

ADVISORY | Securities

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SEC USHERS IN NEW SEASON FOR CLIMATE CHANGE DISCLOSURE

Earlier in the day of President Obama's first State of the Union address, one in which he again called for legislative action on climate change issues, the Securities and Exchange Commission voted to give "guidance" to public companies on climate change disclosure.¹ Chairman Mary Schapiro was careful to set correct legal and policy context, pointing out that the agency was creating no new or revised legal standard and signaling no opinion on "whether the world's climate is changing, at what pace it might be changing, or due to what causes." The guidance, she said, is simply intended to "ensure that our disclosure rules are consistently applied."²

None of this comes as a surprise. The agency has been petitioned for years by environmental and investor groups to speak in this area, and, last Fall, SEC Commissioner Elisse Walter foreshadowed the result in a Chicago speech where she said, "We are taking a very serious look at our disclosure system in [the climate change] area. ... And, I believe that it is time for us to consider issuing interpretive guidance regarding disclosure in this area."³

The vote of the five-person Commission earlier this week, however, split 3-2 on party lines and proved that even an unremarkable reminder about existing disclosure requirements can stoke an already heated debate. With certainty, and even accounting for the exaggerated importance that will be placed on this week's action, the SEC's guidance will result in heightened attention to climate change-related disclosures by both investors and regulators.

SUMMARY OF GUIDANCE

The new guidance lays out four broad climate change-related issues companies should consider in preparing disclosures. These are:

- the direct impact of potential new legislation or regulation dealing with climate change,
- the potential impact of international accords and treaties dealing with climate change,
- the actual and potential indirect consequences of climate change and potential climate change legislation and regulation, and
- the actual and potential impacts of the physical effects of climate change on operations.

The guidance indicates that these four issues are relevant to the disclosure requirements in several areas, as described below.

¹ Our description of the SEC's upcoming interpretive release is based on the agency's press release and statements at its open meeting on January 27, 2010. The full text of the interpretive release is not yet available.

² Chairman Mary Schapiro, [Statement Before the Open Commission Meeting on Disclosure Related to Business or Legislative Events on the Issue of Climate Change](#) (Jan. 27, 2010).

³ Commissioner Elisse B. Walter, [SEC Rulemaking--'Advancing the Law' to Protect Investors](#), Speech to 48th Annual Corporate Counsel Institute, Northwestern University School of Law (Oct. 2, 2009).

Description of Business

Item 101 of Regulation S-K calls for, among other things, a narrative description of a company's business, including recent material changes.⁴ The SEC's interpretive guidance clarifies that, as a part of this disclosure, companies should consider the effects of climate change in several specific respects.

- Item 101(c)(iii) calls for disclosures relating to sources and availability of raw materials. This also may be an area picked up when considering disclosure dealing with the physical effects of climate change.
- Item 101(c)(xii) requires disclosure as to the material effects of environmental compliance on earnings, competitive position and capital expenditures (including those estimated for the balance of the current year and the next and for such further periods as may be material).⁵ As part of this disclosure, companies should discuss any materially adverse effects of potential new legislation or regulation dealing with climate change issues, including, for example, the impact and risks associated with proposed legislation dealing with greenhouse gas ("GHGs") emissions .
- Disclosures should address the indirect effects climate change has on a company's business, including, among other things, changes in demand for certain types of goods, changes in technology, and changes or harm to reputation.

Legal Proceedings

Under Item 103 of Regulation S-K, a company must disclose material pending legal proceedings (but not "ordinary routine litigation incidental to the business") to which the company is a party, including those "known to be contemplated" by government authorities.⁶ This includes, for example, material proceedings under state or Federal laws regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment.⁷ The SEC guidance clarifies that climate change-related disclosures may be appropriate under this item regarding, for example, the risk of litigation or proceedings over GHG emissions.

Management's Discussion and Analysis

Item of 303 of Regulation S-K requires a description of a company's financial condition, changes in financial condition and results of operations.⁸ Generally, Item 303 calls for relevant historic information, by segment where appropriate, dealing with liquidity, capital resources, results of operation, off-balance sheet arrangements and contractual obligations. Under this item, a company is also to disclose "currently known trends, events, and uncertainties that are reasonably expected to have material effects."⁹ Thus, all four of the issues discussed in the interpretive guidance would likely need to be assessed for possible discussion in the MD&A.

Risk Factors

Under Item 503(c) of Regulation S-K, a company must discuss the most significant risks that could affect its business. In discussing the new guidance at the agency's open meeting, the SEC staff noted that the

⁴ 17 C.F.R. §229.101.

⁵ See 17 C.F.R. §229.101(c)(xii).

⁶ 17 C.F.R. §229.103.

⁷ 17 C.F.R. §229.103, Instruction 5.

⁸ 17 C.F.R. §229.303.

⁹ Id. See also Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, Rel. Nos. 33-8350; 34-48960 (Apr. 24, 1987).

risk factors section might include risks arising from (1) potential new legislation or regulations dealing with climate change; (2) indirect risks associated with climate change, including such things as reputational risks, technological changes and changes in demand; (3) potential risks associated with international treaties and accords dealing with climate change; and (4) the actual and potential physical effects of climate change to the company's operations, including changes in availability of natural resources and hazards to property.

EFFECTS OF THE NEW INTERPRETIVE GUIDANCE

The interpretive guidance does not create any new legal requirements or modify existing disclosure rules. As such, it does not mandate any specific climate change-related disclosures. Rather, it clarifies the application of existing disclosure requirements to climate change-related matters. Companies must expect, however, that the SEC staff will follow this guidance as it reviews and comments upon public filings and other disclosures. The guidance will also be a benchmark that informs input from investors and environmental interest groups. Perhaps for these reasons, two members of Congress who weighed in with the SEC against its new guidance offered the hyperbolic, but not totally off-the-mark, prediction that the guidance will be considered by "wise corporations as absolutely binding."¹⁰ At a minimum, in response to the new guidance, companies will want to have a specific disclosure process that considers climate change-related matters as part of the overall controls and procedures surrounding the periodic reporting regime.

As we noted in our [September 25, 2009 E-Alert](#) regarding the Environmental Protection Agency's mandatory GHG emission reporting rule, beginning this year many companies will be required to report to their GHG emission levels to the EPA. In that same E-Alert, we discussed the increasing reputational stakes for companies presented by such efforts as the Carbon Disclosure Project and Newsweek's Green Corporate Rankings. Separately, New York Attorney General Cuomo has entered into consent agreements with several utilities requiring disclosure of their GHG emissions in settlement of investigations of the adequacy of these companies' disclosure practices. The SEC's new interpretive guidance also appears intended to dovetail with these and other public disclosure initiatives related to climate change.

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¹⁰ [Letter from Repts.](#) Joe Barton and Greg Walden to Chairman Mary Schapiro (Jan. 26, 2010).