

SEC Interpretive Guidance Addresses Climate Change Disclosure Requirements

February 4, 2010

On February 2, the Securities and Exchange Commission (SEC) issued interpretive guidance¹ for public companies regarding the application of the SEC's existing disclosure requirements to climate change (the Guidance). The SEC noted that, as an "interpretive release," the Guidance does not create any new legal requirements or modify existing ones. Nonetheless, the mere issuance of the Guidance is an indication that the SEC is focused on climate change disclosure, and therefore companies need to consider the Guidance in analyzing whether their current climate change disclosure is adequate and responsive.

The Guidance highlights the following topics for possible climate change disclosure:

- **The impact of existing laws, regulations, and international accords related to climate change.** For example, capital expenditures for environmental control facilities resulting from existing or pending regulation of greenhouse gas emissions and costs to purchase, or opportunities to profit from the sales of allowances or credits under a "cap and trade" regime.
- **The indirect consequences of regulation or business trends potentially affected by climate change.** For example, increased competition to provide goods with lower emissions and associated innovative technologies; increased demand for alternative energy sources and associated innovative technologies; and reputational costs associated with carbon-intensive industries.
- **The potential physical impacts of climate change.** For example, changes to profits or losses attributable to changing demand for goods and services due to the physical effects of climate change on suppliers or customers or the financial and operational effects associated with adapting to such climate change effects as rising sea levels, water availability and quality, arability of farmland, and changes in weather patterns and intensity.

The SEC indicated that disclosure of climate change issues in documents filed with the SEC may be required by the following existing disclosure requirements:

- Regulation S-K Item 101, Description of Business, which contains an express requirement to disclose material effects and costs of complying with environmental laws.

¹ Release Nos. 33-9106; 34-61469; FR-82.

- Regulation S-K Item 103, Legal Proceedings, which requires disclosure of material pending legal proceedings in which the company itself is a party, or its property is at issue, and includes specific requirements for disclosure of certain environmental litigation.
- Regulation S-K Item 503(c), Risk Factors, which requires disclosure of the most significant factors that make investment in the company uniquely speculative and risky.
- Regulation S-K Item 303, Management’s Discussion and Analysis of Financial Condition and Results of Operations, which requires disclosure of known trends, events, or uncertainties unless the company determines that the known trend, event, or uncertainty is not reasonably likely to occur or, if it does occur, is not reasonably likely to have a material impact on its financial condition.
- Form 20-F, Foreign Private Issuers, which contains various items that require disclosures analogous to those discussed above in Regulation S-K that are applicable to annual reports on Form 10-K, quarterly reports on Form 10-Q, and certain registration statements under the Securities Act of 1933 and the Securities Exchange Act of 1934.

Notably, all of the existing disclosure requirements discussed by the SEC require disclosure only upon a finding by the company that the information to be provided is material. The Guidance does not change the current “materiality” standard established by case law, which provides that information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision or, put another way, if the information would alter the total mix of available information.² However, the Guidance notes that while materiality standards should drive what information a company decides to disclose, they should not limit what information should be considered by a company in making its disclosure decisions.

Conclusion

The Guidance outlines topics that companies should consider in drafting their disclosure documents, but does not ultimately change the legal standards applicable to disclosure decisions. However, given the SEC’s focus on the topic, companies may need to intensify their analysis of the potential impacts of climate change on their operations and financial conditions. The SEC noted that many companies voluntarily provide information to the public about the impact of climate change on their businesses, and reminded companies that this information needs to be reconsidered on a regular basis for possible disclosure under the existing disclosure requirements highlighted above.

As the SEC noted, “[C]limate change regulation is a rapidly developing area. Companies need to regularly assess their potential disclosure obligations given new developments.”³ If you need information regarding the current state of climate change regulation and related disclosure practices and trends, Morgan Lewis can assist.

The full Guidance document can be found at <http://sec.gov/rules/interp.shtml>, release number 33-9106.

If you have any questions or would like more information on any of the topics discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

² Guidance, page 11, citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), and *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988).

³ Guidance, page 24.

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