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SEC Issues Interpretive Release on Climate Change Disclosure

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On February 2, 2010, the U.S. Securities and Exchange Commission (SEC) published an interpretive release regarding disclosure obligations of public companies relating to climate change.

An interpretive release, as opposed to a formal rule, goes into effect upon publication in the *Federal Register*. To read the interpretive release, [click here](#).

The guidance was long-sought by numerous institutional investors, including Ceres (a national coalition of investors and environmental groups) and the California Public Employees Retirement System, which have filed several petitions with the SEC over the past few years requesting clarification on requirements for climate change reporting. The guidance suggests that companies should review their reporting practices relating to climate change under existing standards due to recent regulatory, legislative, and other developments, including reputational factors arising from increased public concern. (To read a previous Ballard Spahr alert regarding such developments, [click here](#).) The guidance also makes clear that the SEC will give heightened scrutiny to the adequacy of climate change disclosure to determine if further guidance or rulemaking is necessary.

SEC Chairman Mary Schapiro stated that the guidance is intended to provide clarity to companies in assessing what information to disclose and ensure consistency in the application of the disclosure rules. In fact, the guidance does not amend the "well-defined rules concerning public company reporting obligations, nor redefin[e] long-standing interpretations of materiality," but rather emphasizes that a company should be engaging in the type of evaluation so as to give management enough information to determine whether certain disclosures need to be made. The release highlights a number of new developments—such as the Environmental Protection Agency actions in making an "endangerment finding," adopting new greenhouse gas emissions reporting rules, and issuing proposed rules affecting large emitters such as power plants—as factors requiring review of disclosure under existing standards.

The release points out that a company should not limit the information considered in preparing its Forms 10-K and expects management to consider all relevant information even if not required to be disclosed when making its materiality determination. Once management looks at such information, it may determine that the risks or opportunities arising from climate change are not material and that no disclosure is necessary. The release also indicates—as

with other trends, demands, commitments, events, or uncertainties in the MD&A section—that management must make two assessments: whether such events are likely and, if so, the consequences if such events should come to fruition. Registrants should also consider disclosure of the difficulties in assessing the timing and effect of the pending legislation or regulation.

Although such guidance does not create new legal requirements, the SEC has sought "to remind companies of their obligations under existing federal securities laws and regulations" to assess and disclose risks they face from climate change. The release encourages companies to review the adequacy of their disclosure controls and procedures when preparing Forms 10-K to ensure that material information that promotes an understanding of financial condition, liquidity and capital resources, changes in financial condition, and results of operations is disclosed. Companies should have adequate processes and controls in place to ensure that they have sufficient financial and nonfinancial information to measure and identify climate-related risks and information. Disclosures of climate change risks can be found outside of publicly filed disclosure documents. Therefore, companies should consistently report information in SEC filings, voluntary disclosures such as press releases, and other reports filed as a result of regulatory requirements.

The release reviews the most pertinent nonfinancial statement rules requiring disclosure of climate change risks and discusses "some of the ways climate change may trigger disclosure" under existing rules and regulations.

The release indicates that Items 101 (Business), 103 (Litigation), 503(c) (Risk Factors), and 303 (MD&A) of Regulation S-K require disclosure of impacts due to existing and pending federal and state legislation and regulation, as well as international treaties and accords, if such impacts are material. Such impacts could include: (i) costs to purchase, or profits from sales of, allowances or credits under cap and trade programs; (ii) expenditures for facilities and equipment improvements to reduce greenhouse gas emissions to comply with regulatory limits or mitigate the financial consequences of a cap and trade law; or (iii) changes to profit or loss arising from increased or decreased demand for goods and services produced by registrant due to legislation or regulations and, indirectly, from changes in costs of goods sold.

The SEC noted that legal, technological, political, and scientific developments may create new opportunities or risks that should be disclosed in a company's risk factors, MD&A or, if significant enough, in the description of its business. The indirect consequences of regulation or business trends may consist of:

- A decreased demand for goods that produce significant emissions
- Increased demand for goods that result in lower emissions than competing products
- Increased competition to develop innovative new products

- Increased demand for generation and transmission of energy from alternative sources
- Decreased demand for services related to carbon based energy sources

Shifts in a company's plan of operation, such as material acquisitions of plants or equipment to take advantage of potential opportunities and adverse consequences from reputational damage, should be disclosed if the facts and circumstances make these opportunities, obligations, and consequences material to its business operations or financial condition.

The SEC noted that companies whose personnel, physical assets, supply chain, and distribution chain may be vulnerable to severe weather- or climate-related events should consider disclosure of those material risks or consequences. The effect of significant physical impacts of climate change on a company's operations and results may include: (i) property damage; (ii) disruptions to its operations or the operations of its customers or suppliers; (iii) increased insurance claims and liabilities for insurance and reinsurance companies; (iv) decreased agricultural production capacity in areas affected by drought, flooding, or other weather-related changes; and (v) increased insurance premiums and deductibles or a decrease in the availability of coverage for plants and operations in areas subject to severe weather.

In addition to the above rules, the SEC noted that, pursuant to Rule 408 under the Securities Act of 1933, as amended, and Rule 12b-20 under the Securities Exchange Act of 1934, as amended, companies must disclose "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading" and also noted that companies should consider financial statement implications under applicable accounting standards.

The SEC states that it will monitor the impact of the release on company filings as a part of its ongoing disclosure review program. The SEC's Investor Advisory Committee will also provide advice and recommendations on these issues, and the SEC intends to convene a public roundtable on climate change disclosure this spring. The SEC will evaluate input from these sources in determining whether additional guidance or rulemaking is required.

Ballard Spahr's Securities Group assists clients in complying with public reporting, proxy, and disclosure obligations. Please do not hesitate to contact Gerald J. Guarcini (215.864.8625 or guarcini@ballardspahr.com), C. Baird Brown (215.864.8518 or baird@ballardspahr.com), Adiah I. Ferron (215.864.8523 or ferrona@ballardspahr.com), or any member of the group with questions.

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