

## When Attorneys General Attack

### *AGs' Aggressive Investigation of Climate Change Disclosures, and Getting Your Insurer to Provide Coverage*

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*Who's afraid of New York's Martin Act? Right now, a lot of Wall Street and energy industry companies, that's who. Why are they concerned about the Martin Act? Because it grants the New York State Office of the Attorney General (NYAG) power to aggressively scrutinize the public statements of energy companies on the subject of climate change. Many other states' attorneys general have also indicated that they will step up climate change-related investigations in their jurisdictions. This client alert focuses on strategies for managing and obtaining insurance coverage for such investigations.*

#### **Background: Under the Martin Act, NYAG Ramps Up Investigations of Energy Companies' Climate Change Disclosures**

Enacted in 1921 to deter fraud in the sale of securities and commodities, the Martin Act has been reinvigorated by the New York State Office of the Attorney General to aggressively scrutinize the public statements of energy companies on the subject of climate change. The Martin Act generally gives NYAG exceptionally broad powers to bring civil and criminal actions against suspected perpetrators of securities fraud. Unlike certain federal securities provisions, this state "blue sky" law does not require the government to prove scienter (intent to defraud), or show that investors acted in reliance upon allegedly fraudulent statements or suffered damages as a result.

In 2007 and 2008, using its authority under the Martin Act, NYAG opened investigations into the climate change disclosures of publicly-traded utilities doing business in New York. These investigations resulted in Assurance of Discontinuance agreements with the targeted utilities, *i.e.*, negotiated settlements containing stipulated findings and remedies to further the goal of accurate disclosure. The agreements were influential in the development of the SEC's climate change disclosure document, which was issued in February of

2010.<sup>1</sup> The guidance contained in the SEC's disclosure document has been applicable to annual reports on Form 10-K and other SEC filings made subsequent to its issuance.

In 2013, NYAG launched an investigation into the adequacy of the climate change disclosures of Peabody Energy Company. In November 2015, Peabody resolved that investigation by entering into a settlement in which it agreed to make more detailed disclosures to investors about the financial risks faced by the company from changes in policies and regulations on climate change and other environmental issues that could reduce the demand for coal and thus affect the company's profitability.<sup>2</sup> Also in November 2015, the New York Attorney General issued a subpoena to ExxonMobil Corporation, again using its authority under the Martin Act. The subpoena sought documents related to the company's research into the effect that climate change could have on the company's business.<sup>3</sup>

### Other Attorneys General Join the Effort

In the months following these developments in New York, a group of state attorneys general from 17 jurisdictions announced a cooperative effort called "AGs United for Clean Power." This coalition consists of the attorneys general of California, Connecticut, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Rhode Island, Vermont, Virginia, and Washington State, as well as the attorneys general of the District of Columbia and the Virgin Islands. This coordinated enforcement approach has been compared to the efforts of various attorneys general to investigate misleading public statements of the tobacco industry regarding the dangers of cigarette smoking. AGs United for Clean Power may also seek to recruit other state attorneys general to join the cause. Finally, U.S. Attorney General Loretta Lynch has publically acknowledged that the Department of Justice is evaluating the possible pursuit of civil actions against those who deny the effects of climate change in their public statements to investors, and that the FBI is assessing the potential involvement of federal law enforcement.

Thus, there is escalating effort to bring pressure to bear on companies with respect to their public securities statements on the effects of climate change. Although the details of future enforcement activity are not clear, it is reasonable to expect increasing government scrutiny of climate change related disclosures. We discuss below steps which companies can take to prepare for any such investigation, specifically, initial management strategy and assessment of the availability of insurance coverage.

### Strategies for Managing and Responding to Civil Investigative Demands and Subpoenas

Targets of climate change-related investigations should consider the following initial steps. Review the subpoena, Civil Investigative Demand (CID) or other investigative demand carefully. Ensure that you understand the scope of information requested, terms used, and time frame affected. It is highly advised that counsel experienced in handling subpoenas be consulted. Counsel can begin the conversation with the issuing government official in order to fully understand the information being requested by the Government. Counsel can also help to evaluate whether the scope of the request is overly broad and could be narrowed to (i) effectively target the relevant information sought by the Government, and (ii)

<sup>1</sup> *Commission Guidance Regarding Disclosure Related to Climate Change* (Release Nos. 33-9106; 34-61469; FR-82).

<sup>2</sup> Clifford Krauss, Peabody Energy Agrees to Greater Disclosures of Financial Risks, *New York Times*, Nov. 8, 2015, <http://www.nytimes.com/2015/11/09/business/energy-environment/peabody-energy-agrees-to-greater-disclosures-of-financial-risks.html>.

<sup>3</sup> Justin Gillis and Clifford Krauss, *New York Times*, Nov. 5, 2015, <http://www.nytimes.com/2015/11/06/science/exxon-mobil-under-investigation-in-new-york-over-climate-statements.html>.

efficiently respond to the Government's requests and minimize the disruption that collecting such information entails.

Importantly, any recipient of requests should promptly issue document preservation directives to the appropriate custodians likely to have relevant information. Proper response to such requests is critical. Depending on the circumstances, an internal investigation may be appropriate to fully understand risks and liabilities that may flow from the Government request.

### **Insurance Coverage for Climate Change Investigations**

Energy companies can expect to incur significant expenses if they are forced to respond to government investigations into their securities disclosures about climate change-related risks. The categories of costs faced by the subject of such an investigation could include:

- Outside counsel fees for the review of a subpoena, CID or other information request, and for the review and production of documents;
- The cost of any internal investigation commissioned by the company;
- Outside counsel fees for ongoing interaction with the AG or other enforcement officials; and
- Settlements or judgments associated with the investigation or resulting lawsuits.

In addition, publicized government scrutiny of an energy company's securities disclosures could inspire civil actions such as shareholder derivative suits and securities class actions.

Fortunately, energy companies should be able to call upon their directors and officers (D&O) and possibly other liability insurers to help defray these costs. D&O policies, for example, cover "claims" arising from alleged "wrongful acts" of certain officers, directors, and employees of the company, as well as, in some cases, those of the company itself. Depending upon the wording of each particular policy, investigation-related expenses may be covered. Potential sources of recovery should not be overlooked simply because an insurer or broker asserts that the "conventional wisdom" is that a certain policy is not "meant" to cover subpoenas or other investigation response costs.

### **Getting Coverage for Subpoena Response Costs**

The subpoena—a written order commanding the production of documents and/or witness testimony—is a widely used tool in government investigations, and is often the first step in a larger investigation. For instance, NYAG's two-year investigation into Peabody Energy's securities disclosures, discussed above, was preceded by a subpoena in 2007. NYAG's recent subpoena issued to ExxonMobil may similarly lead to further investigation. As a threshold matter, insurers often dispute that a subpoena is a "claim" within the meaning of that term in D&O policies. There is an emerging consensus in various jurisdictions that insurers are wrong on this issue.

The typical D&O policy contains a definition of "claim" similar to the following:

- (1) a written demand for monetary or nonmonetary relief;

- (2) a civil, criminal, administrative, regulatory or arbitration proceeding for monetary or nonmonetary relief which is commenced by:
- (i) service of a complaint or similar pleading;
  - (ii) return of an indictment, information, or similar document (in the case of a criminal proceeding); or
  - (iii) receipt or filing of a notice of charges

A number of courts have held that a subpoena constitutes a “demand for nonmonetary relief.”

An important recent New York case is *Syracuse University v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, in which the New York Supreme Court, affirmed by the Appellate Division, held that under the policy’s definition of “claim,” the plain meaning of the term “nonmonetary relief” encompassed subpoenas issued by the U.S. Attorney’s Office and a county district attorney’s office in connection with their investigations into sexual abuse. The court relied heavily on *MBIA Inc. v. Federal Ins. Co.*, in which the U.S. Court of Appeals for the Second Circuit found coverage for subpoena response costs, stating: “We reject the insurers’ crabbed view of a subpoena as a ‘mere discovery device’ that is not even ‘similar’ to an investigative order. New York case law makes it crystalline that a subpoena is the primary investigative implement in the NYAG’s toolshed.” The *Syracuse University* court also noted that, pursuant to both New York and federal law, failure to comply with a subpoena is a punishable offense.

Courts in other jurisdictions have also found D&O coverage for subpoena response costs. *Protection Strategies v. Starr Indem. and Liab. Co.* (E.D. Va.) (applying Virginia law and finding defense coverage for NASA subpoena and search and seizure warrant); *Minuteman International Inc. v. Great American Ins. Co.* (N.D. Ill.) (applying Illinois law and finding coverage for compliance with SEC subpoena); *Polychron v. Crum & Forster Ins. Cos.* (8th Cir.) (applying Arkansas law and finding coverage for grand jury subpoena served on a bank).

Courts have also found coverage under errors and omissions (E&O) policies for subpoenas and CIDs. For example, *Ace American Insurance Co. v. Ascend One Corp.* involved a policyholder that was subject to an administrative subpoena issued by the Maryland Attorney General’s office and a CID issued by the Texas Attorney General’s office. The E&O policy at issue defined “claim” to include “[a] civil, administrative or regulatory investigation . . . commenced by the filing of a notice of charges, investigative order or similar document.” Applying Maryland law, the U.S. District Court for the District of Maryland held that the subpoena and CID were part of an investigation into potential consumer protection law violations, and were therefore an “investigation” under the policy.

### Coverage for Other Investigation-Related Costs

In addition to responding to a subpoena, an energy company facing an AG investigation may engage in many other costly tasks. For example, in some cases, a subpoena may be preceded by a less formal information request from the authorities, and decisions will have to be made (often with the advice of outside counsel) as to whether and how to respond to such requests. In the *MBIA* case mentioned above, the Second Circuit found coverage for costs incurred by the insured in voluntarily complying with the SEC’s and NYAG’s informal, oral document requests. The Second Circuit held that this activity was covered because it was intended to head off formal subpoenas and additional public relations damage.

A company under investigation may also engage a public relations firm, security service and other vendors to help manage the fallout from publicized government scrutiny. While these “indirect” response costs are

arguably investigation defense costs, there is scant case law on whether they are covered. But a policy with “crisis response” coverage might provide some relief. Coverage might also be available for resulting shareholder lawsuits, because such lawsuits commonly fit into the definitions of “claim” in D&O and E&O policies.

### Practical Tips for Policyholders

Energy companies should keep the following points in mind in order to maximize coverage for government investigations:

- Be proactive. Even before a subpoena or “target letter” lands on the GC’s desk, work with your broker to negotiate a relatively broad definition of “claim” in your D&O and E&O policies. Some newer policy language can provide coverage for certain “pre-claim” inquiries from government agencies and specifically for subpoenas, which would also include attorneys’ fees and costs associated with interviews or meetings with enforcement authorities. Policy exclusions must also be scrutinized. Consult competent coverage counsel to review proposed policy language.
- Understand and comply with notice obligations. A government investigation may begin with a formal subpoena, or even informally at an earlier point in time. It is essential that you understand when, under your D&O and E&O policies, notice of claim, or notice of circumstances giving rise to a claim, must be given. On a similar note, it is important to understand your obligation to provide information to and cooperate with your insurer in defending an investigation. Best practice is to involve coverage counsel early—the advice will be protected by the attorney-client privilege, whereas conversations with a broker may not be.

When faced with a government investigation, policyholders should carefully examine all potentially available sources of coverage. The law is different in many states, and some courts have not addressed the issue. Policyholders should be careful to understand their policies, the law and their risks before they are subject to an investigation.

Our White Collar and Insurance Recovery and Advisory attorneys routinely evaluate CIDs and subpoenas and help clients not only to develop strategies to respond, but to maximize the potential that our clients’ insurance companies pay for that response. In most cases, we are able to review and evaluate specific situations for relatively low cost or fixed fee arrangements, which enable us to assist our clients to proactively improve our clients’ position and minimize their risk.

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