

# **Bond Case Briefs**

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## **Have California Munis Misled Investors And Bond Insurers About Climate Risk?**

### **Summary**

- Last summer, seven California cities and counties sued 17 oil and gas energy producers claiming that they have created a public nuisance and have caused climate change related damage.
- Given the severity and specificity of the claimed harm and damages sought, it is peculiar that the disclosures in the plaintiff's municipal and city bond issuance documents are very limited.
- There is little doubt that these suits have been the result of the dissatisfaction some states feel towards federal environmental and energy policies.

Last summer, seven California cities and counties sued 17 oil and gas energy producers claiming that they have created a public nuisance and have caused climate change related damage that has increased sea levels in California and exposed the plaintiff governments to massive damages from natural disasters. Exxon Mobil (XOM) has now filed a petition, in District Court, to depose a number of people in the matter.

This is the latest in a series of lawsuits brought by California, Massachusetts, Vermont, and New York and a small number of other cooperating state and local governments against auto, utility, and energy-producing businesses.

Given the severity and specificity of the claimed harm and damages sought, it is peculiar that the disclosures in the plaintiff's municipal and city bond issuance documents make very limited disclosures of any climate change risks. As a result, it appears these suits will either (A) create new economic risks and hazards for bond investors and, in the case of 'wrapped' deals, the bond insurers that wrap those California municipal debts or (B) provide the investors and bond insurers with the information with which to claim they have been defrauded by those municipalities.

Ironically, as a result of the subprime mortgage crisis, many of the same California counties that brought these latest environmental lawsuits filed suits against the five largest municipal bond insurers for "forcing" local governments to needlessly buy bond insurance in order to get higher credit ratings and issue debt with lower interest rates.

### **Analysis**

We have compiled a full analysis of each municipal bond issued within each plaintiff geography and all relevant details. In the coming days, we will quantify the wrapped versus unwrapped exposures and, in the case of an insured transaction, the bond guarantor. In 2016 and 2017 alone, these issuers sold bonds with over \$25.36 billion of principal amount.

### **Have the tables turned?**

The lawsuits against Chevron (CVX), Exxon Mobil, BP (BP), Shell Oil (RDS.A) (RDS.B) and over a dozen other firms now may provide the bond insurers and investors with a cause of action against

the California plaintiffs in this case for failure to disclose, in bond deals, what it claims are massive environmental risks and damages to those counties and cities.

While the lawsuits claim significant harms to those cities and counties, those harms were not disclosed in the hundreds of bond issuances by those governments. In fact, while the plaintiffs in the suits claim grave and specific harms, their bond filings were largely silent on those risks and harms. As The Wall Street Journal highlighted in a headline today: "California Municipalities' Debt Disclosures Contrast With Climate Warnings." As a result, the issuers were almost certainly able to benefit from lower issuance costs that they would have been had they disclosed the risk to investors and, in the case of bonds that were wrapped by bond insurers, they likely paid lower insurance premiums than they would have had they fully disclosed the risks to the insurers.

As example, the City of Oakland claimed, in the lawsuits massive fossil-fuel production causes a gravely dangerous rate of global warming and ongoing and increasingly severe sea level rise harms to Oakland and that by 2050, a hundred year flood will occur every 2.3 years. These claims are in stark contrast to Oakland's disclosures in its bond disclosures in this they state:

"The City is unable to predict when seismic events, fires or other natural events, such as sea rise or other impacts of climate change or flooding from a major storm, could occur, when they may occur, and, if any such events occur, whether they will have a material adverse effect on the business operations or financial condition of the City or the local economy."

Similarly, San Francisco, another plaintiff, claims it is planning to fortify its Seawall in an effort to protect itself from rising sea levels and that the short-term costs of doing so will be more than \$500 million with long-term upgrade costs of \$5 billion. In San Francisco's bond disclosures, it has stated:

"The City is unable to predict whether sea-level rise or other impacts of climate change or flooding from a major storm will occur, when they may occur, and if any such events occur, whether they will have a material adverse effect on the business operations or financial condition of the City and the local economy."

Similar inconsistencies exist between the claimed harms and bond disclosures of Marin County, San Mateo County, the City of Imperial Beach, the County and City of Santa Cruz (the other plaintiffs in the lawsuits).

If one looks at the history of state, municipal and local lawsuits against various parties for damages related to their contribution to climate change, it becomes clear that these suits are actually targeting environmental federal policies through legal actions against federally regulated entities.

## **Background**

In 2004, eight states, three land trusts, and the City of New York filed two coordinated lawsuits against five power generation companies, including American Electric Power (NYSE:AEP). The cases were consolidated as *Connecticut v. Am. Elec. Power Co.*, 406 F. Supp. 2d 265 (S.D.N.Y. 2005). The plaintiffs alleged the pollution created by the defendants generation of power led to global warming and constituted a public nuisance under federal common law.

In 2006, California Attorney General filed another related lawsuit, this time against the six-largest

U.S. automakers. The suit alleged the automakers' emissions contributed to global warming and that the State had suffered property and other damage as a result.

In 2011, the Supreme Court ruled against the plaintiffs, and for the industry, in the AEP suit. In the Opinion of the Court, Justice Ginsberg stated: "[W]hen Congress addresses a question previously governed by a decision rested on federal common law," the Court has explained,

"the need for such an unusual exercise of law-making by federal courts disappears... We hold that the Clean Air Act and the EPA actions it authorizes displace any federal common law right to seek abatement of carbon-dioxide emissions from fossil-fuel fired power plants. Massachusetts made plain that emissions of carbon dioxide qualify as air pollution subject to regulation under the Act. 549 U. S., at 528-529. And we think it equally plain that the Act "speaks directly" to emissions of carbon dioxide from the defendants' plants."

The current suit by five California municipal governments is filed as tort complaints against Exxon Mobil and 17 other energy companies accusing them of harms associated with rising sea levels. While we believe the chances of success by the plaintiffs are remote, the risks they create for all parties are meaningful and worth watching.

## **Politics**

While each of these suits targets different business interests commonly associated with climate change and global warming risks there is little doubt that these suits have been the result of the dissatisfaction some states feel towards federal environmental and energy policies. As example, in explaining the basis for the AEP lawsuit, one of the strategists behind it stated,

"the cases were brought in response to the lack of response from the George W. Bush Administration to the climate change crisis. Specifically, the public nuisance lawsuit, seeking only injunctive relief, was filed after the Administration announced it would not support amendment of the Clean Air Act to impose new emissions limits on CO<sub>2</sub>, and after the White House disavowed the Kyoto Protocol".

## **Seeking Alpha**

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