

**Cognistar**

**2-02 14.03 Climate Change Corporate Disclosure and Directors and Officers: Liability Coverage Issues for Energy Companies**

ROBERTO SCALESE: Good afternoon, everyone. The Association of Corporate Counsel and SmartPros Legal and Ethics welcome you to today's webcast: Climate Change, Corporate Disclosure and Director's and Officer's Liability Coverage Issues for Energy Companies.

*[The instructions provided here were intended for attendees of the live webcast when it was originally broadcast. You may submit questions and comments regarding the content of this course using the Questions and Comments link on the left side of your screen below the video.]*

LEONARDO GUGLIELMI: Welcome. Thank you, Roberto, and thank you everyone for joining us today. My name is Leonardo Guglielmi. I am a member of the Association's Energy Committee and will be moderating today's webcast. We're going to discuss today about the increasing challenges facing corporate disclosure of climate-related issues in light of current and potential future legal requirements and the liability of directors and officers for deficiencies in such disclosures.

This presentation is brought to you by the Agency's Energy Committee and by Covington & Burling. I'd like to thank Covington & Burling for being one of the ACC's energy committee's 2009 sponsors, and for presenting and sponsoring today's webcast.

We have two great speakers joining us today. Our first presenter will be David Martin, who is the co-head of Covington's corporate and securities practice. David advises clients in corporate governance, securities regulation and transaction matters. His practice also includes enforcement cases before the SEC [U.S. Securities and Exchange Commission], internal investigations, and corporate compliance issues. David's career includes seven years of service with the SEC where, prior to joining Covington, he was the director for the divisions of corporate finance of that agency.

Also joining us today is Marialuisa Gallozzi. Marialuisa practices for Covington's Washington D.C. office. She is appointed within Covington's insurance coverage practice and has over 20 years of experience advising policyholders. Marialuisa has particular expertise dealing with run-off, trouble and insolvent insurers. She has been listed in several peer-recommended directories such as Chambers, who is the legal among others. In fact, Covington's policyholders' practice was ranked number one by Chambers U.S.A and Legal 500 U.S. 2009 edition. According to Chambers U.S.A guide, clients appointed Covington's policyholder practice as the gold standard in the industry. So, we really have two heavyweights presenting to us today.

Before I turn it over to our speakers today I would like to remind all Energy Committee members to join us for our next committee meeting scheduled for December 16<sup>th</sup> at 4 p.m. eastern time. Once again December 16<sup>th</sup> at 4 p.m. eastern time. Roberto, if you can step in now and give us the first verification code for CLE, I'd appreciate it.

ROBERTO SCALESE: Thank you, Leo. I'd like to give out that first verification code now for

any attorneys applying for CLE. Please, write this code down, as you will need it when you retrieve your certificate. The first code for today's program is GH2465. That is G as in George, H as in Harry, 2, 4, 6, 5. Thank you, back to you, Leo.

LEONARDO GUGLIELMI: Thank you, Roberto. And now I am going to turn it over to Marialuisa, who, I understand will make a brief introduction to the topic and then hand it over to David. Marialuisa?

MARIALUISA GALLOZZI: Good afternoon. Thank you, Leo. Welcome, everybody. Thank you very much for joining us for this topic. I wanted to give you the overall structure of this presentation, which we've kept simple. It will be basically in two parts: David is going to start by discussing the disclosure requirements as they pertain to climate-change related issues, and then I will pick up and talk to you for a few minutes about directors' and officers' liability coverage in general and then spend a few minutes reflecting on how that kind of coverage might apply to climate-change related liabilities that may emerge in the future. And with that, I will turn to David.

DAVID MARTIN: Thank you very much. Good afternoon, everyone. For my portion, let me telegraph my punch. It's a pretty simple punch at that, which is that I think public companies will be required and expected to provide more in the way of disclosure surrounding climate change and the risks of climate change coming from climate change in the not too distance future. And by that I mean the next one to three years.

This topic has been on the table for many years—not so much climate change as environmental risks—and so in exploring my simple thesis—I think to sort of unpack that to the side, or at least see if you agree with me—that the time has now come for this and there are reasons why it hadn't come before that. The purpose of my section really isn't to preach as much as to predict, and so that's what I intend to do.

Again, at a high level, I think the reason you haven't seen more disclosure here in the past is multi-faceted and multi-layered. But we certainly know that the SEC has ample disclosure requirements—and I will review those in a second—and you might consider that those would have been enough. Apparently a number of people think they haven't been enough. But on top of that we had some new developments that I think are going to raise the bar. And then I'd like to finally talk about sort of what we can expect the SEC to do and what I expect public companies are going to do in response to all of this. So, let me, as I said, sort of break it down a bit.

Let me start by just reviewing for people the current state of play at the SEC; the current set of legal requirements. For some of you that have read literature in this area, you'll recognize this litany, this set of portfolio of requirements, but for others I want to review those.

The first—and I am taking this sort of in the order that you would sort of naturally think they would come in, based on a number of different factors. The first is the requirement to describe the company's business. And the SEC has some learning here, and specific disclosure requirements around having to disclose investments in material amount of assets, to sources and availability of raw materials, to the regulatory profile in which a company's business finds itself, to such things as the seasonality of the business, and quite specifically the description of the

business needs to include the material effects of environmental compliance on earnings, competitive position and capital expenditures. Not only a mouthful, but certainly it sort of gets towards the climate change area.

Next in the SEC's portfolio of disclosure requirements is the need to disclose material and pending litigation which is not in the ordinary course—not routine litigation incidental to the business—which includes proceedings known to be contemplated by the government. That same requirement does indicate that if the matter arises under environmental laws regulating discharges of material into the environment or for the protection of the environment, you must disclose it unless it isn't material, it doesn't involve a claim of 10% of the assets of the company, or it is involving the government, but doesn't involve more than a \$100,000. So, there is some pretty rigorous disclosure in the legal proceedings area surrounding environmental types of litigation and proceedings.

Companies are next required to put in a fulsome section that is known as management's discussion and analysis, or MD&A. This requires a sort of a description of the company's business and the financial information about the company's business. And it asks for, in very general terms, disclosure about the financial condition of the enterprise and the results of operation. But it also asks for full disclosure regarding liquidity and capital resources and results of operations and off balance sheet arrangements and contractual obligations and for the very segments of the organization. And the SEC has said numerous times in describing this sort of mother lode of disclosure—financial disclosure—that it should also pick up any current known trends, events, and uncertainties that are reasonably expected to have material effects. Again, a fairly high bar there in terms of what's expected in thinking about risks.

Speaking of risk, there is a second disclosure item that requires companies to list their most significant risks that could affect the business. Within the financial statements alone, there [are] requirements to get into accounting for disclosure regarding contingent liabilities, including the assumption of assets and liabilities in business combinations that may be contingent. And this is a tough standard for many companies with environmental risks or climate change risks, because you really have to be thinking about what the contingent aspects of the risks may be in the financial statements, which involves your auditors.

There are some requirements regarding experts, that is to say: If you have someone that comes in to give you advice, expert advice, with regard to an environmental risk, including an environmental risk that might involve, say greenhouse gas emissions—clearly a climate change kind of issue—that expert, and you wanted to name that expert in a registration statement, you would have to file a consent for that expert to be named. And finally, if all of this weren't enough, the SEC has sort of a rubber requirements under both of its major disclosure acts that if we haven't thought of it we are hereby telling you that you have to disclose anything else that's material, particularly information that the absence of which would render what you have to disclosed materially deficient. So, you have to put in everything that you can think of and anything you omitted to think of.

You know, you might say, and we're going to the next slide here—that all of that should be enough. And for years, I think, the SEC has felt that it is enough, that we have plenty of requirements out there, if someone has a material issue, a material risk, a material commitment, a

material contingency, including environmental risks, including climate change risks, they ought to go in the disclosure documents, so what more do we need to do? But as a matter of fact, a great many people are beginning to think that the SEC needs to do more and, in any case, are underwhelmed by the level of disclosure in the climate change area.

More specifically really, since 2004 the SEC has been receiving, I would say, persistent petitions to open a rulemaking proceeding, to require more, to ask more of people in this space. Principally these have been generated by various nonprofits, particularly Ceres, which is an investor-based association, including sort of subcommittees and task forces of Ceres, including the Investor Network on Climate Risk. Including most recently, as of November the 23 [2009], I believe, a supplement to a prior Ceres petition, this signed by 20 or more, I guess, large institutional investors, I would probably guess all the usual suspects and then some. And the sum and substance of these various petitions have been to ask the SEC to one, provide more guidance to people as to how their disclosure should play out in this climate change area or taking into account for climate change, to enforce the existing disclosure requirements with more rigor, to allow shareholder proposals in this area, and to, basically, require more disclosure of environmental risks, particularly based on the global reporting initiative, which is a standard used by many, many large companies.

So, if you are to look at the slide that's before you now—I really probably shouldn't make it as a list so much as a circle—because I really, I don't even know where to start. All of these areas of significant developments really do sort of feed off of one another, and it's hard to know what comes first. I have listed public policy first because if you want to think about significant developments it could incite the SEC to say more and expect public companies to say more. I think you would certainly want to know that the EPA [Environmental Protection Agency] recently adopted rules which will put up to 10,000 U.S. companies in an annual reporting regime regarding greenhouse gas emissions. And these were issued in September [2009], and this will create a new reporting regime, which will have to be disclosed by companies at some level, is my guess, depending on how the EPA handles this and depending on what the reports are showing. I am not saying it'll be a disclosable item that you actually file one of these reports, but over time, I can see the reporting regime itself becoming a regulatory overlay that would be described in a very neutral and practical sort of way in disclosure documents.

Just as importantly, the EPA at the same time has proposed rules that actually would limit greenhouse gas emissions for large facilities starting in 2011. And obviously if you are one of those companies and these rules get adopted—and there is a lot of “ifs” in there—that would create a disclosure hurdle for you, it would seem to me if you—particularly if you were going to exceed the limitations on your greenhouse gas emissions. And one would argue, I guess, that the EPA's rule proposal was a part of the Obama administration's interest in really urging the Congress to do more. And there is federal legislation, the most notorious act being the Kerry-Boxer Act, which would institute what's called a cap and trade regime. You know, betting people, and people that work the Hill—and I don't, I am not either one of those—would say that there is going to be this yin and yang, this push-me-pull-you that is going to have to take place here, but it's clear that there is going to be some real pressures from a public policy standpoint in terms of greenhouse gas emissions. And I also should mention, and it's quite a bit in the press, now that we are, the U.S., is going to be participating in a conference in Copenhagen later this month and much has been said about what kind of pronouncements and commitments people

will make there. So, that's sort of public policy and I listed that first.

But the public and investors are seeking more. I mentioned Ceres and those, and the letters that have come in, the petitions to the SEC, but the SEC is allowing more shareholder proposals and proxy statements. There have been increased numbers of shareholder proposals every year, and those increased proposals are getting more and more support by investors. Something called a carbon disclosure project, which is a nonprofit based in London that sends out environmental questionnaires, is getting increasing response rates to that, and we could certainly look at other factors or developments here. But I think [that] investors in the public are expecting and asking more here.

Commercial activities are being somewhat informed by interests regarding climate change risks. The insurance regulators, NAIC [National Association of Insurance Commissioners] adopted a requirement last winter, I think it was, that insurance companies—or maybe it was spring—with annual premiums of \$500 million or more would be required to complete a disclosure survey, which would include financial risks from climate change. This is the portfolios of companies, whether they are held by insurance regulators—and who knows where the banks will end up—looking to see whether or not ownership of a company that has climate risks could be a risk to the regulator, to the insurance industry. WalMart, more recently—let me before going to that—I'll just say that we from time to time will see and deal documents—because I am thinking about commercial activities—questions, due diligence interest in exposure to climate risk. So I think there is commercial activities that are developing that will increasingly raise expectation levels in terms of disclosure.

Next here, I said other private ordering, e.g. lists and litigation, because I wanted to mention a project that WalMart is engaged in, in which it is trying to create a system of awarding sustainability scores to its suppliers. And it is doing this through a questionnaire, and it's doing this through some sort of jawboning and maybe more. But I think the WalMart questionnaire—I should have mentioned that Newsweek is doing a green-rankings, and that's another list not to appear on, or to appear high on, etc. So, I think there is a certain amount of private ordering that's going on. And then I mention finally litigation. And for people in the energy world this is probably old news, but I just need to remind you that in late 2008 the Attorney General of New York, Andrew Cuomo, entered into settlements with Excel Energy and Dynegy, which resulted in a specific disclosure in annual reports regarding climate change risks and more.

And so, we can move on to the next slide. I think we have a lot of significant developments that are pushing companies and the SEC to do more here. What do we think the SEC will do: the next step? Well, the first thing we should know is that we have a new chair of the SEC as of last February, several new commissioners, and I would have to say a new attitude in this area. It is clear that by body language and by meetings and by speeches, we know that the senior officials at the SEC are, for whatever reason, taking the climate change risk issue seriously when it comes to disclosure.

One of the commissioners gave a speech this Fall [2009] in which she said quite point blank, "We are taking a very serious look at our disclosure system in this area." And she went on to say that you should expect more.

So, I think we'll see these staff issuing more comment letters here; and speaking of the staff I should tell you that the SEC has an investor advisory committee, which is made up of outsiders that are to meet, and their agenda is still a little bit unshaped and uncertain as to what it will do, this committee, and how long it will be in existence. But the staff, in trying to sort of force feed this committee some talking points and some agenda setting points, called out as one of the areas that this committee might want to look at: environmental, climate change and sustainability disclosure. So I think we see the staff at the SEC working on stuff, and in this area. And likely what this would be would be either rulemaking or some kind of interpretive guidance. And I think we should expect something out of the SEC in the near future, whether that's next month or next year is another question. But I just think there's a lot of pressure building on the agency based on the inputs I discussed and the developments I discussed to do something. And I think what they will do will be some form of guidance.

Let me just switch to the next slide and say, just briefly, what this might look like if you're a company that hasn't really tackled this area with too much enthusiasm or too much scope yet. Obviously there are going to be some companies that are more impacted by this than others. And electric power, extractive, transportation; they're sort of obvious. Those industries are going to be hit, but I mentioned insurance earlier and I do think insurance and banking will have to think about this carefully. And the catch all other, really, is to simply say you sort of have to follow the greenhouse gas emissions or the companies that are in that area, so suppliers to these companies have to worry whether or not there is going to be a significant commitment of capital change in attitude about who they deal with, etc. So, not all companies need to go to general quarters on this, but I think some companies are going to be obviously more likely to be in a full-stage alert.

What kind of disclosures should companies be planning for? Well, there are precedents out there, believe it or not, and I mentioned two of them: Excel Energy and Dynegy; other companies do have things here, so there [are] good precedents. But finally I mentioned current frameworks and why don't we just go to the next slide very quickly, because most of the aficionados of this area, people that have thought about it, written about it, they have an interest in environmental disclosure, they have an interest in environmental issues to be sure, but they have done a fairly careful job of thinking this through, and this really came—this was part of the Cuomo settlement with the two companies that I mentioned.

Of course there is more risk disclosure. And it can be risks from a regulatory commitment that you have to make, it can be risks from potential litigation, or it could be risk from physical impacts of climate change. And that's the buckets that people think about risks in. But those are financial risks, there are also operational risks, as in, "Maybe we won't be able to continue to get our raw materials from a particular supplier that we've enjoyed a long-term relationship with because that supplier has a deforestation problem or has some sort of a climate change risk." There are going to be reputational risks, and those will have to be thought through; all these dreaded lists that I mentioned. Eventually people are going to say, "Why aren't you doing better on the green score? Or why don't you have a sustainability quotient?" And these can have an impact.

And finally, and this is I think the hardest disclosure to write, but probably more substantive in the interest, in the minds of investors, will be, "What are your strategies for dealing with climate change? Do you have any position with respect to climate change? Do you have plans? Are your

plans going to be capital intensive? And is the board involved? What kind of governance is overseeing this? Is this just a crackpot idea from someone in a division that is big on climate change issues, or is this a company culture that investors are buying into? And what have been the results of things that you have done?”

I think I am going over, I'd like to turn the baton to Marialuisa, but just to say, I think if you were to say, “Fine, fine, you have persuaded us, the current regime is probably good enough at the SEC,” but people are expecting more under it. And in any case the SEC is likely to be coming out soon to tell us to do something. So, let's get ahead of that and let's think about it.

I think there are some useful precedents. And there are some useful ways of thinking about how you would build this, because surely you don't want to over-disclose or disclose in a harmful way. So, I think there [are] some good examples. And start wrapping your mind about how you would handle this.

Maria, why don't we move to you?

MARIALUISA GALLOZZI: Thank you. David. I am going to do two parts: Just a quick overview of D & O [directors and officers] coverage, which may be very familiar to some of you, and then some thoughts on how climate change, in particular, may intertwine with D&O coverage issues.

The insurance industry generally has really been in a vanguard of monitoring and being active in the area of climate change disclosure and regulation. And I think they are cognizant that, assuming that there are these climate change risks, that they can come home to the insurance industry by hitting them in several ways; not only the disclosure requirements of the insurance industry may have as businesses themselves, but also derived from their policyholders. And I will say in the interest of full disclosure, we only represent policyholders in insurance issues.

They could hit, for example, third-party liability insurance, where a company has liability for property damage or for bodily injury. They could hit first-party property insurance coverages, for example, where you might find coverage for a lot of hurricane-related damage and so forth, which has been the subject of a great deal of litigation. And they also may hit the focus of what we are talking about today, which is D&O coverage.

And the D&O coverage is essentially there to cover the liability exposure of directors and officers from their activities in those capacities. And the policies are essentially structured with three basic parts. And they are referred to—although you won't always see this language in the policy, and I will tell you, this is generic, I am not taking this from any particular policy—Side A, which provides coverage directly to the directors and officers when they are not indemnified by the company. Side B is reimbursement to the company when it indemnifies its directors and officers, the individuals. And Side C is something that's called “entity coverage” —it's also something that's referred to as “enterprise coverage” —which covers the company for its own liability. This is frequently limited only to securities claims against the company. And sometimes the coverage is only triggered when the securities claim is also maintained simultaneously against an individual director or officer.

D&O coverage sometimes is a package that wraps in other things like employment practices,

some limited costs of investigation before a charge has been brought, that's typically subject to a sublimit. And sometimes there are PR [public relations] or crisis management costs, which are also subject to a sublimit. D&O coverage also is subject to retentions, which are sometimes referred to as deductibles, and, generally, they apply to coverages B and C, which is what the company would be out of pocket. They typically don't apply to Side A, where the individual is going to be directly out of pocket, because the individual is not indemnified.

Let me move on to the next slide, which is the basic coverage grant. And the way this is phrased is that the policy covers "loss" that arises from a "claim" that is made during the policy period, and is based on a "wrongful act." And each of those terms and many, many, many others is defined in the policy. And the definitions of these key terms, which footnote also may be significantly amended by endorsement, vary from policy to policy and from year to year, and they're something that should be studied carefully.

Let me just highlight a few potential areas of controversy. The "loss" typically refers to damages, judgments, settlements, pre- and post-judgment interests, and it includes defense costs. And what this means is that since your D&O policy covers the cost of defending a claim against a D&O, that defense cost coverage erodes the limits of the policy, and theoretically could chew the entire thing up. So if you spend \$25 million of a \$25 million dollar policy in defending a claim, that could be all you get out of the policy. And that's different from some other kinds of liability policies, so that's worth noting.

However, loss also excludes certain things like: fines, penalties, taxes, punitive damages and certain matters that are deemed uninsurable as a matter of law. And one area of controversy that it can be potentially significant that I wanted to alert you to is that there is some recent case law concerning damages that are imposed pursuant to § 11 of the 1933 Act, where the insurers have taken the position—with some success in certain circumstances—that those damages are not covered. I don't know if David wants to insert a sentence on § 11, here.

DAVID MARTIN: Well, § 11 under the Securities Act of 1933 comes close to being a strict liability set of provisions for certain persons, including the issuer, where there is a materially inaccurate statement in a registration statement. And where the sanction is what securities lawyers call "put right"—but it's a basically a rescission of the placement, so if you sold common stock, a large company sells common stock to the public for some amount of money, and somebody can trace the purchase of that stock to a materially false statement in that registration statement, the investor can come to the company and say, "I want my money back. And you can take your darn stock and do what you will with it." And I guess the question would be, as you teed this up, is: Is that really a damage, a loss that would be covered under the policy, or would it be argued to be some sort of a disgorgement or—

MARIALUISA GALLOZZI: Well, insurers would do exactly that, which is take the position that damages that are restitutionary or disgorgement are not insurable as a matter of law. And that may come as an unpleasant surprise for people looking at their D&O policies for coverage. I mentioned this just because it can be an important issue. There is some unpleasant case law on this subject, which I can point you to. And policies can be endorsed to provide, expressly to provide, coverage for these claims.

And that leads me to a bigger point, which is that it is not infrequent for companies to treat insurance policies more or less as kind of off-the-shelf products, and these policies in particular are worth focusing on a little bit and making sure that they provide the protection that the company may be counting on in the event of adverse developments. And this is one of those areas that should be considered when you're reviewing a policy at renewal.

Let me switch to the next slide and talk about some of the other key terms. "Claim" is typically the thing that triggers the policy. These are claims-made policies that are triggered by claims during the policy period, as opposed to events or injuries that occurred during the policy period. And they need a demand or a proceeding—formal legal proceeding of some sort—seeking monetary or non-monetary relief. Typically a claim has to be based on an allegation of a wrongful act. And so, for example, if you have a subpoena that is served as an investigative matter but doesn't appear to target an individual or target a particular alleged wrongful act, it may be difficult to find coverage for the cost of compliance with an investigative-type subpoena, which could be significant. And that's one of the reasons that you sometimes get these add-ons that provide a limited amount of coverage for such purposes.

DAVID MARTIN: This is David. I wanted to ask you a question. So, I think that means if you went through two or three years and millions and millions of dollars of investigatory expense in response to an SEC investigation that might not be covered?

MARIALUISA GALLOZZI: Potentially. Yes, if there is no specific wrongful act that's alleged and if the policy defines the claim as based on an alleged, an actual or alleged wrongful act. The term "wrongful act" can be very broad, which includes any breach of duty, neglect, error, omission, etc. And it in some cases can be limited to negligence. And we'll talk a little bit later about what that might be in the context of a climate change policy.

If we flip over to the next slide: As we mentioned before, some distinctive features of the D&O policy are here. It's a claims-made trigger, strict reporting requirements under D&O policies—and with almost any insurance policy these are absolutely key to compliance—and there are some courts that are particularly hostile to late reporting, and it's an easy defense for an insurer, defense costs erode the limits of the policy, [and] the insured typically undertakes its own defense and is reimbursed.

We will flip quickly to the next slide, which is just examples of the kinds of claims that, in general, will trigger D&O policies. And the first of these, you'll see, is the issue of proper disclosure in financial reporting, and that is the area that, at the moment, seems to be the most likely battleground with respect to climate change claims. I don't need to go through the rest of these, so we'll just turn to the next slide.

I do want to focus on these defenses. There are innumerable defenses that insurers may assert to coverage claims generally and D&O claims in particular. And we'll just focus on some of them here.

Wrongful acts not committed in the insured capacity. These are very often in some self dealing situations and things like that, and I think are less likely specifically in the climate change.

No claim or no loss, as we highlighted before some of the issues in bringing a particular matter

within the definition of a claim or definition of loss.

Late notice, noncompliance with the basic policy condition is something that should be avoided at all cost.

Policy exclusions, we'll come back to. I will mention that at this point I am not aware that there are specific exclusions that deal with climate or with greenhouse gasses. Stay tuned. That could change at your next renewal. But right now I am not aware that those things are out there.

The most popular—or one of the most popular defenses that we've seen recently in the insurance industry is the misrepresentation or rescission defense. And it strikes me as something that insurers may look to increasingly in this area of climate change. And that is basically an attempt to void the policy from the beginning because there was not proper disclosure or full disclosure, or a full response to questions in the application at the time that the policy was procured. And so, in a way, it's kind of a fraud in the application concept. One of the things that's important to remember is that D&O applications, in particular, incorporate by reference a host of other documents that are deemed to be part of the application and on which the insurer is reliant or says it has relied. And so, therefore, if your disclosure requirements in your SEC filings are not met and those SEC filings then become part of the application, the insurer then looks to those disclosure issues and believes it has a case to move forward with rescission.

Going to the next slide: I have summarized here some of the climate related litigation sequentially, mentioning in particular the one that really deals with disclosure issues, which is the New York Attorney General actions brought against Excel and some follow-on actions there. The important thing to note here is that these are mostly tort actions. These aren't actions against the directors and officers, and they are not actions against directors and D&O insurers. But what commentators have been suggesting about this line of cases and the varying results that have been achieved, is that they suggest, particularly in the most recent months, that the courts, in general, are becoming more receptive to claims founded on the notion of climate change or greenhouse gas emissions. And that that may create an environment in which there are greater bases on which to bring claims that are founded on improper disclosure of climate or carbon emissions-related exposures. And so these cases don't tell you anything about directors and officers' liability, except that there may be a climate change related to that.

Flipping over to the next slide. If we try to drill down just a little bit further and apply some of these concepts to the universe of climate-change-related exposures, some commentators have suggested that a wrongful act that might be alleged for purposes of a D&O policy might include either failure to address carbon emissions at all or sufficiently or in a timely way, failing to disclose them, or conversely—which I found interesting, and you'll see this on the next slide—doing too much or getting ahead of the market in addressing these risks, and perhaps making an excessive expenditure of resources in this area beyond what is actually called for by current exposure or regulation.

Let me just turn over to the issue of exclusions. The exclusions in insurance policies, by definition, and D&O policies are numerous. Some that have been identified as potential battlegrounds are bodily injury and property damage exclusion. And one of the issues here is that both in the area of bodily injury and property damage, which you see excerpted on the next page,

and then the pollution exclusion, found in most D&O policies, which you will see on the following page, these are really intended, broadly speaking, to interact with other policies. You have a general liability policy that is intended to cover you for bodily injury and property damage liability; that is not what your D&O policy is supposed to do. And so, in theory, that exclusion ought simply to take your general liability out of your D&O policy. Where there have been some issues for both bodily injury and pollution exclusion where insurers have attempted to argue that claims based on misrepresentation or nondisclosure of potential pollution liabilities or bodily injury or property damage liabilities are actually taken out of the D&O coverage by these exclusions. And the counterargument to that is that those claims do not seek recovery for pollution. They don't seek reimbursement for bodily injury. They seek the damages to the shareholders or to the company that are occasioned by improper or incomplete disclosure of those potential liabilities. And, in some cases, there have been kind of mixed results on that. But again it is worth looking carefully at both those exclusions to make sure that they are narrowly constructed and don't inadvertently sweep more broadly than might be intended. It's thought that the pollution exclusion—at least for now, and in light of the Massachusetts, the EPA case—is where insurers will likely look to say that there is existing an exclusion applicable to climate change and greenhouse gasses.

To my point earlier that when you've got a policy, it's not off the shelf, there are ways in which pollution exclusion, for instance, can be narrowed explicitly in a way that it does not carve out shareholder claims, and I mention that to you as an area that this group probably should be looking at more carefully in D & O renewals to make sure that the pollution exclusions aren't so broadly worded or aren't changed here and there at the next renewal in such a way that they would exclude or be construed to exclude climate change or related liabilities.

On the next slide, it just reiterates my point that there are no greenhouse gas exclusions yet to my knowledge, although we may see them soon.

Coming to the end of this presentation, I just wanted to circle back to my initial point, which is: When we look at the enhanced disclosure requirements that David prognosticates we're likely to see, it may serve to make these rescission or misrepresentation defenses—of which the insurers are so very fond—more attractive at this point. And one of the things that we're seeing, in part, is that insurers themselves—and Swiss Re, for example, has been public about this—are increasing the level of disclosure that they're requiring in the application or renewal forms. And on one hand it's advisable to be very candid and forthcoming with your insurer because down the road if they discover something you didn't tell them they will surely decide that they wanted to know about it beforehand. But on the other hand, it creates a standard that creates an opportunity for rescission action to go forward.

So, I think the lesson of this is that both policyholders and insurers will be looking very hard—and should be looking very hard—at disclosures they make both in the financial reporting sector and in the insurance sector, which, as we've seen, are entirely intertwined, because it may well have consequences not only for liability to shareholders but also for D & O coverage for those liabilities going forward.

The last thing I wanted to mention is that—again, coming back to this point that these are not necessarily off-the-shelf policies—there are endorsements that can protect individuals,

particularly individual officers and directors who are going to be very interested in this subject, against rescission actions. And so if you have an innocent officer or director who was not aware of a nondisclosure or not aware of an error in the application, then even if there is a rescission action that that individual can be carved out and coverage can be preserved for that individual. And those two are fairly standard endorsements or policy language that are available in the market, and it's something that I think individual officers and directors will be increasingly interested in and will want to know that that kind of protection exists in their policy, even if the insurers do get aggressive in the area of rescission and misrepresentation related to climate change.

That, I think, brings us to the end of our time. I think we might have a few seconds for questions. And I think David and I would certainly be happy to take questions offline if we don't get to them in the next few minutes.

LEONARDO GUGLIELMI: Thank you very much, Marialuisa and David. This is Leo again, the moderator. We have just a couple of minutes to begin the Q & A session. Just before that I'll ask Roberto to come back and give us the second verification code for the CLE participants who are attending for CLE.

ROBERTO SCALESE: Thank you, Leo. I'd now like to give the second verification code for any attorneys applying for CLE. Please write this code down, as you'll need it when you retrieve your certificate.

Our second code is: 5485BN. That is five, four, eight, five, B as in Beth, N as in Nancy. Thank you. We are now about to start our Q & A session. As a reminder for our audience members, you can ask a question at any point using the questions tool on your control panel. Simply type the question in and hit send the way you would use any sort of IM program that you've used since the Internet was invented.

OK, with that I'll send it back to Leo.

LEONARDO GUGLIELMI: Thank you. I see a couple of questions coming in, and I think I'm going to take this one, which I believe is for David. David, you mentioned during the presentation that you see the SEC coming forward with some guidance. What do you see in that respect?

DAVID MARTIN: Yes, and I probably should just distinguish for non-SEC people the difference between guidance and rulemaking. A rule—which I don't expect—would be the SEC saying that, "In the future a filing must include," and you fill in the blank, the type of disclosure that would be required, such as: Must require a description of your greenhouse gas emissions policy. I don't expect that. That would be a rule, and I think the SEC is unlikely to do that. But I do expect some kind of a SEC pronouncement, typically these are called Releases, it's a pronouncement in which, honestly I think, if I were to do this, I would recite pretty much what I talked to you about in the beginning of the program: the current disclosure requirements. And then sort of talk about climate change and climate change related risks and remind people how those existing disclosure requirements would pertain in the context of climate change risk. In effect, sort of a fancy way of jawboning people to think more creatively about how the disclosure

requirements, the existing requirements, apply. We have a really good model for this in the late 20th century. Right before Y2K [The Year 2000], the SEC issued a bunch of statements about how people should be thinking about management's discussion analysis, risk factors, contingent liability, description of the business when it came to advising investors and shareholders as to what was going on in the area of preparing for Y2K. If everybody on this phone would tell me that climate change is going to be the next Y2K, then we don't have to do all this. But if you're still uncertain on this, I think the SEC would follow that sort of format. And honestly, I predict some sort of an interpretive release that reads a little bit like that within the next—I would not be surprised if it's the next couple of months, given some of the drum roll of interest that I've seen at the agency.

LEONARDO GUGLIELMI: Well, thank you very much. I see another question here that I want to direct to Marialuisa. Marialuisa, do you see insurers writing new coverage specifically to address climate related issues?

MARIALUISA GALLOZZI: Yes and no. The insurers—as I mentioned before—have been really active in this area and they're—particularly property insurers—are getting out there and writing first-party coverages or green building or getting things back up to meet new certification standards or to comply with evolving building codes, that sort of thing. So, in the green area, yes, there are. What you're not seeing—to my knowledge—is the same sort of activity in the liability sector. And that I think applies to D&O as well as to basic tort liability. I think this is one of those emerging areas of liability, where the first thing you see is an effort to carve it out of existing liability products. And insurers then sometimes follow that move—carving it out from their existing liability exposures—by filling that gap with a new product and—guess what— a new premium. We haven't seen the latter point yet and folks that I've talked to informally are of the view that this can't really be quantified in any meaningful way at this point, so the actuaries are stumped and it's difficult to set premiums for or to predict the magnitude of the liability. They might attempt to do something creative like providing limited insurance for the cost of litigating or defending some of these claims like the Attorney General action against General Motors or the village of Kivalina claims and things like that. But as far as taking on the underlying liability, I have not seen an effort by the insurance industry to do that. So I think what we should be looking for in the near term are efforts to carve it out of existing policies, which means that folks will have to be very vigilant about purchasing new policies or renewing old policies.

LEONARDO GUGLIELMI: OK. Thank you very much. I think our time is almost over here, so I'd just like to remind once again all energy committee members to join us for our next committee meeting on December 16 at 4 PM Eastern time. And with that I'm going to hand it over to Roberto so he can conclude this webcast.

ROBERTO SCALESE: Thank you Leo. And thank you Marialuisa and David for that excellent presentation. On behalf of the Association of Corporate Counsel and SmartPros Legal and Ethics, thank you again for listening to today's program. For those users who want to apply for CLE, please log back into your SmartPros account and click on the course listing in your "My Courses" page. Follow the directions there to enter the verification codes and print your certificate.

This program is now concluded. Thank you again and have a great day.