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SEC issues interpretive guidance regarding disclosure related to climate change

CORPORATE GOVERNANCE AND CAPITAL MARKETS ALERT

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On February 2, 2010, the SEC issued an interpretive release to provide guidance to public companies regarding the SEC's existing disclosure requirements as they apply to climate change matters.

"Climate change" generally refers to the potential effects of greenhouse gas emissions on our environment and related environmental concerns. Climate change has become a topic of intense public discussion in recent years, including among scientists, government leaders, legislators, regulators, businesses, investors, analysts and the public at large. It is the subject of several federal, state, local and international laws, with the prospect of further regulations and developments to come. Climate change and other environmental disclosures have also been the subject of notable state securities enforcement actions, as well as numerous shareholder proposals calling for additional disclosures.

In its new interpretive release, the SEC does not create new legal requirements or modify existing ones, but it does express its views regarding when climate change disclosures are required under current securities laws and regulations. Accordingly, public companies should carefully consider their climate change and other environmental disclosures in light of the new interpretative guidance.

The relatively short, 29-page interpretive release is available [here](#).

Existing Rules Requiring Disclosure of Climate Change Issues

The SEC has encouraged disclosures regarding material environmental issues since the 1970s, when it initiated several rulemaking efforts spawning extensive litigation and public hearings. Ultimately, this process culminated in the adoption of rules in 1982 requiring the current environmental disclosures in certain reports and registration statements.

In its new interpretive release, the SEC indicated that the following disclosure items may trigger climate change or other environmental disclosures:

- ▶ **Description of Business.** Item 101 of Regulation S-K requires a registrant to describe its business and that of its subsidiaries, including, among other topics, the material effects that compliance with environmental laws may have upon capital expenditures, earnings and competitive position, as well as material estimated capital expenditures for environmental control facilities.
- ▶ **Legal Proceedings.** Item 103 of Regulation S-K requires a registrant to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party, generally including proceedings arising under environmental laws that are material to its business or financial condition, involve an amount that exceeds 10 percent of consolidated current assets, or to which a governmental authority is a party involving potential monetary sanctions of \$100,000 or more.
- ▶ **Risk Factors.** Item 503(c) of Regulation S-K requires a registrant to discuss the most significant factors that make an investment in the registrant speculative or risky.
- ▶ **Management's Discussion and Analysis.** Item 303 of Regulation S-K requires disclosure known as Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), which should provide material historical and prospective textual disclosure enabling investors to assess the financial condition and results of operations of the registrant. Among other things, MD&A should discuss important trends, demands, commitments, events or uncertainties that could have a material impact on the registrant's liquidity, capital resources or results of operations.
- ▶ **Foreign Private Issuers.** Although the disclosure obligations of foreign private issuers are principally set forth in Form 20-F, the foregoing disclosure requirements in Regulation S-K have direct parallels under Form 20-F.

How Existing SEC Rules may Require Climate Change Disclosures

In its new interpretive release, the SEC provided guidance of how the existing disclosure items set forth above may require disclosure regarding the impact of climate change. Depending on the facts and circumstances of a particular registrant, the SEC indicated that the following topics may trigger disclosure obligations.

Impact of Legislation and Regulation. Significant developments in federal, state and local law relating to climate change may trigger various disclosure obligations under the following existing rules:

- ▶ **Description of Business.** Existing federal, state and local provisions relating to greenhouse gas emissions may require disclosure of material estimated capital expenditures for environmental control facilities for the remainder of a registrant's current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material.
- ▶ **Risk Factors.** Registrants should consider specific risks they face as a result of climate change legislation or regulation and avoid generic risk factor disclosure that could apply to any company. For example, registrants that are particularly sensitive to greenhouse gas legislation or regulation, such as registrants in the energy sector, may face significantly different risks from climate change legislation or regulation compared to registrants that currently are reliant on products that emit greenhouse gases, such as registrants in the transportation sector.
- ▶ **MD&A.** A registrant must assess whether any enacted climate change legislation or regulation is reasonably likely to have a material effect on its financial condition or results of operations. For known uncertainties, such as pending climate change legislation or regulations, management should first evaluate whether it is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, management must then determine whether the legislation or regulation is reasonably likely to have a material effect on the registrant, its financial condition or results of operations. Unless management determines that a material effect is not reasonably likely, MD&A disclosure is required. In addition to disclosing the potential effect of the pending legislation or regulation, the registrant should also consider disclosure, if material, of the difficulties involved in assessing the timing and effect of the pending legislation or regulation.

The SEC also noted that changes in the law, or in the business practices in response to the law, may provide new opportunities for registrants that should be discussed.

Examples of potential MD&A disclosure may 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.
- ▶ Changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

International Accords. The SEC indicated that potential disclosure obligations related to international accords are the same as those discussed above for US climate change regulation. In satisfying their disclosure obligations, registrants whose businesses are reasonably likely to be affected by international accords should monitor the progress of any potential accords and consider their possible impact.

Indirect Consequences of Regulation or Business Trends. The SEC indicated that legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for registrants that merit disclosure. Possible indirect consequences or opportunities may include decreased demand for goods that produce significant greenhouse gas emissions, increased demand for goods that result in lower emissions, 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, such as drilling services or equipment maintenance services. The SEC indicated that such indirect consequences may trigger disclosure obligations under the following existing rules:

- ▶ **MD&A.** MD&A disclosure may be required if material business trends or risks are presented.
- ▶ **Risk Factors.** Risk factor disclosure may be required if material risks are presented. The SEC specifically noted that registrants should consider whether climate change may indirectly impact a registrant's reputation. Depending on the nature of a registrant's business and its sensitivity to public opinion, a registrant 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 its business operations or financial condition resulting from reputational damage.
- ▶ **Description of Business.** If the indirect consequences of legal, technological, political or scientific developments have a significant enough impact on a registrant's business, disclosure may be required in the registrant's business description. For example, if a registrant plans to reposition itself to take advantage of new potential opportunities, such as through material acquisitions of plants or equipment, then that disclosure should be included in its business description.

Physical Impacts of Climate Change. The SEC noted that significant physical effects of climate

change, such as effects on the severity of weather (for example, floods or hurricanes), sea levels, the availability of farmland and water availability and quality, have the potential to affect a registrant's operations and results. This may include property damage, disruptions to manufacturing or distribution, disruptions to the operations of major customers or suppliers, decreased agricultural production capacity and increased insurance premiums and deductibles or decreases in the availability of coverage.

The SEC indicated that registrants whose businesses may be vulnerable to severe weather or climate related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents. Presumably, such disclosure could be appropriate in risk factors, MD&A and the description of business, depending on the circumstances. These issues may have particular application to insurance or agricultural companies.

Conclusion

The SEC indicated that it will monitor the impact of its climate change interpretive release on company filings, which may suggest that it is planning to use the release as the basis for comments in 2010. The SEC also indicated that it will consider whether further guidance or rulemaking relating to climate change disclosure is necessary or appropriate. We will also continue monitoring climate change disclosure developments to assist public companies in considering appropriate disclosures in their SEC reports and registration statements.

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