

# PUBLICATIONS

Home > Publications > SEC Issues Interpretive Guidance on...

## SEC Issues Interpretive Guidance on Climate Change Disclosures

Feb 4, 2010

[Print preview](#)

At a meeting held on January 27, 2010, the Securities and Exchange Commission ("SEC") approved by a 3-2 vote an interpretive release (the "Interpretive Release") providing guidance to public companies on the SEC's existing disclosure requirements as they apply to climate change matters. The Interpretive Release makes clear that companies who have not done so should establish a process for assessing whether and to what extent climate change matters are material to the company and, if so, include appropriate disclosures in their SEC filings.[1] This is especially critical for calendar-year companies who will be filing their Annual Reports on Form 10-K in the coming weeks. The Interpretive Release is available at <http://www.sec.gov/rules/interp/2010/33-9106.pdf>.

### Commission Deliberations

The SEC approved the Interpretive Release by a 3-2 vote with Commissioners Kathleen Casey and Troy Paredes dissenting. The Commissioners disagreed on whether the Interpretive Release meant that the SEC was taking a position on climate change.[2] Several Commissioners and the SEC staff emphasized that the Interpretive Release only clarifies existing disclosure obligations and does not alter those obligations or change longstanding interpretations of materiality. However, Commissioner Parades warned that the Interpretive Release may result in additional disclosures that are unlikely to improve investor decision making.[3] A summary of the Interpretive Release, which the SEC published earlier this week, is set forth below.

### Overview of the Interpretive Release

The Interpretive Release states that it is intended to clarify that existing SEC disclosure rules may require public companies to describe climate change matters, including (under Regulation S-K): Item 101 (Description of Business); Item 103 (Legal Proceedings); Item 303 (Management's Discussion of Financial Condition and Results of Operations (MD&A)); and Item 503(c) (Risk Factors). It then discusses four topics that may trigger climate change disclosure under these rules.

**1. The impact of climate change legislation and regulation.** The Interpretive Release states that companies should consider the impact of both existing legislation and regulation and, in some circumstances, pending legislation and regulation related to climate change. Possible disclosures include:

- Under the Item 101 description of business, material effects that compliance with Federal, state and local provisions regulating the discharge of materials into the environment (like greenhouse gas emissions), or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of a company and its subsidiaries. Companies must also disclose material estimated capital expenditures for environmental control facilities to limit greenhouse gas emissions in order to comply with environmental laws for the remainder of a company's current fiscal year, the next fiscal year and additional periods that the company may deem material.
- Risk factor disclosure under Item 503(c) regarding specific risks arising from existing or pending climate change-related legislation or regulation, such as the potential for climate change legislation or regulation to materially increase the company's costs to operate its facilities and the potential impact on demand for the company's products.

### SEARCH PUBLICATIONS

Practice

Topic

Type

[2008 Annual Report](#)

### RELATED PUBLICATIONS

[Securities Regulation and Corporate Governance](#)

[Environmental Litigation and Mass Tort](#)

- MD&A disclosure under Item 303 if any *enacted* climate change legislation or regulation is reasonably likely to have a material effect on the company's financial condition or results of operation. MD&A disclosure of any *pending* legislation or regulation also may be required. A company must first assess whether the pending legislation or regulation is reasonably likely to be enacted. Unless the company determines that it is *not* reasonably likely to be enacted, the company must assume that it will be enacted. The company must then assess whether the legislation or regulation (if enacted) is reasonably likely to have a material effect on the company, its financial condition or results of operation. MD&A disclosure is required unless the company determines that a material effect is *not* reasonably likely. Companies should consider including in any disclosure of pending legislation or regulation both the potential effect and, if material, the difficulties in assessing the timing and effect of the pending legislation or regulation. It is important to note that the Interpretive Release indicates that "reasonably likely" is a lower disclosure standard than "more likely than not."

The Interpretive Release also includes other examples of possible consequences of pending legislation and regulation related to climate change that may need to be disclosed, including costs and profits related to implementation of a "cap and trade" system<sup>[4]</sup> and changes to profit or loss related to increased or decreased demand for goods and services produced by the company.<sup>[5]</sup>

**2. The impact of international climate change accords.** The Interpretive Release notes that, even though the United States has not signed the Kyoto Protocol, some companies operate in signatory countries. Moreover, the Interpretive Release indicates that the European Union is active with respect to climate change matters. Similar to the disclosures discussed above regarding the impact of legislation and regulation, the Interpretive Release advises companies to consider, and disclose under existing SEC rules where material, the impact of international accords relating to climate change.

**3. Indirect consequences of climate change regulation or business trends.** The Interpretive Release indicates that companies should consider actual and potential indirect consequences of climate change-related regulation and business trends. For example, the Interpretive Release suggests that companies may find it important to discuss in the description of business, MD&A and/or risk factors any actual or expected:

- 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 with lower greenhouse gas emissions;
- increased demand for energy from alternative energy sources;
- decreased demand for services related to carbon-based energy sources, such as drilling services or equipment maintenance services;
- increased material acquisitions of plants or equipment to take advantage of potential opportunities related to climate change; and
- risks arising from reputational damage related to climate change, such as possible negative public reaction to data on the company's greenhouse gas emissions levels.

**4. The physical impacts of climate change.** The Interpretive Release also states that companies should consider actual or potential impacts of the physical effects of climate change on their business. For example, the Interpretive Release suggests that companies may find it important to disclose actual or expected physical impacts of climate change such as:

- the impact on a company's employees, physical assets, supply chain and distribution chain of changes in weather patterns, such as the effects of increases in storm intensity, sea-level rise, melting of permafrost and temperature extremes on facilities or operations;
- changes in the availability or quality of water, or other natural resources on which the company's business depends, or damage to facilities;
- financial risks if the company's suppliers are impacted by climate change, such as if a company purchases agricultural products from farms hurt by floods or drought;
- decreased consumer demand for products or services, such as if warmer temperatures reduce demand for residential and commercial heating fuels, service and equipment;

- property damage and disruptions to operations that may result from climate change, such as at companies with operations concentrated on coastlines;
- indirect financial and operational impacts from disruptions to the operations of major customers or suppliers as a result of severe weather, such as hurricanes or floods;
- increased insurance claims and liabilities for insurance and reinsurance companies;
- 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; and
- decreased agricultural production capacity in areas affected by drought or other weather-related changes.

### **What Companies Should Do Now**

In light of the Interpretive Release, public companies (particularly those in industries most affected by climate change matters) should:

1. As part of the company's disclosure controls and procedures, review the existing process or establish a process for assessing the materiality of climate change matters to the company and determine what (if any) disclosures should be included in their SEC filings with respect to climate change matters. The process should include discussions among the company's securities law counsel, environment/safety/health as well as government relations personnel and members of the company's disclosure committee.
2. Assess the company's other public climate change disclosures (*e.g.*, state- and EPA-mandated disclosures, voluntary disclosures in sustainability reports and to third-party organizations like the Carbon Disclosure Project, and disclosures on websites or in investor presentations). The Interpretive Release indicates that, although certain of this reporting is voluntary, some of this information may be required to be disclosed in SEC filings under existing disclosure requirements.
3. Monitor legislative and regulatory developments on greenhouse gas and climate change matters at the international, Federal, state and regional levels,<sup>[6]</sup> and assess the potential impact of such developments on the company's business.

Finally, companies should remain mindful that the SEC will continue to assess public company disclosures relating to climate change matters. The Interpretive Release indicates that the SEC's Investor Advisory Committee is considering such issues as part of its broader mandate to provide advice and recommendations to the SEC. The Interpretive Release also states that the SEC plans to hold a public roundtable on climate change disclosure this Spring and that further guidance or rulemaking relating to climate change disclosure is possible in the future.

[1] See our [client alert](#) issued on September 22, 2008 for more information on other developments regarding disclosure of climate change matters in SEC filings.

[2] SEC Chairman Mary Schapiro stated, "the Commission is *not* making any kind of statement regarding the *facts* as they relate to the topic of 'climate change' or 'global warming.' And, we are not opining on whether the world's climate *is* changing; at what pace it might be changing; or due to what causes. Nothing that the Commission does today should be construed as weighing in on those topics." However, Commission Casey noted, "I can only conclude that the purpose of this release is to place the imprimatur of the Commission on the agenda of the social and environmental policy lobby, an agenda that falls outside of our expertise and beyond our fundamental mission of investor protection."

[3] Commissioner Paredes stated, "it is worth recalling that, in rejecting the view that a fact is 'material' if an investor 'might' find it important, Justice Marshall, writing for the Supreme Court in *TSC Industries*, warned that 'management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information — a result that is hardly conducive to informed decisionmaking.'"

[4] For example, there are two bills pending in Congress that would establish a "cap-and-trade" mechanism for controlling greenhouse gas emissions, The Clean Energy Jobs and American Power Act of 2009 (S. 1733) and The American Clean Energy and Security Act of 2009 (H.R. 2454).

Additionally, the U.S. Environmental Protection Agency ("EPA") has proposed to regulate greenhouse gas emissions from both mobile and stationary sources.

[5] For example, the Federal Renewable Fuels Standard and California's Low Carbon Fuel Standard could impact the demand for fuels derived from various sources.

[6] For periodic updates concerning legal developments in climate change and greenhouse gas matters, see our Environmental News: Climate Change newsletter.



*Gibson, Dunn & Crutcher's lawyers are available to assist in addressing any questions you may have regarding these issues.*

*To learn more about the firm's Securities Regulation and Corporate Governance Practice, please contact the Gibson Dunn attorney with whom you work, or any of the following:*

*John F. Olson (202-955-8522, [jolson@gibsondunn.com](mailto:jolson@gibsondunn.com))  
Brian J. Lane (202-887-3646, [blane@gibsondunn.com](mailto:blane@gibsondunn.com))  
Ronald O. Mueller (202-955-8671, [rmueller@gibsondunn.com](mailto:rmueller@gibsondunn.com))  
Amy L. Goodman (202-955-8653, [agoodman@gibsondunn.com](mailto:agoodman@gibsondunn.com))  
Elizabeth A. Ising (202-955-8287, [eising@gibsondunn.com](mailto:eising@gibsondunn.com))  
Gillian McPhee (202-955-8230, [gmcphée@gibsondunn.com](mailto:gmcphée@gibsondunn.com))*

*To learn more about the firm's Environmental Litigation and Mass Tort Practice, please contact the Gibson Dunn attorney with whom you work, or any of the following:*

*Raymond B. Ludwizewski (202-955-8665, [rludwizewski@gibsondunn.com](mailto:rludwizewski@gibsondunn.com))  
Thomas McHenry (213-229-7135, [tmchenry@gibsondunn.com](mailto:tmchenry@gibsondunn.com))  
Peter E. Seley (202-887-3689, [pseley@gibsondunn.com](mailto:pseley@gibsondunn.com))  
Charles H. Haake (202-887-3581, [chaake@gibsondunn.com](mailto:chaake@gibsondunn.com))*

© 2010 Gibson, Dunn & Crutcher LLP

*Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.*