What Is Material?: Creating a Conducive Environment for Climate-Related Information Disclosure in the Oil and Gas Industry

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ABSTRACT: The Securities and Exchange Act of 1934 requires public companies to disclose material information to investors. The definition of "material" has been construed by courts to mean information that a reasonable investor would find substantially important. The scope of materiality has traditionally been limited to information having a direct financial impact on a company. Today, climate change has become an increasingly important factor to investors. The U.S. Securities and Exchange Commission ("SEC") came out with a new proposal in March of 2022 that would require public companies to disclose certain climate-related information. As investors are beginning to demand and rely on companies' climate-related information, the definition of "material" has begun to evolve with the expectations of a "reasonable investor." The evolving nature of materiality has created an uncertain environment for companies to disclose climate-related information. This uncertainty leaves companies susceptible to securities litigation, especially private actions. This Note argues that the evolving nature of materiality and the SEC's disclosure regimes place the oil and gas industry in an untenable position when trying to disclose climate-related information. It proposes that the SEC update its guidance report on climate-related materiality rather than impose its new March 2022 climate disclosure proposal. It also proposes that the Private Securities Litigation Reform Act ("PSLRA") be amended to include stronger safe-harbor provisions and a shorter statute of limitations period. These changes will create a more predictable environment for climate-related information disclosure in the oil and gas industry which will lead to greater transparency.

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INTRODUCTION

Many investors are pushing to reform the capital markets industry. They are looking beyond the traditional financial metrics toward an additional set of nonfinancial factors to make investment decisions. These nonfinancial factors include environmental, social, and governance ("ESG") factors.[1] ESG factors are essentially "a set of factors used to measure the non-financial impacts of particular investments and companies."[2] They provide investors with an additional way to measure company success by taking into account how companies impact their surrounding communities, employees, and business partners.[3] The Business Roundtable—a group made up of CEOs of the largest companies across the globe—has made it clear that it, along with other influential investors and corporations, "want capitalism to serve workers, customers, and the environment in addition to shareholders."[4] The proposed capital markets reform would not discard traditional financial metrics. Instead, it would include ESG factors as an *additional* tool for investors to gauge the success of companies.

Investors and other influential actors in the capital markets industry are putting pressure on the SEC to begin mandating corporations to disclose their ESG data publicly.[5] In 2021, Congress proposed a bill titled the ESG Disclosure Simplification Act of 2021.[6] This proposed bill provided that the SEC mandate "public companies 'to disclose [ESG] metrics' in any filing that

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1. *See* Michael O'Leary & Warren Valdmanis, *An ESG Reckoning Is Coming*, HARV. BUS. REV. (Mar. 4, 2021), https://hbr.org/2021/03/an-esg-reckoning-is-coming [https://perma.cc/P365-4CZG]; Mark S. Bergman, Ariel J. Deckelbaum & Brad S. Karp, *Introduction to ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 1, 2020), https://corpgov.law.harvard.edu/2020/08/01/introduction-to-esg [https://perma.cc/Y2J6-6VDJ] ("ESG grew out of investment philosophies clustered around sustainability and, thereafter, socially responsible investing.").

2. Bergman et al., *supra* note 1.

3. *Id.*

4. O'Leary & Valdmanis, *supra* note 1.

5. *See* David A. Katz & Laura A. McIntosh, *SEC Regulation of ESG Disclosures*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 28, 2021), https://corpgov.law.harvard.edu/2021/05/28/sec-regulation-of-esg-disclosures [https://perma.cc/DTA4-TQT9]. *See generally* Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821 (2021) (discussing possible frameworks for ESG-disclosure).

6. ESG Disclosure Simplification Act of 2021, H.R. 1187, 117th Cong. § 101 (2021).

requires audited financial statements."[7] It also required the disclosure "of any process the [company] uses to determine the impact of ESG metrics on [its] long-term business strategy."[8] Congress does not define "ESG metrics" in the proposed bill; rather, it leaves the SEC with discretion to define such metrics through its own rulemaking processes.[9] The bill goes go on to say that "[i]t is the sense of Congress" that such undefined ESG metrics "are *de facto* material for the purposes of disclosures under the Securities Exchange Act of 1934."[10] The SEC currently does not require corporations to disclose ESG data and instead requires only that data deemed "material" be disclosed; however, that may change in the coming months with its March 2022 proposal discussed *infra*.[11]

The definition of "material" is dynamic and depends on a "reasonable investor's" perception of what information is important in making an investment decision.[12] The definition is therefore a facts and circumstances heavy inquiry.[13] As ESG's impact on nonfinancial metrics for company success begins to reform the capital markets industry, the definition of materiality has more facts and circumstances to account for.[14] This uncertain definition of materiality has created challenges for companies trying to determine what information must be disclosed.[15] The uncertain definition of materiality has been especially challenging for the oil and gas industry as it attempts to disclose climate-related information.[16]

This Note argues that the uncertain definition of materiality and the SEC's climate-related disclosure regimes have exposed oil and gas companies to securities liability as they attempt to appease investor pressure to disclose environmental information. This Note proceeds in five parts. Part I provides a brief background of ESG and presents its historical underpinnings. Part II discusses how the case law definition of materiality allows it to evolve with investor trends and industries. Part III moves into how the SEC's disclosure regimes and the evolving definition of materiality have resulted in a wave of securities litigation for the oil and gas industry. Part IV offers a solution for the evolving definition of materiality and the increased securities litigation in the oil and gas industry. The Conclusion will portray this problem in a broader perspective and show why reaching a solution affects how the oil and gas industry combats climate change.

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7. Rose, *supra* note 5, at 1831 (quoting H.R. 1187 § 2(b)(1)(A)).
8. H.R. 1187 § 103(a)(1)(B); Rose, *supra* note 5, at 1830–31.
9. H.R. 1187 § 103(b)(1)(B); Rose, *supra* note 5, at 1831.
10. H.R. 1187 § 103(b)(3) (emphasis added); Rose, *supra* note 5, at 1831.
11. *See infra* Section I.E.
12. *See infra* Section II.A.
13. *See infra* Section II.A.
14. *See infra* Section II.A.
15. *See infra* Sections III.A–.C.
16. *See infra* Parts II and III.

I. THE RISE OF ESG

From early on, investors have influenced the capital markets industry. They used their investments to play activist roles in a multitude of movements that eventually culminated into ESG. This Section walks through the historical underpinnings that led to the rise of ESG. It will first discuss the origins of socially responsible investing ("SRI"), the origins of corporate social responsibility ("CSR"), and how both laid the groundwork for ESG. It will then discuss how shareholder activism influenced capital markets, the two major catalysts that led investors to demand ESG metrics, and how ESG obtained a tangible presence through organizations. Finally, it will discuss the Securities and Exchange Act of 1934 and how it relates to ESG.

A. SRI AND CSR CREATED THE FOUNDATION FOR ESG

Beginning in the 1950s and '60s, SRI began laying the groundwork for American investors to consider environmental, social, and governance factors in capital markets.[17] Traditional SRI began on a simple premise: "[a]void[] products or industries that conflict with a set of moral values."[18]

It gained recognition during a time in America when "antiwar movement[s,] . . . racial equality, women's rights, consumer protection, and the environment" were at the forefront of public discourse.[19] "By the early 1970s, [these social and cultural influences that were shaped by American progressive values] led to the creation of the first mutual funds" that took civil rights and environmental concerns into consideration.[20] These mutual funds would only invest in companies that were perceived to be upholding values in line with progressive environmental and equality concerns.[21] The SRI movement toward investing did not progress without its critics.[22] Among the critics, famed economist, Milton Friedman, stated in response to SRI, "the social responsibility of business is to increase profits."[23] Traditional SRI received much criticism early on because its investment decisions were not solely based on numbers or financial data but rather on a sense of morality.[24]

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17. Blaine Townsend, *From SRI to ESG: The Origins of Socially Responsible and Sustainable Investing*, J. IMPACT & ESG INVESTING, Fall 2020, at 1, 2–3, https://www.bailard.com/wp-content/uploads/2020/09/History-Socially-Responsible-Investing-and-ESG-Investing.pdf [https://perma.cc/PZS9-63F9]; *see also* Mauricio Andrés Latapí Agudelo, Lára Jóhannsdóttir & Brynhildur Davídsdóttir, *A Literature Review of the History and Evolution of Corporate Social Responsibility*, 4 INT'L J. CORP. SOC. RESP. 1, 3–5 (2019) (detailing the development of corporate social responsibility in the 1950s and 1960s).

18. Townsend, *supra* note 17, at 2.

19. *Id.*

20. *Id.*

21. *See id.*

22. *Id.*

23. *Id.*

24. *See id.* at 3.

As the 1970s progressed, SRI began gaining traction and became more popular among investors and firms.[25] This heightened awareness of SRI led to the First Spectrum Fund, where its "founders . . . promis[ed] that no investment would be made before it analyzed companies' performance in 'the environment, civil rights, and the protection of consumers.'"[26] Many prominent business leaders began to consider their company's workplace practices and impact on society.[27] Milton Moskowitz, a prominent business journalist, was instrumental in voicing these moral investment concerns to the public.[28] Moskowitz's writing brought corporate social responsibility ("CSR"), a term coined by Howard Bowen in 1953, into the spotlight.[29] Bowen used CSR to "define[] the *social responsibilities* of business executives as 'the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.'"[30] CSR and SRI are inextricably related.[31] CSR emphasizes that *corporate directors* consider their impact on society with each decision they make.[32] SRI emphasizes that *investors* hold directors accountable for their decisions by investing in corporations that have a desirable impact on society.[33]

With SRI and CSR at the forefront of investment and corporate decision-making, investors began championing their causes through screening.[34] Investors engage in screening when they make decisions about which companies to include or exclude in their portfolios "based on social and/or environmental criteria."[35] When investors use this process, they do both a *qualitative* analysis on a corporation's practices, relations, and overall societal impact, as well as a *quantitative* determination of future profits.[36] However, the use of this "double bottom line analysis process" was challenging because companies were not open about their policies and practices.[37]

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25. *See id.* at 3–4.

26. *Id.* at 4 (quoting Milton Moskowitz, *Why "Good Guy" Funds have Flopped*, N.Y. TIMES, Feb. 11, 1973, at F15).

27. *See id.* at 3–4.

28. *See id.* at 4.

29. *See id.*; Agudelo et al., *supra* note 17, at 4.

30. Agudelo et al., *supra* note 17, at 4 (quoting HOWARD R. BOWEN, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN 6 (1953)).

31. *See id.*; *see also* Townsend, *supra* note 17, at 6 (noting that SRI influences ESG and will likely continue to be "married" to it).

32. *See* Townsend, *supra* note 17, at 4.

33. *See id.*

34. Steve Schueth, *Socially Responsible Investing in the United States*, 43 J. BUS. ETHICS 189, 190 (2003); Townsend, *supra* note 17, at 5.

35. Schueth, *supra* note 34, at 190.

36. *Id.*

37. *See id.*

The lack of transparency from companies about their business practices became a major impediment to the screening process.[38] As a result, only companies "with egregious patterns of behavior around workplace, governance, environment, social justice, and/or other issues that could be quantified or identified" would be screened by investors.[39] Therefore, "classic avoidance screens" for North America became "alcohol, tobacco, weapons, gambling, pornography, and nuclear energy."[40] This avoidance framework was then used to create the Domini 400 Social Index, which had the "ability to track the S&P 500 Index over long periods of time" and account for "egregious patterns of behavior" from companies.[41] This index established confidence in investors as it was the one of the first, and most prominent, of its time to track long-term patterns of company behavior and correlate them with financial status.[42] The success and notoriety of the Domini 400 Social Index played an instrumental role in the growth of SRI.[43] Investors and companies began to realize the impact that nonfinancial factors could have on corporate success.[44]

B. Shareholder Activism Influenced Capital Markets

The rise of SRI and CSR was accompanied by a rise in shareholder activism.[45] There is a necessary distinction to be made between "stakeholders" and "shareholders." *Stakeholders* include anyone who is affected by a company's actions.[46] A stakeholder need not be a shareholder, just someone who feels the effect of a company's actions.[47] *Shareholders* include only those who own stock in a corporation and therefore have ownership in proportion to their shares, granting them access to company information and the right to vote on certain company matters.[48] Shareholder activism describes shareholders using their access to company information and voting powers to influence the board of directors, who manage the corporation.[49] This influence is achieved by voting on matters that affect the company or by voting to approve elected members

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38. *See* Townsend, *supra* note 17, at 5; *see also* Schueth, *supra* note 34, at 190 (noting that screening decisions require "careful research" and are never "black and white"; they are "always gray").

39. *See* Townsend, *supra* note 17, at 5.

40. *See id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*; Schueth, *supra* note 34, at 190–91.

46. Jason Fernando, *What Are Stakeholders: Definition, Types, and Examples*, INVESTOPEDIA (June 29, 2022), https://www.investopedia.com/terms/s/stakeholder.asp [https://perma.cc/NT52-R4N3].

47. *Id.*

48. Adam Hayes, *Shareholder (Stockholder): Definition, Rights, and Types*, INVESTOPEDIA (Nov. 22, 2022), https://www.investopedia.com/terms/s/shareholder.asp [https://perma.cc/4N6Q-3VHY].

49. Schueth, *supra* note 34, at 190–91.

of the board.[50] The more shares a shareholder has, the more voting power they have to influence company decisions and board elections.[51]

Traditionally, shareholders engaged in activism by compiling enough shareholder funds to buy a large number of company shares.[52] With this large number of shares, the shareholders would gain influence over company decisions and board members through their voting power.[53] Shareholder activism of this sort led to the creation of "new funds [that would raise] money from . . . investors" to buy shares and gain "minority board representation (i.e., one or two board seats, rather than a board majority)."[54] With more company shares and members on the board whose values aligned with activist shareholders, such funds influenced corporate strategy.[55] Hedge funds quickly began playing an instrumental role in shareholder activism because of their vast resources and ability to buy enough shares to gain voting power to influence corporate strategy.[56]

As SRI and CSR took center stage in the capital markets industry, shareholders continued to encourage companies to have a more positive impact on society.[57] The SRI and CSR movements were influential and companies began to feel the financial burdens of their societal impact.[58] This sparked an interest among many companies in measuring these financial burdens and integrating them into capital markets analyses to determine future corporate strategy.[59] These initiatives marked the inception of ESG.[60]

C. The Two Major Catalysts That Led Investors to Demand ESG Metrics

There were two main catalysts that led investors to demand ESG metrics.[61] The first was a rising awareness that poor corporate governance and environmental practices could have negative effects on a corporation's finances.[62] The second was a debate over whether the purpose of a corporation was to

50. *See* U.S. Securities and Exchange Commission, *Shareholder Voting*, INVESTOR.GOV, https://www.investor.gov/glossary-term-categories/shareholder-voting [https://perma.cc/2NNE-XFJ4].

51. *See* Hayes, *supra* note 48.

52. Mary Ann Cloyd, *Shareholder Activism: Who, What, When, and How?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 7, 2015), https://corpgov.law.harvard.edu/2015/04/07/shareholder-activism-who-what-when-and-how [https://perma.cc/4B9F-P2JR].

53. *Id.*

54. *Id.*

55. *Id.*

56. *See id.*

57. *See* Townsend, *supra* note 17, at 5–6.

58. *See* Georg Kell, *The Remarkable Rise of ESG*, FORBES (July 11, 2018, 10:09 AM), https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg [https://perma.cc/LU22-EY3V].

59. *See id.*

60. *See id.*

61. *See* Townsend, *supra* note 17, at 6.

62. *Id.* at 6–10.

maximize *shareholder* value (i.e., profits) or *stakeholder* value (i.e., societal impact).[63]

1. Rising Awareness of Poor Corporate Governance and Environmental Practices

The first catalyst began when former UN Secretary General Kofi Annan sent a letter to more than "50 CEOs of major financial institutions," requesting that they participate in an initiative "to integrate ESG into capital markets."[64] The scale and international context of this initiative forced investors to take notice, which eventually produced an instrumental report a year later by Ivo Knoepfel.[65] The report was titled "Who Cares Wins" and argued that including ESG factors into capital markets was rational and would lead "to more sustainable markets" and have a positive impact on society through financial pressures.[66] Knoepfel also asserted that it was important for the financial industry to discover ways in which it could measure company-adopted ESG initiatives to gauge whether such choices influenced capital markets.[67] This report was influential to the public and put pressure on corporations to adopt sound governance and environmental practices, as ESG metrics could expose inadequacies and have financial consequences.[68]

2. What Is the Purpose of a Corporation?

The second catalyst was a debate over whether the purpose of a corporation was to maximize shareholder value or stakeholder value. This debate was addressed through a report, commonly known as the "Freshfield Report," that was produced by a London-based law firm and was commissioned by the United Nations Environment Programme ("UNEP").[69] UNEP posed the following questions: (1) Whether it is a legal requirement to include environmental, social, and governance issues into investment policy; and (2) whether "fiduciary duties require" portfolio managers to invest *solely* for the

63. *See id.* at 6.

64. Kell, *supra* note 58.

65. *See id.*

66. *Id.*; THE GLOB. COMPACT, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD 7 (2004) [hereinafter THE GLOB. COMPACT, WHO CARES WINS], https://documents1.worldbank.org/curated/en/280911488968799581/pdf/113237-WP-WhoCaresWins-2004.pdf [https://perma.cc/9UCH-HV6P]; *see also* THE GLOB. COMPACT, INVESTING FOR LONG-TERM VALUE 2 (2005), https://www.ifc.org/wps/wcm/connect/9d9bb80d-625d-49d5-baad-8e46a0445b12/WhoCaresWins_2005ConferenceReport.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE-9d9bb80d-625d-49d5-baad-8e46a0445b12-jkD172p [https://perma.cc/Q9K4-D9NQ] ("ESG factors play an important role in the context of longer-term investment strategies and . . . the financial industry must improve their consideration in research and investment processes.").

67. *See* THE GLOB. COMPACT, WHO CARES WINS, *supra* note 66, at 10–11.

68. *See* Kell, *supra* note 58.

69. *Id.*; Townsend, *supra* note 17, at 7.

maximization of profit.[70] In addressing these questions, the Freshfield Report, examining U.S. law, concluded "that ESG issues are relevant for financial valuation," and that America's "modern prudent investor rule . . . provides that . . . there is no duty to 'maximise' the return of individual investments, but instead a duty to implement an overall investment strategy that is rational and appropriate to the fund."[71]

Thus, the Freshfield Report concluded that (1) it is *not* a legal requirement to include ESG factors into investment policy and (2) fiduciary duties do not constrain an investment manager's decision-making to maximizing shareholder return.[72] The biggest takeaway from the Freshfield Report was that fiduciary duties provide decisionmakers with "latitude to follow a wide range of diversified investment strategies, provided their choice of investments is rational and economically defensible."[73] The Freshfield Report began a broader conversation around whether ESG considerations may be relevant to fiduciaries and directors if their financial implications were considered "rational and economically defensible."[74] Thus, the conversation began that the purpose of a corporation may not *solely* be to maximize shareholder wealth through profits.[75]

D. *ESG Becomes More than an Ideology Through New Organizations*

ESG was now firmly in the minds of corporate directors and investors, but it had yet to establish a presence in the capital markets industry beyond a mere ideology. The launch of the Principles for Responsible Investment ("PRI") at the New York Stock Exchange and the Sustainable Stock Exchanges Initiative finally gave ESG a true, organizational presence.[76] PRI is an international organization that promotes the practice of incorporating ESG factors into investment decisions.[77] The Sustainable Stock Exchanges Initiative is a UN organization with the mission of creating a "global platform" to explore ways of improving performance on ESG issues to best promote sustainable investing.[78]

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70. FRESHFIELDS BRUCKHAUS DERINGER, UNITED NATIONS ENVIRONMENT PROGRAMME FINANCE INITIATIVE, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT 6 (2005).

71. Kell, *supra* note 58; FRESHFIELDS BRUCKHAUS DERINGER, *supra* note 70, at 8.

72. FRESHFIELDS BRUCKHAUS DERINGER, *supra* note 70, at 8.

73. *Id.* at 102.

74. *Id.*; Townsend, *supra* note 17, at 6.

75. *See* Townsend, *supra* note 17, at 6.

76. Kell, *supra* note 58. "The UN Principles for Responsible Investment (PRI) is an international organization that works to promote the incorporation of environmental, social, and corporate governance factors (ESG) into investment decision-making." Jason Fernando, *UN Principles for Responsible Investment (PRI)*, INVESTOPEDIA (June 12, 2022), https://www.investopedia.com/terms/u/un-principles-responsible-investment-pri.asp [https://perma.cc/WW8B-UL8X].

77. *See* Fernando, *supra* note 76.

78. The Sustainable Stock Exchanges Initiative ("SSEI") is a UN Partnership Program "organised by UNCTAD, the UN Global Compact, UNEP FI and the PRI." *About the SSE Initiative*, SUSTAINABLE STOCK EXCHS. INITIATIVE, https://sseinitiative.org/about [https://perma.cc/H5FK-YNEN]. "SSE's mission is to provide a global platform for exploring how exchanges, in

Although ESG was well understood by investors and corporate directors as an ideology, these two organizations established an organizational presence for ESG and further integrated it into the capital markets industry.[79]

As the presence of ESG continued to increase, institutional investors and corporate directors pushed back.[80] They asserted that their fiduciary duties were solely to maximize shareholder profits and did not include any other considerations, such as stakeholders.[81] This argument, however, was met with evidence showing that ESG issues had financial implications.[82] The debate as to whether corporate fiduciaries owe duties to anyone outside of shareholders is a lengthy one with many arguments on both sides.[83] This debate, along with the increased demand for ESG metrics in the capital markets industry, began to put pressure on the SEC to regulate ESG disclosures.[84]

E. The Securities Exchange Act of 1934 and the Importance of Materiality to ESG

The Securities Exchange Act of 1934 ("the 1934 Act") was passed in response to the stock market crash in 1929 and created the SEC in order to regulate the securities industry.[85] The 1934 Act's purpose was to build public confidence in the stock market once again and prevent fraudulent activities that undermine investor confidence.[86] In doing so, it empowered the SEC to require public companies to periodically disclose certain information to the public about their businesses.[87] The 1934 Act gave the SEC broad authority to bring civil law suits against those committing fraud or misleading investors

collaboration with investors, companies (issuers), regulators, policymakers and relevant international organizations, can enhance performance on ESG . . . and encourage sustainable investment" aligned with sound ESG practices. *Id.*

79. *See* Kell, *supra* note 58. Foreign countries such as Australia, France, Germany, United Kingdom, and Italy did have mandatory disclosure rules for ESG. FRESHFIELDS BRUCKHAUS DERINGER, *supra* note 70, at 11.

80. Kell, *supra* note 58.

81. *Id.*

82. *Id.*; GORDON L. CLARK, ANDREAS FEINER & MICHAEL VIEHS, FROM THE STOCKHOLDER TO THE STAKEHOLDER: HOW SUSTAINABILITY CAN DRIVE FINANCIAL OUTPERFORMANCE 9–10 (2015).

83. A discussion about this topic is beyond the scope of this Note. For more discussion on corporate fiduciary duties and who falls within the scope of corporate fiduciary duties, see Jackson C. Esker, Note, *Corporate Social Responsibility: Can a Corporation Be Responsible if Its Only Responsibility Is to the Shareholders?*, 106 IOWA L. REV. 1961, 1966–70 (2021). *See generally* George Shepherd, *Not Just Profits: The Duty of Corporate Leaders to the Public, Not Just Shareholders*, 23 U. PENN. J. BUS. L. 823 (2021) (arguing that corporations should have a duty to the public and not just shareholders).

84. *See* Townsend, *supra* note 17, at 8.

85. *SEC: Securities and Exchange Commission*, HISTORY (Dec. 6, 2019), https://www.history.com/topics/us-government/securities-and-exchange-commission [https://perma.cc/6BCX-C9K9].

86. *Id.*

87. *The Laws that Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry [https://perma.cc/5KCT-VM77].

with company information—or lack thereof.[88] In addition to SEC enforcement of the 1934 Act, shareholders could also bring private securities claims under the act.[89] The SEC brought a litany of civil suits against companies that began to develop a body of case law and form the groundwork for SEC regulation.[90] Through many cases, the 1934 Act began to expand in order to keep up with insider trading and fraudulent misrepresentation of financial information.[91] The SEC eventually found itself limited by the language in the 1934 Act, which only "prohibited fraud and misstatements in the *sale* of securities."[92] The SEC subsequently created Rule 10b-5 which added language to prohibit fraud and misstatements "in *connection* with the purchase of securities."[93]

Rule 10b-5 of the 1934 Act gave the SEC more latitude to regulate the securities industry and ensure material information was getting out to the public.[94] In 2000, the SEC addressed another concern that was outside of the scope of Rule 10b-5.[95] The SEC issued a final rule to address selective disclosure and insider trading.[96] The regulation provided "that when an issuer, or person acting on its behalf, discloses *material nonpublic information* to certain enumerated persons . . . it must make public disclosure of that information."[97] In its final form, Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means . . . (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[98]

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88. *Id.*

89. *Id.*; *Exchange Act: Section 10(b) Defenses Against Untimely Claims*, WESTLAW (2022), https://1.next.westlaw.com/Document/Ied9c55e191591 1e598dc8b09b4f043e0/View/FullText.html [https://perma.cc/4FUA-TQUA]; *see U.S. Supreme Court Extends Time to File Federal Securities Fraud Suits*, GIBSON DUNN (Apr. 29, 2010), https://www.gibsondunn.com/u-s-supreme-court-extends-time-to-file-federal-securities-fraud-suits [https://perma.cc/ FER2-QJ5S].

90. *See SEC: Securities and Exchange Commission*, *supra* note 85; *Historical Timeline*, ENCYC. BRITANNICA (June 6, 2013, 3:27 PM), https://insidertrading.procon.org/view.resource.php?resourceID=002391 [https://perma.cc/V72L-LGHK].

91. *Historical Timeline*, *supra* note 90.

92. *Id.* (emphasis added).

93. *Id.* (emphasis added).

94. *Id.*

95. SEC Final Rule: Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, Securities Act Release No. 7,881, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716, 51,716 (Aug. 20, 2000) [hereinafter SEC Final Rule].

96. *Id.*

97. *Id.* (emphasis added).

98. 17 C.F.R. § 240.10b-5 (2022).

Rule 10b-5 did not define the term "material," but rather relied on the courts to establish its definition through precedent.[99]

Case law has established that "[i]nformation is material if 'there is a substantial likelihood that a reasonable shareholder would consider it important' in making an investment decision."[100] Thus, whether withheld or misrepresented information is material hinges on how significant the information would be to a "*reasonable* investor."[101] The case law has made it clear that the determination of "materiality" is a facts and circumstances heavy inquiry.[102] Such a determination of materiality "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him."[103]

The relationship between the definition of materiality and the newly emerging practice of disclosing nonfinancial ESG data remains unclear. As investors continue to show an increased demand for mandatory ESG disclosures in the capital markets industry, the SEC has remained consistent that they require the disclosure of "material" information.[104] With little guidance beyond the uncertain standard of "materiality," corporations are left unsure what ESG-related information might leave them legally exposed under Rule 10b-5.

II. THE EVOLVING DEFINITION OF MATERIALITY IN THE OIL AND GAS INDUSTRY

An interesting dynamic has emerged between investor demand for companies to disclose their ESG-related information and the definition of materiality. Currently, the SEC only requires companies to disclose information that is "material"—but that may be subject to change with the SEC's March 2022 proposal discussed *infra*.[105] Many companies, however,

99. SEC Final Rule, *supra* note 95, at 51,721.

100. *Id.* (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)); *see also* Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (noting that materiality with respect to contingent or speculative events will depend on a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity).

101. *Basic*, 485 U.S. at 240 (emphasis added).

102. *TSC Indus.*, 426 U.S. at 450.

103. *Id.*

104. Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Speech by SEC Chairman: Statement Before the Open Commission Meeting on Disclosure Related to Business or Legislative Events on the Issue of Climate Change (Jan. 27, 2010), https://www.sec.gov/news/speech/2010/spch012710mls-climate.htm [https://perma.cc/283G-RY7E]; Townsend, *supra* note 17, at 8.

105. *See* Sara K. Orr & Bart J. Kempf, *Voluntary Sustainability Disclosure and Emerging Litigation*, 19 CLIMATE CHANGE, SUSTAINABLE DEV., & ECOSYSTEMS COMM. NEWSL., Nov. 2015, at 12, 12–13; Aisha I. Saad & Diane Strauss, *The New "Reasonable Investor" and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation*, 17 BERKELEY BUS. L.J. 391, 392–94 (2020). The current disclosure regime may change as the SEC came out with a proposal on March 21, 2022, that would *require* companies to disclose certain climate-related information, but it is still in the comment stage and is not yet in effect. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act

want to respond to investor demands by *voluntarily* disclosing ESG-related information through public statements or disclosures.[106] These voluntary disclosures have been made difficult by the definition of material.[107] The case law's definition of material is dynamic and it changes with investors' expectations and trends.[108] Scholars have referred to this idea as the "evolving nature" of materiality.[109] As investors demand more nonfinancial information such as ESG, the contours of materiality begin to expand.[110] The reasonable investor now relies on information that has an indirect effect on financial performance (i.e., environmental data) *in addition* to traditional metrics that have a direct effect on financial performance (i.e., revenue).[111] Thus, the scope of materiality is evolving and what began as *voluntary* disclosures of ESG information may be becoming "material" to investors.

This Section focuses on the definition of materiality and how its dynamic nature has posed challenges for the oil and gas industry. It begins with a discussion about the evolving nature of the definition of materiality. It then moves into how each industry has its own definition of materiality, limiting and expanding what information is material for each industry. Finally, this Section ends with a discussion about how growing pressure from investors for companies to disclose their ESG information is affecting the definition of materiality.

A. *The Evolving Definition of Materiality*

Courts ultimately determine the definition of materiality through securities litigation.[112] Currently, case law defines "material information" by stating that "[i]nformation is material if 'there is a substantial likelihood that a reasonable shareholder would consider it important' in making an investment decision."[113] Scholars have noted that case law does not offer a specific definition of materiality, and "[c]ourt opinions on materiality have done little more than sketch its conceptual contours."[114] Courts have instructed that a reasonable investor will "exercise[] due care" in staying informed about pertinent information and "take[] into account the customs and practices of the relevant

Release No. 94,478, Securities Act Release No. 11,042, 87 Fed. Reg. 21,334, 21,334 (proposed Mar. 21, 2022) [hereinafter SEC's 2022 Proposal].

106. Saad & Strauss, *supra* note 105, at 392–93.

107. *See infra* Parts II and III.

108. Saad & Strauss, *supra* note 105, at 393–94.

109. *Id.* at 394 (describing the challenges of the "evolving nature of the reasonable investor").

110. *Id.* at 393.

111. *Id.*

112. Of course, the SEC could leave a comment and define "materiality," but it would ultimately be up to the courts to determine its exact meaning through precedent. *See supra* Section I.E.

113. SEC Final Rule, *supra* note 95, at 51,271 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

114. *See, e.g.*, Robert G. Eccles & Tim Youmans, *Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality*, 28 J. APPLIED CORP. FIN. 39, 42 (2016).

industry."[115] In determining materiality, courts have consistently rejected a formulaic approach and have instead chosen a case-specific approach, taking into consideration factors from all angles, including those of the investor, company, and industry.[116] The most challenging aspect about this definition is that even though it is a facts and circumstances heavy inquiry, there are not "degrees of materiality." Information is either material or not material.[117]

Oil and gas companies are struggling to determine what environmental information is material because materiality is driven by investors. A reasonable investor standard is dynamic and evolves with the mainstream market.[118] Therefore, as society acknowledges the importance of climate change and ESG, investors will find certain environmental information substantially important to their investment decisions.[119] Oil and gas companies are then forced to keep up with this evolving standard of "material," making determinations about whether to disclose environmental information increasingly difficult and costly.

The evolving definition of materiality also poses a challenge for courts as they must keep up with the current investor trends in each market.[120] Materiality is industry-specific and the reasonable investor is not determined by investors generally but by investors in the specific industry in question.[121] This means that in determining materiality, courts must examine certain industries as a whole to find trends among investors in *that particular* industry as opposed to investors in general.[122] The evolving definition of materiality puts the onus on courts to remain informed about investor trends in each industry when deciding if information is material.[123] The propensity for investor trends to change quickly creates an unpredictable environment for oil and gas companies that

115. FindWhat Inv. Grp. v. FindWhat.com, 658 F.3d 1282, 1305 (11th Cir. 2011); Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175, 190 (2015).

116. *See* Hana V. Vizcarra, *Climate-Related Disclosure and Litigation Risk in the Oil & Gas Industry: Will State Attorneys General Investigations Impede the Drive for More Expansive Disclosures?*, 43 VT. L. REV. 733, 751 (2019) (recommending consideration of qualitative factors and analysis of all relevant considerations when determining materiality); *see also* Basic Inc. v. Levinson, 485 U.S. 224, 236 (1988) ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive."); Litwin v. Blackstone Grp., L.P., 634 F.3d 706, 717 (2d Cir. 2011) (noting that the Second Circuit has "consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation" (quoting Ganino v. Citizens Utils. Co., 228 F.3d 154, 162 (2d Cir. 2000))).

117. Eccles & Youmans, *supra* note 114, at 42.

118. *See* Hana V. Vizcarra, *The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures*, 50 ENV'T L. REP. 10106, 10108 (2020).

119. *See id.*

120. *See id.* at 10109.

121. *See id.*; United States v. Litvak, 889 F.3d 56, 64–65 (2d Cir. 2018) ("The standard of a 'reasonable investor,' like the negligence standard of a 'reasonable man,' is an objective one. The standard may vary, therefore, with the nature of the traders involved in the particular market." (citations omitted)).

122. *See* Vizcarra, *supra* note 118, at 10109.

123. *See id.*

are voluntarily disclosing environmental information.[124] This unpredictability stems from the fact that case law cannot keep up with fast-changing investor trends to produce reliable precedent.[125] Thus, the evolving definition of materiality creates an unpredictable environment for ESG disclosure.

B. Industry-Specific Standards for Materiality Are Not Favorable to the Oil and Gas Industry

The definition of materiality is fact-specific and considers, among many other things, the company and industry.[126] The diversity and pace of corporate America means that it is unlikely for any one issue to be relevant to all industries, and issues can go from peripheral to relevant quickly.[127] By definition, materiality depends on a reasonable investor's perception of how a given fact relates to a certain company and industry.[128]

The Sustainability Accounting Standards Board ("SASB") has recognized the materiality differences among industries.[129] In response, it created a standard-setting approach that accounts for what issues are most likely material among different industries.[130] Issues were found likely to be material for certain industries based on archival research of stakeholder interest in the issue and financial impact of the issue.[131] The issues examined were subsets of environmental, social, and governance factors.[132] An example of one issue was greenhouse gas emissions—a subcategory of the environmental factor and a metric that the SASB considered a "disclosure topic."[133] The oil and gas industry was in "Scope 1" for this subcategory, meaning that emissions can be measured directly from the oil and gas company.[134] Greenhouse gas emissions were considered a "disclosure topic" because the SASB's "process reveal[ed] evidence of financial impact and evidence of investor interest through research and market consultation with both companies and investors."[135] The data

124. *See id.*

125. *See id.*

126. *See supra* Section II.A.

127. Katz & McIntosh, *supra* note 5.

128. *See supra* Section II.A.

129. David Freiberg, Jean Rogers & George Serafeim, *How ESG Issues Become Financially Material to Corporations and Their Investors* 4 (Harv. Bus. Sch. Acct. & Mgmt. Unit Working Paper, Paper No. 20-056, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3482546 [https://perma.cc/43ZR-P9SV]; *see* SUSTAINABILITY ACCT. STANDARDS BD., SASB IMPLEMENTATION SUPPLEMENT: GREENHOUSE GAS EMISSIONS AND SASB STANDARDS 1 (2020), https://www.sasb.org/wp-content/uploads/2020/10/GHG-Emmissions-100520.pdf [https://perma.cc/G6K3-C2MM].

130. Freiberg et al., *supra* note 129, at 4; *see* SUSTAINABILITY ACCT. STANDARDS BD., *supra* note 129, at 1–2.

131. Freiberg et al., *supra* note 129, at 4; *see* SUSTAINABILITY ACCT. STANDARDS BD., *supra* note 129, at 1–2.

132. SUSTAINABILITY ACCT. STANDARDS BD., *supra* note 129, at 1–2.

133. *Id.* at 2–3.

134. *Id.* at 3.

135. *Id.* (emphasis omitted).

showed that greenhouse gas emissions were highly likely to be material in the oil and gas industry.[136] The SASB's standard-setting approach shows that materiality is different among industries and that certain issues can become material through an increase in stakeholder interest and financial impact.

A recent study from the Harvard Business School has illustrated how ESG factors can become material to certain industries over time.[137] The study has ascertained five "stages of materiality" as they relate to ESG factors: (1) status quo, (2) catalyst, (3) stakeholder pressure, (4) company response, and (5) regulatory response and innovation.[138] Stage one demarcates the point where an ESG factor is *least* material and stage five demarcates the point where an ESG factor is *most* material.[139] A particular ESG factor advances through these five factors—becoming more material—as the misalignment between business practices and societal values increases.[140] Misalignment occurs in two ways: (1) Business practices "move[] away from what is currently considered socially acceptable," or (2) "societal norms about what is acceptable corporate behavior move away from current corporate practices."[141]

The first stage of materiality for an ESG issue occurs when societal values and corporate strategies regarding the issue align.[142] At this point, an issue is least material as it receives little to no attention from companies or stakeholders.[143] The second stage is where societal values and corporate strategies regarding the ESG issue begin to diverge.[144] Once this misalignment becomes noticeable enough to raise societal concern, the ESG issue moves to stage three and stakeholders take action.[145] At this stage, stakeholders begin by engaging with companies directly to correct the misalignment.[146] If stakeholders are unsuccessful, they turn to politicians to enact regulation to correct this misalignment.[147] These pressures take the ESG issue into the fourth stage, "[c]ompany and [i]ndustry [r]eaction."[148] At this stage, companies in the industry react by changing corporate strategies to regain public trust and reputation.[149] These changes can be costly or ineffective.[150] Finally, the ESG issue reaches the fifth stage of materiality, "[r]egulation and [i]nnovation," in which regulation

136. *See id.*
137. Freiberg et al., *supra* note 129, at 1.
138. *Id.* at 9 tbl.1, 28 fig.1.
139. *Id.*
140. *Id.* at 11.
141. *Id.*
142. *See id.* at 9–10 tbl.1.
143. *See id.*
144. *See id.*
145. *Id.* at 16.
146. *Id.*
147. *Id.*
148. *Id.* at 21.
149. *Id.*
150. *Id.*

is enacted to realign societal and corporate interests, or the industry is disrupted through innovation in the market.[151] In either case, such regulation or innovation to the industry is substantial and leads to changes in stock price or fundamental business operations.[152] This is where materiality for an ESG issue becomes most prominent.[153]

The key factor to materiality is the public's acute awareness of the misalignment.[154] This awareness factor is shown best through the Harvard Business School's explanation of the pharmaceutical industry:

> An issue that is still in [the status quo] stage in the pharmaceutical industry is drug pollution—pharmaceuticals present in the environment from human metabolytes and improperly disposed of drugs. While environmental data indicate widespread pharmaceutical contamination is affecting ecosystems, drinking water supplies and human health, companies have not yet been held responsible for this "externality" because society has not internalized the information regarding the magnitude of the misalignment. . . . Investors are beginning to take note of this issue and to raise public awareness. . . . Conditions are ripe for a catalyst that could trigger the materiality of this issue.[155]

The oil and gas industry has moved quickly through these stages as the misalignment between climate change initiatives and the corporate strategies of oil and gas companies gain stakeholder awareness.[156] This heightened awareness is creating concern among oil and gas companies as to what ESG issues are reaching higher stages of materiality.

C. *The Oil and Gas Industry Responds to Investor Pressures by Increasing Climate-Related Information Disclosures*

Investor trends are beginning to change as influential actors in the capital markets industry are calling for companies to disclose their ESG information. Former SEC commissioner Robert J. Jackson wrote that "materiality—the importance of a subject to a reasonable investor—is the touchstone of our securities laws. But too much of corporate America has forgotten who decides what is material."[157] Investors drive what information is material, and the

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151. *Id.* at 24.

152. *Id.*

153. *Id.* at 28 fig.1.

154. *Id.* at 8.

155. *Id.* (citation omitted).

156. *See infra* Section II.C.

157. Steven Mufson, *Exxon Shareholders Want Action on Climate Change. The SEC Calls it Micromanagement.*, WASH. POST (May 8, 2019), https://www.washingtonpost.com/national/health-science/exxon-shareholders-want-action-on-climate-change-sec-calls-it-micromanagement/2019/05/08/de283bf4-6c49-11e9-a66d-a82d3f3d96d5_story.html [https://perma.cc/A2VE-8GCS].

environmental factor of ESG continues to demand the most attention as investors hold corporations accountable for their environmental impact.[158]

Statements made by influential investors have made it clear "that sustainability will be at the center of investment strategies moving forward."[159] BlackRock CEO, Larry Fink, "expects companies to change the way they disclose ESG metrics to their investors" and stated that investors needed a "clearer picture of how companies are managing sustainability-related questions."[160] Fink also warned that BlackRock "will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."[161] Cyrus Taraporevala, CEO of State Street Global Advisors, also stated that "ESG is 'no longer an option for long-term strategy'" and that addressing such concerns was "essential to a company's long-term financial performance."[162] "The New York State Comptroller sent letters to companies . . . requesting that they 'develop robust transition plans and business strategies that are to be aligned with'" climate change values.[163] Vanguard joined in as well, announcing "its willingness to take public positions on topics such as climate disclosures even if it requires voting against management."[164]

Vanguard, BlackRock, and State Street Global Advisers make up what is colloquially referred to as "the Big Three" institutional investors.[165] "[A]s of the end of 2019, the Big Three collectively held, on average, 21.4 [percent] of the shares of S&P 500 corporations, and . . . BlackRock and Vanguard each

158. *See* Hana V. Vizcarra, *Breaking Down "E, S, and G": Climate Change as a Material Concern for the Energy Sector*, 18 OIL, GAS & ENERGY L. INTEL. 1, 1 (2020) ("A recent survey of institutional investors found that over half considered climate risk as important as traditional financial reporting."); Saad & Strauss, *supra* note 105, at 392–93; Pete Michaels & Alyssa Scruggs, *The Rise of Shareholder Activism and Litigation Related to Environmental, Social, and Governance Investing*, AM. BAR ASS'N (Apr. 1, 2021), https://www.americanbar.org/groups/litigation/committees/securities/articles/2021/rise-of-shareholder-activism-and-litigation-environmental-social-governance-investing [https://perma.cc/JHT5-FYUE]; *see also* Emirhan Ilhan, Philipp Krueger, Zacharias Sautner & Laura T. Starks, *Climate Risk Disclosure and Institutional Investors* 2–3 (Swiss Fin. Inst. Rsch. Paper Series, Working Paper No. 19-66, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3437178 [https://perma.cc/8TGE-E7JM] ("The [institutional investor] respondents share a strong belief that climate risk disclosure is important: [seventy-nine percent] believe climate risk reporting to be at least as important as financial reporting, with almost one-third considering it to be more important.").

159. Connor Kuratek, Joseph A. Hall & Betty M. Huber, *Legal Liability for ESG Disclosures*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 3, 2020), https://corpgov.law.harvard.edu/2020/08/03/legal-liability-for-esg-disclosures [https://perma.cc/MNY3-GM2T].

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. Vizcarra, *supra* note 118, at 738.

165. Lucian Bebchuk & Scott Hirst, The Power of the Big Three, and Why it Matters 1 (Feb. 21, 2021) (unpublished manuscript), http://www.law.harvard.edu/faculty/bebchuk/The_Power_of_the_Big_Three_and_Why_It_Matters.pdf [https://perma.cc/MDF8-V6UK].

had positions of [five percent] or more in more than [ninety-five percent] of S&P 500 companies."[166] These three institutional investors are among the most influential shareholders and place significant pressure on public corporations with their voting power.[167] Given the prominence that these three institutional investors have in the capital markets industry, it raises the question whether their actions alone can influence what the "reasonable investor" standard is for materiality. Put differently, would a reasonable investor consider the statements and actions of the three largest institutional investors substantially important when making investment decisions?

Although there may not be a consensus about the influence of the Big Three, energy companies have adjusted by increasing climate-related disclosures in response to investor pressures.[168] In its 2018 report, the Task Force on Climate-Related Financial Disclosures ("TCFD") reviewed climate-related disclosures across various industries and found that industries varied drastically in their disclosures.[169] The 2018 report that analyzed 270 energy company disclosures showed that the energy industry was "further along" in its disclosure practices than other industries.[170] In total, the energy industry "had the highest percentage of disclosures."[171] However, because ESG disclosures do not neatly align with financial reporting, companies have been unsure how to best disclose such information.[172] Therefore, oil and gas companies have refrained from incorporating additional information and data into their reports, including mostly boilerplate language.[173] They have prepared "tailored sustainability or climate-specific reports" in line with TCFD recommendations that have provided some guidance.[174] In short, the data shows gas and oil companies are trying to respond to investor pressure, but they are still unsure how best to do so and are seeking guidance.[175]

166. *Id.* at 3–4.

167. *See* Kuratek et al., *supra* note 159.

168. Vizcarra, *supra* note 118, at 742–45.

169. *Id.* at 742; *see* TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES: STATUS REPORT, at ii–iii (2018), https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2018-TCFD-Status-Report-092518.pdf [https://perma.cc/8D486UGD].

170. Vizcarra, *supra* note 118, at 742–43.

171. *Id.* (quoting TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, *supra* note 169, at 30).

172. *Id.* at 742.

173. *Id.* at 743.

174. *Id.*; *see* Amir Amel-Zadeh, The Financial Materiality of Climate Change: Evidence from a Global Survey 11 (June 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295184 [https://perma.cc/A5B4-9DUW].

175. *See* Amel-Zadeh, *supra* note 174, at 11.

III. Disclosures Lead to Securities Litigation in the Oil and Gas Industry

The SEC has created a challenging environment for the oil and gas industry to disclose its climate-related information. Prior to March of 2022, the SEC had provided little guidance on the types of ESG information that might be material.[176] This uncertainty left many companies guessing when they voluntarily disclosed ESG information, and their disclosures were heavily scrutinized by investors.[177] Then, on March 21, 2022, the SEC issued a proposal ("2022 Proposal") that would *require* public companies to disclose certain climate-related data and departed slightly from the materiality standard.[178] The evolving definition of materiality and the contradictory disclosure regimes that the SEC set forth place oil and gas companies in an untenable position when disclosing their climate-related information.[179]

Regardless of the disclosure regime, when oil and gas companies release climate-related information to the public, if their actions do not align with their disclosures, then they are sued by shareholders for misleading "material" information.[180] As climate change remains important to investors, securities litigation over environmental information has been especially harsh on the oil and gas industry.[181] Recent securities cases show "emerging incongruities" between the older understanding of a reasonable investor who focused solely on financial metrics and the more contemporary understanding of a reasonable investor who focuses on both financial and nonfinancial metrics.[182] Shareholders are bringing private securities claims against companies that go beyond the traditional, fraudulent financial or accounting practices.[183] Such claims have dealt with climate-related projections or environmental disasters.[184] Many of these claims result from an evolving definition of materiality and the SEC's creation of a challenging climate-related disclosure environment.

This Part focuses on how the SEC has created a challenging environment for climate-related disclosures in the oil and gas industry and the implications of this challenging environment. First, this Part will discuss the SEC's contradictory disclosure regimes by comparing its current disclosure regime to its new 2022

176. Saad & Strauss, *supra* note 105, at 393–94.

177. *Id.*

178. *See* SEC's 2022 Proposal, *supra* note 105, at 21,334; *see Proposed SEC Climate Disclosure Rule*, BL (Aug. 12, 2022), https://pro.bloomberglaw.com/brief/proposed-sec-climate-disclosure-rule [https://perma.cc/9D46-RNDF].

179. Saad & Strauss, *supra* note 105, at 392–93.

180. *See generally* David Hackett, Reagan Demas, Douglas Sanders, Jessica Wicha & Aleesha Fowler, *Growing ESG Risks: The Rise of Litigation*, 50 ENV'T L. REP. 10849 (2020) (noting the growing ESG litigation following voluntary disclosure of ESG initiatives by public corporations).

181. *See infra* Section III.B.

182. Saad & Strauss, *supra* note 105, at 394.

183. *See id.*

184. *See infra* Section III.B.

Proposal. Second, it will move into climate-related disclosures and how these have led to increased securities litigation. Third, this Part will end with a discussion about the Private Securities Litigation Reform Act ("PSLRA") and why it is ineffective against increased private securities litigation.

A. *The SEC Created a Challenging Climate-Related Disclosure Environment*

Although the court ultimately decides what information is "material" for securities litigation, the SEC has provided conflicting guidance on climate-related disclosures.[185] In January of 2021, the SEC reissued a guidance report ("2010 Guidance Report") on climate-related disclosures that it drafted back in 2010.[186] The 2010 Guidance Report reaffirmed the traditional materiality standard for disclosures and offered limited examples of what types of climate-related information may be material.[187] Then, in March of 2022, the SEC issued an extensive proposal that would require companies to disclose climate-related information.[188] While the SEC's 2022 Proposal once again reaffirms the materiality standard used in the 2010 Guidance Report, it also requires further climate-related disclosures that depart from the materiality standard.[189]

This Section will compare the SEC's two disclosure regimes and illustrate how they create a challenging disclosure environment for the oil and gas industry. First, it will discuss the implications of the 2010 Guidance Report on the oil and gas industry. Second, it will discuss the implications of the SEC's 2022 Proposal on the oil and gas industry.

1. The SEC Reissues Its 2010 Guidance Report

The SEC's 2010 Guidance Report acknowledges the challenges faced by companies in determining what climate-related information is material because of the nature of the definition.[190] The report states that "[a]nalyzing the materiality of known trends, events or uncertainties may be particularly challenging for registrants preparing . . . disclosure[s]."[191] It further states

185. Andrew Ramonas, *New SEC's First Climate Disclosure Tool Is Blast from the Past*, BL (Feb. 9, 2021, 3:46 AM), https://news.bloomberglaw.com/securities-law/new-secs-first-climate-disclosure-tool-is-blast-from-the-past [https://perma.cc/AW8G-KFTZ]; *see* Commission Guidance Regarding Disclosure Related to Climate Change, Exchange Act Release No. 61,469, Securities Act 9,106, 75 Fed. Reg. 6290, 6294–95 (Feb. 8, 2010) [hereinafter "2010 Guidance Report"].

186. Ramonas, *supra* note 185; *see* 2010 Guidance Report, *supra* note 185, at 6294–95.

187. *See* 2010 Guidance Report, *supra* note 185, at 6295–97.

188. *Proposed SEC Climate Disclosure Rule*, *supra* note 178; *see* SEC's 2022 Proposal, *supra* note 105, at 21,334.

189. *See* SEC's 2022 Proposal, *supra* note 105, at 21,335–37; Allison Handy, *The SEC's Climate Proposal: Where Did We Wind Up with "Materiality"?*, PUB. CHATTER (Mar. 24, 2022), https://www.publicchatter.com/2022/03/the-secs-climate-proposal-where-did-we-wind-up-with-materiality [https://perma.cc/2CLT-RNNJ].

190. *See* 2010 Guidance Report, *supra* note 185, at 6295.

191. *Id.*

that "climate change regulation is a rapidly developing area" and "[r]egistrants need to regularly assess their potential disclosure obligations given new developments."[192]

The 2010 Guidance Report focuses solely on climate-related information that affects a company financially.[193] It states that companies drafting "disclosure[s] should focus on material information and eliminate immaterial information that does not promote understanding of registrants' financial condition, liquidity and capital resources, changes in financial condition and results of operations."[194] Although it mentions the need to include "risk factor disclosure regarding existing or pending legislation or regulation that relates to climate change," this is solely for financial concerns to account for increasing operating costs.[195] The 2010 Guidance Report does not address the materiality of ESG and nonfinancial disclosures such as carbon emissions.[196] The SEC's guidance report is outdated and limited. It does not provide adequate guidance for companies currently facing an evolving definition of materiality and investor pressure for climate-related transparency.

After reissuing its 2010 Guidance Report, the SEC began sending individualized comment letters to companies that voluntarily disclosed climate-related information.[197] Comment letters respond to a company's voluntary climate change disclosures by asking for more details or clarity on specific matters.[198] SEC comment letters are common for mandatory disclosures and reports but have seldom been used for *voluntary* disclosures.[199] The letters provided insight for what the SEC may look for in climate disclosures, but the letters were only sent to individual companies and tailored specifically to them.[200] In addition, they could be considered vague. By way of example, the SEC asked a number of companies "to report *any* risks they faced from climate change in 2021 or better describe them."[201] Thus, SEC comment letters offer limited, individualized guidance for materiality. Such guidance still leaves most companies in the dark when determining materiality as they face increased pressure to disclose climate information.

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192. *Id.* at 6296.

193. *See id.* at 6294.

194. *Id.*

195. *Id.* at 6296.

196. *See id.*

197. *Id.*

198. *Id.*

199. *See* Andrew Ramonas, *SEC Boots Climate Disclosure Scrutiny Before Reporting Mandate*, BL (Jan. 19, 2022, 5:00 AM), https://news.bloomberglaw.com/securities-law/sec-boosts-climate-disclosure-scrutiny-before-reporting-mandate [https://perma.cc/VB29-7MN9].

200. *See id.*

201. *Id.* (emphasis added).

2. The SEC's March 2022 Proposal

The SEC's 2022 Proposal drastically departs from its 2010 Guidance Report and *requires* companies to disclose *both* material climate-related information and emissions information that may not necessarily be material.[202] The proposal is an extensive, approximately five-hundred-page report that requires companies to disclose: (1) their direct and indirect greenhouse gas emissions and their supply chain's greenhouse gas emissions; (2) specific information relating to their corporate governance and oversight of climate-related risks; (3) how climate-related risks affect their strategy, business model, and outlook in the short, medium, and long-term; (4) their detailed processes for identifying, assessing, and managing climate-related risks or opportunities; (5) their targets and goals, including how they will meet those environmental goals and what data is relevant for measuring success; and (6) the impact of climate-related events and transition activities on their financial statements.[203]

The SEC's 2022 Proposal strays away from its 2010 Guidance Report and requires disclosure of nonfinancial information.[204] On the contrary, the 2010 Guidance Report focused solely on financial metrics.[205] It told companies to "eliminate immaterial information that does not promote understanding of registrants' *financial* condition."[206] The 2022 Proposal, however, goes beyond financial metrics and requires companies to disclose nonfinancial information such as their emissions, corporate governance and oversight, and environmental goals.[207] The proposal also departs from the materiality standard by requiring public companies to disclose "climate-related risks totaling [one percent] or higher of a total line item in relevant year financial statements."[208] Therefore, companies would need to disclose the financial impacts of things like climate-related risks, impacts of severe weather events, and transition activities if their aggregated financial impact is one percent or more of a consolidated financial

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202. *Proposed SEC Climate Disclosure Rule*, *supra* note 178; *see* SEC's 2022 Proposal, *supra* note 105, at 21,334.

203. Meredith B. Cross et al., *SEC Issues Groundbreaking Climate Disclosure Proposal*, WILMERHALE (Mar. 22, 2022), https://www.wilmerhale.com/insights/client-alerts/20220322-sec-issues-groundbreaking-climate-disclosure-proposal [https://perma.cc/67R3-A5QN]; *see generally* SEC's 2022 Proposal, *supra* note 105 (discussing the new climate-related disclosure requirements for public companies).

204. *See generally* SEC's 2022 Proposal, *supra* note 105 (discussing the new climate-related disclosure requirements for public companies and noting the inclusion of new greenhouse gas emissions disclosures).

205. *See* 2010 Guidance Report, *supra* note 185, at 6294.

206. *Id.* (emphasis added).

207. Cross et al., *supra* note 203; *Proposed SEC Climate Disclosure Rule*, *supra* note 178. *See generally* SEC's 2022 Proposal, *supra* note 105 (discussing the new climate-related disclosure requirements for public companies and including mandatory disclosures of nonfinancial metrics).

208. *Proposed SEC Climate Disclosure Rule*, *supra* note 178; *see* SEC's 2022 Proposal, *supra* note 105, at 21,345–46.

statement line item in a given year.[209] In short, the SEC's 2022 Proposal is far more extensive than its 2010 Guidance Report and adopts a more prescriptive approach in its disclosure regime. It forces companies to disclose significantly more information by departing from the materiality standard and leaving registrants with less discretion.[210]

The energy industry has reacted to the SEC's 2022 Proposal with comments and concerns.[211] The main concerns are: (1) the implementation of a one percent threshold that deviates from the materiality standard for certain climate-related disclosures; (2) overloading investors with information that may be "immaterial, uncomparable, or unreliable data"; (3) a potential "chilling effect on [energy] companies to set internal emissions reduction targets or other climate-related goals to avoid additional liability risks"; and (4) the proposal's broad definitions of "climate-related events," "physical risks," and "transition activities."[212]

Energy companies assert that a "'bright line' [one percent] threshold for climate-related financial metrics" would result in a quantity over quality approach to disclosures, and would bury investors in immaterial information.[213] Some oil and gas companies feel that the "proposed requirements will cause issuers to incur enormous costs to provide information that fails to meet a reasonable materiality threshold and will be inconsistent across issuers."[214] Oil and gas companies are also concerned about the burden and uncertainty of the required disclosures relating to indirect greenhouse gas emission from their supply chains.[215] ExxonMobil Corporation commented that this disclosure requirement should be excluded until "more useful and effective standards

209. Sehrish Siddiqui, *The SEC's Proposed Climate Change Rules Are Out: Making Sense of 500+ Pages*, BASS, BERRY & SIMS (Mar. 27, 2022), https://www.bassberrysecuritieslawexchange.com/proposed-climate-change-rules [https://perma.cc/CUU4-5M3Q]; SEC's 2022 Proposal, *supra* note 105, at 21,345–46.

210. *See* Handy, *supra* note 189; Hillary H. Holmes & Justine Robinson, *Energy Industry Reacts to SEC Proposed Rules on Climate Change*, HARV. L. SCH. F. CORP. ON GOVERNANCE (Sept. 5, 2022), https://corpgov.law.harvard.edu/2022/09/05/energy-industry-reacts-to-sec-proposed-rules-on-climate-change [https://perma.cc/SR5R-L3NW].

211. *See* Holmes & Robinson, *supra* note 210.

212. *Id.*; Letter from Alan D. McLean, Exec. Vice President Tax'n & Controller, Shell PLC, to U.S. Sec. & Exch. Comm'n 1–3 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131871-302323.pdf [https://perma.cc/X7PQ-Q6T9] (sending comments from Shell to the SEC "on the proposed amendments to its rules under the Securities Act of 1933 . . . and Securities Exchange Act of 1934 . . . that would require registrants to provide certain climate-related information in their registration statements and annual reports"); SEC's 2022 Proposal, *supra* note 105, at 21,346–48.

213. Letter from Alan D. McLean, *supra* note 212, at 3; Letter from Kathryn A. Mikells, Senior Vice President & Chief Fin. Off., ExxonMobil Corp., to U.S. Sec. & Exch. Comm'n 3–4 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132323-302882.pdf [https://perma.cc/58LN-7BF9] (sending comments from ExxonMobil Corporation to the SEC on climate-related disclosures).

214. Letter from Kathryn A. Mikells, *supra* note 213, at 3.

215. *Id.* at 4; *see* Holmes & Robinson, *supra* note 210.

for assessing indirect emissions [] mature and develop to avoid significant estimation and double-counting."[216] Oil and gas companies are also concerned with the proposal's broad definitions such as "climate-related events," "physical risks," and "transition activities."[217] The combination of the proposal's prescriptive nature, nonfinancial and speculative disclosure requirements, and broad definitions expose oil and gas companies to private securities liability.[218]

The oil and gas industry's concerns are shared by other influential actors, such as Commissioner Hester M. Peirce and the Business Roundtable—an organization that loudly voiced its support for ESG transparency.[219] Commissioner Peirce stated that the proposal "will undermine the existing regulatory framework," and "harm[] investors, the economy, and this agency."[220] She further asserted that this proposal "tells corporate managers how *regulators,* doing the bidding of an array of non-investor stakeholders, expect them to run their companies."[221] Commissioner Peirce also argued that the proposal "dispenses with materiality in some places and distorts it in others."[222] The Business Roundtable stated that the SEC's 2022 Proposal is "unworkable . . . and may not result in decision-useful information for investors."[223] It also noted that the proposal "would require registrants to produce overwhelming amounts of information that would not be comparable, reliable or meaningful, much less material, for investors."[224] Finally, and perhaps most concerning for the oil and gas industry, the Business Roundtable stated that the proposal "would . . . subject registrants to significant liability for disclosures that inherently involve a high degree of uncertainty."[225]

In sum, regardless of the disclosure regime, the SEC has created a challenging environment for the oil and gas industry to disclose its climate-related information. Under either disclosure regime, oil and gas companies are subjected to potential securities liability for climate-related information they disclose to the public. The speculative nature of climate-related information, challenging disclosure environment, and evolving definition of materiality

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216. Letter from Kathryn A. Mikells, *supra* note 213, at 4.

217. Letter from Alan D. McLean, *supra* note 212, at 3; SEC's 2022 Proposal, *supra* note 105, at 21, 345–48.

218. *See* Letter from Alan D. McLean, *supra* note 212, at 3; Holmes & Robinson, *supra* note 210.

219. *See supra* note 4 and accompanying text.

220. Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, We Are Not the Securities and Environment Commission – At Least Not Yet (Mar. 21, 2022), https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321 [https://perma.cc/MHB6-3W53].

221. *Id.*

222. *Id.*

223. Maria Ghazal, *The Proposed SEC Climate Disclosure Rule: A Comment from the Business Roundtable*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 12, 2022), https://corpgov.law.harvard.edu/2022/07/12/the-proposed-sec-climate-disclosure-rule-a-comment-from-the-business-roundtable [https://perma.cc/9N4F-2BXM].

224. *Id.*

225. *Id.*

have all placed the oil and gas industry in an untenable position to comply with SEC and investor demands for more climate-related transparency.

B. "VOLUNTARY" DISCLOSURES HAVE LED TO INCREASED SECURITIES LITIGATION

Increasing investor pressure to disclose climate-related information has led oil and gas companies to "voluntarily" disclose their environmental information.[226] However, companies have made these ESG disclosures with little guidance on best practices and no standard disclosure regimes.[227] In addition, the definition of "material" under Rule 10b-5 has the propensity to change along with the perceptions of a "reasonable investor."[228] This uncertainty has posed challenges for the oil and gas industry on whether to disclose environmental information and such disclosures have been met with close investor scrutiny.[229] As a result, when a company's ESG disclosures do not closely align with their actions, investors have begun to use their shareholder rights to bring private securities claims under Rule 10b-5 for "misleading" or "false" statements of "material fact[]."[230] The evolving definition of "material" and the mixed guidance on climate-related disclosures have left companies susceptible to two different types of private securities litigation: (1) traditional securities litigation and (2) event-driven securities litigation.[231] This Section will discuss both and how they are exacerbated under an evolving standard of materiality.

1. "Traditional" Securities Litigation Under an Evolving Standard of Materiality

Traditional securities litigation deals with financial or other reports that allegedly mislead investors about the company's financial status or business operations.[232] An example of traditional securities litigation as it relates to environmental information is the 2018 securities lawsuit involving ExxonMobil Corporation ("Exxon").[233] Exxon was sued for misleading its investors in its "Energy and Carbon—Managing the Risks" report.[234] The voluntary report

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226. *See supra* Section II.C.

227. *See supra* Section III.A.

228. *See* Kuratek et al., *supra* note 159; *supra* Section II.A.

229. *See* Orr & Kempf, *supra* note 105, at 12–13; Kuratek et al., *supra* note 159; Rose, *supra* note 5, at 1828–32.

230. *See* Kuratek et al., *supra* note 159.

231. *See id.*; *see generally* Hackett et al., *supra* note 180 (providing an overview of the legal theories brought in claims regarding ESG disclosure).

232. Subodh Mishra, *Event Driven Securities Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 18, 2020), https://corpgov.law.harvard.edu/2020/12/18/event-driven-securities-litigation [https://perma.cc/U5AS-G92F].

233. Hackett et al., *supra* note 180, at 10855.

234. Ramirez v. Exxon Mobil Corp., 334 F. Supp. 3d 832, 839, 847 (N.D. Tex. 2018) (surviving a motion to dismiss after plaintiffs sufficiently alleged material misstatements).

stated that Exxon accounted for future government climate change policies and the effects of such policies when projecting financial outlooks on any investment project.[235] The Exxon report stated that it used a proxy cost of sixty dollars per ton for carbon dioxide to account for such policies.[236] However, the plaintiffs—a group of shareholders—showed that the proxy costs actually used by Exxon were forty dollars per ton.[237] The court found that the plaintiffs "sufficiently alleged ExxonMobil made material misstatements regarding [its] use of proxy costs in formulating business and investment plans" and overcame a motion to dismiss.[238]

Approximately a year later, Exxon was sued again.[239] This time the oil corporation was sued for allegedly misleading investors in its report responding to shareholder inquiries about how the company "factored climate change risks and regulations into its business decisions."[240] Exxon agreed to voluntarily draft two reports about the "manner in which Exxon[] addresses the evolving policies and regulations governments may implement to reduce the emissions of greenhouse gases in a rapidly growing world population."[241] The two voluntary reports were projections on energy requirements for the years 2030 and 2040, using a "proxy cost of carbon."[242] This "proxy cost of carbon" was a metric commonly used by Exxon in assessing future demand for fossil fuels to help with inventory and budgeting.[243] Internally, however, Exxon used different greenhouse gas costs that were more accurate and based on the particular jurisdiction where future projects would take place.[244] This created a difference between the projections on the reports and the projections Exxon

235. *Id.* at 839–40 ("The MTR Report explained that ExxonMobil considers possible government policy changes on climate-related controls, such as restricting emissions, and the effect of these policy changes on oil and gas exploration, development, production, transportation, and use of carbon-based fuels. The MTR Report stated that ExxonMobil takes these policies into consideration by factoring in a proxy cost of carbon when calculating any investment's or project's projected financial outlook. On March 31, 2014, ExxonMobil also released a report entitled 'Energy and Climate,' which stated ExxonMobil applied a proxy cost of approximately $60 per ton in 2030 and $80 per ton in 2040.").

236. *Id.* at 846.

237. *Id.* at 846–47 (noting that the report stated that ExxonMobil used a proxy cost for carbon "to consider [future] governmental policies associated with climate change" that was publicly stated to be sixty dollars per ton, while the internal documents show the actual proxy cost used was forty dollars per ton in 2030).

238. *Id.* at 847.

239. *See* Vizcarra, *supra* note 118, at 10113–14. *See generally* New York v. Exxon Mobil Corp., No. 567, slip op. (N.Y. Sup. Ct. Dec. 10, 2019) (suing Exxon for allegedly misleading statements on its report addressing future climate policies and how such risk is factored into business costs).

240. *Exxon Mobil Corp.*, slip op. at 2; *see* Vizcarra, *supra* note 118, at 10113–14.

241. *Exxon Mobil Corp.*, slip op. at 2–3.

242. *Id.* at 18–21.

243. *Id.*

244. *Id.* at 22–23.

used internally to make business decisions.[245] The court—using the same federal standard of materiality—found that the allegedly misleading information was not material because no reasonable investor from 2013 to 2016 would rely on the report's projected costs for 2030 and 2040.[246]

The judge opined that "[n]o reasonable investor during the period from 2013 to 2016 would make investment decisions based on speculative assumptions of costs that may be incurred 20+ or 30+ years in the future with respect to *unidentified* future projects."[247] The judge also noted that the facts in the report were not misleading and that no actual investors were proved to be misled by the report.[248] In addition, the report made it clear that Exxon regularly uses various cost metrics to make business decisions, and "the proxy cost of carbon" is just one method used for financial projections.[249] The report was also clear that "the proxy cost of carbon" method for cost projections was not the sole method used to make investment decisions and that Exxon did not want to release all of its methods due to the competitive nature of the oil and gas industry.[250]

These two Exxon cases illustrate just how important certain facts are in determining materiality. The cases also show that voluntary disclosures can become material under the right circumstances. Securities cases "are very fact specific" since the definition of material is based on the perceptions of a reasonable investor in a certain industry.[251] This specificity makes "it difficult to discern [a] generally applicable" rule from any given case.[252] Because precedent in these cases often lacks generally applicable rules and securities cases are so fact-specific, different judges may reach different conclusions on similar facts.[253] This uncertainty raises a host of questions for *Exxon* and future securities cases: Would a shorter cost projection have made the information more likely to be material in the second case? Would the second case have come out differently if Exxon was not clear that the "proxy cost of carbon" was merely *one* of their metrics used for financial projections? As technology advances, would a twenty-year or thirty-year projection be deemed reasonable to rely on for investment purposes? What if the plaintiffs could prove that certain investors relied on this information? How many investors must rely on disclosed information to make the information material?

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245. *Id.*

246. *Id.* at 34.

247. *Id.* (emphasis added).

248. *Id.* at 34–35.

249. *Id.* at 35.

250. *Id.*

251. *See* Hana Vizcarra, *Understanding the* New York v. Exxon *Decision*, ENV'T & ENERGY L. PROGRAM (Dec. 12, 2019), https://eelp.law.harvard.edu/2019/12/understanding-the-new-york-v-exxon-decision [https://perma.cc/Y67T-BQND].

252. *Id.*

253. *See id.*

Securities fraud cases ultimately turn on how investors treat specific pieces of information that companies disclose.[254] Therefore, the more investors engage with and rely on disclosed environmental information in making their investment decisions, the more likely it is that courts will consider such information material.[255] Investor reliance is a useful measure of whether certain information is material once it has been publicly disclosed, but it is a retroactive measure.[256] Investor reliance does not help companies proactively determine whether information will be material *before* they disclose or withhold it.[257] Thus, the evolving definition of materiality creates an uncertain environment for oil and gas companies to navigate when responding to increased investor pressures to disclose environmental information.[258]

2. "Event-Driven" Securities Litigation Under an Evolving Standard of Materiality

Securities litigation has traditionally stemmed from corporate insiders doctoring company financial statements or lying about certain business operations in an attempt to mislead investors about the status of the corporation.[259] This "traditional" securities litigation is illustrated above by the Exxon cases. A more recent trend has been for shareholders to sue companies when they "engage in conduct that primarily harms" those who are not necessarily shareholders.[260] Such securities litigation has been coined "event-driven litigation" because it often follows a disastrous event of some sort.[261] This "disastrous event" directly harms those people involved and then indirectly hurts shareholders by lowering the company's stock price.[262] The shareholders subsequently sue the company, alleging that it failed to disclose the underlying facts leading to the disaster and that investors were harmed by being left in the dark.[263] These cases have continued to become more

254. *See id.*

255. *Id.*

256. *See* Hackett et al., *supra* note 180, at 10849–51; Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 AM. BUS. L.J. 645, 649–52 (2019).

257. *See* Hackett et al., *supra* note 180, at 10849–51; Jebe, *supra* note 256, at 649–52.

258. Jebe, *supra* note 256, at 649–50; *see* SEC Final Rule, *supra* note 95, at 51,721; Vizcarra, *supra* note 118, at 10106.

259. Emily Strauss, *Is Everything Securities Fraud?*, 12 U.C. IRVINE L. REV. 1331, 1333 (2022).

260. *Id.* at 1331.

261. *Id.* at 1333–34.

262. *Id.*; *see* MICHELLE REED & MATTHEW LLOYD, THOMPSON REUTERS EXPERT ANALYSIS, STEMMING THE TIDE OF MERITLESS SECURITIES LITIGATION 2–3 (2019), https://www.akingump.com/a/web/102513/SEC-Reed-Lloyd.pdf [https://perma.cc/U4SX-82RD]; *see also* Kevin LaCroix, *Guest Post: "Stock Drop Lawsuits*,*"* THE D&O DIARY (June 28, 2020), https://www.dandodiary.com/2020/06/articles/securities-litigation/guest-post-stock-drop-lawsuits [https://perma.cc/J6GC-L3DV] (discussing when stock drops lead to securities litigation).

263. *See* Strauss, *supra* note 259, at 1333–34.

common, and scholars have criticized them for being opportunistic and generally lacking merit.[264]

Event-driven securities litigation has been problematic for the oil and gas industry as their business practices are susceptible to "disastrous events."[265] Disasters are concrete events that make it easy for courts and shareholders to use as evidence of misalignment between a company's past statements and its actions.[266] If a disaster (e.g., an oil spill) occurs after a company publicly states their specific strategies to clean up the environment, shareholders can allege this statement is a material misrepresentation and thus violates Rule 10b-5.[267]

A growing body of ESG-related securities case law hinges on whether a company's ESG statements or disclosures are "actionable," meaning such statements are sufficient to bring securities litigation.[268] ESG statements or disclosures are most likely to be "actionable" when "in response to, and in the aftermath of, previous environmental and safety incidents."[269] Climate-related ESG litigation has shown that a "finding of materiality thus far generally coincides with a fact pattern involving acute events, such as spills or accidents."[270] Therefore, companies are susceptible to securities litigation for their public statements made both before and after a disaster. This type of event-driven securities litigation was best illustrated by the British Petroleum ("BP") Deepwater Horizon incident in 2010.[271]

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264. *See id.*; *see also* Matt Levine, *Snap Earnings and Emissions Fraud*, BLOOMBERG (May 11, 2017, 8:10 AM), https://www.bloomberg.com/opinion/articles/2017-05-11/snap-earnings-and-emissions-fraud [https://perma.cc/V4EA-3PSZ] ("An odd fact of the U.S. legal system for public companies is that every crime is also securities fraud: If a company does a bad thing, and regulators find out about it, then the bad-thing regulators can punish it for doing the bad thing, but the securities regulators can also punish it for not disclosing the bad thing to shareholders . . . . It is a strange combination: Generally speaking the companies do the bad things on behalf of shareholders—to make more money for them—but then the securities regulators come in and fine them for defrauding shareholders." (emphasis omitted)).

265. *See* Vizcarra, *supra* note 118, at 10112; *see In re* BP P.L.C. Sec. Litig., 922 F. Supp. 2d 600, 633 (S.D. Tex. 2013).

266. Vizcarra, *supra* note 118, at 10112.

267. Saad & Strauss, *supra* note 105, at 394.

268. *See* Orr & Kempf, *supra* note 105, at 14–15; *see In re BP P.L.C.*, 922 F. Supp. 2d at 633; Pete Michaels & Alyssa Scruggs, *The Rise of Shareholder Activism and Litigation Related to Environmental, Social, and Governance Investing*, AM. BAR ASS'N. (Apr. 1, 2021), https://www.americanbar.org/groups/litigation/committees/securities/articles/2021/rise-of-shareholder-activism-and-litigation-environmental-social-governance-investing [https://perma.cc/4RJS-GBL6].

269. *See* Orr & Kempf, *supra* note 105, at 14.

270. Vizcarra, *supra* note 118, at 10112; *In re* Plains All Am. Pipeline, L.P. Sec. Litig., 307 F. Supp. 3d 583, 593 (S.D. Tex. 2018) (discussing the plaintiff's complaint that alleged the oil company had made false and misleading claims about a comprehensive program to prevent oil spills prior to the subsequent oil spill); *In re BP P.L.C.*, 922 F. Supp. 2d at 633 (S.D. Tex. 2013) (finding misstatements about key safety measures in corporate sustainability reports and public statements to be material).

271. The court in *In re BP P.L.C.* found several BP statements regarding ESG initiatives prior to 2010 were actionable. *In re BP P.L.C.*, 922 F. Supp.2d at 633. It found that CEO, Tony Hayward, made a materially false and misleading statement in response to the 2005 Texas City BP refinery

It is possible that the evolving definition of materiality has forced many corporations to settle their lawsuits, because they are uncertain about the merits of such claims.[272] Companies are often under pressure to settle event-driven securities cases because of the size of the claim and public exposure rather than because of the merits.[273] A study of approximately four hundred class action securities cases against public companies from 2010 to 2015 found that "traditional" securities cases were nearly twenty percent more likely to be dismissed than event-driven securities cases.[274] In addition, the study showed that the average settlement from event-driven securities cases is 24.3 million dollars, while the average settlement for "traditional" securities cases is 7.2 million dollars.[275] Also according to the study, nearly seventy percent of the event-driven securities cases were brought by institutional investors.[276]

Although ESG encompasses three factors, shareholders have used the environmental factor to wield the most power within securities claims.[277] These settlement statistics show that climate-related securities cases do not necessarily need to be successful in court to impact the oil and gas industry.[278] Company reputation and goodwill play influential roles in the capital markets industry. In the 2010 Guidance Report discussed in Section IV.A, the impact of reputational damage stemming from climate issues is considered a "risk factor disclosure" and can be material information.[279] The report states that "[d]epending on the nature of a registrant's business and its sensitivity to public opinion, a registrant may have to consider whether the public's perception of any publicly available [climate information] could expose it to potential adverse consequences" from reputational harm.[280] Therefore, oil and gas companies may feel more pressure to settle quickly before their information

explosion. *Id.* at 635–36. He stated that BP's operating management system would be consistent among all operating sites but failed to disclose that it would not be consistent when operating sites were owned by contractors. *Id.* The court held these statements regarding BP's operating management system to be materially false because six out of the seven offshore drilling sites were owned by contractors. *Id.* at 634–35. Thus, the statements regarding BP's operating system safety were misleading and the information was deemed material to investors given the safety concerns of BP. *Id.* at 625.

272. Cydney Posner, *Why Event-Driven Securities Litigation Has Become a Thing—And a Lucrative One Too*, COOLEY PUBCO (May 25, 2021), https://cooleypubco.com/2021/05/25/event-driven-securities-litigation [https://perma.cc/W8RH-CNP5]; *see* Vizcarra, *supra* note 158, at 2.

273. Posner, *supra* note 272.

274. Strauss, *supra* note 259, at 1333–34.

275. *Id.* at 1345–47.

276. *Id.*

277. LATHAM & WATKINS, ESG LITIGATION ROADMAP: WHAT YOU NEED TO KNOW 3–4 (2020), https://www.lw.com/admin/upload/SiteAttachments/ESG-Litigation-Roadmap.pdf [https://perma.cc/Q4EN-LRS6] ("To date, ESG litigation has largely focused on climate change litigation or catastrophic environmental events.").

278. *See* Strauss, *supra* note 259, at 1334–35.

279. *See* 2010 Guidance Report, *supra* note 185, at 6296.

280. *Id.*

becomes public. Quick settlements are an attempt to mitigate reputational damage which may cause harm to business operations and financial status.

The study of four hundred class action securities cases also shows the power that institutional investors have to influence oil and gas companies through event-driven securities claims.[281] Securities regulation was designed to protect investors, specifically "Main Street" investors[282]—which "describe[s] the individual small investor as opposed to the professional securities trader."[283] But now, institutional investors are using securities regulation as a sword rather than a shield to push political agendas and evolve the "investor-dependent" standard of materiality.

C. The PSLRA Is Ineffective Against Current Environmental Securities Litigation

The Private Securities Litigation Reform Act ("PSLRA") was enacted to limit frivolous securities lawsuits brought by shareholders by amending the Securities Exchange Act of 1934.[284] The PSLRA included several amendments to prevent frivolous private securities claims, but this Section will focus on two in particular. First, it implemented safe-harbor provisions to protect forward-looking statements made by public companies.[285] Second, the PSLRA increased the evidence required to overcome a motion to dismiss, creating a heightened pleading standard for plaintiffs.[286] This Section will discuss both amendments and explain why they are ineffective against environmental securities litigation.

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281. *See* Strauss, *supra* note 259, at 1333–36.

282. *What We Do*, U.S. SEC. & EXCH. COMM'N (Nov. 22, 2021), https://www.sec.gov/about/what-we-do [https://perma.cc/Q44K-QHVY] ("[W]e have stayed true to our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation . . . . [W]e continue to focus on the interests of long-term Main Street investors who are entrusting their hard-earned savings to our securities markets to fund home purchases, college educations, and other important life events.").

283. Will Kenton, *Main Street*, INVESTOPEDIA (Apr. 26, 2022), https://www.investopedia.com/terms/m/mainstreet.asp [https://perma.cc/N7F6-7PKQ].

284. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67 § 1, 109 Stat. 737, 737 (codified in scattered sections of 15 U.S.C.).

285. The PSLRA

> [a]mends the [Securities Exchange Act of 1934] to provide certain issuers of securities a safe harbor from liability for forward-looking statements regarding a security's projected performance or operations, if: (1) the statement is immaterial or is identified as a forward-looking statement and accompanied by certain cautionary statements; or (2) the plaintiff fails to prove that the statement was made with either actual knowledge of its false or misleading nature by a natural person, or actual approval by an executive officer.

Summary: H.R. 1058—104th Congress (1995-1996), CONGRESS.GOV, https://www.congress.gov/bill/104th-congress/house-bill/1058 [https://perma.cc/8DYB-XE7R]. Finally, it "[p]rescribes conditions for satisfaction of such requirements by oral forward-looking statements," and "[s]tates that there is no duty upon any person to update a forward-looking statement." *Id.*

286. *Id.*

1. Safe-Harbor Provisions

Before the PSLRA, plaintiffs could bring private securities fraud claims against companies and use hindsight to prove fraudulent statements.[287] In doing so, plaintiffs would find optimistic or forward-looking company statements made in the past and compare those statements to current company conditions in an attempt to show misalignment.[288] Plaintiffs would then allege that the company should have been aware, or was aware, that their past statements would be misleading.[289] This type of securities claim caused hesitancy among companies to disclose projections or optimistic statements, because they feared that shareholders would bring lawsuits if projections did not materialize as predicted in the future.[290] The securities market uses such projections to stay informed, so the PSLRA responded to this type of securities litigation through safe-harbor provisions.[291]

Safe-harbor provisions in the PSLRA are aimed at allowing companies to make good faith projections about future strategies or financial outlooks without being held legally liable if their projections do not materialize.[292] Companies enjoy safe-harbor provisions as long as their forward-looking statement meets *one* of the following requirements: (1) "the forward-looking statement is . . . identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement"[293]; (2) the forward-looking statement is "immaterial"[294]; or (3) "the plaintiff fails to prove that the forward-looking statement . . . was made with actual knowledge . . . that the statement was false or misleading."[295] Forward-looking statements have been defined broadly to include nearly any statement or projection made by a company, whether financial or strategical.[296]

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287. TIMOTHY K. ROAKE & GORDON K. DAVIDSON, FENWICK & W., THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, at 1 (1996), https://assets.fenwick.com/legacy/FenwickDocuments/Corp_Sec_01-00-96.pdf [https://perma.cc/R3SG-X4DF]; *see* 15 U.S.C. § 78u-5 (2018).

288. ROAKE & DAVIDSON, *supra* note 287, at 1.

289. *Id.*

290. *Id.*

291. *Id.*; *see* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 102, 109 Stat. 737, 749; 15 U.S.C. § 78u-5.

292. ROAKE & DAVIDSON, *supra* note 287, at 1; *see* Private Securities Litigation Reform Act of 1995 § 102.

293. Private Securities Litigation Reform Act § 102; ROAKE & DAVIDSON, *supra* note 287, at 1; 15 U.S.C. § 78u-5.

294. Private Securities Litigation Reform Act § 102; ROAKE & DAVIDSON, *supra* note 287, at 1; 15 U.S.C. § 78u-5.

295. ROAKE & DAVIDSON, *supra* note 287, at 1–2; Private Securities Litigation Reform Act § 102; 15 U.S.C. § 78u-5.

296. ROAKE & DAVIDSON, *supra* note 287, at 2.

> The term "forward-looking statement" is defined broadly as a statement containing a projection of revenues, income, earnings, earnings per share, capital expenditures,

The puffery defense is a tool used by companies to distinguish forward-looking statements that are immaterial from those that are material.[297] This defense is most successful when forward-looking statements are vague or general.[298] Companies use the puffery defense to argue that no "reasonable investor would have relied on" its forward-looking statement.[299] For a statement to be puffery, defendants must show that the statement is "so obviously unimportant to an investor that reasonable minds cannot differ."[300] While the puffery defense may have been effective in the past, the evolving definition of materiality and increasing investor pressure for environmental information is decreasing its effectiveness.[301] Investor trends are changing, and investors are relying more on environmental statements to stay informed, especially those that are forward-looking (e.g., emissions projections).[302] Given this trend, even vague or general statements have the potential to be relied upon by investors, and hence material.

Safe-harbor provisions and the puffery defense have shown decreasing effectiveness against environmental securities litigation. Since the puffery defense requires a showing that a reasonable investor would not rely on the forward-looking statement, companies again face the same concerns from the evolving definition of materiality.[303]

The ineffectiveness of safe-harbor provisions is illustrated by the first Exxon case that overcame a motion to dismiss.[304] In that case, Exxon failed to meet *any* of the three requirements of the PSLRA's safe-harbor provisions.[305] Exxon had made its report too specific and did not include the requisite

> dividends, capital structure or other financial items, a statement of the plans and objectives of management for future operations (including plans or objectives relating to products or services of the company), a statement of future economic performance (including any statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the SEC), any statement of the assumptions underlying or relating to the statements described above, any report issued by an outside reviewer retained by the company to the extent that the report assesses a forward-looking statement made by the issuer, or any statement containing a projection or estimate of such other items as might be required by rule or regulation of the SEC.

Id.

297. Saad & Strauss, *supra* note 105, at 403–04.

298. *Id.* at 403.

299. *Id.* at 405.

300. Shapiro v. UJB Fin. Corp., 964 F.2d 272, 280 n.11 (3d Cir. 1992); *accord* Saad & Strauss, *supra* note 105, at 4

301. *See* Saad & Strauss, *supra* note 105, at 419–20.

302. *See id.* at 420; *supra* Part II.

303. *See supra* Section III.C.

304. *See supra* Section III.B.1. *See generally* Ramirez v. Exxon Mobil Corp., 334 F. Supp. 3d 832 (N.D. Tex. 2018) (surviving a motion to dismiss after plaintiffs sufficiently alleged material misstatements).

305. *Ramirez*, 334 F. Supp. 3d at 851, 857, 859.

"cautionary statements" because it assumed its report was immaterial.[306] Exxon and the court had differing opinions on whether "reasonable minds could disagree" that its government regulation report was misleading.[307] This case illustrates the challenges imposed by the evolving definition of materiality and how the puffery defense is becoming less effective. It also shows the cost of being too specific in a forward-looking statement.

The evolving definition of materiality makes it hard for companies to predict whether their forward-looking statements are "immaterial." Therefore, companies seem to have three options: (1) refrain from making forward-looking statements, which is what the PSLRA was enacted to prevent[308]; (2) ensure that they have included sufficient cautionary statements in line with the first requirement[309]; or (3) make forward-looking statements general and vague enough to be protected by the puffery defense.[310] These three options do not create a conducive environment for future projections or transparency of climate-related information, which is something that the securities market thrives on and investors are demanding.[311]

2. Heightened Pleading Standard

Prior to the PSLRA, shareholders could reasonably bring a private securities claim against a company when the price of its stock changed significantly.[312] By bringing the lawsuit, shareholders hoped to find fraudulent activity through the discovery process so the lawsuit could proceed.[313] In response to these claims, the PSLRA created three requirements for plaintiffs bringing forth private securities fraud claims: (1) Plaintiffs must provide the particular company statements that are allegedly fraudulent; (2) plaintiffs must provide "specific allegations of facts" that the defendant made the allegedly fraudulent statements recklessly or intentionally; and (3) plaintiffs must prove that they incurred financial loss as a result of the allegedly fraudulent statements.[314] The PSLRA therefore heightened the pleading standard for

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306. *Id.* at 850–51.

307. *Id.* at 851.

308. ROAKE & DAVIDSON, *supra* note 287, at 1.

309. Exxon included sufficient cautionary statements in their forward-looking projection in the second "traditional" securities case discussed in Section III.B.1.

310. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 102, 109 Stat. 737, 753–55; Nathan Campbell, Note, *The Duty to Update Corporate Emissions Pledges*, 74 VAND. L. REV. 1137, 1170 (2021); R. Gregory Roussel, *Securities Fraud or Mere Puffery: Refinement of the Corporate Puffery Defense*, 51 VAND. L. REV. 1049, 1056–58 n.31 (1998).

311. *See* ROAKE & DAVIDSON, *supra* note 287, at 1; *supra* Section II.C.

312. James Chen, *Private Securities Litigation Reform Act (PSLRA)*, INVESTOPEDIA (July 18, 2022), https://www.investopedia.com/terms/p/pslra.asp [https://perma.cc/ZY2E-ZPA4].

313. *Id.*

314. The PSLRA

> sets forth as prerequisites for securities fraud actions: (1) particularity in securities fraud actions alleging misleading statements and omissions;

plaintiffs bringing private securities claims, making it easier for courts to dismiss weak cases.[315]

The heightened pleading standard has been largely ineffective against event-driven securities litigation.[316] Practitioners and scholars assert that plaintiffs do not spend much time putting together their claims but rather file them quickly in hopes of early settlement.[317] They note that the "legitimacy of these lawsuits is highly suspect" but that the large public exposure, high defense costs, uncertain landscape of securities litigation, and potential reputational damage lead to quick settlements.[318] They further assert that "[t]he characteristics of this event-driven litigation . . . are just like . . . those that led Congress to pass the PSLRA."[319] The PSLRA has failed to prevent "event-driven securities" litigation because settlements occur before a motion to dismiss needs to be decided, rendering the PSLRA's heightened pleading requirements ineffective.[320]

There is tension between the SEC's use of the term "material" and how investors are currently using the term to shape policy. Ruth Jebe, Assistant Professor of Legal Studies in Business at Boise State University, has stated that "while the government uses materiality to shape legal obligations, investors use materiality to encapsulate the sum total of information they actually deem important for investment decisions."[321] Investors are using the evolving definition of materiality as a vehicle to pursue environmental policy goals at the expense of the oil and gas industry. This raises the question of whether such securities litigation is counterproductive. Shareholders want more information, so they bring private securities claims. Yet, such private securities claims make companies more reluctant to provide information. This creates a stalemate.

> (2) specific allegations of facts giving rise to a strong inference that the defendant acted with the required state of mind in a private action in which the plaintiff may recover money damages; and (3) the burden on the plaintiff of proving loss causation.

Summary: H.R.1058—104th Congress (1995–1996), *supra* note 285; *see* 15 U.S.C. § 78u-4.

315. The PSLRA "[r]equires the court to dismiss the complaint upon defendant's motion if the first two such requirements are not met." *Summary: H.R.1058—104th Congress (1995–1996)*, *supra* note 285; *see* 15 U.S.C. § 78u-4(b)(3) (setting forth plaintiffs' pleading requirements).

316. *See* Posner, *supra* 272; John C. Coffee, Jr., *Securities Litigation in 2017: "It Was the Best of Times, It Was the Worst of Times*,*"* CLS BLUE SKY BLOG (Mar. 19, 2018), https://clsbluesky.law.columbia.edu/2018/03/19/securities-litigation-in-2017-it-was-the-best-of-times-it-was-the-worst-of-times [https://perma.cc/Z23T-Q7P5].

317. *See* Posner, *supra* note 272; Coffee, *supra* note 316.

318. *See* Posner, *supra* note 272.

319. *Id.*

320. *See id.*; Strauss, *supra* note 259, at 1333–35; Coffee, *supra* note 316.

321. Jebe, *supra* note 256, at 650.

IV. UPDATED SEC GUIDANCE AND PSLRA REFORM

There is much debate among scholars and practitioners as to whether the SEC should, or has the authority to, implement a mandatory climate-related disclosure regime.[322] Currently, the SEC's 2010 Guidance Report reaffirms the traditional materiality standard for disclosures and offers limited examples of what types of climate-related information may be material.[323] In contrast, the SEC's 2022 Proposal adopts an extensive and prescriptive approach that departs from the materiality standard for climate-related disclosures.[324] The oil and gas industry may benefit from a middle-of-the-road approach that offers more guidance on materiality and avoids extensive and prescriptive nonfinancial climate-related disclosures. Put differently, the SEC must clear up the definition of materiality for climate-related information before mandating disclosures through a regime that may add further uncertainty.

This Note proposes that the U.S. Government should create a more conducive environment for climate-related disclosures by providing further guidance on materiality and granting companies more protection from securities litigation. This proposal is two-fold: (1) The SEC should annually update its 2010 Guidance Report to include more current guidance on materiality, especially for climate-related information; and (2) Congress should amend the PSLRA to have stronger safe-harbor provisions and a shortened statute of limitations period.

A. UPDATED SEC GUIDELINES FOR ESG DISCLOSURE AND MATERIALITY

The SEC should produce an annually updated guidance report that responds to ESG disclosures which have plagued the capital markets industry with uncertainty. This report would respond to the uncertainties of materiality by creating a best practices guide for ESG disclosure. Each year it would produce an updated interpretation of what is likely material ESG information for companies operating in certain industries. The annual guidance report would be similar to the 2010 Guidance Report, but it would include more robust guidance on, and comprehensive examples of, information that may be material for each major industry.[325]

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322. *See generally, e.g.*, Rose, *supra* note 5 (arguing that mandating ESG disclosure includes too many policy decisions not suitable for the SEC to make); *see* Letter from Lawrence A. Cunningham, Professor, Geo. Wash. Univ. L. Sch., to U.S. Sec. & Exch. Comm'n 1–2 (Apr. 25, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf [https://perma.cc/79AW-JMHZ]; Michael Thrasher & Arleen Jacobius, *BlackRock, CalSTRS Weigh in on SEC's Climate Proposal*, 50 PENSIONS & INVS. 25, 25 (2022).

323. *See supra* Section III.A.1.

324. *See supra* Section III.A.2.

325. This layout would be similar to the 2010 Guidance Report that the SEC reissued. *See generally* 2010 Guidance Report, *supra* note 185 (noting specific examples of what kinds of information may be material under certain facts and circumstances).

To accomplish this task, and make its guidance specific to each industry, the SEC could work with the SASB. The SASB has already created methods for determining industry-specific materiality standards.[326] Finally, to respond to the constantly evolving nature of materiality, the SEC should produce this industry-specific guidance report annually. An annual report would more accurately track investor trends as the reasonable investor evolves quickly in response to new changes.

Opponents may argue that an industry-specific, annual report imposes a great burden on the SEC and its resources. This report will likely require the SEC to do extensive research each year into industries, financial statements, and investor trends. However, the SEC's 2022 Proposal would impose an even greater burden on the SEC due to its extensive and prescriptive nature.[327] Under the proposal, the SEC would expend the resources to *both* enforce and review the extensive climate-related disclosure data for every registered company and their supply chains in the United States year after year.[328] Disclosures under the SEC's 2022 Proposal go beyond the materiality standard,[329] so the amount of reported data will be more than the disclosure data under the current regime.

Admittedly, both options will require a considerable amount of time and resources from the SEC. The advantage of the industry-specific annual report is that it will leave companies some discretion to disclose climate-related information, while still providing them with guidance on materiality. This discretion will help avoid information overload and allow investors to focus on information that may actually change how they invest. The prescriptive nature of the SEC's 2022 Proposal would likely lead to an incomprehensible amount of disclosure information.[330] Such a vast amount of information would dilute the material information that investors need with immaterial information that is required to be disclosed.[331] Information overload would unnecessarily expend the resources of both registered companies and the SEC, as well as overwhelm investors.

The SEC's 2022 Proposal would also force companies to expose themselves to greater legal liability.[332] The proposal requires extensive disclosures at an unprecedented level of detail, and our understanding of climate risk continues to evolve.[333] In addition, climate-related disclosures, especially those far into the future, involve a high degree of uncertainty and rely on assumptions and third-party reports.[334] This uncertainty may lead to inconsistent, incomparable,

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326. *See supra* Section II.B.
327. *See supra* Section III.A.2.
328. *See supra* Section III.A.2; Letter from Lawrence A. Cunningham, *supra* note 322, at 8.
329. *See supra* Section III.A.2.
330. *See supra* Section III.A.2; Letter from Lawrence A. Cunningham, *supra* note 322, at 14.
331. *See supra* Section III.A.2; Letter from Lawrence A. Cunningham, *supra* note 322, at 14.
332. Ghazal, *supra* note 223.
333. *Id.*
334. *Id.*

and unreliable data.[335] It therefore seems prudent to provide more guidance and create a better understanding of materiality before compounding climate-related disclosures with more uncertainty.

Lastly, an annually updated guidance report would allow the SEC to avoid the legal battles that lie ahead for its 2022 Proposal and better maintain its apolitical status as a regulator of the capital markets industry.[336] The politicized environment surrounding climate change would make the prescriptive nature of the SEC's 2022 Proposal appear as a political stance.[337] By offering industry-specific guidance on materiality through annual reports, the SEC would avoid both extensive legal battles and burying investors in immaterial and speculative information. With annual guidance reports, companies would be able to disclose climate-related information more accurately, and investors would have more reliable and comprehensible information to help them make informed investment decisions.

B. Amend the PSLRA's Safe-Harbor Provisions and Statute of Limitations Period

Amending the PSLRA offers another solution for addressing the increased private securities litigation created by an evolving definition of materiality. This Section proposes that the PSLRA should be reformed in two ways. First, the PSLRA should be amended to include stronger safe-harbor provisions. Second, the PSLRA should be amended to shorten the statute of limitations period and eliminate the discovery rule. These two reforms would work in tandem to provide companies with safer footing to be more transparent with their environmental disclosures.

1. Amending Safe-Harbor Provisions

The PSLRA's safe harbor provisions should be amended to better protect good faith projections and statements about future corporate initiatives. Companies should be encouraged to be specific and accurate in their forward-looking projections, rather than be punished through private securities claims. Offering more protection to forward-looking statements will provide better information for investors. Investors will have more information because companies will be willing to disclose it. Also, the information would not have to be overly general or vague to remain immaterial and thus protected by the

335. *See supra* Section III.A.2; Katz & McIntosh, *supra* note 5; Letter from Jones Day to U.S. Sec. & Exch. Comm'n 1 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131663-302052.pdf [https://perma.cc/ NU9N-R9GV].

336. Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2021 COLUM. BUS. L. REV. 840, 879–80; Letter from Lawrence A. Cunningham, *supra* note 322, at 8–10.

337. Rose, *supra* note 5, at 1845–47; Letter from Lawrence A. Cunningham, *supra* note 322, at 7–9.

puffery defense.[338] In short, amending safe-harbor provisions would allow investors to be more informed about future environmental information and aspirations in the oil and gas industry.

Better protection would be provided if the PSLRA's safe-harbor provisions included key words or phrases that companies could incorporate into their statements to virtually guarantee protection. Currently, the PSLRA's safe-harbor provisions provide that companies can include "meaningful cautionary statements" with their forward-looking statements to enjoy protection.[339] Such statements, however, are rather unclear and do not offer the predictability that would encourage increased environmental information disclosure in the oil and gas industry. Therefore, by providing certain key words or phrases in the amended PSLRA that would virtually guarantee protection under the safe-harbor provisions, predictability could be achieved.

Opponents of this proposal may argue that such key words and phrases would render private securities claims for forward-looking statements useless. Opponents may also argue that the Main Street investor is no longer protected under this new safe-harbor regime. First, the PSLRA only affects private securities claims, so the SEC will still have its full enforcement power to protect the Main Street investor from securities fraud.[340] Second, if investors want more environmental information from the oil and gas industry, then they must adopt a more hands-off approach when it comes to private securities litigation for forward-looking statements. Oil and gas companies will have no incentive to share future aspirations, innovations, or projections if they are constantly subject to private securities claims. Amending the PSLRA to strengthen its safe-harbor provisions through the addition of key words and phrases will provide the oil and gas industry with a more predictable environment to be transparent.

2. Adding a New Statute of Limitations to the PSLRA

The PSLRA should be amended to shorten the statute of limitations period and eliminate the discovery rule. The statute of limitations for Section 10(b) and Rule 10b-5 of the Securities and Exchange Act of 1934 is governed under Section 804 of the Sarbanes Oxley Act of 2002.[341] The Sarbanes Oxley Act states that a plaintiff must bring its claim at the earliest of either: (1) "[two] years after the discovery of the facts constituting the violation" or (2) "[within five] years after such violation."[342] The word "discovery" means that the two-year statute of limitations period begins running once the plaintiff is aware,

338. *See supra* Section III.C.1.

339. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 102, 109 Stat. 737, 750; ROAKE & DAVIDSON, *supra* note 287, at 1; *see* 15 U.S.C. § 78u-5; *supra* Section III.C.1.

340. *See* Private Securities Litigation Reform Act § 102; 15 U.S.C. § 78u-5.

341. *Exchange Act: Section 10(b) Defenses Against Untimely Claims*, *supra* note 89; *see* 28 U.S.C. § 1658(b).

342. 28 U.S.C. § 1658(b)(1)–(2).

or should be aware, of its fraudulent claim.[343] This concept is referred to as the discovery rule.[344] This Section's proposal to shorten the statute of limitations period and eliminate the discovery rule would limit a plaintiff's ability to take advantage of event-driven securities claims in the oil and gas industry.

Currently, once an oil and gas company experiences a disastrous event such as an oil spill, shareholders and their counsel immediately begin digging through company documents and statements.[345] The goal being to find some statement or document that evidences a misalignment (i.e., fraud) between what was publicly shared and the disastrous event.[346] Plaintiffs use the discovery rule to avoid the earlier two-year statute of limitations period by stating that they were unaware of the misalignment until the disastrous event occurred. The discovery rule thus becomes a *de facto* bypass to the two-year period, giving them up to five years to file a claim.[347]

Maintaining a shorter statute of limitations period of one year and disposing of the discovery rule would limit event-driven securities claims. Under this proposed regime, a disastrous event must occur within one year after an allegedly fraudulent statement or document was released. If such an event does not occur within the one-year timeframe, then any event-driven securities fraud claims will be barred by the statute of limitations. This amendment would curtail plaintiffs from using the discovery rule to extend the statute of limitations period and capitalize on disastrous events. It would also provide a safer securities environment for companies to be transparent without being subjected to securities fraud claims five years later after a disastrous event.

An amendment to the PSLRA shortening the statute of limitations period and eliminating the discovery rule will not affect the SEC.[348] The PSLRA only affects private securities litigation.[349] Therefore, this proposal will not hinder the SEC's ability to protect the Main Street investor.[350] In addition, since nearly seventy percent of event-driven securities cases are brought by institutional investors,[351] this amendment would have minimal effect on Main Street investors. Therefore, this proposed amendment to the PSLRA would curtail opportunistic private securities litigation while maintaining the SEC's ability to protect the Main Street investor. It would also encourage transparency from the oil and gas industry.

343. *Exchange Act: Section 10(b) Defenses Against Untimely Claims*, *supra* note 89.

344. *Id.*

345. *See supra* Section III.B.2.

346. *See supra* Section III.B.2.

347. *See* 28 U.S.C. § 1658(b)(1)–(2).

348. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104–67, § 107, 109 Stat. 737, 758; 15 U.S.C. § 78u–4.

349. Private Securities Litigation Reform Act § 108.

350. *What We Do*, *supra* note 282.

351. Strauss, *supra* note 259, at 1375.

Conclusion

The goal for this Note is to shed light on problems that the evolving definition of materiality has created for the oil and gas industry and to offer potential solutions. As climate change becomes more impactful to our policies and day-to-day life, investors want to know what companies are doing to adapt. The oil and gas industry is at the forefront of this conversation. It is important that there is meaningful discussion between oil and gas companies and the public about how both will work to combat this challenge.

Although investor interest in environmental information is being reflected in the evolving definition of materiality, it is counterproductive to use private securities litigation as an avenue for change. It is instead important that the U.S. Government creates a conducive environment for oil and gas companies to disclose environmental information. Companies can then undergo trial and error with their disclosures to better understand how to communicate effectively. Encouraging the release of such information will inform the public, who can then choose how to invest their money. Given the influence of investor trends, it seems likely that the invisible hand of the market is capable of sorting out which oil and gas companies adapt to climate change and which ones fail to do so.