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Does Climate Change Affect Your Business? SEC Issues Interpretive Guidance on Disclosure for Public Companies

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On February 2, 2010, the Securities and Exchange Commission issued an interpretive release related to climate change disclosure for publicly traded companies. The SEC approved the issuance of this guidance on January 27, 2010, as discussed in our [February 1, 2010 Update](#). The interpretive release is effective when published in the Federal Register. This Update summarizes the key issues in the interpretive release and offers practical advice.

SEC Applies Existing Disclosure Requirements to Climate Change Matters

The SEC's interpretive release provides guidance to companies on how they should evaluate their existing disclosure requirements as they apply to climate change matters. It does not implement any new requirements. Instead, the release focuses on disclosure obligations arising from changing regulatory, legislative and other business developments related to climate change, as well as physical changes such as weather and availability of resources, any of which could have a direct or indirect effect on a company's finances and operations. As discussed in our earlier Update, the disclosure requirements most likely to be relevant relate to the description of business, legal proceedings, management's discussion and analysis and risk factors. Foreign private issuers may also need to provide disclosure under similar disclosure requirements.

Materiality Analysis is Key

The interpretive release does not mandate specific disclosure, but rather directs companies to make their own materiality analysis. Each company must assess its own business and the impact of the climate change regulation on it. In making its analysis, a company should evaluate both the likelihood that a risk or opportunity, or a known trend or uncertainty, related to climate change will develop, as well as the material effect to the company of that risk, opportunity, trend or uncertainty, if it does develop.

SEC Identifies Four Areas of Potential Disclosure

The SEC suggests categories, described below, where climate change developments may trigger disclosure obligations. Because of the individualized materiality analysis discussed above, companies should view these categories as nonexhaustive.

- **Existing and Pending State and Federal Legislation and Regulation.** Recent and ongoing developments in climate change regulation could have a material effect on a company's business that requires disclosure. For example, if existing or pending legislation causes a company to plan material capital expenditures, the company must disclose those estimated expenditures under the business description. Likewise, pending legislation could create a known uncertainty for a

company that triggers disclosure obligations in its management's discussion and analysis.

Look at the Positive and Negative. Because climate change regulation may create opportunities for some companies, a company should assess its disclosure obligations based on both the positive and negative effects of existing and pending regulation. For example, a company falling below its allowable emissions allotment under a proposed cap and trade law may profit in the future by selling its allowances, or if the company is not covered by statutory emissions caps, any offset credits for which it qualifies.

Avoid Generic Risk Factors. When considering risks related to climate change regulation, companies should avoid generic risk factor disclosure and focus instead on risks that are specific to them. For example, the interpretive release notes that greenhouse gas regulation creates significantly different risks for companies in different sectors, such as energy and transportation.

- **International Accords.** If treaties or international accords relating to climate change materially affect, or are reasonably likely to materially affect, a company's business, a company must disclose the effects in satisfying its disclosure obligations. Examples of climate change-related treaties or international accords that could have a material impact on certain companies include the Kyoto Protocol, the European Union Emissions Trading System and other international activities related to climate change remediation.
- **Indirect Consequences of Regulation or Business Trends.** Legal, technological, political and scientific developments related to climate change may have indirect consequences on a company that create material business trends or risks. If so, the company should disclose these indirect consequences as risk factors, in management's discussion and analysis or, if significant, in the business description.

Will Climate Change Developments Affect Your Demand? When evaluating these indirect consequences, companies should consider whether developments related to climate change increase or decrease the demand for their goods and services in a material manner. For example, demand may increase for products that result in lower greenhouse gas emissions, as compared to those that produce significant emissions, and services that support the use of alternative energy sources, as compared to carbon based energy sources.

Is Your Reputation at Risk? With increasing public availability of data relating to a company's greenhouse gas emissions, a company should consider whether public perception of the data could negatively affect its reputation, leading in turn to adverse consequences for the company's business operations or financial condition.

- **Physical Impacts of Climate Change.** Changes to the climate or environment, such as severe weather and resource availability, may affect a company's business. In assessing its disclosure obligations, a company should consider whether the effects of changes in climate or environment are, or are reasonably likely to be, material to its business, financial condition or results or operations.

SEC Will Monitor Developments

The SEC plans to monitor the effect of this interpretive release on company filings, consider the advice its Investor Advisory Committee on climate change matters and hold a roundtable in the spring of 2010 to discuss climate change disclosure. Based on the experience and information gained from this process, the SEC will determine whether to issue further guidance or rules related to climate change disclosure.

Practical Tips

- **Analyze the Impact of Climate Change.** Companies should analyze the impact of climate change on their business and financial condition. In making this analysis, companies should think broadly about the consequences of climate change, including the positive and negative, direct and indirect, and potential and actual consequences.
- **Evaluate Existing Disclosure Now.** Companies should review their existing disclosure to determine whether they adequately disclose any material effects and potential impacts of climate change.
- **Plan to Revisit Disclosure Regularly .** Companies should regularly assess their potential disclosure obligations given the rapidly changing landscapes of climate change regulation, emerging emissions reduction and alternative energy technologies and business trends related to climate change issues. What is not material now could become material later.
- **Watch for Future SEC Guidance or Rulemaking.** Do not be surprised if the SEC issues further guidance or rulemaking related to climate change disclosure after it gathers more information about how companies respond to its guidance. Watch for additional Updates if the SEC does take additional action.

Additional information

This Update summarizes the SEC's new guidance on climate change-related disclosure. You can read the [full text of the interpretive release](#) on the SEC's Web site. You can find discussions of other recent cases, laws, regulations and rule proposals of interest to public companies on our [Web site](#).