

February 11, 2010

## SEC Clarifies Climate Change Disclosure Obligations

On February 2, 2010, the Securities and Exchange Commission (the "SEC") announced guidance regarding public companies' disclosure obligations related to climate change.<sup>1</sup> On February 8, 2010, the SEC published that guidance in the Federal Register, at which time it became effective. As a result, calendar year-end companies with upcoming annual reports on Form 10-K should evaluate whether their disclosures concerning climate change are consistent with the new guidance.

### Disclosure Items

The interpretive release notes four disclosure items of Regulation S-K that potentially cover the effect of climate change on companies:

- Item 101 of Regulation S-K, which relates to the description of a company's business, including the material effects on the company's capital expenditures, earnings and competitive positions as a result of complying with environmental laws.
- Item 103 of Regulation S-K, which requires disclosure of certain proceedings relating to environmental laws that (i) are material to the company's business or financial condition, (ii) involve damages or monetary sanctions, capital expenditures, deferred charges or charges to income of greater than 10% of the current assets of the company or (iii) include a governmental authority as a party to the proceeding unless the company reasonably believes any resulting monetary sanctions will be less than \$100,000.
- Item 503(c) of Regulation S-K, which requires a discussion of the most significant risks in investing in a company.
- Item 303 of Regulation S-K, which relates to management's discussion and analysis of the company's financial condition and results of operations ("MD&A"). MD&A includes disclosing any known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material adverse effect on the financial condition or operating performance of the company.

### Climate Change Items

The interpretive release identifies several topics related to climate change that may trigger either positive or negative disclosure under one of these four items of Regulation S-K.

- Existing or pending legislation and regulation regarding climate change could require disclosure under one or more of the referenced items. Any risk factors should be specific to the company and generic risk factors should be avoided as companies in different industries will be affected by legislation and regulation in different manners. The interpretive release notes that two industries likely to be impacted – energy and transportation – face significantly different risks. In addition, certain companies that have positive consequences from legislation or regulation should explain the opportunities that are available

<sup>1</sup> <http://www.sec.gov/rules/interp/2010/33-9106.pdf>

to them. For example, certain companies would profit from a “cap and trade” system if one is put in place through the sale of excess allowances for emissions.

- Treaties or international accords related to climate change could necessitate disclosure in the same manner as existing or pending legislation or regulation.
- Indirect consequences or opportunities from regulation or business trends should be examined. These indirect consequences or opportunities may require disclosure in MD&A or risk factors. If the indirect consequences or opportunities have a material enough impact on the business, they may require disclosure under Item 101. Indirect consequences may include changes in demand for goods based upon their green house gas emissions. The interpretive release notes that another potential indirect risk is the potential reputational risk to a company based upon the public’s perception of the company’s greenhouse gas emissions data.
- Climate change could have physical impacts such as increasing the severity of weather (hurricanes and floods), rising sea levels, the arability of farmland and the availability and quality of water. These physical impacts could have a direct and indirect impact on companies.

### Immediate Action Required

The interpretive release is now effective. Therefore, calendar year-end large accelerated filers filing their annual reports on Form 10-K by March 1 should consider whether climate change disclosure should be included in the Form 10-K and, if so, which items of Regulation S-K should be addressed. Companies that are not calendar year-end companies should examine these issues in connection with their upcoming quarterly reports on Form 10-Q. The interpretive release states the SEC will monitor the impact of the release on company filings.

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