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Climate Change Based Securities Litigation: A Reminder of Risks to Executives in PSLRA Cases



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On August 14, 2018, the U.S. District Court for the Northern District of Texas issued an opinion in a case reported to be the first-ever securities class action concerning climate change-related allegations, denying defendant ExxonMobil Corporation's motion to dismiss. In *Ramirez v. Exxon Mobil Corp., et al.*, No. 3:16-cv-3111-K (N.D. Tex. Aug. 14, 2018), investors alleged that Exxon Mobil Corporation (''Exxon'') and certain of its executives made misleading statements concerning the company's oil and gas reserves in order to maintain or improve Exxon's credit rating leading up to a March 2016 $12 million public debt offering. The plaintiffs further alleged that Exxon falsely stated values for the proxy cost of carbon in public statements that differed from the proxy cost Exxon actually applied in its internal calculations. These proxy costs represent the company's evaluation of its future costs of carbon to account for government policies associated with climate change—policies which could result in higher production costs or restrictions.

The court's analysis of the scienter element required to state a claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 is notable. The court concluded that the plaintiffs adequately pleaded scienter as to Exxon and all but one of the individual defendants.

In particular, the court rejected Exxon's argument that a company's motive to maintain or improve its credit rating is not actionable. The complaint alleged that Exxon was motivated to improve its credit rating in order to receive ''critical'' funds, including the proceeds from a March 2016 $12 billion public debt offering, and to maintain payment of dividends to Exxon shareholders. As a result, Exxon purportedly concealed the true state of its oil and gas reserves, and failed to report asset impairments. Exxon's motive supported a strong inference of scienter because, the court concluded, the complaint sufficiently alleged that maintaining Exxon's AAA credit rating was ''uniquely important'' to the company in its debt offering.

This reasoning departs from the holdings of several Circuits that the analogous desire to appear profitable is not actionable because it is ''universally held.'' These courts have reasoned that a company's wish to maintain a high credit rating does not create sufficient fraudulent motive because ''if scienter could be pleaded on that basis alone, virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions.'' *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1269 (10th Cir. 2001) (quoting *San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Co., Inc.*, 75 F.3d 801, 814 (2d Cir. 1996)) (internal quotation marks omitted); *see Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 664 (8th Cir. 2001) (explaining that the ''desire to maintain a high credit rating is universally held among corporations and their executives and consequently does not contribute significantly to an inference of scienter'').

The *Ramirez* court's analysis of scienter relied heavily on allegations that the defendants had particular knowledge of Exxon's alleged fraud. Specifically, the complaint alleged that individual defendants who were members of Exxon's management committee, including Rex Tillerson, ''extensively'' reviewed, discussed, and prepared Exxon's annual ''Outlook for Energy'' publication, which was published on the first day of the class period. The publication allegedly described the basis for the company's investment planning and Exxon's use of

a proxy cost of carbon to account for government regulation of carbon emissions. The court concluded that these defendants ''would have extensive knowledge of the proxy cost of carbon and should have known a different proxy cost was stated in'' the publication than was actually applied to the company's investments and business operations.

In addition, the fact that certain individual executives had signed public statements filed with the SEC was another factor weighing in favor of the court's conclusion that the complaint adequately alleged a strong inference of scienter. The court reasoned that the individual defendants had signed Form 10-Ks and Form 10-Q quarterly reports containing allegedly materially misleading financial statements. These allegations supported a strong inference of scienter in the context of other, specific allegations demonstrating knowledge of alleged fraudulent statements. These were: (1) the allegation that one defendant was directly involved in drafting a report which the complaint alleged fraudulently stated the proxy cost Exxon used to make its business and investment decisions, and (2) the allegation that two other defendants were members of the management committee which received in-depth briefings related to climate change, including discussing proxy costs of carbon. Such allegations—not just the defendants' signatures alone—gave these defendants ''reason to know'' that the public statements they signed were materially misleading.

In a similar vein, the court also considered specific internal Exxon emails attached to the complaint which indicated that Exxon executives allegedly had knowledge of the nature of the alleged misstatements. For example, the court concluded that some of these emails showed that management knew that Exxon was using a different, lower proxy cost internally than it publicly disclosed. The emails indicated to the court that Tillerson ''was aware of and 'happy with' the different proxy costs,'' further supporting a finding of a strong inference of scienter.

In this regard, the plaintiffs benefited from documents attached to an affirmation in a filing in the New York Office of the Attorney General's investigation into Exxon and alleged public misrepresentations Exxon made about the effects of climate change on its business. The *Ramirez v. Exxon* court explained that, in deciding the defendants' motion to dismiss, the court would not consider the allegations, inferences, and conclusions in the affirmation itself, but it would consider the documents attached to the affirmation, and any portion of the complaint referencing those documents. Accordingly, plaintiffs in this case were able to use documents produced in another matter in order to bolster their claims in their initial pleading, early in the case, before undertaking their own discovery.

The *Ramirez* court's scienter analysis is also notable in that the court found a strong inference of scienter even though the complaint did not contain any allegations of insider trading—which is often an aspect in a court's analysis of Section 10(b) and Rule 10b-5 allegations. Here, Exxon actually conducted a stock buyback, repurchasing billions of dollars' worth of its own stock during the class period. The court reasoned that the lack of insider trading weighed against a finding of scienter but nonetheless found the complaint's allegations sufficient based on the other factors.

Finally, the court also found that the complaint sufficiently alleged loss causation based on the totality of the alleged facts. Notably, the court did not rely for this conclusion on any single identifiable corrective statement by Exxon and resulting stock drop; instead, loss causation was sufficiently pleaded based on ''alleged partial disclosures'' primarily made in press reports and quarterly financial results.

Notwithstanding ample case law supporting the position that a defendant's officer status and awareness of or involvement in securities filings generally is insufficient to satisfy the scienter pleading requirements under the PSLRA—especially absent allegations of insider trading—these cases remain very fact- and circumstance- specific. A court may consider the strength of the allegations of scienter differently depending on the factual backdrop of the allegations. Even though a company's officers may not have engaged in insider trading during the class period in question, there are always risks that carefully pled complaints might succeed at the motion to dismiss stage, if the facts as alleged are deemed compelling under the PSLRA.

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