

C O M M E N T

A Bridge Too Near: Response to *How Cheap Is Corporate Talk?*

by Jeffrey A. Smith

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Prof. James Coleman has a keen eye, and he has constructed a useful methodology to take full advantage of a rare opportunity to parse “corporate talk,” assessing the so-called “two audience” problem in a way not previously achieved by others. Circumstances served up a laboratory, and Professor Coleman has created what likely will prove to be a benchmark study.

His immediate topic—the ongoing implementation of the Renewable Fuels Standard (RFS)—is unique raw material, because it sits at the crowded crossroads of the RFS approval process where several powerful forces meet on a regular basis. Each year brings a new set of regulatory implementation challenges and industry comment on those challenges. Each year the same companies also file their 10-K reports, in which they address the material aspects of the same issues for the capital marketplace. The net result is a matrix of assertions, over time, by highly interested parties in two very different contexts and intended, nominally, for two very different audiences. They can be compared at all points of the compass with statements made by the same company at a different time and, most revealingly, with statements made for a different audience and in a different regulatory context.

Professor Coleman’s language coding methodology, which tracks both stated nuances and differences in emphasis, allows him to record a unique level of resolution regarding the details of such corporate communication. It is at this point, however, that “Cheap Talk,” by illuminating the entrenched challenges of the past, indirectly poses but does not answer the growing challenges of the future in corporate communication on complex environmental regulatory issues.

Professor Coleman is, of course, keenly aware that he neither invented nor discovered the “dual audience” issue.¹ Twenty-five years ago, for example, in a case not cited by Professor Coleman, *International Paper* was called to task not for cheap talk, but for “corporate happy-talk” in a deci-

sion that analyzed the adequacy of the company’s statements about its environmental performance in the proxy statement context, which has since become a prominent battleground.² Today, many companies are at risk of being in the same basic position as *International Paper*; telling their own story in environmental reports, website postings and through other media in a manner that contrasts sharply, in substance and tone, with the story they tell investors in their mandatory filings or in opposing their proposals.³ This is a dual audience problem at its base, but splintered to multiple audiences in multiple media.

At issue in the *International Paper* case was a shareholder resolution calling on the company to implement the Valdez Principles and to cooperate with shareholders and the public in matters of “public environmental accountability.”⁴ *International Paper* distributed a proxy statement opposing the resolution, asserting that: the company had addressed environmental matters “in an appropriate and timely manner” and was in the “forefront” of industry; the Valdez Principles were not applicable to the company’s operations, would not provide “any greater protection than now exists” and could impose unjustifiable costs on shareholders; the company had already adopted comprehensive industry-specific principles on environmental matters and had invested heavily in pollution control equipment; a committee of the Board of Directors had been established to advise the Board broadly on the company’s diverse environmental programs and policies.⁵

The shareholder group alleged that the proxy statement included misleading statements and omitted material facts in violation of Section 14(a) of the Securities Exchange Act and Rule 14a-9, and relied on statements made in the company’s 10-K, which revealed that the company had been accused of numerous environmental offenses, had pled guilty to felonies, had agreed to pay substantial fines, and

1. See James W. Coleman, *How Cheap Is Corporate Talk? Comparing Companies’ Comments on Regulations With Their Securities Disclosures*, 40 HARV. ENVTL. L. REV. 47, 49–53 nn.4–8 (2016) (citing extensive historical and ongoing scholarship).

2. See *United Paperworkers International Union v. International Paper Co.*, 985 F.2d 1190 (2d Cir. 1993) [hereinafter *International Paper I*].

3. For example, over 60% of shareholder resolutions for Fortune 500 companies in 2015 concerned environmental, social policy, or sustainability issues. *International Paper II* at 1193.

5. *United Paperworkers International Union v. International Paper Co.*, 801 F. Supp. 1134, 1137 (S.D.N.Y. 1992) [hereinafter *International Paper I*].

had been the target of numerous environmental administrative complaints.⁶

The trial court sided with plaintiffs, finding that International Paper's argument that the proxy statement was not misleading was "palpably without merit."⁷ Comparing the company's actual experience in environmental litigation to the Company's statement that it has a "strong environmental compliance program," the court found that the company's proxy statement was "to put it charitably, inconsistent with the serious and ongoing environmental challenges that the Company has endured."⁸ Further, the court characterized the company's statements as "flowery corporate happy-talk," included to defeat the shareholders' proposal.⁹

The judicial exercise of comparing and contrasting the words in affidavits and administrative consent orders on the one hand, with statements of corporate policy (and pride) on the other, foreshadows the opportunity afforded to Professor Coleman by the RFS proceedings. For the trial court, there was no contest—and no mercy. The Second Circuit affirmed, holding that the proxy statement, standing alone, was materially misleading about the company's environmental record. According to the Court, the company's self-laudatory remarks "conveyed an impression that was entirely false,"¹⁰ and that the Annual Report did not cure the misleading statements in the proxy statement. In the Court's view, the level of disclosure in the Annual Report, and the nature of the details that were omitted, were insufficient to put a reasonable shareholder on notice that the falsely "pristine picture" painted in the proxy statement was misleading.¹¹

In the regulatory context, at about the same time as *International Paper* was being decided, various agencies were making the first attempts to break down the silos in which useful information, reported by companies to different agencies for different purposes, was being stored. For instance, as environmental databases became substantially more robust—to address regulatory requirements (e.g., the toxic release inventory, TRIS); optimize the use of existing data¹²; and respond to public pressure for access, transparency, and informational tools for deci-

sionmaking—these databases provided increasingly broad and accessible sources of detailed information for use by stakeholders. Just as mandatory reporting of the results of wastewater discharge and air emissions monitoring became the basis for citizens' suits in the 1980s, and the instantaneous transmission of news of environmental catastrophes dramatically increased public awareness while reducing risk tolerance in the 1990s, the wide availability of substantial environmental performance data has already had a profound effect on discussions of global corporate environmental behavior.

In the securities fraud arena of today, high profile environmental calamities and a torrent of corporate information issued to multiple audiences have provided a flash point of comparison that is arguably more explosive and complex in its consequences than the similar RFS communications matrix examined by Professor Coleman.

In the Ninth Circuit's recent ruling in *Reese v. Malone*, for example, the complexities of a publicly-traded oil company's responsive positioning to a crisis are in full view.¹³ In *Reese*, the Ninth Circuit allowed shareholder damage suits to continue after examining the discrepancies between BP's public and private records concerning leaks in two areas of BP's Alaskan pipeline system, one of which spilled 200,000 gallons of oil in March 2006 and the other, five months later, in a different transit line. Both leaks were the product of pipeline corrosion that had been exacerbated by what BP subsequently admitted were substandard corrosion detection protocols.

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

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

While each communication proved damaging to BP in different elements of the case, the Court specifically took BP to task for the boilerplate disclosure in its Annual Report, which stated that "Management believes that [its] activities are in compliance in all material respects with applicable environmental laws and regulations." According

6. *Id.* at 1138-1139.

7. *Id.* at 1140.

8. *Id.* The source of the court's information was, in part, the company's own 10-K filings, and, in part, affidavits from current and former International Paper employees.

9. *Id.* at 1144.

10. *Id.* at 1200. A slightly different dynamic prevailed two decades later in *Reese v. Malone*, discussed *infra*.

11. *Id.*

12. EPA's Enforcement and Compliance History Online or "ECHO" database, for example, was designed to address concerns that public companies were under reporting environmental enforcement actions. The database, which was made available on the EPA website, identified companies' compliance history and listed formal enforcement actions and related penalties on a facility-by-facility basis. The database was also shared with the SEC, and the two agencies implemented procedures designed to foster sharing of information regarding company specific environmental liabilities. This information could then be compared to a company's SEC filings to verify compliance with SEC disclosure obligations. In a series of widely-reported speeches in the early 1990s, then SEC Commissioner Roberts highlighted significant disclosure shortcomings, particularly with respect to the requirements of Item 303 of Reg. S-K, involving environmental legal proceedings.

13. See *Reese v. Malone*, 747 F.3d 557 (9th Cir. 2014).

to the Court, the egregious nature of the violations, all of which had occurred before the annual report was formally issued, the ongoing discussions with PHMSA in the context of violations of the Corrective Action Order, and BP's comparatively poor performance compared to industry norms belied the assertion of "material compliance."

In light of the prominence and magnitude of the violations, the Ninth Circuit reasoned that it would be "absurd" to suggest that top management was unaware of the compliance issues that rendered the annual report statement misleading. Not satisfied with tearing through the veil of these standard qualifiers, the Ninth Circuit also contrasted the specific statements with BP's broad boilerplate language concerning general environmental risks facing the company. The Court concluded that BP's statement concerning management's belief that there had been general compliance actually misdirected shareholders away from the specific problems that BP was facing as a result of the corrosion of the pipelines and the resulting leaks. Rather than providing general cover, these two elements of the annual report compounded the falsity of the statements.

In another case highlighting the perils of communicating into the headwinds of an environmental calamity in a matter involving technical complexity, *In re BP p.l.c. Sec. Litig.*¹⁴ Plaintiffs alleged that, in connection with the Deepwater Horizon well blowout, BP had misrepresented the range of its internal oil spill flow rate estimates in its public statements.¹⁵ The court concluded that facts omitted by BP about the spill's volume did not "fairly align" with what a reasonable investor could have concluded based on the company's statement.¹⁶ The degree of specificity of the company's stated opinion, the absence of hedges and disclaimers, the unequivocal nature of the statements, and the absence of comparable experiential data which a reasonable investor might have used to benchmark BP's estimates obscured for a reasonable investor to what was, in fact, the tentative nature of the company's flow estimate.¹⁷

For as apt, and sometimes stark, as Professor Coleman's conclusions are about the duality of corporate messaging on the RFS, the disclosure issues that have already arisen that transcend the "two audience problem" suggest that the article's insights—and its suggested remedies—are just the beginning of the journey that must be undertaken to remedy the underlying communications problems and reconcile the sources of the tensions.

Professor Coleman suggests that regulators "integrate review of securities disclosure into their rulemaking" to gain a "more accurate picture" of the risks.¹⁸ He also sug-

gests that securities regulators (and investors) review corporate comments on regulation to identify "regulatory risks that companies are not disclosing" and urges corporate counsel to "harmoniz[e] the messages."¹⁹

At other places in his discussion, Professor Coleman suggests that securities disclosure can be used to "audit corporations' regulatory submissions,"²⁰ "easing the regulator's dilemma"²¹ and that they can be used as an "interpretive aid for regulators, helping them suss out which regulations actually may be infeasible,"²² and make them reluctant to accept industry's "exaggerated picture of the cost of regulation"²³ by shedding light on the "very different impressions" that securities disclosure may create of the same topic.²⁴

Let's leave aside quibbles about whether the regulatory and securities law lexicons are necessarily so different—in level of detail, technical focus, political intent or otherwise—that even seemingly dramatic inconsistencies in substance or tone turn out to be ill-adapted tools to accomplish any of these worthy objectives when they are actually applied to a regulatory problem. The larger issue may be that they are all deckchairs on the information and data *Titanic*. Shifting two of them to align them may indeed give some of the passengers a better view, at least for a while, but the massive amounts of data that now exist on the same topics; the ultimate accessibility of that data; the pressure on companies from multiple sources to render it in a digestible form to multiple marketplaces, both in times of crisis and as part of the ordinary course of business; and the absence of any universal framework—or even agreed-upon common language—for much of that communication combine to suggest that this ship is headed for an inglorious end with all passengers aboard, unless the marketplace can change how it navigates.

Put differently, the "harmonization" that Professor Coleman sensibly urges corporate counsel to undertake to reconcile the bilateral two audience problem is only the necessary beginning of more far-reaching and universal issues of corporate communication which have been manifested with increasing frequency in the global capital marketplace.

This is not to criticize Professor Coleman's article for failing to be something that he never intended. Nor is it to slight the deftness and importance of finding an ideally illustrative set of facts, and creating a rigorous and nuanced way to measure the outcomes. Rather, after benefitting from the bright light that Professor Coleman shines in the dark lower decks of disclosure, it is to exclaim, "We have a much bigger problem than we imagined!"

14. See *In re BP p.l.c. Secs. Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 99,108 (May 31, 2016) (citing *In re Velti PLC Sec. Litig.*, 2015 WL 5736589, at 38 (N.D. Cal. 2015)).

15. *In re BP p.l.c. Fed. Secs. Litig.*, at 1.

16. *Id.* at 14.

17. See *id.* at 12–13 ("The Court is not holding that, as a general rule, speakers must expressly disclose the full range of every estimate To the contrary, the Court's holding is driven by the unique factual contours of the case—specifically, the unusual asymmetry of information between BP and its investors—which demand a bespoke pattern rather than a blanket approach.").

18. Coleman, *supra* note 1, at 81.

19. *Id.*

20. *Id.* at 54.

21. *Id.*

22. *Id.* at 76.

23. *Id.*

24. *Id.*