $40 per ton at 2030, as opposed to the publicly represented number, $80 per ton at 2040.\textsuperscript{62} The New York lawsuit alleges the same claims on the same facts as \textit{Ramirez}.\textsuperscript{63} The internal communications suggest using a different internal cost of $40 per ton at 2030, as opposed to the publicly represented number, $60 per ton.\textsuperscript{64}

Although the plaintiff’s pension fund in \textit{Fentress} alleged Exxon Mobil and its executives had a different internal proxy cost than the publicly stated price, in hindsight it failed to provide this specific proof.\textsuperscript{65} The Court in \textit{Ramirez} also did not raise the same findings denouncing the significance of proxy cost calculation, among other possible factors, into the devaluation of assets as the \textit{Fentress} court.\textsuperscript{66}

Ultimately, proxy cost is a challenging metric, as it is difficult for courts to trust figures that quantify future regulatory cost.\textsuperscript{67} However, future regulatory action can be estimated by use of accurate accounting models.\textsuperscript{68} As evidenced in \textit{Ramirez}, if there is sufficient evidence the company had two different public and internal figures for proxy cost, a \textit{prima facie} showing of misrepresentation can be made.\textsuperscript{69} Proxy cost also presents a challenge as it relates to the requirement of materiality, which is what an investor might deem important before the sale or acquisition of a security.\textsuperscript{70}

\begin{thebibliography}{99}
\bibitem{61} \textit{Id.} at 579.
\bibitem{62} \textit{Ramirez v. Exxon Mobil Corp.}, 334 F. Supp. 3d 832, 846 (N.D. Tex. 2018);
\bibitem{64} \textit{Id.} at 22.
\bibitem{65} \textit{See Ramirez}, 334 F. Supp. 3d at 845–47.
\bibitem{66} \textit{See id.; see also Fentress v. Exxon Mobil Corp.}, 304 F. Supp. 3d 569, 576–80 (S.D. Tex. 2018).
\bibitem{67} \textit{See Fentress}, 304 F. Supp. 3d at 576–80.
\bibitem{69} \textit{See Ramirez}, 334 F. Supp. 3d at 845–47.
\bibitem{70} \textit{TSC Indus., Inc. v. Northway}, 426 U.S. 438, 449 (1976).
\end{thebibliography}
B. Proxy Cost, ESG Reporting, and Materiality

In 2010, the SEC released an Interpretive Release that clarified the applicability of disclosing climate change proxy costs. Proxy costs are an aspect of the broader ESG required disclosure found in the Management Discussion and Analysis (MD&A) section of a company’s SEC disclosure. Though the Interpretive Release did not impose new disclosure requirements or take a position on whether climate change exists, it indicated that the direct and indirect effects of climate change on a registrant’s business may be material to its investors and, therefore, require disclosure in the registrant’s SEC filings. The SEC acknowledged that local, state, federal, and international regulation of GHG emissions may require registrants to increase capital expenditures to reduce GHG emissions or incur expenses related to participation in regulatory schemes. The SEC further stated that registrants who may not be directly affected by such developments could still be indirectly and materially affected, for example, from changes in supply-chain prices.

In general, SEC disclosures require three types of material under SEC Rule S-K, which includes 10-Q quarterly reports and 10-K updates.
to quarterly reports. Item 103 requires disclosure of material pending legal proceedings and Item 303 mandates disclosure of management’s analysis of the financial condition and results of operations of the company, including the financial costs of future litigation, regulation, or legislation. To comply with Item 303, management must evaluate whether the pending legislation or regulation is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, it must proceed on the assumption that the legislation or regulation will be enacted. Second, management must determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the registrant, its financial condition or results of operations. Unless management determines that a material effect is not reasonably likely, MD&A disclosure is required.

Materiality is largely an economic-oriented analysis, as a reasonable shareholder invests for economic reasons. However, there is no generally accepted calculation or formula for determining materiality. Both the SEC and courts have resisted any attempt to formulate a bright-

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79. Hansen, supra note 38, at 496–508.

80. Id.

81. Id.

82. Id.

83. Id.

84. See, e.g., Thomas Joo, Global Warming and the Management-Centered Corporation, 44 WAKE FOREST L. REV. 671, 690 (2009) (“While carbon-impact information might be important to the buying and selling decisions of some, even many, environmentally concerned individuals, the legal standard is that of an objective ‘reasonable shareholder,’ who is presumed to invest in order to make money.”).

line rule for materiality. In August 1999, the SEC issued *Staff Accounting Bulletin No. 99*, which acknowledged the practice of using thresholds to determine whether something would be material. The SEC acknowledged that the 5 percent materiality threshold is useful as a rough metric. This threshold, used by some registrants and auditors, means that a misstatement or omission that is below 5 percent of the company’s value would not be material, absent any other “egregious” conduct. However, the SEC warned against its exclusive reliance.

In addition, for contingent or future events, the probability of the event occurring must be weighed against the magnitude of the event. This aspect of the materiality rule is important for assessing climate change, as its costs are largely intrinsic to the contingent nature of future events. Assessing magnitude requires some determination of the “degree of importance” of the development because “probability essentially requires a look into a crystal ball in an effort to determine the likelihood the development will occur.” Registrants have struggled and may continue to struggle with assessing the materiality of developments that may not be probable, but could have a significant impact on the issuer if they occurred.

C. Securities Litigation and Circular Wealth Transfer

Scholars believe that securities laws essentially transfer wealth from one set of shareholders to another. Professor John Coffee argues this circular transfer occurs when secondary purchasers of securities successfully sue. This wealth transfer occurs because the class is certified by the period in which the securities were bought, therefore leaving the rest of the shareholders to bear the brunt of the penalties

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86. Litwin, 634 F.3d 706, 717 (rejecting bright-line tests for materiality and approving of SEC Staff Accounting Bulletin No. 99).
88. *Id.*
89. *Id.*
90. *Id.*
93. *Id.*
94. *Id.*
95. See, *e.g.*, Coffee, Jr., *supra* note 18.
96. Coffee, Jr., *supra* note 18, at 1556.
against the corporation.\textsuperscript{97} Sometimes, shareholders will be in both the plaintiff class and the remaining shareholder class that bears the cost of the litigation.\textsuperscript{98} This is because the shareholders purchased stock before and during the class period.\textsuperscript{99} Therefore, these shareholders are making wealth transfers to themselves, minus the cost of litigation.\textsuperscript{100}

Large institutional investors are also making wealth transfers to themselves without any benefit.\textsuperscript{101} A large pension fund may hold several hundred stocks.\textsuperscript{102} Based on a calculation of the average amount of securities class action cases, the plaintiff class consists of the pension fund in half of all cases, and in the other half, it is the defendant class that constitutes the pension fund.\textsuperscript{103} Therefore, the pension fund will only transfer wealth from one case to the next, without effectively gaining from the transfer.\textsuperscript{104}

Therefore, as Professor Coffee argues, the law should attempt to impose a greater share of securities class actions’ costs on the more culpable insiders rather than the company.\textsuperscript{105} He argues the most likely beneficiaries of the fraud are the insiders who sold at inflated prices.\textsuperscript{106} However, securities lawsuits may include inside executives alongside the corporation as defendants, and insurance would cover the settlement or judgment amount.\textsuperscript{107} This presents a conflict of interest, as directors may want to settle their own liability with corporate funds.\textsuperscript{108} Therefore, the insiders who are most culpable escape personal liability in securities class actions through insurance and corporate monies.\textsuperscript{109}

\textsuperscript{97} Id.
\textsuperscript{98} Id. at 1558.
\textsuperscript{99} Id.
\textsuperscript{100} Id.
\textsuperscript{101} Id.
\textsuperscript{102} See id.
\textsuperscript{103} Id.
\textsuperscript{104} Id.
\textsuperscript{105} Id. at 1554.
\textsuperscript{106} Id.
\textsuperscript{107} Id. at 1557–58.
\textsuperscript{108} Id.
\textsuperscript{109} Id.
D. SECURITIES FRAUD AND SOCIETAL COST

When it comes to how the securities laws quantify harm caused, there are varying perspectives.110 Some scholars raise the idea that the diversified investor is not harmed.111 Diversified investors may not really need compensation from litigation because they have diversified against the risk of securities violations.112 Institutional investors diversify their portfolios and change financial positions frequently.113 Therefore, the chance of being on the losing or winning side of a transaction when the stock price is distorted is essentially random.114

Institutional investors may be overcompensated by litigation.115 These investors will be compensated for losses through lawsuits, while innocent gains are not accounted for from occasionally being the advantaged party to fraud.116

There is also a normative argument, where any fraudulent conduct should be morally condemned.117 There is a “societal need” to deter securities fraud because fraud itself is a harm done to the public.118 In many types of securities fraud—particularly civil securities fraud—the requirement of scienter reinforces the argument that the morally culpable individual should be punished.119 The origins of the securities laws evidence this phenomenon, as many were created after significant market downturns, such as the Great Depression and the Recession of 2008.120

The courts have identified at least eight other separate policies underpinning securities fraud, most of which include costs to society and


111. Easterbrook, supra note 110, at 641; Alexander, supra note 18, at 1502.

112. Alexander, supra note 18, at 1502.

113. Id.

114. Id.

115. Id.

116. Id.


118. Olazabal, supra note 110, at 1427.

119. Herschkopf, supra note 110, at 468.

120. See id. at 476–79.
the markets. These include maintaining free securities markets, equalizing access to information, insuring equal bargaining strength, providing for disclosure, protecting investors, assuring fairness, building investor confidence, and deterring violations while compensating victims.

Many scholars ultimately agree that the societal impact of securities fraud rests on investor confidence and subsequent loss of capital. Professor Coffee argues that the cumulative impact of the Enron and WorldCom scandals between 2000 and 2002 made stockholders wary, chilling the markets and causing investors to demand a higher return. When the cost of capital increases, the economy suffers—and thus, society suffers as a result. Even smaller fraud cases may be aggregated, and therefore, it is argued, do affect the markets negatively.

The fundamental mechanism of securities laws is proper disclosure. Disclosure is an essential aspect of investor confidence. When investors know what product they are receiving, and that the price is accurate, markets function more efficiently. The markets rely on trust and transparency, and disclosure is fundamental to these goals.

121. Herpich v. Wallace, 430 F.2d 792, 801, 806, 808 (5th Cir. 1970) (discussing free markets, fairness, disclosure, protecting investors, equal access, and equalization of bargaining position); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 847–48, 851–52, 855, 858, 860 (2d Cir. 1968) (mentioning fairness, equal access, deterrence, free markets, disclosure, and protecting the investing public).
122. Herpich, 430 F.2d at 801, 806, 808; Texas Gulf Sulphur, 401 F.2d 833, 847–48, 851–52, 855, 858, 860.
123. Coffee, supra note 18, at 1565–66.
124. Id.
125. Id.
126. See id.
127. Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988) (“The 1934 Act was designed to protect investors against manipulation of stock prices . . . . Underlying the adoption of extensive disclosure requirements was a legislative philosophy: There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.”) (internal citation and quotation marks omitted).
128. Id.
129. See id.
130. Id.
E. Significant Financial Institutions Under Dodd-Frank, Systemically Focused Regulation

1. Scope

Dodd-Frank was passed in 2010 with the goal of preventing and mitigating “risks to the stability of the financial system of the United States.”

2. Criteria

There is no specific threshold that the FSOC has that would automatically include a company as a non-bank financial institution. However, the FSOC looks to a list of factors that would indicate a need for enhanced regulatory oversight. The FSOC factors include: (a) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies; (b) the importance of the company as a source of credit for households, businesses, and state and local governments and as a source of liquidity for the United States financial system; (c) the importance of the company as a source of credit for low-income, minority,

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134. Id.
135. Id.
136. Id.
137. Id.
or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities; and (d) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company, among other factors.138

As all administrative agencies are required to do, the FSOC must state with particularity how the regulatory body made its decision.139 This means the FSOC must state “what the actual [systemic financial] losses would be” if the corporation went into financial distress and “how the market would destabilize as a result.”140 Although the FSOC makes a predictive judgment, it must be based on reasoned predictions.141 The reasoning must also include an analysis of cost, where it must be “appropriate” and “risk-weighted,” considering systemic risk and insolvency risk compared to the regulatory cost imposed on the company.142

3. Requirements Imposed

Once a company is deemed a non-bank financial institution, the company must adhere to a list of standards imposed by the FSOC.143 The most important aspect of this regulation is the same requirement imposed on the regular SIFIs: nonbank financial institutions must maintain a debt to equity ratio of no more than 15 to 1.144

Non-bank financial institutions are also prohibited from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus.145 These companies may also be required to establish a risk committee that would be responsible for the oversight of the enterprise-wide risk management practices.146 Further regulations may be prescribed, including periodic public disclosures by non-bank financial institutions.

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138. Id.
140. Id.
141. Id.
142. Id. at 241.
144. Id.
145. Id.
146. Id.
financial institutions in order to support market evaluation of the risk profile, capital adequacy, and risk management capabilities.147

Other requirements include potential intermediate holding company requirements, examinations of liquidity through stress tests, and enhanced reporting and information collection.148 In conducting its supervisory stress tests, the Federal Reserve calculates the projections of each firm’s balance sheet, risk-weighted assets, net income, and resulting regulatory capital ratios under these scenarios using data on firms’ financial conditions and risk characteristics provided by the firms and a set of models developed or selected by the Federal Reserve.149

III. EXXON MOBIL AS SIGNIFICANT CARBON INSTITUTION? DODD-FRANK INSPIRED REGULATION IN THE CLIMATE CHANGE ARENA

The proposed regulation seeks to capture negative externalities associated with climate change, including harm to the economy and vulnerable populations. The proposal does so through a loose comparison to Dodd-Frank SIFI regulation. Much like Dodd-Frank’s SIFI regulation, this proposal seeks to capture negative externalities.150 Dodd-Frank’s SIFI regulation and the proposal seek to avoid large negative externalities through greater disclosure and targeted requirements. The proposal goes beyond proxy cost, to capture all climate change-related ESG reporting. The proposal, although a proposed federal regulation, also recommends to states to adopt a similar regulatory package.

First, the proposal requires the SEC to implement an emissions reduction commitment for all disclosing companies, alongside a standardized reporting framework. The framework adopted is the Climate Change Reporting Framework (CCRF) created by the Climate Change Disclosure Standards Board (CDSB).151 To calculate GHG emissions, the proposal mandates the use of the Greenhouse Gas Protocol (GHG

147. Id. § 5365(j)(3).
Protocol) accounting methodology.152 Transparent and comprehensive disclosure makes markets more efficient, as capital can be allocated to the best investments.153 On the contrary, financial fraud creates chilling effects on economic behavior and allows companies and their executives to enjoy inflated share values and its associated benefits.154

Second, the proposal adopts a similar sanction framework as Dodd-Frank.155 Dodd-Frank permits the FSOC to recommend participating agencies to force an over-leveraged, systemically compromising company to divest assets or dissolve.156 This proposal grants the SEC the asset divestiture power, but only as a last resort after a five-year grace period. The proposal first focuses on monetary penalties and increasing regulatory oversight in the event of non-compliance.

Third, the proposal expands the available SEC remedies to use sanction funds to support climate change-related adaptation, mitigation, and cleanup efforts for communities most affected—especially lower-income and disadvantaged groups. The proposal provides for EPA oversight of this program, given the agency is tasked with environmental regulatory oversight. Although this remedy goes beyond the traditional underpinnings of securities laws, as it is not “injured-shareholder-centric,”157 providing benefit to non-shareholders of the defendant company, it furthers the fundamental legal goal of remedying harm caused. Through fraudulent conduct, companies obtain inflated value through material misstatements from climate change-causing business practices.

Finally, the proposal recommends that the SEC and individual states pursue climate change securities fraud lawsuits as opposed to relying on private class actions to deter and remedy harmful conduct. Government use of securities fraud is a better tool than private class actions for remedying the external, societal costs of climate change.158 Private securities litigation, especially when secondary purchasers sue, creates a circular transfer, as plaintiff share classes obtain monetary remedy from

152. See GHG Protocol, supra note 68.
153. See supra Part II.D.
154. See supra Part II.D.
158. See supra Part II.C.
the remaining stakeholders\textsuperscript{159} of the company.\textsuperscript{160} Government lawsuits can obtain civil and criminal damages, which can indirectly compensate the injured external, societal stakeholders.\textsuperscript{161} Furthermore, coupled with standardized, frequent disclosures, federal and state governments will ideally be able to bring more comprehensive cases to stop fraudulent activity.

\textbf{A. Transfer of Wealth from Exxon’s Stakeholders to Exxon’s Shareholders}

Securities litigation tends to create a circular wealth transfer when secondary purchasers sue for material misrepresentation against a corporation.\textsuperscript{162} Either the class is certified or the shareholder group is named in a public lawsuit by the period in which the securities were bought, therefore leaving the rest of the shareholders to bear the brunt of the penalties against the corporation.\textsuperscript{163} The transfer of wealth occurs from the stakeholder remainder group to the class shareholder group, even as this group is not the source of the harm.\textsuperscript{164}

In \textit{Ramirez} and \textit{Fentress}, both the plaintiff classes are pension funds, which are diversified, institutional investors.\textsuperscript{165} The pension fund group is one of many large investors comprising the pool of investors who own Exxon Mobil.\textsuperscript{166} The New York lawsuit essentially seeks the same damages as \textit{Ramirez} and \textit{Fentress}, albeit for a longer period and more diverse shareholder group, as all shareholders in that period are

\begin{flushleft}
\textsuperscript{159} “Stakeholders” is a term that traditionally refers to those individuals, other than shareholders, who have a stake in the success of a corporation, for example, labor, creditors, consumers, and the surrounding community. \textit{See Stakeholder, BLACK’S LAW DICTIONARY} (2d online ed.) https://thelawdictionary.org/stakeholders/[https://perma.cc/FF8M-9ME3].
\textsuperscript{160} \textit{See supra} Part II.C.
\textsuperscript{161} \textit{See} Ketchum v. Green, 557 F.2d 1022, 1025 (3d Cir. 1977); \textit{see also} A.J. White \& Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977), \textit{cert. denied} 434 U.S. 969 (1977).
\textsuperscript{162} \textit{See supra} Part II.C.
\textsuperscript{163} Coffee, \textit{supra} note 18, at 1557.
\textsuperscript{164} \textit{See supra} Part II.C.
\textsuperscript{166} \textit{Ramirez}, 334 F. Supp. 3d at 839.
\end{flushleft}
included. The damages are the artificially inflated paid prices that would not have been if the information was publicly known.

Therefore, the climate change disclosure securities lawsuits, if successful, would transfer the court calculated disgorgement amount from the company to the shareholder group. This cost would effectively be imposed on the remaining stakeholder group, comprised of shareholders who were not in the lawsuit group, including executives, creditors, suppliers, employees, and other groups reliant on Exxon Mobil’s value.

This Note assumes, furthermore, that the New York lawsuit is largely motivated by the desire to effectuate a carbon-accountable and emission-responsible society. Therefore, the circular and internalized remedy does not further its goal, apart from the element of deterrence. Funds are not transferred to the harmed external parties.

B. Scope

When large financial institutions underleverage and a market downturn or significant financial loss occurs, causing insolvency and bankruptcy, catastrophic societal costs are borne. One large insolvency creates insolvencies for many other institutions. This leads to systemic job loss, inability to obtain credit for businesses and consumers alike, and foreclosures, among many other issues. Financial crises also affect vulnerable communities, including low-income, minority, and underserved populations. These communities are more likely to suffer from job loss, lack of credit, and foreclosure. The societal risk from underleveraging and risky financial behavior can be compared to the societal risk of climate-related disaster from the overconsumption of fossil fuels.

168. Id. at 86.
169. See supra Part II.C.
170. See supra Part II.C.
171. See supra Part II.C.
172. See supra Part II.C.
174. Id. at 208.
175. Id.
176. Id. at 209.
177. Id.
Overconsumption leads to overaccumulation of GHG emissions in the atmosphere, worsening the effects of climate change.178 The societal costs associated with climate change include loss of life, loss of habitable area, loss of private and public property, inadequate nutrition, and increased exposure to environmental toxins, among many others.179 These costs are due to sea-level rises, droughts, crop yield decreases, temperature increases, climate fluctuations, and severe weather events.180 These societal costs harm the national economy by increasing the cost of healthcare, energy, essential items, and insurance, lowering corporate profits from stranded assets and damaged property.181 These costs also increase the financial burdens of municipalities and governments in adaptation, mitigation, and cleanup efforts, among many others.182

Climate change particularly harms vulnerable communities.183 Children, pregnant women, and the elderly are more sensitive to elevated levels of pollution, environmental toxins, and heat exposure.184 Lower-income communities are more likely to be exposed to extreme heat, groundwater, and air pollution.185 The ability to perceive the risks to which the impoverished are exposed, their ability to respond to evacuation and emergency warnings, and their ability to relocate to a safer location is lower than other communities.186 Lower-income communities are also more likely to lack the financial ability to pay the costs associated with rebounding from a disaster.187 Additionally, blue collar workers—such as farm workers, construction workers, utility repair workers, emergency responders, and other outdoor laborers—have a greater risk of exposure to climate change-related harms.188

178. See generally NATIONAL CLIMATE ASSESSMENT, supra note 1.
179. See id.
180. Id.
181. Id.
182. Id.
183. See id. at Ch. 14.
184. Id.
185. Id.
186. Id.
187. Id.
188. Id.
Climate change also has the potential to disrupt financial markets.\textsuperscript{189} Climate change weather events, like severe droughts or hurricanes, can create stranded assets for corporations and increase risk for insurance companies.\textsuperscript{190} If the event is large enough, the manifested risks may not be effectively shifted from a company’s financial portfolio, causing market-influencing insolvency.\textsuperscript{191}

C. PROPOSED REQUIREMENTS

1. A Mandate: Targeted Proxy and ESG Reporting

Both large and small investors demand more comprehensive ESG reporting.\textsuperscript{192} Both financial and non-financial ESG information is becoming more important to investors in evaluating and comparing investments.\textsuperscript{193} The Chartered Financial Analyst (CFA) Institute conducted a survey of 47,000 analysts and portfolio managers in 2017.\textsuperscript{194} The results of the survey found that 73 percent of the respondents take ESG issues into account in their investment analysis and decisions.\textsuperscript{195} The three most cited factors limiting the respondents’ organization’s ability to use ESG information in investment decisions are “a lack of appropriate

\begin{footnotesize}
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\item \textsuperscript{190} Davenport, \textit{supra} note 189.
\item \textsuperscript{191} Id.
\item \textsuperscript{195} Id.
\end{itemize}
\end{footnotesize}
quantitative ESG information, a lack of comparability across firms, and questionable data quality or lack of assurance."

A group of the largest public investors in 2017, including state treasurers, public pension funds, unions, legal experts and ESG reporting advocates petitioned the SEC “to promptly initiate rule-making to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful [ESG] information.” The group emphasized that standardized disclosure is critical for evaluating companies’ long-term performance and risk management. They stated that while some companies voluntarily disclose, varying reporting methods make it difficult for investors to compare companies or rely on the information for their investment decisions.

Larry Fink, the Chairman and CEO of BlackRock—currently the world’s largest asset manager with $5.98 trillion in assets under management—is an important voice on the issue. He continually advocates for the largest companies to disclose their ESG risks given a changing landscape that requires more disclosure from the investing public. In his 2019 Letter to CEOs, he emphasized that with the world undergoing the largest transfer of wealth in history, trillions of dollars transferring hands from baby boomers to millennials, ESG matters will be increasingly material to corporate valuations. He emphasized that BlackRock focuses its resources on increasing the accuracy and breadth of its analytics for measuring ESG factors, helping its clients implement similar systems and thereby providing a model for other corporations.

Fink further emphasized the financial necessity for increased ESG metrics

196. Id.
198. Id.
201. Id.
202. See Fink supra, note 193.
203. Id.
and disclosure, as “stakeholders [will] reap rewards over the long-term . . . and [c]ompanies that ignore them stumble and fail.”

Exxon Mobil has felt the pressure of investors to disclose more comprehensive ESG metrics. In December 2018, Exxon Mobil shareholders issued a resolution to set GHG emissions reduction targets, which is the first of its kind at Exxon Mobil. The resolution suggests reduction targets in line with the Paris Climate agreement. The effort was led by New York State Comptroller, Thomas DiNapoli, as a trustee of the New York State Common Retirement Fund, and the Church of England’s investment fund. Other large investors support the resolution, including the California Public Employees’ Retirement System, HSBC Global Asset Management, Presbyterian Church USA, and Fonds de Solidarité des Travailleurs du Québec. The resolution was developed with the Climate Action 100+, a global initiative with 310 investors and more than $32 trillion assets under management. Other large oil companies, like Royal Dutch Shell (Shell), also face growing investor pressure.

Given pressure from a significant portion of the world’s largest investors, this Note proposes a mandated GHG emissions reduction framework and required quarterly reporting of accurate climate change-related internal data. The proposal seeks to standardize all GHG emissions climate change reporting, rather than varied, non-standardized ESG reporting and proxy costs that are currently being used by corporations. The CCRF does not specify rules for the calculation of GHG emissions.

204. Id.
206. Id.
207. Id.
208. Id.
209. Id.
210. Id.
212. CDSB, supra note 151.
213. Id.
therefore, the proposed regulation mandates the use of the GHG Protocol developed by the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD) as the GHG emissions accounting methodology.\textsuperscript{214} The WRI and WBCSD have created many easy-to-use tools to calculate corporate emissions.\textsuperscript{215} Among Fortune 500 companies, 92 percent of companies responding to the Climate Disclosure Project used GHG Protocol directly or indirectly through a program based on GHG Protocol.\textsuperscript{216} GHG Protocol provides the accounting platform for virtually every type of corporate GHG emissions reporting program in the world.\textsuperscript{217}

The ESG reporting mandate, alongside the GHG emissions reduction target, will serve as a climate change “stress test” within the proposed regulatory framework. The “stress test” will provide the markets with more accurate and comprehensive data.\textsuperscript{218} Better disclosure makes markets more efficient\textsuperscript{219} and also serves to deter fraudulent conduct.\textsuperscript{220} Much like Dodd-Frank’s requirement for the FSOC and the Federal Reserve to conduct regular stress tests for SIFIs to mitigate potential risk, periodic disclosure within a regulatory reduction framework serves the same end.\textsuperscript{221}

Instead of relying on prospectus information, voluntary disclosure, or internal documentation, the New York Attorney General, other prosecutors, and the investing public can rely on comprehensive quarterly disclosures for more accurate information.\textsuperscript{222} They can compare this information to their own findings—whether through investigative means or through third party analysts and independent sources—to find any evidence of inaccurate or fraudulent information.\textsuperscript{223} This will serve to make disclosure easier to use, and evidence of fraud or inaccurate or misstated information easier to find.\textsuperscript{224} Additionally, the proposal may have the effect of creating more securities fraud liability through material

\begin{flushleft}
\textsuperscript{214} See GHG Protocol, \textit{supra} note 68.
\textsuperscript{215} Id.
\textsuperscript{216} Id.
\textsuperscript{217} Id.
\textsuperscript{218} See \textit{supra} Part III.E.
\textsuperscript{219} See \textit{supra} Part III.D.
\textsuperscript{220} See \textit{supra} Part III.D.
\textsuperscript{221} See \textit{supra} Part III.D.
\textsuperscript{222} See \textit{supra} Part III.D.1.
\textsuperscript{223} See \textit{supra} Part III.D.1.
\textsuperscript{224} See \textit{supra} Part III.D.1.
\end{flushleft}
misstatements for corporations, given the comprehensiveness required in the disclosures.\textsuperscript{225} This is not to punish, but to create a more transparent and accountable environment. The proposal seeks deterrence through enhanced disclosure and litigation risk.

The enhanced GHG emissions and climate change disclosure framework developed by this proposal may only be mandated for companies that emit more than a certain threshold of GHG. However, since it is not a required practice to disclose GHG emissions, it would be necessary to first require the disclosure before implementing a threshold.\textsuperscript{226} The threshold would serve to eliminate unnecessary cost and effort spent on disclosure on businesses whose operations would not significantly contribute to climate change. An initial proposed threshold could be around 10,000 metric tons of carbon dioxide per year, based on data from utilities and oil producers compared to smaller corporate entities.\textsuperscript{227} For comparison, a typical passenger vehicle emits about 4.6 metric tons of carbon dioxide per year.\textsuperscript{228} Once a company passes beyond the threshold, disclosure would be required.

By requiring specific disclosure on GHG emissions, investors will be better equipped to mitigate climate change-related risks in their portfolio through diversification, and companies will be deterred from using the lack of mandatory reporting for financial gain from greater valuation than may exist.\textsuperscript{229} Mandatory social reporting also reduces strategic disclosure and gaming of reporting, which involves the voluntary disclosure of portions of ESG data to avoid inquiry about other data, or to provide

\begin{footnotesize}
\begin{itemize}
\item[225.] See supra Part III.D.1.
\item[226.] See GHG Protocol, supra note 68, at 3.
\item[229.] See supra Part III.D.1.
\end{itemize}
\end{footnotesize}
general, non-helpful ESG data to investors. Mandatory disclosure also requires fiduciaries to act in a socially-responsible manner. Furthermore, it already exists in other contexts.

Dodd-Frank contains a “conflict minerals” provision. This provision requires reporting companies to disclose to the SEC their internal measures to exercise due diligence and chain of custody of minerals mined in the Democratic Republic of the Congo or adjacent countries which have historically been linked to civil strife, human rights abuses, and violence. The human rights impact of conflict minerals directly and indirectly involves business. For example, local mining companies and their security providers are directly involved in human rights abuses such as forced labor. Further, an array of companies—both locally based and multi-national—that buy, trade, transport, process, and finance the purchase of conflict minerals may fund and thereby perpetuate the conflict in the Democratic Republic of the Congo.

Dodd-Frank’s conflicts provision seeks to restrict funding sources for armed groups in the Congo through the dissemination of information about the connection between their commercial activity and human rights violations. Targeted climate change disclosure seeks to eliminate externalized harms similarly stemming from business practices. However, the conflicts provision does not have a remedy for non-compliance. It solely relies on the reputational effects of non-compliance.

This proposal, however, contains monetary, enhanced oversight, and divestiture remedies. Rather than focusing on the passive means of reputational deterrence, these remedies serve to directly and actively deter

231. Id.
233. Id. at 90.
234. Id. at 106.
235. Id.
236. Id.
237. Id.
238. Id.
239. Id. at 91–92.
240. Id. at 106–07.
241. Id. at 91–92.
continued non-compliance. The proposal’s focus on direct, severe sanction mechanisms seeks to create a regime of greater corporate compliance.\(^{242}\) Additionally, mandatory climate change ESG disclosure will also aid investors and corporations in calculating related reputational risks.\(^{243}\)

Corporations are aware of the risks to their brands from adverse human rights, environmental, and labor impacts in their supply chains.\(^{244}\) Additionally, specific disclosure may complement reputational harm by making violations of social norms related to climate change more unambiguous, as they will be codified in law.

One objection is that it suggests that adverse social impacts can be quantified.\(^{245}\) Risk, it is argued, is itself defined by societal and political norms that define what type of events create “risk” in the first place.\(^{246}\) However, as reputational risks include an estimation of how these risks affect the business and its valuation, the challenge of quantification should not count out its beneficial societal and market-transparent effect.

2. Proposal: Stress Test

The specific proposal follows the December 3, 2018 commitments made by Royal Dutch Shell.\(^{247}\) Shell agreed to commit to a 50 percent reduction in GHG emissions, with an interim commitment of 20 percent by 2035.\(^{248}\) Shell also committed to setting three- or five-year periodic goals to meet both interim and final commitments.\(^{249}\) Shell’s long-term reduction commitments are the highest of any other large company in the

\(^{242}\) See e.g., Vincent Di Lorenzo, *Principles-Based Regulation and Legislative Congruence*, 15 N.Y.U. J. LEGIS. & PUB. POL’Y 45, 89 (2012) ("[A] legal regime with clear standards that stipulate required action or course of conduct (rules-based regime) is the approach that generates greater corporate commitment to legal compliance.").

\(^{243}\) See id.

\(^{244}\) See Margaret M. Blair, Cynthia A. Williams, & Li-Wen Lin, *The New Role for Assurance Services in Global Commerce*, 33 J. CORP. L. 325, 338–42 (2008).

\(^{245}\) Di Lorenzo, *supra* note 242.

\(^{246}\) Id.

\(^{247}\) Shell Joint Statement, *supra* note 211.

\(^{248}\) Id.

\(^{249}\) Id.
oil and gas sector. The commitment includes Scope 1 and 2 emissions, which are the direct emission from company operations, and emissions from energy use by the company, respectively.

However, Shell also committed its Scope 3 emissions, which include any emissions from the corporation’s products or supply-stream. Scope 3 is the most expansive, as it also accounts for emissions from the use of the fossil fuels sold by Shell. The proposal adopts Shell’s interim and long-term reduction commitment—including Scope 1, 2, and 3 emissions—to all disclosing companies above 10 metric tons of carbon dioxide per year.

The proposal has consequences for non-compliance to target reduction similar to those of non-compliance for non-bank SIFIs. Dodd-Frank permits the FSOC to recommend participating agencies to force an over-leveraged, systemically compromising company to divest assets or dissolve. For example, if the proposal starts in 2020, once a disclosing company is deemed non-compliant at either the 15 (2035) or 30-year (2050) target, the SEC, with the EPA’s guidance, would issue monetary penalties and provide recommendations for reduction. If further non-compliance occurs over the course of the next five-year target cycle, the SEC and EPA could force the divestiture of non-compliant assets or divisions.

As the FSOC’s administrative reasoning must include an analysis of cost, so does the proposal. The analysis of cost must be “appropriate” and consider “risk-related” factors, which include systemic risk and insolvency risk compared to the regulatory cost imposed on the

252. Id.
253. See id.
254. See id.
256. See MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 241 (D.D.C. 2016) (finding that FSOC’s designation of a large insurance company as a SIFI was “arbitrary and capricious” because it failed to consider the economic costs of its determination), appeal dismissed per stipulation, 2018 U.S. App. LEXIS 1624 *3 (D.C. Cir. 2018).
company.\textsuperscript{257} Given the significant and systemic climate-related risks to the national economy and vulnerable populations of continued GHG emissions,\textsuperscript{258} the proposal would be an appropriate regulation, as the risks it addresses outweigh the regulatory burden of a 30-year emissions target and disclosure regime. The proposal also considers “risk-related” factors, as it takes into account an adequate timeframe—30 years—to significantly reduce the corporation’s emissions. The weight of economic and societal harm outweighs the harm of any one corporation’s reduction in emissions over the course of 30 years.

The proposal’s general requirements follow the CCRF and GHG Protocol.\textsuperscript{259} Disclosures must include a strategic analysis of risk and governance.\textsuperscript{260} This includes “[m]anagement’s view of the extent to which the organization’s strategy and operational performance are affected by climate change-related risks and opportunities . . . .”\textsuperscript{261} Disclosures must also include governance processes for addressing those effects, which provides vital information for investors and decision-makers in assessing the condition of the organization.\textsuperscript{262}

The CCRF additionally mandates information about the future outlook and any uncertainties or key dependencies related to climate change and a company’s business.\textsuperscript{263} This information is decision-useful when it (a) describes long-term strategic developments that may enhance opportunities or increase risk, such as organic growth or decline, acquisitions or divestments and operational changes; (b) includes estimates of investment in or the cost of GHG emissions abatement or climate change adaptation that could materially affect the growth, future earnings and the direction of the organization; (c) includes an estimate of future movements in direct and indirect GHG emissions, taking account of expected GHG emissions, energy efficiency, and reduction plans; and (d) estimates any cost savings associated with GHG emissions abatement and energy efficiency expectations.\textsuperscript{264}

For the specific GHG emissions reporting information, both the CCRF and GHG Protocol mandate the inclusion of movements in GHG emissions.

\textsuperscript{257} Id.
\textsuperscript{258} See supra Part IV.B.
\textsuperscript{259} See CDSD, supra note 151; see GHG Protocol, supra note 68.
\textsuperscript{260} See CDSD, supra note 151, at 19.
\textsuperscript{261} Id.
\textsuperscript{262} Id.
\textsuperscript{263} Id. at 21.
\textsuperscript{264} Id.
emissions results over time, along with a description of activities that caused them and the reasons behind them.\textsuperscript{265} In terms of the target emission reduction, both the CCRF and GHG Protocol require information that, in order to be decision-useful, (a) specifies the GHG emissions reduction activities and sources; (b) describes the activities and investments required to achieve the plans and any risks or limiting factors that might affect achievement of the plans and targets; (c) analyzes progress to date against previously set plans or targets; and (d) analyzes progress against regional, national, international, or sectoral targets.\textsuperscript{266}

3. Community Stakeholders as Recognized by the Market and the Law

Corporations widely recognize their effect on community stakeholders.\textsuperscript{267} One such company is Swiss Re, a large reinsurance company that has been at the forefront of recognizing climate change as a threat to its business.\textsuperscript{268} Swiss Re has stated its “actions are based on the premise that it is in the interest of shareholders, clients and employees, the wider stakeholder community and society in general to tackle this [climate change] issue.”\textsuperscript{269}

Many energy companies also understand the need to incorporate the wider community, as their business is intertwined with the community.\textsuperscript{270}

\begin{itemize}
  \item \textsuperscript{265} Id. at 22.
  \item \textsuperscript{266} Id. at 21.
  \item \textsuperscript{267} See infra text accompanying note 270.
  \item \textsuperscript{268} See Kevin W. Weigand, Climate Change Disclosure: Ensuring the Viability of the Insurance Industry While Protecting the Investor, 34 WM. & MARY ENVT. L. & POL’Y REV. 281, 306 (2009).
  \item \textsuperscript{269} Id. at 306–07.
Companies speak of their community engagement through volunteering, charity, employment and education opportunities, and economic development of surrounding communities. Exxon Mobil has addressed its direct community engagement on environmental issues through effective community wastewater solutions. Furthermore, the law recognizes community stakeholders.

In banking, Dodd-Frank requires enhanced regulatory oversight for SIFIs, as their insolvency would cause societal harm. The communities affected, low-income and vulnerable populations, and the greater working public are recognized by the law. In securities law, the SEC recently revised its mining disclosure regulations to include engagement and study of the interests of agencies, non-governmental organizations, communities, and other stakeholders as required items to be disclosed under a pre-feasibility or feasibility study of a mining project. The SEC defended its inclusion of these disclosure requirements, stating “[w]e believe that the inclusion of . . . [these] risks . . . [is] necessary because factors such as environmental regulatory compliance, the ability to obtain necessary permits, and other legal challenges can directly impact the economic viability of a mining project.”


271. Id.
273. See supra Part III.E.
274. See supra Part III.E.
275. See supra Part III.E.
277. Id.
The Delaware Supreme Court ruled that boards of directors can consider other stakeholder interests during takeover negotiations. Many other states have corporate “stakeholder laws” that allow the consideration of surrounding communities or society when making business decisions. Some states, such as Wyoming, even mandate societal consideration for the board in business decisions.

4. Proposal: Fair Fund

This Note argues for an adoption of the use of the SEC’s fair funds authority. The proposal uses this authority as a legal mechanism of compensating climate change-related remediation, mitigation, and cleanup efforts, with a focus on vulnerable groups. Much like Dodd-Frank’s SIFI liquidity requirement that essentially creates an internally managed fund to safeguard from external harms or systemic failure, the fair fund mechanism is an externally managed fund used to remedy internal parties or stakeholders.

This proposal instead seeks to use fair funds to remedy external harms. As the SEC’s primary goal is to protect investors and safeguard the public interest by ensuring that capital markets are “fair, orderly, and efficient,” fair funds tailored for remedying the external, environmental harm created by market activity help in achieving this goal.

Sarbanes-Oxley authorizes the SEC to add civil fines paid in enforcement actions to disgorgement funds, which are called “fair funds,” and distribute funds to the victims of securities violations. The decision to distribute these funds to investors is at the discretion of the SEC or, upon the SEC’s motion, the court, in cases in which the SEC brings suit against the defendant. At the time the SEC recommends a negotiated


281. See supra Part III.C.


283. Id. at 333, 339.

284. Id. at 342.
settlement or to initiate litigation, it must also consider whether to propose the creation of a fair fund:285

The SEC’s ultimate decision to distribute collected funds depends largely on two factors: whether there is an identifiable class of investor victims who suffered an identifiable harm, and whether the amount of money likely to be collected from the defendant is large enough to justify a distribution given the number of potential victims.286

However, fair funds have also been subject to the circularity critique, especially in cases that involve fraudulent disclosures by public companies.287 In these cases, management overstates the company’s performance, pushing up its stock price.288 However, unless the firm issues new stock or trades in its own stock during the period of overstatement, its gain from the misrepresentation is minimal.289 When the firm is forced to pay the penalty, its current shareholders are then forced to bear the costs of that penalty, even though many of those same shareholders suffered losses from the fraud.290

Therefore, for large corporate securities fraud, the proposal suggests fair fund distribution to externally harmed, vulnerable communities as a better allocation of resources to remedy the harm. External distribution would avoid stakeholders bearing the cost of securities fraud settlements through costs to the corporation when they are an innocent party.291 Dispersal to mitigation, remediation, and cleanup efforts would serve to create a net benefit to society, rather than a zero sum or net loss through circular dispersal.292

Fair funds also allow dispersal to the government if the SEC determines investors cannot be successfully or practically reimbursed.293

285. Id.
286. Id.
287. William W. Bratton & Michael L. Wachter, The Political Economy of Fraud on the Market, 160 U. PA. L. REV. 69, 139 (2011) (Recognizing that fair fund distributions have been described as circular, “every bit as much an exercise in pocket shifting as is payment of a [class action] settlement”); see Barbara Black, Should the SEC Be a Collection Agency for Defrauded Investors?, 63 BUS. LAW. 317, 345 (2008); see also Velikonja, supra note 284, at 375.
288. Velikonja, supra note 284, at 375.
289. Id.
290. See supra Part III.C.
291. See supra Part III.C.
292. See supra Part III.C.
293. Velikonja, supra note 284, at 365.
The majority of sums collected for fair funds since its adoption were deposited in the U.S. Treasury’s General Fund for this reason. The proposal would not get rid of the option to contribute to the U.S. Treasury, as it is still a net gain and can be used in mitigation, remediation, and clean-up efforts. However, the most direct benefit would be direct application of the fair fund for these efforts to low-income, vulnerable communities affected by climate change.

5. Recommendation to Regulators and Prosecutors

As traditional securities remedies suffer from circularity, it is important for prosecutors—both federal and state—to bring cases that externalize remedies. Externalized remedies can be general or specific. General externalized remedies take the form of disgorged or sanctioned payments to the federal or state government. In the fair fund context, the SEC sends disgorged or sanctioned amounts—which cannot be effectively allocated to investors—to the Treasury. Payments to the government can be used to effectuate the remedying of external harms—as in the climate change context—including mitigation, adaptation, and cleanup efforts for vulnerable populations. The specific remedies in this context take the form of payment directly to the EPA for remediation, mitigation, and adaptation programs from the fair fund, as pursuant to this proposal.

Therefore, the proposal recommends a larger, “public class counsel” role for the SEC and state prosecutors to take on this type of fraud. This public class counsel role increases an agency’s focus on remedying public harms through seeking litigation that recoups harm caused and best deters the conduct. In many instances, the SEC and other enforcement

295. See supra Part IV.C.
296. See supra Part IV.C.
297. See supra Part II.C.
299. Id.
300. Id. at 1113.
301. Id. at 1107.
302. Id.
agencies already choose cases seeking deterrent effects. Yet, in terms of the SEC, the agency has been reluctant to use the fair funds provision to its full potential as a targeted remedial device, choosing instead to recoup money directly to the U.S. Treasury. Nevertheless, by bringing cases that seek external remedies, whether through the fair funds device or through sanctions paid to the government, the securities laws can be an effective remedial and deterrence mechanism of climate change-related fraud.

CONCLUSION

Circularity in remedy, lack of mandatory disclosure, and the challenge of quantifying proxy cost render using securities fraud an ineffective mechanism to combat climate change. In order to effectuate more transparent markets and a carbon accountable society, this Note proposes a regulatory solution.

The proposal is modeled from Dodd-Frank as a stakeholder, and externally focused law. The proposal has three mechanisms: enhanced disclosure, GHG emissions reduction, and fair funds. The first two mechanisms will provide the markets with more accurate and comprehensive data, thereby resulting in more efficient markets. The mechanisms working together also serve to deter fraudulent conduct through litigation risk. The last mechanism, fair funds, serves to capture the external harm left uncaptured by traditional remedies through dispersal to vulnerable communities most affected by climate change.

303. Id. at 1110.