Shareholder litigation puts a spotlight on environmental risk

July 12 2016, by Madison Condon, Earth Institute, Columbia University

Bento Rodrigues, destroyed by a flood of chemical-laced water and sludge after a tailings dam collapsed in Brazil in November 2015. Credit: Columbia University

Rule 10b of the Securities Exchange Act gives shareholders the right to bring a lawsuit to recover economic loss sustained as a result of fraud related to the trading of their investments in stocks or bonds. This fraud can come in many forms, including insider trading, price fixing or corporate misrepresentations to its investors. This last type of fraud has seen increased attention (primarily at the state level) from those who want to see corporate statements regarding future environmental liabilities, including climate change impacts.

In the past year, lawsuits against three different foreign-owned mining companies operating in South America were brought in U.S. courts regarding mismanagement and lack of disclosure of environmental risk.

The Canadian mining company Barrick Gold announced in May that it had reached a preliminary agreement to pay [$140 million to settle claims] brought by shareholders regarding its failure to comply with [environmental regulations] at its mining operation on the Chile-Argentina border. And both Vale and BHP Billiton are on the receiving end of [multiple shareholder lawsuits] stemming from the tragic collapse of a tailings dam operated by its Brazilian joint venture, Samarco.

Barrick acquired the proposed site for its Pascua-Lama mine in 1994: a gold ore deposit at 15,000 feet in the Andes mountains, buried under, and surrounded by, fragile glaciers. Due to doubts over water quality from the nearby community, and national concern over destruction of the glaciers, it was difficult for Barrick to obtain the necessary permits to begin construction of the mine.

It finally gained approval after agreeing to 400 separate environmental conditions imposed by the Chilean government. Barrick was required to implement dust control mechanisms to prevent particulate matter from reaching the glaciers, and to construct an elaborate water management and treatment system. However, during the initial phase of construction, Barrick realized that there was not enough water available at the site to perform adequate dust control on its roads, yet declined to purchase chemical alternatives to prevent the dust from reaching the glaciers.

Barrick also modified the water management plan without seeking approval from Chilean regulators.

In April 2013, when a Chilean appeals court issued an injunction against further construction of the Pascua-Lama mine and indicated that Barrick was potentially liable for $10.2 million in fines for failure to comply with environmental regulations, Barrick's stock price fell 8.4 percent. On May 24, 2013, the Chilean government suspended the project, citing 23 violations of an environmental permit, and imposed a fine of $16 million. Barrick halted trading of its stock for several hours following the news, but its stock price nevertheless dropped approximately 2 percent.

Prior to these events, Barrick made repeated statements to its shareholders that it was in compliance with all permits and environmental legislation. In March of this year, the U.S. judge overseeing the securities litigation ruled that Barrick's misstatements regarding its environmental compliance meant that investors could not accurately weigh their investment risk. After this ruling, the parties reached a preliminary settlement agreement for $140 million, which is awaiting court approval.

Last November, an iron ore tailings dam collapsed in Brazil, releasing around 60 million cubic meters of mining waste into the Doce River Basin, and destroying the village of Bento Rodrigues. Seventeen people were killed, hundreds were displaced, and the tailings waste, containing mercury and arsenic, flowed more than 300 miles downstream to the Atlantic Ocean.

Vale and BHP Billiton jointly owned the corporate operator of the dam, Samarco. Following the tragedy, it additionally came to light that Vale regularly deposited waste from its own mining operations into the faulty tailings dam.

Several shareholder class actions have been filed against Vale and BHP Billiton alleging that the corporate parents had information indicating that the dam had structural weaknesses and yet did not take steps to mitigate the disaster. An additional group of shareholders that purchased Vale stock after the disaster occurred are suing on the basis of alleged misstatements regarding the contents of the spill. Following the spill, Samarco and BHP made repeated statements that the tailings waste released into the river basin was not harmful to human health. However, both the United Nations and a local Brazilian research institute reported that levels of lead, copper and chromium were many times higher than the legal maximum.

All of the cases filed against Vale and BHP are awaiting class certification and consolidation.

Brazilian independent prosecutors have likened the Samarco disaster to the 2010 Gulf of Mexico oil spill, saying, "(u)nless one wishes to suppose that the environment of Brazil is worth less than that of the U.S., it's inadmissible that the valuation of the environmental damage caused by the defendant companies falls below, at first glance, the $43.8 billion acknowledged by the party responsible for the tragedy in the Gulf of Mexico." The BP oil spill disaster similarly spawned many shareholder class actions, and the success and failure of these lawsuits may shed light on the future of the Samarco securities litigation.

Early last month oil giant BP agreed to pay $175 million to settle a shareholder class-action lawsuit over statements it made regarding the 2010 Gulf oil spill. The shareholders in this class, all of whom had purchased BP stock after the spill had occurred, accused BP of making misleading statements regarding the severity of the spill and its ability to clean up the disaster. The shareholders in the action argued that they would not have chosen to invest their money in BP if they had known just how much oil was being released into the Gulf. This settlement is in addition to the 2012 agreement reached between the Securities and Exchange Commission and BP for $525 million, the third largest penalty obtained in commission history.

In both cases, the underlying complaint of fraud was that BP had made repeated statements to investors that oil was leaking from the Macondo well at the rate of 5,000 barrels of oil per day despite knowing that the actual rate was more than 50,000 barrels per day.

A second class of shareholders, those who had purchased stock before the spill occurred, were blocked from proceeding with their complaint alleging that BP had deliberately overstated its ability to manage potential disasters and had created an "impression that the risk of catastrophic risk was lower than it actually was." The court declined to certify the pre-spill class, explaining that even if BP had misrepresented the risk, they lacked a "clear causal link between the misrepresentation and the economic loss."

The court hypothesized with an example, that if BP had reported the risk of the blowout at around 0.5 percent, while the actual risk was in fact 2 percent, there were certainly some high-risk investors in the class who would have continued to purchase BP stock, although at a reduced price. The court reasoned that it was not able to separate out this class of investors and therefore any securities fraud claims regarding pre-spill misrepresentation of risk management had to be brought as individual actions rather than as part of a class.

Based on the types of claims that were allowed to proceed against BP, it is reasonable to conclude that shareholders could have a more successful claim against Vale for alleged misstatements regarding the toxicity of the material released into the Boce River, rather than more generalized allegations of misrepresentations of Samarco's ability to manage risk.

Shareholder litigation of the type discussed here may serve as one additional incentive to companies to avoid environmental mismanagement. These lawsuits may police undisclosed environmental risks, promote transparency, and in the long term encourage better internal corporate risk management policies.

Unlike direct tort litigation over the disaster itself, however, the payments awarded in these types of cases can serve only a punitive function. None of the money paid out by the company makes it into the hands of the community impacted by the disaster or goes toward remediating the environmental damage.

In the case of the Samarco disaster, the settlement reached with the Brazilian authorities requires a total minimum payout of $1.1 billion. (This amount was deemed insufficient by independent prosecutors who announced in May they would be seeking $44 billion in damages in a civil suit and accused the government of "selling out.")

Given that shareholders of BHP and Vale stock could potentially recover hundreds of millions of dollars in a securities class action, the punitive effect of this payout relative to the total amount required by the official settlement is significant.

This story is republished courtesy of the Earth Institute, Columbia University: blogs.ei.columbia.edu/ .

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Citation: Shareholder litigation puts a spotlight on environmental risk (2016, July 12) retrieved 26 April 2024 from
https://phys.org/news/2016-07-shareholder-litigation-spotlight-environmental.html