THE REASONABLE INVESTOR AND CLIMATE-RELATED INFORMATION: CHANGING EXPECTATIONS FOR FINANCIAL DISCLOSURES

by Hana V. Vizcarra

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In recent years, the drumbeat for more expansive climate-related corporate disclosures has grown louder and more consistent within a broader swath of the financial community. This intensifying call argues for considering more climate-related information legally material under existing U.S. securities disclosure law. A key component of materiality as defined in U.S. securities law—who is a "reasonable investor"—is evolving when it comes to climate-related information. This evolution may soon impact what climate-related information courts consider material.

There are myriad articles on corporate responsibility and environmental, social, and governance (ESG) issues across multiple disciplines.[1] U.S. securities law and its disclosure regime, including the meaning of "materiality" as defined by the U.S. Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, have likewise been the subject of much discussion.[2] Recent papers have also considered the materiality of ESG issues for purposes of disclosure under U.S. securities law.[3] Fewer have considered how courts view the materiality of sustainability and ESG issues or the materiality of climate-related information specifically.[4]

Yet, understanding how courts may treat climate-related information under the existing securities law framework is crucial to achieving more expansive disclosures. International jurisdictions have begun to incorporate climate information into their disclosure regimes, but investors and companies must live with an unchanged regulatory environment in the United States. A lack of regulatory guidance and directly relevant case law on what climate-related information is "material" fosters uncertainty.

With such uncertainty comes corporate hesitance to disclose new types of information. We are unlikely to see new regulatory guidance, enforcement activity, or legisla-

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1. *See* Cynthia Williams, *Corporate Social Responsibility and Corporate Governance*, *in* The Oxford Handbook of Corporate Law and Governance (Jeffrey N. Gordon & Wolf-Georg Ringe eds., Oxford Univ. Press 2018) (discussing trends in corporate sustainability, related disclosure requirements, and corporate governance globally as well as research on these topics).
2. Westlaw returns 903 law review and journal articles in the past three years alone that reference "materiality" and "TSC Industries." *See, e.g.*, Robert Eccles & Tim Youmans, *Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality*, 28 J. Applied Corp. Fin. 39 (2016) (noting "the legal field offers no specific definition" and "[c]ourt opinions on materiality have done little more than sketch its conceptual contours"); Hilary Sale, *Disclosure's Purpose*, 107 Geo. L.J. 1045 (2019) (discussing U.S. disclosure requirements, enforcement, and treatment by courts); James Cox et al., *Inquiries Into the Materiality of Information*, *in* Securities Regulation: Cases and Materials (Wolters Kluwer 8th ed. 2017).
3. *See, e.g.*, Eccles & Youmans, *supra* note 2 (discussing investor appetite for reporting material ESG information, how such reporting fits within directors' fiduciary duties, and the role of the director in determining the materiality of ESG information; also proposing a statement of significant audiences and materiality to help provide a clearer view of what is considered "material" by a company's board); Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 Geo. L.J. 923 (2019) (arguing for incorporating sustainability information into U.S. Securities and Exchange Commission (SEC)-mandated disclosures); Daniel C. Esty & Quentin Karpilow, *Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation*, 36 Yale J. on Reg. 625 (2019) (proposing a three-tiered mandatory ESG reporting regime and discussing how materiality should be considered, including some discussion of climate-related reporting).
4. *See, e.g.*, Nicholas G. Terris, *Some Liability Considerations Relating to ESG Disclosures*, K&L Gates, May 2017 (discussing existing securities case law and its application to ESG disclosure); Leah A. Dundon, *Climate Change Risks and Disclosure Obligations in an Age of Uncertainty*, Envtl. Disclosure Committee Newsl. (American Bar Association Section of Environment, Energy, and Resources), Aug. 2017, at 1 (discussing the application of disclosure laws to climate information); Caitlin Ajax & Diane Strauss, *Corporate Sustainability Disclosures in American Case Law: Purposeful or Mere "Puffery"?*, 45 Ecology L.Q. 703 (2019) (comparing cases arising under different statutory frameworks to draw conclusions about courts' treatment of sustainability information, and predictably concluding the statute under which a claim is brought is an important factor in a court's determination of whether information is material; the authors focus on the "form" of disclosures, but their case descriptions indicate *content* and specificity of the statements are significant for whether courts find them material under particular statutes' concept of materiality).

tive action in the near future that clarifies how climate-related information fits into the existing mandatory disclosure regime. As a result, courts will likely set the first guardrails for how to consider climate-related information, increasing the importance of how courts' understanding of the definition of materiality could apply to climate-related information.

Discussion of "material" information is often conflated with information salient to various stakeholders. But material information has a particular, if somewhat nebulous, definition in U.S. securities law, which guides a company's financial reporting to the U.S. Securities and Exchange Commission (SEC) and communications with its shareholders. Improper reporting (e.g., reporting false or misleading information or omitting material information) may result in legal liabilities.[5] The impacts of legal definitions, case law, and regulatory decisions have not always been carefully considered in conversations about expanding the scope of corporate disclosures on climate-related risks and opportunities.[6]

When, how, and even whether certain topics become material under the current legal framework depends on case specifics. A court does not consider the materiality of ESG information as a whole, or even climate information as a broad category; rather, it looks at a specific piece of information in relation to an individual company's situation and determines if the information is material to a reasonable investor. Those specifics and how they are addressed in current law matter. How a court applies the current definition of materiality to new types of information will determine how effectively climate-related information is integrated into mainstream investing. To properly account for climate change risk and opportunity in the market as a whole and not have it relegated solely to the concerns of impact investors, we must understand when and how it is financially material under the current legal construct.

Treating ESG issues as a block when discussing materiality determinations does not provide the needed clarity on what type of climate-related information investors and companies should rightfully consider within range of the material information threshold. Courts will provide the first contours that define the set of climate-related information deemed "material" under federal securities law, warranting more careful consideration of existing case law on materiality and its application to the type of information investors are currently pressuring companies to reveal. This Comment attempts to contribute to that conversation by surveying current trends that may influence courts' analyses of the materiality of climate-related topics.

Four trends in the corporate-investor disclosure dance indicate that today's reasonable investor considers more and more climate-related information material: (1) the growing, consistent vocal interest by mainstream investors in climate-related information; (2) recent indications that investors use the climate information they get from companies and are seeking out and incorporating additional information; (3) companies' response to investor demands for more information; and (4) the consolidation of investment decisionmaking in the hands of a smaller number of fund managers, increasing the importance of their views on climate information and incentivizing them to portfolio-level climate impacts.

The shift in how reasonable investors view climate-related information means companies can no longer make materiality determinations the way they always have. As more reasonable investors consider such information material, the likelihood increases that courts will too.

I. Materiality and Its Reliance on the Reasonable Investor

U.S. securities law requires that public companies share certain information with investors and the public, and imposes liability for making untrue statements, misleading investors, and omitting financially material information.[7] The crux of the decisions a company must make about what information and when to disclose to SEC centers on whether or not it is material—a definition dependent on what a reasonable investor would find useful. SEC's line item disclosure requirements extend to include material environmental information.[8]

Management and boards decide what to disclose,[9] but the definition of materiality requires them to consider the shareholder's viewpoint. The Supreme Court defined "material" information as information a "reasonable investor" is "substantially likely" to view as "significantly altering the total mix of information" available.[10] Only that which

5. For a more detailed discussion of the U.S. securities law regime around financial disclosures, 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, 745-54 (2019) (describing corporate disclosure requirements under federal law and the role of materiality within them), *available at* http://eelp.law.harvard.edu/wp-content/uploads/VLR_Bk4_Vizcarra.pdf.
6. In developing their recommended framework, the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) actively engaged investors, other financial institutions, and a wide range of industry representatives, but did not specifically enlist the views of lawyers. Their recommendations largely shied away from questions of law, making references to the need for reporting entities to consider the legal definition of materiality within their respective jurisdictions.
7. *See* Vizcarra, *supra* note 5.
8. SEC disclosure requirements most relevant to climate disclosures include requirements to disclose material capital expenditures and the material effects of complying with environmental regulation (Item 101); material legal proceedings (Item 103); "known trends or uncertainties" reasonably expected to have a "material favorable or unfavorable impact" on the business and "events that will cause a material change in the relationship between costs and revenues"—in particular "material events or uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition" (Item 303); and "the most significant factors that make the offering speculative or risky" (Item 503). 17 C.F.R §229.101(c)(xii) (2019), §229.103, §229.303(a)(2)(ii), Instruction 3 for §229.303(a), §229.503.
9. The responsibility to determine materiality "could well be described as the essence of directors' fiduciary duty." Eccles & Youmans, *supra* note 2, at 41.
10. *See* Vizcarra, *supra* note 5, at 750 (citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976), and noting SEC adjusted its definition to align with the Supreme Court in Rule 12b-2, which defines "material" as limiting the disclosure required to "those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered." 17 C.F.R. §240.12b-2 (2019) (also citing Business and Financial Disclosure Required by Regulation S-K, Concept Release, 81 Fed. Reg. 23916, 23925 (Apr. 22, 2016) (explaining that SEC changed the definition of materiality used in Rule

a reasonable investor finds material is material. However, "investors have no voice in a company's materiality determination process other than through lawsuits,"[11] making court reviews of corporate materiality determinations all the more important.[12]

Material information is not limited to what SEC mandates companies to disclose. Information not specifically requested by SEC could be material if it is "necessary to make the required statement, in the light of the circumstances . . . not misleading."[13] Misstatements made outside of SEC filings (in voluntary sustainability or climate reports) can lead to liability should they support a claim of securities fraud.[14]

Courts contend the reasonable investor standard is objective, a standard measured by the views of the mainstream market as a whole in which the reasonable investor sits as neither the "worst informed" nor the best.[15] A reasonable investor is not expected to be a "scientific expert," but should be well-informed (i.e., read prospectuses, reports, and other information relevant to their investments),[16] "exercise due care" in considering information, "have information available in the public domain," and "take into account the customs and practices of the relevant industry."[17] When a court considers whether an omitted piece of information was material, its determination is highly dependent on the circumstances of the case—a mixed question of law and fact.[18]

Reasonable investors do not view statements of opinion made in disclosures to be guarantees. Such statements are not misleading merely because they are incorrect. However, an opinion statement that does not "fairly align" with the information the issuer had at the time can support a shareholder action if the issuer omits "material facts that cannot be squared with . . . a fair reading" of the issuer's statement.[19] If a company omits available facts, making the opinion statement "misleading to a reasonable person reading the statement fairly and in context," the opinion statement in the disclosure may be misleading.[20]

Corporate disclosures include considerations of trends and impacts on future operations (required under Regulation S-K Item 303), which can result in statements about future outcomes. These forward-looking statements often create consternation among board members concerned with whether future outcomes that do not align with the statements could lead to liability. There are both common-law and statutory protections for these statements (also sometimes referred to as "soft" information). These protections are particularly important when considering disclosure of climate-related information addressing potential future impacts on a business.

Under the "bespeaks caution" principle, companies are sheltered from securities fraud claims for forward-looking statements if they are accompanied by meaningful cautionary language that is "substantive and tailored."[21] There is also a statutory protection for forward-looking statements when accompanied by meaningful cautionary statements or when not made with actual knowledge that the statement was misleading.[22] The factors addressed in the cautionary statement are those reasonably considered important at the time of the statement, not necessarily those that came to be the most impactful over time.[23]

Defining the reasonable investor in relation to the whole of investors engaged in the market allows for variability over time as "[t]he standard may vary . . . with the nature of the traders involved in the particular market."[24] How the definition of a reasonable investor interacts with an emerging issue like climate change is key to determining when it crosses the materiality threshold. Investors' focus on climate concerns may represent a shift in what a reasonable investor considers important to the total mix of information, a shift that boards should consider when making materiality determinations.

12b-2 in 1982 to that adopted by the Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*)).

11. Eccles & Youmans, *supra* note 2, at 42.
12. That said, when it comes to climate information, investors are using shareholder engagement, shareholder proposals, and the power of their proxy votes to encourage companies to seriously consider whether certain types of climate-related information are material.
13. 17 C.F.R. §230.408(a) (2019).
14. As stated at 17 C.F.R. §240.10b-5:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
> (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.

15. *See* Vizcarra, *supra* note 5, at 752-53 (citing United States v. Litvak, 889 F.3d 56, 65 (2d Cir. 2018) ("[T]here must be evidence of a nexus between a particular trader's viewpoint and that of the mainstream thinking of investors in that market. Materiality cannot be proven by the mistaken beliefs of the worst informed trader in the market.")).
16. *Id.* at 753 (citing Alaska Elec. Pension Fund v. Pharmacia Corp., 554 F.3d 342, 347 (3d Cir. 2009)).
17. *Id.* (citing FindWhat Investor Group v. FindWhat.com, 658 F.3d 1282, 1305 (11th Cir. 2011)).
18. Cox et al., *supra* note 2, at 620 ("In litigation, a fact's materiality is a mixed question of law and fact, so that it arises in pretrial motions as well as at trial. Outside of litigation, considering whether an item is material and thus must be disclosed is frequently an ulcerating experience.").
19. Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 135 S. Ct. 1318 (2015).
20. *Id.*
21. Kaufman v. Trump's Castle Funding, 7 F.3d 357 (3d Cir. 1993); *see also* Cox et al., *supra* note 2, at 652 ("the first line of defense for a 'missed' forecast under the case law as well as the statutory safe harbor for forward-looking statements is not the reasonableness of its preparer's efforts but whether the forecast was accompanied by meaningful cautionary language").
22. *See* Cox et al., *supra* note 2, at 657.
23. Asher v. Baxter Int'l, Inc., 377 F.3d 727 (7th Cir. 2004):

> What investors would like to have is a full disclosure of the assumptions and calculations *behind* the projections; then they could apply their own discount factors. . . . [T]his is not a sensible requirement. Many of the assumptions and calculations would be more useful to a firm's rivals than to its investors. . . . The [Private Securities Litigation Reform Act] does not require the *most* helpful caution; it is enough to "identify [ ] important factors that could cause actual results to differ materially from those in the forward-looking statement." . . . The statute calls for issuers to reveal the "important factors" but not to attach probabilities to each potential bad outcome, or to reveal in detail what could go wrong . . . .

24. United States v. Litvak, 889 F.3d 56, 64 (2d Cir. 2018).

SEC recognized the potential for such a shift in its 2016 concept release.[25] This ability for the reasonable investor to evolve over time, impacting as it does the materiality of information considered for disclosure, means that disclosures can also evolve to tackle new topics as they influence corporate financial outcomes. The evolution of investors' interest in climate-related information in their decision-making processes is making certain types of climate-related information more material, which should be reflected in corporate disclosures.

II. Recent Trends Lean in Favor of Considering Climate Information Material to the Reasonable Investor

Courts have yet to address which investors are "reasonable" when it comes to demands for expanded climate-related disclosures. Many voices in the investment community express interest in climate information, but their demands vary. The challenge of determining who is a reasonable investor is further complicated by the variable nature of what is reasonably asked of particular industries. Materiality is both sector- and entity-specific.[26] Despite these challenges, certain trends in the investment community support the inclusion of climate-related information in the total mix of information deemed reasonable for investors' decisionmaking.

A. *Investors' Growing Interest in Climate Information*

The United Nations-supported Principles for Responsible Investment (PRI),[27] designed to help incorporate ESG factors into investment and ownership decisions, grew from 63 signatories to more than 1,900 (and $80 trillion in assets under management, up from an initial $6.5 trillion) from 2006 to 2018.[28] In 2015, the G-20's Financial Stability Board established the Task Force on Climate-Related Financial Disclosures (TCFD)[29] and Mark Carney, governor of the Bank of England, spoke of "breaking the tragedy of the horizon" to Lloyd's of London.[30] In June 2016, BlackRock published a document calling for "a consistent global framework that enables stakeholders and market participants to develop detailed ESG standards and best practice guidelines."[31]

In June 2017, the TCFD released recommendations for climate-related disclosure.[32] The framework provided an outline of the type of climate information companies should disclose with a descriptive approach on how to do so, and encouraged companies to incorporate as much information as possible into mandatory financial reporting. However, it did not wade into the murky waters of materiality, instead instructing reporting companies to consider their home jurisdiction's interpretation. Mainstream investors, as well as voluntary reporting and rating organizations, supported the TCFD's recommendations and have sought detailed, expansive, and data-supported information. Major asset managers have voted in support of efforts to improve corporate governance on climate, and pension funds have made commitments on disclosure reporting and climate-related investments.[33]

B. *Investors' Active Use of and Engagement on Climate Information*

Key to pinpointing what a reasonable investor considers material is how investors are actually using the disclosed information. A 2018 survey by Oxford and Harvard Business School professors Amir Amel-Zadeh and George Serafeim indicated that a large majority of investors consider ESG information when making investment decisions and do so because they believe it is financially material to investment performance.[34]

Investors are actively engaging companies on climate, as evidenced by the number of climate change-related shareholder resolutions withdrawn in 2019 after negotiations with the target companies.[35] Investment firms are developing new ways to incorporate climate information

25. Business and Financial Disclosure Required by Regulation S-K, Concept Release, 81 Fed. Reg. 23916, 23971 (Apr. 22, 2016) ("The role of sustainability and public policy information in investors' voting and investment decisions may be evolving as some investors are increasingly engaging on certain ESG matters . . . .").
26. *See*, *e.g.*, Eccles & Youmans, *supra* note 2, at 40 ("Materiality, in its essence, is entity-specific. Whether the interests and issues of a certain stakeholder audience are material will vary from company to company, depending on sector, strategy, business model, and the time frame under consideration."); Esty & Karpilow, *supra* note 3, at 675 (noting that the TCFD has recognized variability of the materiality of climate change according to sector).
27. Principles for Responsible Investment, *About the PRI*, https://www.unpri.org/about-the-pri (last visited Dec. 10, 2019).
28. Vizcarra, *supra* note 5, at 736 (citing Barbara Novick, Vice Chairman, BlackRock, Building Sustainable Markets: What Is Needed for a Transformation to a Sustainable Market Place?, Remarks at the World Economic Forum (Sept. 24, 2018), https://www.blackrock.com/corporate/literature/publication/remarks-barbara-novick-building-sustainable-markets-092418.pdf).
29. TCFD, *Home Page*, https://www.fsb-tcfd.org/ (last visited Dec. 10, 2019).
30. Mark Carney, Governor, Bank of England, and Chairman, Financial Stability Board, Breaking the Tragedy of the Horizon—Climate Change and Financial Stability, Speech at Lloyd's of London (Sept. 29, 2015), https://www.bis.org/review/r151009a.pdf.
31. Vizcarra, *supra* note 5.
32. TCFD, Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures (2017) (TCFD recommendations), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf; *see also* Vizcarra, *supra* note 5, at 741 (describing the TCFD framework and ensuing activity).
33. Vizcarra, *supra* note 5, at 737-39 (describing a series of actions taken by BlackRock, State Street, and Vanguard in 2017 and 2018, noting reports of changes in voting practices of institutional investors and announcements by California about reporting on climate by pension funds and by New York City pension funds regarding investments in climate change solutions).
34. Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence From a Global Survey*, 74 Fin. Analysts J. 87 (2018) (finding 82% of respondents, who were mainstream investors, consider ESG information and of those, 63% did so because they believe it is financially material).
35. Steve Mufson, *Exxon Shareholders Want Action on Climate Change. The SEC Calls It Micromanagement.*, Wash. Post, May 8, 2019 ("The climate-related total is down from the most recent years, perhaps because many companies are already taking steps on issues such as adopting renewable energy. Half of the resolutions this year have been withdrawn after negotiations between companies and proxy sponsors.").

into their decisionmaking processes. For example, Wellington Management and Woods Hole Research Center launched an initiative in September 2018 to integrate climate science into Wellington's asset management by creating models to analyze climate impacts on global capital markets, and the California Public Employees' Retirement System committed to applying the resulting insights in its portfolio.[36] BlackRock has also partnered with Rhodium Group to identify how physical climate risks impact financial performance.[37]

Further evidence that the investment world is taking climate information seriously are the acquisitions of climate data and risk analysis companies by investor advisor companies like Institutional Shareholder Services and MSCI and ratings agencies like Moody's and Standard & Poor's (S&P). In 2019, Moody's acquired climate data and risk analysis company Four Twenty Seven, Inc.,[38] and MSCI acquired Carbon Delta.[39] Further, S&P Global Ratings launched the ESG Evaluation program and ESG Risk Atlas designed to inform investors and companies of risks, including that of climate change.[40] In 2017, Institutional Shareholder Services acquired the investment climate data division of the South Pole Group.[41] The rise in firms looking to partner with climate data providers also creates questions of data quality, as more providers develop opaque methods for analyzing potentially dubious underlying data.[42]

C. Corporations Respond by Releasing More Information

The position of mainstream investors that climate-related information, in at least some form, is increasingly important to their decisionmaking has already had an effect on companies' disclosure practices. The number of companies disclosing ESG data has dramatically increased from the early 1990s to recent years.[43] With regard to climate information in particular, the TCFD's June 2019 status report stated that 785 firms had committed to supporting its disclosure recommendations, including many financial firms.[44] Top oil and gas companies have released special climate reports in addition to their annual and sustainability reports, with many designed to align with the TCFD's recommendations.[45]

Numerous groups have arisen to help guide corporate disclosure of ESG considerations and, in particular, climate-related information. In addition to the guidance from the TCFD, organizations such as the Global Reporting Initiative, the International Integrated Reporting Committee, the CDP, and the Sustainability Accounting Standards Board (SASB) have worked to develop standards and guidance on relevant topics. The SASB, created "to establish industry-specific disclosure standards across environmental, social, and governance topics," develops standards specifically focused on the disclosure of material information as defined in U.S. securities law.[46] Its sector-specific disclosure guidance addresses physical and transitional climate risks as they relate to the specific materiality topics outlined.[47]

Each of these groups approaches the issue with a climate-advocacy agenda and has varying levels of credibility with industry, which does not yet have a government regulator to turn to for guidance, given SEC's relative silence. Yet, evolving corporate disclosures on climate-related topics and their engagement with the various groups working to define methods of disclosure indicate an increasing recognition by corporate boards of the reasonableness of investor requests for more substantive climate-related disclosures.

D. Consolidation of Influence by Institutional Investors

Fund managers from BlackRock, State Street, or Vanguard are increasingly likely to have control over investment decisions related to any individual stock. As these entities increasingly rely on the existence or absence of climate information in making decisions, their positions on climate-related disclosure may be considered representative of the "reasonable investor."

The increasing dominance of index funds in the investment community supports considering climate-related

36. Press Release, Woods Hole Research Center, Wellington Management and Woods Hole Research Center Announce Strategic Climate Science Initiative (Sept. 16, 2018), https://whrc.org/wellington-management-and-woods-hole-research-center-announce-initiative/.
37. Rhodium Group, Clear, Present, and Underpriced: The Physical Risks of Climate Change (2019), https://rhg.com/research/physical-risks-climate-blackrock/.
38. Press Release, Moody's, Moody's Acquires Majority Stake in Four Twenty Seven, Inc., a Leader in Climate Data and Risk Analysis (July 24, 2019), https://www.businesswire.com/news/home/20190724005169/en/Moody%E2%80%99s-Acquires-Majority-Stake-Twenty-Leader-Climate.
39. Press Release, MSCI, MSCI to Strengthen Climate Risk Capability With Acquisition of Carbon Delta (Sept. 9, 2019), https://www.businesswire.com/news/home/20190909005263/en/.
40. Don Jergler, *S&P Will Issue "Environmental, Social, and Governance" Evaluations Including on Insurance Sector*, Ins. J., Apr. 18, 2019, https://www.insurancejournal.com/news/national/2019/04/18/524270.htm.
41. Press Release, Institutional Shareholder Services, Acquisition Highlights Rapid Growth in ISS' Responsible Investment Suite of Solutions (June 21, 2017), https://www.issgovernance.com/iss-announces-acquisition-climate-change-division-south-pole-group/.
42. For a discussion of how this phenomenon could intersect with public policy concerns, see Jesse M. Keenan, *A Climate Intelligence Arms Race in Financial Markets*, 365 Science 1240-43 (2019). Data quality remains an issue in company disclosures, as evidenced by the more limited assurance provided to sustainability and climate disclosures. *See* Michael Kraten, *Sustainability Reports and the Limitations of "Limited" Assurance*, CPA J., July 2019 (discussing the problem with accounting firm reliance on limited assurance procedures in annual audits of sustainability reports), https://www.cpajournal.com/2019/07/26/sustainability-reports-and-the-limitations-of-limited-assurance/. If the data in corporate disclosures is not yet able to withstand more fulsome audits, quality problems may be compounded when compiled by climate services firms.
43. "Whereas fewer than 20 companies disclosed ESG data in the early 1990s, the number of companies issuing sustainability or integrated reports had increased to nearly 9,000 by 2016." Amel-Zadeh & Serafeim, *supra* note 34.
44. TCFD, 2019 Status Report (2019), https://www.fsb-tcfd.org/wp-content/uploads/2019/06/2019-TCFD-Status-Report-FINAL-053119.pdf.
45. Hana Vizcarra, *Shifting Perspectives: E&P Companies Talking Climate and the Energy Transition*, Harv. Envtl. & Energy L. Program, Mar. 26, 2019.
46. SASB, *Mission*, https://www.sasb.org/governance/ (last visited Dec. 10, 2019); *see also* SASB, *Working With SASB and Other Frameworks*, https://www.sasb.org/standards-overview/sasb-and-others/ (last visited Dec. 10, 2019).
47. *See, e.g.*, SASB, Oil & Gas—Exploration & Production: Sustainability Accounting Standard, Version 2018-10 (2018).

information as part of a reasonable investor's total mix of information. Harvard Law Professor John C. Coates, in a recent working paper, outlines the rise of index funds.[48] As Professor Coates explains, the typical individual who owns shares in an index fund does not exercise ownership rights: it is the senior management of these funds "that ultimately controls how the rights associated with those shares are used for governance purposes."[49] Professor Coates notes:

> [T]he rise of indexing also has meant . . . concentration of ownership . . . in the hands of a very small number of indexed fund providers. The "Big Three," as they are known—Vanguard, State Street, and BlackRock—controlled approximately 15% of the S&P 500 in 2017—a much greater share of U.S. public companies than any three single investors have ever previously done.[50]

As we "rapidly mov[e] into a world in which the bulk of equity capital of large companies with dispersed ownership will be owned by a small number of institutions,"[51] the positions of these institutions regarding climate disclosure will play an outsized role in corporate response to investors.

Through the formation and engagement of their policies, and their potential for influence in control contests, activist campaigns, and mergers, index funds have significant influence on corporate governance.[52] This extends to how companies consider climate-related information for disclosure. The "Big Three" fund managers have all supported the TCFD's recommendations and pressed for more disclosure on climate-related risks and opportunities.[53]

A recent working paper from Madison Condon, a fellow at the Institute for Policy Integrity at New York University School of Law, described how institutional investors' engagement on corporate climate actions represents a rational interest.[54] The paper argues that the consolidation of ownership in a smaller number of institutional shareholders—whether asset management companies, mutual and index funds, pension and retirement funds, sovereign wealth funds, or insurance companies who invest premiums—motivates them to pursue portfolio-level profit maximization rather than firm-level profit maximization.[55] These universal or common owners are "pursuing profit maximizing objectives" when engaging with companies on climate change and other ESG issues but to benefit their entire portfolio, not the individual firm.[56] The systemic nature of transition, physical, and liability climate-change risks incentivizes diversified institutional investors to engage companies on climate-related risks to curtail negative externalities with the objective of lessening this risk for their portfolios as a whole.[57]

As described previously, institutional investors have clearly demonstrated an interest in getting more climate-related information from companies. Such investors have specific interests in individual companies' or industries' ability to respond to climate impacts, but also have an interest in improving the climate resiliency of their entire portfolio. Regardless of which interest is the primary motivating factor, courts can no longer view climate-related information as relegated to a niche subset of investors dismissible out of hand.

III. Defining What Climate-Related Information Is Reasonable

Accepting that current trends support the idea that climate-related information is reasonable for investors to expect in disclosures, the next step is the thornier one of defining precisely what information crosses the materiality threshold. In one recent proposed framework for defining when ESG issues become material, Jean Rogers of SASB and Professor Serafeim of Harvard Business School identified five stages through which sustainability issues become financially material—moving from the status quo, experiencing catalyst events, then stakeholder reactions followed by company reactions, and finally resulting in regulatory reactions.[58]

SEC, the federal regulator that oversees mandatory financial disclosures, has remained largely absent in this discussion. Its 2010 climate guidance merely reiterates that the definition of materiality applies to climate-related information as it does to any other topic considered for disclosure.[59] SEC has so far resisted recent calls to provide more specific guidance on climate beyond its 2010 guidance[60]

48. John C. Coates IV, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harvard Public Law, Working Paper No. 19-07, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337.
49. *Id.* at 14.
50. *Id.* at 13.
51. *Id.* at 14.
52. *See id.* at 15-17.
53. *See supra* note 32.
54. Madison Condon, *Externalities and the Common Owner* (New York University School of Law, Law and Economics Research Paper No. 19-07, 2019).
55. *Id.* (The paper also argues that climate-related engagement incentivized by common ownership may be anti-competitive, but relies on narrow examples not representative of the full range of investor interest in corporate climate-related disclosures and actions or the full range of potential benefits to firms of targeted climate-related actions to suggest that investor engagement on climate necessarily results in increased product prices and decreased share prices for individual firms).
56. *Id.* at 10.
57. *Id.* at 13:

> If large diversified investors indeed prioritize industry-wide profit over firm-specific profit, they should also prioritize economy-wide profit over industry-specific profit. An owner whose portfolio success tracks the entire market should be motivated to curtail the negative externalities generated by some of the firms in its portfolio if the owner's share of the cost of internalizing the externality are lower than its share of the benefits that accrue to the entire portfolio from the elimination of the externality.

Id. at 14 ("Investors can diversify away from firm-specific risk by investing across the economy. Systemic risk, however, cannot be eliminated through diversification because its effects are felt economy-wide.").

58. Jean Rogers & George Serafeim, *Pathways to Materiality: How Sustainability Issues Become Financially Material to Corporations and Their Investors* (Harvard Business School, Working Paper No. 20-056, 2019).
59. Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290, 6295 (Feb. 8, 2010); *see also* Vizcarra, *supra* note 5, at 754-56 (discussing in detail the contents of the 2010 guidance and the lack of additional clarity it provides for determining materiality of climate-related information).
60. For example, an October 1, 2018, petition to the SEC called for the agency to initiate a rulemaking on ESG disclosure. Letter from Cynthia A. Williams, Osler Chair in Business Law, Osgoode Hall Law School, and Jill E. Fisch, Saul A. Fox Distinguished Professor of Business Law, University

and undertaken few enforcement actions that could clarify its interpretation of the materiality of climate-related topics.[61] Analysts observed little change in disclosures submitted in the wake of the 2010 guidance.[62] Thus, the courts will likely take the first foray into better defining materiality for climate-related disclosures under U.S. securities law.

A. Instructive Case Law Addressing Materiality

Beyond the statutes and regulations, which lack any further definition of materiality besides that provided by the Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, there is case law and regulatory guidance to apply.[63] But, as Robert Eccles and Timothy Youmans have noted, courts "have done little more than sketch [materiality's] conceptual contours."[64]

Any materiality determination requires a case-specific approach and both quantitative and qualitative considerations.[65] Yet, while there is no bright-line rule,[66] there are also no "'degrees' of materiality. A fact is either material . . . or is not material."[67] This binary approach makes courts understandably wary of setting the threshold too low.[68] For contingent events, such as specific climate change outcomes, companies must balance "the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity."[69] Not all material information must be disclosed, but omissions can lead to liability.[70] The financial impact of information can influence but does not determine materiality.[71]

Climate-specific information has not yet been the subject of significant court opinions, but courts have ruled on the materiality of environmental information. A review of this case law indicates that a finding of materiality thus far generally coincides with a fact pattern involving acute events, such as spills or accidents.[72] Such events provide evidence of misalignment between the statement or omission and actual events. In addition to acute events, courts have found substantial noncompliance with environmental regulations material.[73] The question then becomes, will courts find the risks of climate change, whether physical (impacts on a company's physical assets, operations, or supply chain) or systemic (impacts of the economy transitioning away from fossil fuels), material to the reasonable investor? The more seriously investors consider such risks, the more likely courts are to consider them material.

B. Courts Considering the Materiality of Climate Disclosures in Current Cases

Current cases brought by state attorneys general and shareholders will provide some of the first opportunities for courts to consider whether specific types of climate-related information are material, offering some insight into

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of Pennsylvania Law School, to Brent J. Fields, Secretary, SEC (Oct. 1, 2019), Re: Request for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure, File No. 4-730, https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

61. *See* Vizcarra, *supra* note 5, at 756 ("SEC staff sent a handful of comment letters to companies about their climate-related disclosures (25 letters to 23 companies from 2010 to 2013 out of more than 45,000 comment letters and 14 letters to 14 companies out of over 41,000 letters issued from 2014 to 2017).") (citing U.S. Government Accountability Office, GAO-18-188, Climate-Related Risks: SEC Has Taken Steps to Clarify Disclosure Requirements 14 (2018).
62. *See* Vizcarra, *supra* note 5, at 756 (citing Jim Coburn & Jackie Cook, Ceres, Cool Response: The SEC & Corporate Climate Change Reporting 4 (2014), https://www.ceres.org/sites/default/files/reports/2017-03/Ceres_SECguidance-append_020414_web.pdf (reviewing disclosures and finding little discussion of specific material information or quantification of climate impacts in the first few years after the 2010 guidance was issued)).
63. Some of which has been discussed above in Part I of this Comment.
64. Eccles & Youmans, *supra* note 2, at 42.
65. *See* Vizcarra, *supra* note 5, at 751 (citing SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45151 (Aug. 19, 1999) (recommending consideration of qualitative factors and analysis of all relevant considerations when determining materiality)).
66. *See* 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."). *See also* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 30 (2011) ("We conclude that the materiality of adverse event reports cannot be reduced to a bright-line rule."); Litwin v. Blackstone Grp., 634 F.3d 706, 717 (2d Cir. 2011) (stating that the court 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)); Kurt S. Schulzke & Gerlinde Berger-Walliser, *Toward a Unified Theory of Materiality in Securities Law*, 56 Colum. J. Transnat'l L. 16 (2017).
67. Eccles & Youmans, *supra* note 2, at 42.
68. *Basic*, 485 U.S. at 231 ("[A] minimal standard might bring an overabundance of information within its reach, and lead management simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking." (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 448 (1976)).
69. *Id.* at 238 (quoting Sec. Exch. Comm'n v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).
70. *See* Vizcarra, *supra* note 5, at 751 (citing *Basic*, 485 U.S. at 239 n.17 ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5.")); Terris, *supra* note 4 (describing the use of silence as a method to avoid disclosing information); In re Time Warner Sec. Litig., 9 F.3d 259, 266-67 (2d Cir. 1993) ("[A] corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted fact.")).
71. *Id.* (SEC guidance has noted that the accounting practice of considering anything above 5% of the balance sheet total material can be instructive but not determinative. The potential for a misstatement to result in a significant market reaction can also overcome a presumption of immateriality. (citing SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45152 (Aug. 19, 1999) ("Evaluation of materiality requires a registrant and its auditor to consider *all* the relevant circumstances, and the staff believes that there are numerous circumstances in which misstatements below 5% could well be material. Qualitative factors may cause misstatements of quantitatively small amounts to be material . . . ."), and Terris, *supra* note 4 (citing Lee v. Ernst & Young, LLP, 294 F.3d 969, 976 (8th Cir. 2002), as an example)).
72. *See* Vizcarra, *supra* note 5, at 752 (citing In re Plains All Am. Pipeline, 307 F. Supp. 3d 583, 593 (S.D. Tex. 2018) (addressing the plaintiff's complaint of an oil spill off the California coast when the defendants respond with numerous statements of misrepresentations about scope of the oil spill and the economic effects on the oil and gas pipeline owner and operator); Reese v. Malone, 747 F.3d 557, 569-70 (9th Cir. 2014) (finding that plaintiffs sufficiently pled that defendants made material misstatements in alleging securities fraud); In re BP P.L.C. Sec. Litig., 922 F. Supp. 2d 600, 609, 640-41 (S.D. Tex. 2013) (discussing several misstatements regarding key safety measures in corporate sustainability reports, and elsewhere, found to be material)).
73. *Id.* at 754 (citing Meyer v. Jinkosolar Holdings Co., Ltd., 761 F.3d 245, 252 (2d Cir. 2014) (holding "a trier of fact could find that the existence of ongoing and substantial pollution problems—here the omitted facts—was of substantial importance to investors" as "a reasonable investor could conclude that a substantial non-compliance would constitute a substantial threat to earnings")).

how courts view the extent to which reasonable investors' expectations for climate information have shifted. Only two cases directly addressing climate disclosures have resulted in court opinions to date, one a state court opinion in a case brought by a state attorney general and another a federal court opinion in a shareholder suit.

State attorneys general have considered the adequacy of climate disclosures by energy companies,[74] but only one investigation has reached trial.[75] Following the 2019 trial against Exxon Mobil Corporation in New York, the state court determined that the company did not mislead investors in how it discussed in disclosures the potential impacts of future climate change policies on product demand or how it incorporated this information into its project-level business planning.[76] Earlier investigations in New York led to agreements with companies regarding environmental and climate-related disclosures, requiring them to expand their disclosures.[77] The disclosures those agreements achieved appear elementary, as the conversation around climate-related risks and the informational desires of investors has evolved significantly since then.

The New York court addressed materiality in its December decision, saying "[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" (in other words, no reasonable investor would find such information material).[78] The court was not convinced the company's statements or supposed omissions were material. It found plaintiffs' experts unpersuasive and found no evidence of impact on investment analysts' analyses or actual investors' decisions during the relevant timeframe. However, this case turned on whether the company's statements were misleading, not whether they were material. When considering whether the disclosures involved material misstatements or omissions, the court's determination that they were not misleading made the question of materiality less important.

The discovery process in the New York attorney general's case has provided fodder for shareholder litigation as well. Shareholder claims involving the inadequacy of statements about climate-related decisionmaking have also made it to the courtroom in the form of securities fraud suits brought by shareholders of Exxon Mobil Corporation.[79] One of these cases has resulted in a federal court opinion acknowledging the possibility that omissions related to climate information could be materially misleading.[80] When rejecting a motion to dismiss, the court noted, among other findings, that a reasonable investor would likely find it significant that a company used a lower proxy cost of carbon internally than it disclosed publicly,[81] and that the failure to include a proxy cost of carbon in an impairment determination—allegedly violating accounting protocols—could make its opinion materially misleading.[82]

The court also said that failure to disclose an operation run at a loss in violation of generally accepted accounting protocols,[83] using general cautionary language about potential debookings of reserves instead of disclosing more specific knowledge, and not disclosing the likelihood of a debooking by the year end, could potentially be found to be material omissions.[84] The opinion does not reach any hard conclusions, but it provides a window into how a court may eventually view the materiality of certain types of climate-related information.

The specific facts of the Exxon cases, whether the attorneys general or shareholder cases, may yet prove unique as they hinge on whether the company did one thing and said another. Even so, court discussions of the potential materiality of various types of climate-related information in the process of considering these cases will likely shape corporate materiality determinations in the near future.

IV. Trends Support Future Findings That Climate-Related Information Is Material

How the spike in investor focus on climate concerns will shape courts' understanding of the reasonable investor's expectations remains to be seen. It has yet to be substantially tested in court, with the first cases only addressing limited examples of potentially misleading omissions in disclosures. The early *Ramirez v. Exxon Mobil Corp.* opinion is notable for its acknowledgment that information representing climate risks could be material to reasonable investors—if only representative of a single judge's view and only in the context of a motion to dismiss. The recent *New York v. Exxon Mobil Corp.* opinion indicates that companies continue to have leeway in how they consider future transition risks and its impact on their business, as

74. *Id.* at 759-72 (tracking the evolution of attorney general engagement in corporate climate disclosure in Part IV).
75. New York v. Exxon Mobil Corp., Index No. 452044/2018 (N.Y. Sup. Ct. filed Oct. 24, 2018) (alleging violations of the state's Martin Act, Executive Law, common law, and equitable fraud law). However, Massachusetts also filed a lawsuit on October 24, 2019, alleging violations of its Consumer Protection Act and the District of Columbia has an ongoing investigation.
76. New York v. Exxon Mobil Corp., 65 Misc. 3d 1233(A), 49 ELR 20199 (N.Y. Sup. Ct. 2019) (slip copy). The information at issue in this case related to transition risks—it was information about how the company evaluated possible future policy measures to lower greenhouse gas emissions into its models for estimating future demand and supply and how this information was incorporated into project planning from 2013 to 2016. For more discussion of this case, see Hana Vizcarra, *Understanding the New York v. Exxon Decision*, Harv. Envtl. & Energy L. Program, Dec. 12, 2019, https://eelp.law.harvard.edu/2019/12/understanding-the-new-york-v-exxon-decision/.
77. *See* Vizcarra, *supra* note 5, at 765-72 (discussing attorney general investigations into the adequacy of corporate disclosures regarding environmental and climate concerns).
78. *New York v. Exxon Mobil Corp.*, at 20.
79. *See* Ramirez v. Exxon Mobil Corp., 334 F. Supp. 3d 832 (N.D. Tex. 2018) (holding that the plaintiffs sufficiently alleged material misstatements and loss causation, in claiming that oil company, ExxonMobil, committed securities fraud, allowing the plaintiffs to partly survive Exxon's motion to dismiss); Complaint, Saratoga Advantage Trust Energy & Basic Materials Portfolio v. Woods, No. 3:19-cv-16380 (D.N.J. Aug. 6, 2019), ECF No. 1.
80. *Ramirez*, 334 F. Supp. 3d 832.
81. *Id.* at 846 ("A reasonable investor would likely find it significant that ExxonMobil allegedly applied a lower proxy cost of carbon than it publicly disclosed.").
82. *Id.* at 848.
83. *Id.* at 849.
84. *Id.* at 851.

long as their discussion of how they evaluate those risks and incorporate their evaluation into their planning is not misleading. The challenge remains for companies to identify the line between important and material for disclosure purposes. While guidance is improving and consensus is growing in the wake of the TCFD, there remain no bright lines.

Recent trends in the financial community support the argument that climate information of some sort may already be material. Some climate-related information may have reached the fourth stage of the Rogers/Serafeim framework for pathways to materiality, company response. At this stage "[c]ompanies attempt to regain trust through company-specific or industry self-regulation," and "[n]ew norms and beliefs are set for industry behavior."[85] This response begins to shrink misalignment between business and societal interests; issues are already financially material for some companies and are becoming financially material for entire industries.[86] Yet the investment community's internal divergence regarding what specific disclosures companies should make, and through what mechanisms, may leave some types of information further behind on the pathway.

As we have seen, the investor relationship to climate-related information has shifted in the last few years (during and after the period at issue in the New York case against Exxon Mobil Corporation). Investors are now actively considering certain types of climate-related information in their decisionmaking. They are increasingly interested in how companies model future costs of climate policies, how climate change projections impact corporate project planning, and to what extent companies are prepared to adjust to the physical impacts of climate change. Investors are finding new ways to incorporate such information into their portfolio management processes.

These trends make it increasingly important that companies clearly explain how they evaluate and consider climate-related information in a straightforward manner that does not differ from internal practices or mislead investors. As the evidence grows of investors taking climate information into serious consideration, the support for and probability of a court finding such information material also grows.

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85. Rogers & Serafeim, *supra* note 58, at 24.
86. *Id.*