

## SEC Provides Guidance on Climate Change-Related Disclosure

February 8, 2010

On January 27, 2010, the Securities and Exchange Commission (“SEC”) voted 3-to-2 to provide public companies with guidance on disclosure requirements with respect to climate change.<sup>1</sup> Several of the SEC Commissioners and the Staff emphasized that the interpretive release, “Commission Guidance Regarding Disclosure Related to Climate Change,” does not amend the rules regarding companies’ reporting obligations, nor does it redefine existing standards of materiality. As Chairman Mary Schapiro stated, the release is intended to “provide clarity and enhance consistency” for public companies and the investor community.

The Commissioners were divided in their support for the interpretive guidance. In voting against adoption of the guidance, Commissioners Kathleen L. Casey and Troy A. Paredes expressed concerns that the guidance was not needed in light of existing, well-defined rules and could cause some companies to provide burdensome disclosure with limited benefit to investors’ decision-making. On the other hand, Commissioner Elisse B. Walter expressed concern that some public companies are providing too much of their climate change disclosure outside of their SEC filings, perhaps signaling the need for companies to refocus on their disclosure documents. Commissioner Luis A. Aguilar emphasized that companies should be well aware of their greenhouse gas (“GHG”) emissions so that they can adequately evaluate the associated risks, adding that this guidance is only “a first step in an area where the Commission will begin to play a more proactive role . . . to consider the environment in our regulatory action.”

The release becomes effective today with its publication in the Federal Register.

### Review of Existing Disclosure Obligations

#### *Regulation S-K*

In the release, the SEC reminded companies of the provisions of Regulation S-K that may require disclosure of climate change related matters.

---

<sup>1</sup> Release Nos. 33-9106; 34-61469; FR-82; 75 Fed. Reg. 6290 (February 8, 2010), can be found at <http://www.sec.gov/rules/interp/2010/33-9106.pdf>.

- Item 101 - Description of Business
  - Material effects that compliance with environmental laws may have on capital expenditures, earnings and competitive position
  - Material estimated capital expenditures for environmental control facilities for the current and subsequent year and any further periods that are material
  
- Item 103 - Legal Proceedings
  - Material pending legal proceedings to which the company is a party or its property is subject, or known contemplated governmental actions
  - Administrative or judicial proceedings on environmental matters if:
    - Material
    - A claim for damages or potential monetary sanctions, capital expenditures, deferred charges or charges to income of more than 10 percent of current assets
    - A governmental authority is a party and potential monetary sanctions of at least \$100,000
  
- Item 503(c) - Risk Factors
  - Significant factors that make an investment in the company speculative or risky, with the risk and its effect on the company stated clearly
  
- Item 303 - MD&A
  - Management's view of the company's financial condition, changes in financial condition and results of operations *and* its prospects
  - Known trends, events, demands, commitments and uncertainties that are *reasonably likely* to have a *material* effect on financial condition or results of operations

- *Materiality*
  - A substantial likelihood a reasonable investor would consider it important in making an investment decision or the information would alter the total mix of information available<sup>2</sup>
  - All relevant information to be considered in making a *materiality* determination, even if no disclosure is made
  - Sufficiency of disclosure controls and procedures to be considered
  
- *Reasonably likely*
  - No disclosure if known trend *not reasonably likely* to occur
  - If management cannot make that determination, disclosure required, *unless* a material effect on the financial condition or results of operations *not reasonably likely* to occur<sup>3</sup>
  - Disclosure required of difficulties involved in assessing the amount and timing of uncertain events
  
- No future “cut-off” date for this analysis and disclosure
  - Any other information necessary to an understanding of financial condition, changes in financial condition and results of operations

### ***Accounting Standards***

The SEC reminded companies that they must also consider the financial statement implications of climate change under the applicable accounting standards.

---

<sup>2</sup> Basic Inc. v. Levinson, 485 U.S. 224 (1988) and TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976)

<sup>3</sup> Release No. 33-6835 (May 18, 1989)

### ***Foreign Private Issuers***

Foreign private issuers may be required to discuss climate change under Form 20-F disclosure requirements. While generally less prescriptive than regulations applicable to domestic companies, certain items of Form 20-F require disclosure of material risks, the material effects of government regulation on business, environmental issues that may affect the use of assets, management's explanation of factors affecting historical financial condition and results of operations and those anticipated to have a material effect in the future and legal proceedings significantly affecting financial position. Foreign private issuers are also required to provide the Regulation S-K, Item 503(c) risk factor disclosure in Form F-1 and Form F-3 registration statements.

### **Climate Change Related Disclosure**

In the release, the SEC provided four *non-exclusive* examples - "topics" - of climate change related issues that may trigger disclosure under Regulation S-K and suggestions as to where the disclosure should go.

### ***Impact of Legislation and Regulation***

Federal and state legislation and regulation on climate change may require disclosure, and companies should consider the potential impact of pending as well as existing laws and regulations when assessing materiality for disclosure purposes.

Earlier in the release, the SEC summarized recent regulatory, legislative and other developments relating to the regulation of GHG emissions, including:

- U.S. House of Representatives and Senate bills
- State and local initiatives
- Environmental Protection Agency's requirements to collect and report GHG emissions and its GHG endangerment finding
- Kyoto Protocol, the European Union Emissions Trading System and the December 2009 United Nations Climate Change Conference in Copenhagen
- National Association of Insurance Commissioners' uniform standard for disclosure to state regulators of financial risks due to climate change

### ***International Accords***

Companies should consider the impact on their business of international accords and treaties relating to climate change. While past international agreements, such as the Kyoto Protocol, may not have been ratified by the United States, the release notes that many domestic companies' foreign operations nevertheless may be subject to the standards established by such agreements.

### ***Indirect Consequences of Regulation or Business Trends***

Developments regarding climate change, including legal, technological, political and scientific, may have indirect consequences for companies, such as:

- Decreased/increased demand for products with high/low GHG emissions
- Decreased demand for carbon-based energy services, such as drilling or maintenance services
- Increased demand for generation and transmission of energy from alternative sources
- Increased competition to develop new products
- Impact on reputation/public perception
- Increased costs for goods or services from suppliers
- Increased opportunities for investment

### ***Physical Impacts of Climate Change***

The physical effects of climate change may include:

- Changes in weather patterns, such as increasing storm intensity, extreme temperatures and rise in sea levels
- Changes in water availability and quality, as well as the arability of farmland

Companies should assess the actual and potential physical effects of climate change on their business, including their physical assets, supply chain, distribution chain and personnel. The SEC included the following suggestions as to possible effects:

- Property damage, decreased efficiency of equipment, disruption of operations and problems with transportation of products
- Decreased demand for products
- Disruption of operations of major suppliers or customers
- Decreased agricultural production
- Increased insurance claims or premiums and deductibles
- Increased credit risks for banks

***Where Does the Disclosure Go?***

- Item 101 – Business
  - Material effects of compliance with U.S. federal, state and local climate change legislation and regulation as well as international accords on capital expenditures, earnings and competitive position
  - Material estimated capital expenditures for environmental control facilities for GHG emissions for current year, following year and any future time periods that are material
  - Indirect consequences of regulation or trends, if the impact could be significant enough, as, for example, if a company plans material acquisitions of plants or equipment to take advantage of climate change developments
  - Physical effects of climate change on business
- Item 503(c) - Risk Factors
  - Specific risks the company faces, in light of existing or pending U.S. federal, state and local legislation or regulation as well as international accords, including operating costs and capital expenditures, as well as demand for products
  - Specific risks of indirect consequences from climate change legislation or regulation
  - Specific risks of physical effects of climate change on business

The SEC noted that energy sector companies are particularly sensitive to GHG legislation or regulation and may face significantly different risks from companies in other sectors such as transportation that rely on products emitting GHG.

- Item 303 - MD&A
  - Material effects of compliance with existing or pending US federal, state and local legislation or regulation as well as international accords on operations and financial condition, which could be positive or negative
  - Capital expenditures
  - Costs of purchasing, or profits from selling, emission allowances, if “cap and trade” is adopted
  - Indirect consequences of climate change regulation or business trends
  - Physical effects and consequences of climate change on operations and financial results
  - Information for completed periods as well as for future periods, with no time limitation if material

The SEC reminded companies that, under the *reasonably likely to occur* analysis, with respect to pending legislation or regulation, disclosure is required, unless management concludes that:

- The legislation is not reasonably likely to be enacted and
- If enacted, the legislation is not reasonably likely to have a material effect on the company

### **What's Next**

While climate change, and the legislative and regulatory actions developed to counter its effects, are expected to have a broad range of potential impacts on businesses in the United States, the actual impact on an individual company will be determined by a range of business-specific circumstances. It is clear that legislative, regulatory and judicial developments at the federal, state and local levels have the potential to significantly affect the value and profitability of some companies, and investors, lenders, risk managers, insurers and rating agencies have taken note.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

Pursuant to U.S. Treasury Department Circular 230, unless we expressly state otherwise, any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties or (ii) promoting, marketing or recommending to another party any matter(s) addressed therein.

No part of this publication may be reproduced, in whole or in part, in any form, without our prior written consent.

© 2010 Dewey & LeBoeuf LLP  
All rights reserved.

For further information on  
Dewey & LeBoeuf,  
please visit [www.dl.com](http://www.dl.com)

A growing number of electricity generators and other companies with carbon-intensive assets continue to discuss in their public filings the potential impacts of climate change, and it is likely that this guidance from the SEC will result in additional disclosure. The SEC noted in the release that a number of companies have provided information on their GHG emissions outside of their SEC reports to states, the Environmental Protection Agency and groups such as the Climate Registry, the Carbon Disclosure Project and the Global Reporting Initiative and reminded companies that some of this information may need to be disclosed in their SEC filings.

The SEC will hold a public roundtable on climate change related disclosure this spring. The SEC stated that it would take into consideration any recommendations received from the roundtable and the Investor Advisory Committee, as well as its experience in its regular review of disclosure documents, to determine whether future guidance or rulemaking is appropriate.

For the near term, companies in the midst of preparing their annual reports on Form 10-K should take a fresh look at their disclosure in light of this interpretive release.

*If you have any questions regarding the matters discussed in this article, please contact Elizabeth W. Powers at +1 212 259 8662 or [epowers@dl.com](mailto:epowers@dl.com), James A. Thompson, Jr. at + 1 202 346 7822 or [jthompson@dl.com](mailto:jthompson@dl.com), Martin T. Booher at + 1 212 424 7775 or [mbooher@dl.com](mailto:mbooher@dl.com), or your Dewey & LeBoeuf relationship attorney.*