Rising Tides and Rising Risks:

The Impact of Climate Change on Corporate Securities Litigation

KEY TAKEAWAYS:

- **Climate-related litigation is on the rise.** The number of climate change lawsuits in the U.S. quintupled over the last decade, exposing corporations to increased legal and financial risks.
- **Shareholders hold directors and officers accountable.** Corporate leaders are facing litigation for failing to adequately prepare their companies for climate change risks, signaling a shift to greater boardroom accountability.
- **Directors and officers can play a key role in helping reduce liabilities.** Board members and executives should take steps to proactively mitigate the risk of climate-related liabilities to their companies, including securing appropriate D&O coverage.

Evidence linking climate change to an increase in severe weather events has grown in both clarity and urgency over the past few decades. Factors such as rising global temperatures, shifts in atmospheric patterns and warming oceans are prominent markers of climate change causing extreme weather events across the globe.

In 2023, there were nearly 400 global climate disaster events with economic losses totaling $380 billion.

Climate change exposes companies to a wide range of risks, including and beyond physical damage to infrastructure. According to Moody's RMS, the number of climate change-related court cases quintupled in the U.S. over the last decade. More and more, investors are holding corporate leaders accountable for not preparing their companies for extreme weather events.

According to Harvard Law School,

> *"Event-driven lawsuits seek to compensate shareholders, who allege that a company has recklessly concealed or misrepresented business or operational risks, leading to a catastrophic event that, among other things, drives down the company's stock price."*

Indirect Paths to D&O Liability: More Than Physical Liability

Directors and officers may face liability for physical damage or for non-physical, indirect climate-related impacts, even if there is no direct damage to company assets. In such instances, securities litigation can arise from damage to customers, operational failures, supply chain disruptions and leadership's inability to pivot in the face of climate change risks.

EXAMPLE: Lawsuits over Failure to Disclose and Mitigate Wildfire Risks

Public utilities companies have faced withering litigation in the aftermath of a number of recent wildfires for failure to prevent and mitigate wildfire damage. This includes securities litigation against directors and officers. In these cases, shareholders alleged that companies did not properly warn against, and failed to mitigate, wildfire risks.

EXAMPLE: Climate-Driven Canal Closures Trigger Supply Chain Disruption

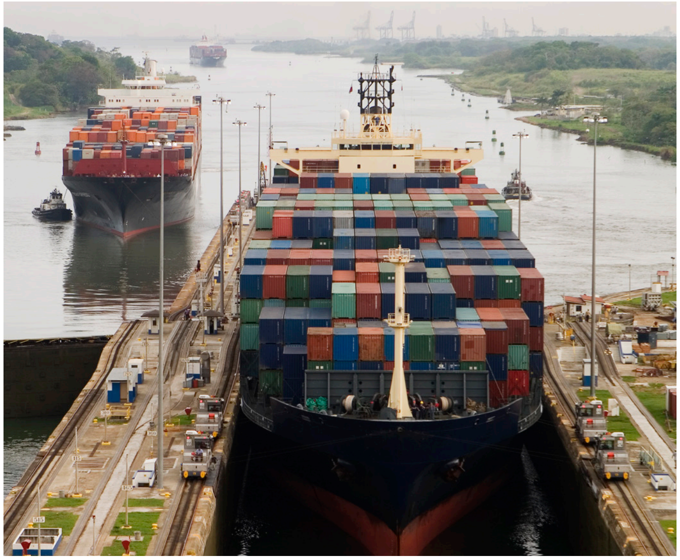
A recent drought in Central America disrupted global supply chains when Panama Canal operators were forced to reduce the number of vessels transiting the waterway to conserve water. Companies had to reroute cargo ships around the tip of South America, which led to significant delays, increased transportation costs and business reputational damage. Incidents like this have become more frequent in recent years and can result in liability for directors and officers.

EXAMPLE: Airline Faces Legal Action from Inadequate Storm Response

A large commercial airline experienced reputational and financial damage when a winter storm, exacerbated by climate change, overwhelmed its crew scheduling platform, forcing the cancellation of over 16,000 flights. The airline eventually paid a large civil penalty and hundreds of millions of dollars in cash, vouchers and airline miles in an effort to make passengers whole. Even with minimal damage to physical assets, companies with sprawling networks may be exposed to liability.

EXAMPLE: Legal Action Highlights Risks from Inadequate Energy Transition Planning

In 2023, a U.K. nonprofit organization ClientEarth filed a shareholder derivate action against Shell's board of directors alleging that leadership of the energy conglomerate "breached their legal duties under the [U.K.] Companies Act by failing to adopt and implement an energy transition strategy that aligns with the Paris Agreement." Although eventually dismissed, the case signals a broader movement among shareholders to hold business leaders accountable for failing to adjust operational strategies in response to developing regulatory frameworks and changing consumer sentiment.



Proactively Managing D&O Risks

The risk of climate change-related litigation has never been greater, and the implications for corporate enterprise risk management will likely grow in the coming years.

When evaluating a company's D&O liability coverage, underwriters are increasingly focused on the effectiveness of a company's enterprise risk management process in identifying and responding to climate-related risks.

With climate-related liabilities expanding, corporate leaders are increasingly expected to take steps to safeguard themselves and their companies. Management teams that understand how D&O underwriters evaluate these risks will improve outcomes with lower insurance costs and better coverage.

Key D&O Questions Underwriters Ask:

- What are the key climate risks that could impact the company's core business, and how well are these risks being managed?
- Is the company taking a proactive approach to these risks?
- How does the company integrate these risks into financial planning and disclosures?
- Does the company's climate risk reporting satisfy the needs of investors and other stakeholders?
- How does the company ensure disclosures are reliable?

Take Action to Minimize Your Risk

As they seek to minimize liability and secure insurance coverage for climate-related D&O risks, boards may want to consider implementing the following best practices:

1 Assess Board Structure

As boards evaluate their approach to climate-related matters, it is important they assess their own governance structures as they pertain to climate oversight.Depending on the materiality of climate-related risks, boards should consider which individuals or teams to identify, evaluate and manage these risks. It may be appropriate for the board to establish a dedicated climate committee based on the risk-level they identify.

2 Engage Outside Expertise

Engaging external subject matter experts (SMEs) for guidance can support a board's ability to ensure climate resilience strategies are appropriate and comprehensive. SMEs can help identify vulnerabilities, and they can ensure that the board and high-level managers receive necessary information prior to acting. Underwriters typically view the presence of SMEs as a positive governance indicator, helping reduce the risk of mismanagement or inadequate disclosure.

3 Evaluate Management Oversight Strategy

When considering mitigation initiatives, it is prudent for boards to review the role senior management plays in implementing those initiatives. This may include requiring executives to develop and commit to short-, medium- and long-term goals. Further, boards can reinforce accountability and encourage proactive risk management by tying executive incentives directly to the achievement of those goals.

4 Review Reporting and Regulation

Directors and officers should assess how the company discloses climate-related risks, opportunities and strategic decisions to meet the growing expectations of investors and stakeholders. Where necessary, corporate leaders should ensure the company clearly and consistently discloses material climate-related risks, opportunities and strategic decisions. Ensuring the accuracy and reliability of these reports is critical to maintaining shareholder trust and meeting government regulations.

In Conclusion

As climate risk intensifies, corporate leaders should identify and mitigate these exposures by aligning risk management processes and corporate governance. At the same time, they should work closely with their insurance brokers and underwriters to make certain their D&O coverage adequately protects them against potential liabilities resulting from climate change. Talk to your brokers and insurers about the steps your company is taking to identify, prepare for and mitigate the potential climate change impacts facing your company.

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