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SEC Releases Guidance on Climate Change Disclosure

On February 2, 2010, the Securities and Exchange Commission issued an interpretive release providing guidance on existing SEC disclosure requirements and how they apply to business or legal developments relating to the issue of climate change.¹

The interpretive release does not create new legal requirements or modify existing ones — it is intended to provide clarity and enhance consistency. SEC Chairman Mary Schapiro noted that the SEC is not opining on whether the world's climate is changing, at what pace it might be changing, or due to what causes it might be changing. The guidance is intended to help public companies in determining what does and does not need to be disclosed under existing rules.

The SEC's existing disclosure requirements include the following non-financial disclosure rules which may require disclosure related to climate change:

- **Description of Business (Regulation S-K Item 101):** requires disclosure of material effects on capital expenditures, earnings and competitive position of compliance with federal, state and local regulation relating to the protection of the environment.
- **Legal Proceedings (Regulation S-K Item 103):** requires disclosure of material pending legal proceedings, or material legal proceedings contemplated by a governmental authority and more specifically, of proceedings relating to the protection of the environment that exceed certain monetary thresholds.
- **Risk Factors (Regulation S-K Item 503(c)):** requires disclosure of the most significant factors that make an investment in a company's securities speculative or risky.
- **Management's Discussion and Analysis (Regulation S-K Item 303):** requires disclosure of, among other things, known trends, events, demands, commitments and circumstances that are reasonably likely to have a material adverse effect on the company's financial condition or results of operation. The SEC has long-standing guidance on MD&A disclosure which companies have been working with for a number of years.
- **Form 20-F and F-1/F-3 Rules for Foreign Private Issuers:** have disclosure requirements which parallel many of the Regulation S-K disclosure rules described above for domestic issuers (although some requirements may not be as prescriptive).

The SEC noted that climate change has become a topic of intense public discussion in recent years and there have been a number of national and international developments in the area of climate change, including:

¹ SEC Release Nos. 33-9106; 34-61469; FR-82. A copy of the release is available on the SEC's website at www.sec.gov/rules/interp/2010/33-9106.pdf.

- A number of U.S. state and local governments have enacted legislation and regulations related to greenhouse gases and federal legislation has been proposed that would implement a “cap and trade” system of allowances and credits.
- The U.S. Environmental Protection Agency recently began requiring large emitters of greenhouse gases to collect and report data on emissions, covering 85% of the nation’s greenhouse gas emissions generated.
- The European Union Emissions Trading System was launched as an international “cap and trade” system of allowances for emitting certain greenhouse gases based on the mechanisms set up under the Kyoto Protocol.
- Insurance regulators recently promulgated a uniform standard for mandatory disclosure by insurance companies to state regulators of financial risks due to climate change and actions taken to mitigate such risks.
- In 2007, the New York State Attorney General launched an investigation of five energy companies relating to climate risk analysis and the disclosure of such risk to investors, leading to settlements and agreements to disclose climate change risk in SEC filings.
- Voluntary disclosure initiatives, such as the Climate Registry, the Global Reporting Initiative and the Carbon Disclosure Project, have resulted in a great deal of information being made publicly available outside of disclosure filed with the SEC.

The interpretive release describes some of the ways climate change may trigger disclosure under the existing disclosure rules and regulations and provides examples of climate change related issues that a company may need to consider:

Impact of Legislation and Regulation

Changes in legislation and regulation regarding climate change at both the federal and state level may trigger increased disclosure obligations. Such developments could have a significant effect on operating and financial decisions, including those involving capital expenditures to reduce emissions and, for companies subject to “cap and trade” laws, expenses related to purchasing allowances where reduction targets cannot be met.

In its release, the SEC outlines the following ways in which disclosure rules may be triggered by new or changed climate change legislation and regulation:

<i>Description of Business</i>	Disclosure of any material estimated capital expenditures for environmental control facilities for the remainder of a company’s current fiscal year and its succeeding fiscal year and for such further periods as deemed material is required.
<i>Legal Proceedings</i>	Legal proceedings may arise out of changes in climate change-related legislation and regulation. In addition, if a company is aware of actions contemplated by governmental authorities, it must disclose such contemplated actions. The instructions to Item 103

provide some specific requirements that require disclosure of certain environmental litigation.

Risk Factors

Additional risk factor disclosure regarding existing or pending legislation or regulation that relates to climate change may be required depending on a company's particular circumstances, for example, companies in the energy industry or companies reliant on products that emit greenhouse gases.

MD&A

Management must assess whether enacted climate change legislation or regulation is reasonably likely to have a material effect on the company's financial condition or results of operation. In addition, for known uncertainties, such as pending legislation or regulation, management must evaluate whether the pending legislation or regulation is reasonably likely to be enacted, and, if enacted, whether it is reasonably likely to have a material effect on the company, its financial condition or results of operations. Unless it is not reasonably likely to be enacted or to have a material effect on the company, disclosure is required. In addition, the company must consider disclosure, if material, of the difficulties involved in assessing the timing and effect of pending changes in law.

Furthermore, the SEC emphasizes that disclosure should not be limited to only negative consequences and changes in law or the business practices of a company in response to a change in law that provides it with new opportunities should be disclosed. For example, if a "cap and trade" emissions program is established under pending legislation, new trading markets for emission credits may develop and a company may have the ability to profit from the sale of allowances resulting from emissions levels being below its allotment.

Examples of possible consequences of pending legislation and regulation related to climate change enumerated by the SEC include:

- Costs to purchase, or profits from sales of, allowances or credits under a "cap and trade" system;
- Costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a "cap and trade" regime; and
- Changes to profit or loss arising from increased or decreased demand for goods and services produced by the company arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

International Accords

Companies should consider, and disclose when material, the impact on their business of treaties or international accords relating to climate change remediation, such as the Kyoto Protocol and the EU ETS. While the U.S. may not have adopted or ratified such international accords, such as the Kyoto Protocol,

they could still have a material impact on companies with operations in adopting nations that file disclosure documents with the SEC.

The potential sources for disclosure obligations under the SEC’s disclosure rules mirror those outlined under “Impact of Legislation and Regulation” above.

Indirect Consequences of Regulation or Business Trends

Indirect effects of regulatory developments and business trends related to climate change should also be disclosed. Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies and may create demand for new products or services, or decrease demand for existing products or services.

The SEC highlighted the following ways in which disclosure may be triggered indirectly by climate change regulation or business trends:

<i>Description of Business</i>	These developments may have a significant enough impact on a company’s business to require disclosure under Item 101. For example, a company that plans to reposition itself to take advantage of potential opportunities, such as through material acquisitions of plants or equipment, may be required to disclose this shift in plan of operation.
<i>Risk Factors</i>	Depending on the nature of a company’s business and its sensitivity to public opinion, a company may have to consider whether the public’s perception of any publicly available data relating to its greenhouse gas emissions could expose it to potential adverse consequences to the business operations or financial condition resulting from reputational damage.
<i>MD&A/Risk Factors</i>	<p>Possible indirect consequences or opportunities of regulation or business trends enumerated by the SEC which might require MD&A (and potentially risk factor) disclosure include:</p> <ul style="list-style-type: none"> • Decreased demand for goods that produce significant greenhouse gas 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 energy sources; and • Decreased demand for services related to carbon-based energy sources.

Physical Impacts of Climate Change

Significant physical effects of climate change, such as effects on the severity of weather, sea levels, arability of farmland, and water availability and quality, have the potential to affect a company's operations and results. A company whose business may be vulnerable to severe weather or climate related events should consider disclosing material risks of, or consequences from, such events.

Examples of possible consequences of severe weather enumerated by the SEC in its release include:

- For companies with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products;
- Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
- Increased insurance claims and liabilities for insurance and reinsurance companies;
- Decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
- Increased insurance premiums and deductibles, or a decrease in the availability of coverage, for companies with plants or operations in areas subject to severe weather.

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The SEC emphasized that the interpretive release merely serves to remind companies of their obligations under existing rules and regulations to consider climate change and its consequences in preparing disclosure documents to be filed with the SEC and provided to investors. The SEC will monitor the impact of the interpretive release as part of its ongoing disclosure review program. Going forward, the SEC plans to hold a public roundtable on disclosure regarding climate change matters in the spring of 2010 and will continue to consider whether further guidance or rulemaking related to climate change disclosure is necessary or appropriate.

**Our client alerts are for general informational purposes and should not be regarded as legal advice.
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