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Episode 2

Wildfires, disclosures, and D&O litigation risks

Welcome to the *Powered* by Marsh FINPRO podcast. Through a series of interviews with experts from across the energy and power industry, host Grace Brighter will examine key challenges and opportunities brought by the energy transition, and how to approach and manage the evolving management liability risks this transformation brings.

Sarah Baldys:

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I am Sarah Baldys, US power and renewables leader at Marsh's financial and professional liability practice, and I am pleased to introduce the host of the *Powered* by Marsh FINPRO podcast, Grace Brighter.

Grace Brighter:

Hello and welcome to *Powered* by Marsh FINPRO. I am your host, Grace Brighter.

For our discussion today, I am joined by Peter Stokes, Partner at Norton Rose Fulbright.

Peter Stokes has spent his entire career representing clients in securities lawsuits, SEC enforcement matters, internal investigations, corporate governance matters, and complex commercial litigation matters. In today's episode we are discussing wildfires, specifically relating to event-driven litigation.

Hey Peter, thanks for joining us today.

Peter Stokes:

Thanks, Grace, for the introduction, and thanks everybody for participating in this podcast today. With respect to event driven litigation, I think of these as catastrophe-driven cases, these are securities cases including securities, class actions and derivative cases that are sparked by catastrophic events such as wildfires, environmental disasters, explosions, accidents, maintenance failures, as well as high profile corporate scandals and government raids and enforcement actions, and those types of things.

We tend to draw a distinction between event driven cases, which aren't really financial as much as the traditional accounting and guidance and earnings cases that make up such a large part of the Securities Litigation filings that get made every year…so these are, like the name suggests, event-driven cases driven more so by events, bad events, as opposed to missed financial performance or accounting restatements or financial disclosures.

Grace Brighter:

Thanks for that overview, Peter. I think now we can pivot to event-driven litigation specifically as it relates to the energy and power sector and then maybe take a deep dive into some of the D&O claim activity that has been out there recently, specifically relating to wildfire events. You know, if you could walk us through what these claims look like, what what's being alleged and how these claims develop over time, that would be great.

Peter Stokes:

Absolutely. And these wildfire related cases, I think we've all seen the news about the California and Hawaii wildfires, over the past couple of years. These have been really catastrophic and awful. Events that have resulted in substantial loss of life, substantial property damage. They are very tragic. They have also resulted in a number of securities, class and derivative filings in California and in Hawaii.

And these filings, they tend to track the same format that we've seen in other event-driven cases. They target a wide variety of disclosures, and they tend to be more qualitative disclosures about environmental risks, about steps the companies have taken to improve their maintenance and safety practices, as well as statements, risk disclosures and other public statements in SEC filings and in other forums as well.

We know that at least one case, one major wildfire case was actually dismissed on the pleadings, and that was affirmed by the 9th Circuit, and so - and that decision was consistent with what we see in a lot of event driven cases where courts say, the statements are too…that the challenge statements are too generalized to support liability and that the company made adequate risk disclosures.

But some of the other cases are still pending and there have been large settlements already paid in some of these cases. There was a $117 million settlement in in involving one major utility on fiduciary duty claims. I believe that the class action disclosure claims are still pending. There was another $10 million settlement more recently involving disclosure claims about blackout management and de-energizations, in California.

And unfortunately in other event driven cases, we've seen similar settlements. These cases can really produce the full spectrum from complete dismissals at early stages to high dollar settlements in the eight or nine figure ranges and whether you have a large settlement. A dismissal often does come down to some relatively simple disclosure issues, and I think it just, again, speaks very strongly to the importance of having careful disclosure practices and making sure the cautionary statements are sufficient and fully accurate.

Grace Brighter:

Thank you, Peter. Umm, would you be able to elaborate on some of those statements that you just touched on that are being challenged?

Peter Stokes:

Absolutely.

So plaintiffs, of course, love to scour SEC filings and they will look for statements about investments, making substantial investments in maintenance and wildfire mitigation systems and practices, particularly with respect to vegetation management practices for Public Utilities and preventing wildfires.

These are statements in the more qualitative parts of the SEC disclosures, so they are, that you'll see statements and the risk disclosures that plaintiffs challenge, where, they'll be generalized disclosures, sometimes, that there are climate change risks and risks from weather events and dried vegetation, and the plaintiffs actually will say that those are misleading because they falsely suggest that the cause of these wildfires is purely external, when in fact that the real cause is the, you know, the allegedly poor maintenance practices and failure to clear vegetation on the part of the utilities.

So companies have to be particularly careful how they phrase risk disclosures to avoid creating that kind of impression. The plaintiffs will also argue that risk disclosures and the SEC filings are misleading because they suggest they may suggest that a possible risk hasn't yet materialized, or is purely theoretical, or is something that might only happen down the road, when in fact that risk has already materialized.

For example, the plaintiffs and the wildfire cases will say that there are already maintenance problems and defective equipment or defective utility poles that that pose a current danger, as opposed to simply a future danger. So companies have to be really careful about what goes into those risk disclosures.

As you probably would expect, plaintiffs also scour ESG reports and other ESG related disclosures. They have picked up on statements, for example, that utilities where they've said they've replaced traditional power lines with insulated conductor systems to improve reliability, the plaintiffs will say that, you know, the facts on the ground show otherwise, and that those types of steps haven't really been taken on a systematic level. Statements in ESG reports about tree trimming and vegetation management, plaintiffs will say that the actual facts on the ground again belie those statement, and, that the vegetation management efforts are insufficient, plaintiffs have also targeted other public disclosures, outside what we call the traditional SEC and investor disclosure universe, they have targeted statements made in the media, they've targeted website disclosures, they've targeted public testimony and filings with utility commissions and other regulatory bodies, not just the SEC.

And I think that's something companies really need to keep in mind as well that when a plaintiff brings a securities class action, every public disclosure out there is fair game for plaintiffs to challenge, and so that there really needs to be a focus on making sure all disclosures are consistent, and that that there's proper oversight and centralized thought, and care so that the company speaks with a, you know, one voice and has a consistent accurate message about these kinds of issues.

So we see these kinds of statements targeted across the board in just all types of event driven cases, and particularly in the wildfire context, the plaintiffs have, really, they've perfected the art, so to speak, of challenging, you know, these sorts of qualitative statements and trying to turn them into significant monetary settlements.

Grace Brighter:

Well, great. Thank you, Peter, for walking us through some of that relevant litigation on, you know a very high level. It's really important for us to understand how these claims do evolve. As I'm sure we will only continue to see more of these cases moving.

Would you be able to speak to some of the arguments defendants made for dismissal in these cases?

Peter Stokes:

Absolutely. And I think the good news here is that a lot of event driven cases are dismissed early, unfortunately quite a few are not. And oftentimes the distinction between a case that's dismissed and a case that settles for a large amount can come down to wording choices and just being more careful about making risk disclosures. And so, for example, the defendants in these cases, the case that was dismissed that I mentioned, they successfully argued, number one, that the statements that were being challenged about environmental priorities and making investments to prevent wildfires, that those statements were too generalized to be materially misleading.

And those arguments often work.

There's a lot of case law out there that say you can't bring claims over these kinds of really generalized disclosures, but I also caution that courts struggle with that issue, and that you can't always rely on the so-called puffery argument, that statements are too generalized, because if there's a severe discrepancy between those statements and the facts on the ground, you may get a court finding what appears to be a generalized statement to be sufficiently concrete, to be material.

The defendants have also argued successfully in some of these cases that the cautionary language would have disabused a reasonable investor of any misleading impression that wildfires were not a significant risk, and particularly when the disclosures say that there are existing maintenance issues as opposed to simply future hypothetical risks, or climate risks, when companies disclose that they are now experiencing maintenance issues, or that they have, you know, certain inspections that have, you know, turned up outdated equipment or possible vegetation issues, or actual vegetation issues, that those kinds of disclosures tend to be more effective in getting courts to dismiss early, as opposed to more generalized disclosures that simply say a risk might occur in the future, or that we have climate risk generally.

And then likewise, defendants have been able to argue in some of these cases that other public disclosures like PUC filings and media reports about high profile, you know, previous wildfires and environmental issues, that those types of disclosures also should put investors on notice that there is a substantial risk of future wildfires and current wildfires.

Again, remember the flip side of that, though, is that plaintiffs themselves can turn around and argue that those same documents and public filings and media reports by, you know, press, press releases, media statements by companies, that those are themselves misleading and can independently support a basis for a possible claim.

So, I think there is a, that there is certainly hope in a lot of these cases that courts will grant dismissal, but whether a court grants dismissal often comes down to simply how these qualitative disclosures are phrased, and whether they either disclose existing issues or whether they're construed as simply, you know, too, too generalized, and too hypothetical and simply disclosing, you know, future risks as opposed to existing issues.

Grace Brighter:

Just to round out the conversation, Peter, you definitely touched on this a little bit now just speaking on those dismissals, but taking it a step further, what conclusions can really be drawn and what lessons can be learned from these current and historical event-driven litigation matters you mentioned?

Peter Stokes:

Absolutely. So I think, number one, process is just so critically important with respect both to disclosures as well as to general board oversight of wildfire risk. The difference again between a case that gets dismissed and a case that survives often comes down to making sure that somebody is watching the company's disclosures in a systematic and centralized way to make sure that they're consistent, that they don't overstate what the company has done, and that there there's just a consistent accurate message.

I think it's really important to have a input from legal counsel. Many companies have disclosure committees where they've got input from different levels of management plus legal counsel to make sure that the statements line up with facts on the ground.

Again, with respect to risk disclosures and qualitative disclosures, I really believe that in many cases, changing a few words and tweaking the disclosure to make clear that there are present tense risks as opposed to simply future risks, I think taking care to say that we, a company for example has current maintenance issues or has, you know, existing facilities that they know are not compliant or have maintenance shortcomings, that is a much more effective disclosure from a liability, securities liability standpoint, than simply disclosing that we operate in a wildfire prone area and are susceptible to climate change and may have risks down the road.

So I think that it's making disclosures more present tense focused in in warning about existing issues as opposed to simply blaming climate change or making risks seem purely hypothetical or future oriented. I think that is a clear distinction between cases that get dismissed and cases that don't.

And then I think on the board process side, it's really important to have good board minutes and good board materials that that really document that the board members are thoughtfully considering wildfire risks, that they're getting reports from management about what the company is doing to mitigate those risks and that they can walk out of every board meeting with confidence that, even if the company hasn't fully remediated all issues or doesn't have an ironclad 100% guarantee that there's never going to be a problem, at least the company is taking reasonable steps, and has a plan in place, to remediate potential wildfire issues.

So I think it's important to document that you know, the courts, particularly in Delaware, will sometimes fault companies for not having sufficient board minutes that corroborate, that the directors are exercising adequate oversight…that also can spell the difference, sometimes between an early dismissal and a case that that hangs around for years and results sometimes in a very large settlement.

So I think it really does come down to having a sound process in place for internally policing the public disclosures and then making sure there's a good record that the board is doing what it needs to do considering mission critical risks, and especially wildfire related risks and that that they have a reasonable basis to be confident in, in the companies policies and procedures on those issues.

Grace Brighter:

Well, this has been a wonderful conversation. I want to thank you, Peter, not only for your time, but also for, you know, offering your expertise in this area. It is very valuable for our colleagues and our trading partners to really learn a little bit more about this space and topic, which is definitely one at the forefront of conversations with our clients. So we really appreciate it.

Peter Stokes:

Thanks so much for the opportunity.

Grace Brighter:

That's all for this edition of *Powered* by Marsh FINPRO. We hope you enjoyed our discussion and thank you for listening. You can rate, review, and subscribe to *Powered* by Marsh FINPRO on Spotify, Apple Podcasts, or any other app you're using. You can also follow Marsh on LinkedIn or X.

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