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The Martin Act: Using New York's "Blue Sky" Law to Require Enhanced Disclosure by CO₂ Emitters

The issue of climate change has garnered much attention in recent years, and there has been an increasing chorus of demands by environmental activists, and a growing contingent of supporters, that policymakers regulate carbon dioxide emissions. One of the recent initiatives in the United States comes from Ceres, a network of investors, environmental organizations and other public interest groups, who, together with Environmental Defense, has filed a petition with the U.S. Securities and Exchange Commission ("SEC") seeking a requirement that publicly traded companies assess and disclose in their SEC filings risks they face related to climate change. The SEC has never established specific guidance on climate change-related disclosure, and the petition remains pending with the SEC.

New York State Attorney General Andrew M. Cuomo was a signatory to this petition, but his activism in the area of climate change disclosure did not end there. In the absence of SEC guidance, Cuomo has sought to compel certain companies in the energy industry to disclose their carbon dioxide emissions and climate change-related risks. Relying on New York's powerful but little-known Martin Act, Cuomo subpoenaed five publicly-traded companies that are connected directly or indirectly to the construction of new coal-fired power plants, demanding additional information relevant to their analysis of climate risks in connection with their business and disclosure of those risks to investors.

This memorandum discusses the broad application of the Martin Act and its potential relevance to Canadian companies whose operations emit significant quantities of carbon dioxide.

What is the Martin Act?

The Martin Act is New York State's "blue sky" law, intended to protect New York investors from fraud in the offer and sale of securities. The terms of the Martin Act have been broadly interpreted, making it one of the most powerful blue sky laws in the United States. The Martin Act permits the New York Attorney General to file civil or criminal charges of fraud in connection with the offer and sale of securities in and from New York State. It also grants the Attorney General potent investigative powers,

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including a broad right to undertake administrative discovery and the ability to subpoena any document from anyone doing business in New York. Those who are subpoenaed to give testimony are not granted a right to counsel nor a right against self-incrimination. Failure to comply with a Martin Act investigative subpoena constitutes *prima facie* proof of fraud. Moreover, neither scienter nor intent to defraud need to be alleged or proven to sustain liability under the Martin Act, nor does actual damage need to be established for liability to accrue. Temporary or permanent injunctive relief is also available and can be used to halt the offer or sale of securities in the state.

The Martin Act was originally passed in 1921, before the passage of the national securities laws that created the Securities Exchange Commission. The eventual passage of federal securities laws did not displace or pre-empt the Martin Act. However, despite the broad powers that it conferred upon the New York State Attorney General, the Martin Act was largely unused until the former New York Attorney General, Elliot Spitzer, resurrected the law to prosecute alleged corruption at some of Wall Street's most prominent institutions, such as stock spinning by several major investment banks and after-hours trading by mutual funds. The breadth and strength of the Martin Act, as discussed above, provides the Attorney General with much leverage; companies targeted for investigation tend to cooperate and settle promptly. Spitzer's successor, Andrew Cuomo, has continued to actively use the Martin Act and has extended its application beyond the financial industry to the energy industry.

The Martin Act is Being Used to Compel Increased Disclosure of Climate Change Issues by Publicly Traded Companies

On September 14, 2007, Attorney General Cuomo issued a letter and accompanying subpoena *duces tecum* to, among others, Dominion Resources, Inc., Dynegy Inc., Peabody Energy and Xcel Energy seeking information from each of these companies about their analyses of climate change risk and the disclosure of these risks to investors in their public filings. While Dominion Resources, Inc., Dynegy Inc and Xcel Energy are established power providers, it is worth noting that Peabody Energy is effectively a coal mining company whose only involvement in the power industry is its two development-stage coal-fired electricity generating stations. The Martin Act gives Cuomo the authority to conduct this investigation, and he is able to claim jurisdiction over these companies because they have sold securities in New York.

In August 2008, Cuomo reached a settlement with Xcel Energy, and in October 2008, Dynegy Inc. settled as well. In both settlements, the companies agreed to provide detailed disclosure of climate change and associated risks in their annual reports on Form 10-K. The required disclosures under the settlement agreements include an analysis of financial risks related to i) present and probable future climate change regulation and legislation, ii) climate change related litigation, and iii) physical impacts of climate change. Additionally, the settlement agreements commit the companies to various specific climate change disclosures, including i) total current annual carbon emissions, ii) projected increases in carbon emissions from planned coal-fired power plants, iii) company strategies for reducing, offsetting, limiting or otherwise managing its global warming pollution emissions and expected global warming emissions reductions from these actions, and iv) corporate governance actions related to climate

change, including whether environmental performance is incorporated into compensation decisions. Adding to the pressure on the remaining companies to settle, environmental groups have applauded, and former Vice-President Al Gore has publicly endorsed, the Attorney General's efforts and the enhanced disclosure in the two settlements.

Relevance to the Canadian Energy Sector

As both Xcel Energy, as a Minnesota company, and Dynegy Inc., as a Texas company, discovered, even outside their home jurisdiction and geographic area, as public companies that issue securities in New York, they were subject to the Martin Act and Cuomo's aggressive use of it to promote greenhouse gas emission-related disclosure. The rest of the energy sector, including Canadian corporations in the energy sector who sell securities in New York, should be mindful of the reach of the Martin Act and Cuomo's focus on climate change disclosure. The Martin Act is noteworthy even to Canadian companies that use the U.S.-Canadian Multijurisdictional Disclosure System ("MJDS"), by which the U.S. securities laws permit qualifying Canadian issuers to register securities in the United States using a Canadian prospectus subject only to Canadian securities disclosure requirements and to meet U.S. reporting obligations by filing Canadian continuous disclosure documents.¹ Because the Martin Act is not pre-empted by the federal securities laws, Canadian companies relying on MJDS are unable to avoid the application of the Martin Act if they issue securities in New York. Moreover, just as Cuomo turned his attention to companies involved in coal-fired electricity generation, he could expand his efforts to include other companies whose operations emit significant quantities of carbon dioxide, for example, companies with operations in the Canadian oilsands.

However, while looking to companies with operations in the Canadian oilsands may be consistent with Cuomo's goal to increase the environmental disclosure provided by energy-intensive companies, it should be noted that the energy companies that have so far been subpoenaed are directly or indirectly responsible for carbon dioxide emissions that impact New York State from out-of-state sources (that is, Midwestern U.S. coal-fired electricity generating plants). While it is the issuance of securities in New York, rather than emissions in the state, that determine the legal application of the Martin Act, the political difficulties of launching investigations against issuers who are not domestic New York companies and who do not release carbon dioxide pollution in the state will likely be sufficient, at least in the near term, to limit Cuomo's activism to those companies responsible for significant greenhouse gas emissions reaching New York state.

The Attorney General is Using the Martin Act to Fill the Void in Federal Guidance on Climate Change Disclosure

Cuomo's campaign to increase the scope and detail of climate change-related disclosure by publicly traded energy companies contrasts with the lack of detailed guidance on climate change disclosure by the SEC. The U.S. federal securities laws generally require companies to report material or potentially material matters, implicitly including material effects of climate change but do not provide a detailed description of

¹ SEC Release No. 34-29354 (June 21, 1991).

what ought to be included in such disclosure. The SEC has not yet responded to the Ceres petition discussed above and has not issued guidance on climate change disclosure.

While the Martin Act provides a powerful tool by which the New York State Attorney General may pursue a climate change-related agenda, in the imminent future it is unlikely that Cuomo will direct his attentions to Canadian oil and gas companies with interests in the oilsands whose securities are traded in New York. But with growing political pressure to regulate disclosure related to greenhouse gas emissions and to climate change related risk, Cuomo's future use of the Martin Act merits a watchful eye by all stakeholders.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decisions should be based solely on its content. Questions concerning the issues addressed in this memorandum can be addressed to:

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