

Energy and Sustainability **ADVISORY**

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Climate Disclosure Obligations under Securities Laws Imposed by New York Attorney General under Precedent-Setting Settlement

Against the backdrop of steadily increasing controversy over climate change and the prospect of significant new regulatory obligations on U.S. companies as to their greenhouse gas footprints, a major energy company has recently succumbed to the claim that *current* securities laws, rules, and regulations require wide-ranging disclosures related to climate change in Securities and Exchange Commission (SEC) filings. Under threat of an enforcement action by the Attorney General of New York, Xcel Energy, Inc. (Xcel) has reached a settlement that could have wide-ranging implications for climate change reporting and for obligations of private companies to compile and analyze information, both to their potential impacts on climate change and the potential impacts of climate change (including, but not limited to, likely new legal regimes) on the financial performance of companies. Although Xcel may be arguably distinguishable from other companies because of the extent of its greenhouse gas (GHG) emissions, the structure of the settlement does not depend on that fact, and the mere existence of the settlement is likely to fan the flames of pressure on a wide range of companies to alter their affairs in light of climate change concerns.

Background of the Settlement

Over the past several years, companies have faced increasing pressure to make voluntary public disclosures related to climate change. For example, the Carbon Disclosure Project (CDP), a consortium of 280 institutional investors with over 41 trillion dollars under management, actively urges companies to disclose GHG emissions and climate change mitigation plans so that investors may weigh the information when making decisions. Additionally, a petition for rulemaking pending with the SEC seeks to have the SEC specifically require companies to disclose information related to GHG emissions and climate change planning.

These voluntary pressures now have taken a turn toward potential compulsory obligations on public companies. In September of 2007, New York initiated an investigation into the adequacy of the public disclosures of five energy companies, issuing subpoenas for documents and information to those companies, including Xcel. After examining information, including Xcel's SEC filings and its submissions to the CDP, New York asserted that the company's SEC filings inadequately addressed the expected impacts of climate change and climate change regulation on Xcel's operations, financial conditions, and plans to construct additional power plants.

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While investigations into the other four energy companies are ongoing, an August 27, 2008, settlement resolves New York's investigation as to Xcel and obligates Xcel to disclose in its SEC Form 10-K filings extensive information related to its own GHG emissions, as well as the possible impacts to its business from climate change, climate change regulation, and potential climate change litigation. This settlement is noteworthy because the terms could be seen as effectively establishing the minimum standards for a proper "climate change disclosure." Further, it underscores the potential viability of the argument that climate change disclosures are required under existing SEC rules and regulations, a result that could give shareholders, regulators, or others a powerful weapon to effectively force companies to not only make disclosures but also to undertake extensive data gathering and climate change related analyses—activities not previously thought required.

Required Disclosures under the Settlement

The information that Xcel must disclose under the settlement is similar in nature and detail to the information that companies must disclose under Items 101, 103, and 303 of SEC regulation S-K, except that the settlement specifically requires information related to climate change. Indeed, Xcel is obligated to disclose the material financial risks that it faces as a result of both present and probable future climate change regulation, as well as physical impacts associated with climate change, e.g., sea-level rise. Similarly, Xcel must disclose the financial risks that it may face as a result of litigation related to climate change pending in any court in any jurisdiction in which Xcel operates or to which Xcel is a party. The settlement further requires Xcel to

- state its position on climate change;
- estimate its GHG emissions and anticipated emission increases;
- describe emission reduction strategies;
- outline the past and anticipated future impact of those strategies; and
- disclose the role of its board of directors with respect to climate change and indicate whether officer compensation is in any way tied to environmental performance, including climate change related objectives.

The Settlement in a Broader Context

The broader significance of the settlement between New York and Xcel, though, is that it may spark shareholder demand, litigation, or regulator allegations that any company's SEC filings are inadequate because of the failure to disclose financial and operating risks related to climate change. Similarly, claims may increasingly be made that Item 303 of SEC Regulation S-K, Management's Discussion and Analysis (MD&A), requires companies to discuss their strategic positioning on climate change. As part of its MD&A disclosure, a company must "identify any known trends . . . events or uncertainties that . . . are reasonably likely to result in" a company's liquidity changing materially. Because of

associated costs and risks, commentators have suggested that climate change and carbon regulation may affect a company's financial condition, may affect the results of a company's operations, and can arguably be characterized as known trends or uncertainties. Companies should also bear in mind, however, that this argument has not been solidified by court rulings or existing SEC guidance.

Moreover, the New York action highlights the risks public companies may face when they engage in public statements or participate in voluntary "disclosure" schemes such as the CDP without considering the potential for inconsistencies between those statements and their SEC disclosures. One of the chilling aspects of the subpoenas that began this matter was the implicit threat that such comparisons would be made. Given that corporate Environmental Health & Safety personnel have often addressed climate change issues as a public relations matter, the potential for inconsistencies between such public statements and SEC disclosures is very real.

Moving Ahead

The terms of the Xcel settlement underscore the need for public companies to consider climate change assessments and strategic planning so that they may be in a position to avoid or respond to investigations like that faced by Xcel, as well as potential litigation related to climate change disclosures. Consequently, it is important for companies to, at the very least, be familiar with the relationship between climate change related information and the SEC regulations, in general, as well as any non-SEC related "disclosures" the company may make. The contours of the Xcel settlement may act as an important precedent for handling both the disclosure of this information, as well as the increased scrutiny of such disclosures.

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