



ENVIRONMENTAL UPDATE

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## DEVELOPMENTS IN REPORTING CLIMATE CHANGE IMPACTS IN SECURITIES FILINGS

Climate change is transforming regulatory, political and business environments. It may also affect how companies approach their securities filings. If a company has significant carbon emissions, or operations that could be affected by climate change-related events, it will want to monitor mounting efforts to clarify or regulate when and how these impacts must be expressly discussed in filings required by securities law. These efforts include a petition recently filed with the Securities and Exchange Commission (“SEC”) and subpoenas issued by the New York State Attorney General.

### Petition to the SEC

On September 18, 2007, a group of institutional investors, environmental advocates and state pension fund managers (“Coalition”) formally petitioned the SEC to clarify when and how publicly-traded companies must specifically disclose how climate change could affect their financial condition or operating performance. Petition for Interpretative Guidance on Climate Risk Disclosure (“Petition”), which the SEC has made available on its website <http://www.sec.gov/rules/petitions/2007/petn4-547.pdf>. The Coalition is reported to manage collectively more than \$1.5 trillion in assets.

Although categorized by the SEC as a request for rulemaking, the petition does not propose any new regulations. Instead, the Coalition requests that the SEC issue an interpretative release construing existing regulations to require that material climate risk information must be disclosed under Items 101 (description of business), 103 (legal proceedings) and 303 (Management’s Discussion and Analysis) of Regulation S-K. In addition, the Coalition states that a discussion of climate risks may also be required under Statement of Financial Accounting Standards No. 5 in a variety of circumstances, including if a company: (1) is a major source of greenhouse gas emissions that are already regulated in the U.S. or abroad; (2) is considering major capital investments that could be subject to evolving regulatory treatment of greenhouse gases; or (3) has operations that may be at risk due to developments such as melting permafrost or storm damage. Finally, the Coalition urges the SEC to compare disclosures of firms within an industry and make further inquiries of registrants that have not disclosed material climate-related risks.

The thrust of the Coalition’s Petition is that all facts which are “material” to investment decisions must be disclosed, and that climate risk information has now passed the materiality threshold for many corporations. The Coalition points to a number of facts

which it asserts show that reasonable investors “consider climate risk part of the total mix of information they assess to make investment decisions”, including: investors representing more than \$41 trillion in assets participate in the Carbon Disclosure Project and its annual requests for climate risk information from corporations; regulatory initiatives to reduce greenhouse gas emissions now apply in territory representing over 58% of the U.S. GDP and 54% of the U.S. population; and statements by numerous business executives that their shareholders are demanding information on climate risks.

The Coalition also asserts that companies have obligations under existing provisions of Regulation S-K to disclose certain information about climate change risk and opportunity.

- **Item 101:** The Coalition states that companies operating in jurisdictions that have adopted greenhouse gas emission regulations need to discuss the material effects of compliance on capital expenditures, earnings and competitive position. In addition to focusing on the provisions of Item 101 specifically applicable to compliance with environmental laws, it argues that the material impacts of climate change should be discussed in accordance with the provisions of Item 101 requiring a description of the “general development of business” and the “competitive position of the business.” According to the Coalition, “both regulatory developments relating to greenhouse gas emissions and the physical risks of climate change pose immediate challenges to the general development of many businesses” (e.g., changes in the cost of energy and uncertainty about the cost of capital improvements). Petition at 16.
- **Item 103:** The Coalition states that corporations that are parties to climate change litigation may be required to discuss it pursuant to the disclosure requirements for environmental legal proceedings. It also reminds litigants that SEC Staff Accounting Bulletin 92 stated “that a company must accrue a charge for environmental liabilities if it is probable that the liability has been incurred, and if it can be reasonably estimated.” Petition at 17.
- **Item 303:** The Coalition asserts that the requirement under Item 303 of Regulation S-K for companies to address “known trends and uncertainties in their MD&A is particularly applicable to climate risk.” Petition at 18. Item 303’s focus on “uncertainties that are reasonably expected to have material effects” means that “the trend toward increased greenhouse gas

regulation, and the associated uncertainty about the impact of this regulation, must be analyzed to determine if they are material and subject to disclosure.” Petition at 20.

### **Subpoenas from New York State Attorney General**

On September 14, 2007, New York State Attorney General Andrew Cuomo issued subpoenas to at least five utilities seeking information and documents relating to internal analyses of their climate change risks and also to their disclosures of such risks to investors. One of the authorities the Attorney General invokes to issue the subpoenas is a provision of the Martin Act, a New York securities law, which authorizes the Attorney General to investigate fraudulent practices. The Attorney General asserts in letters to the companies that they “did not attempt to evaluate or quantify the possible effects of future greenhouse gas regulations, or discuss their impact on the company,” and that these omissions “make it difficult for investors to make informed decisions.” The letters claim, moreover, that these omissions cannot be excused “by claiming there is insufficient information concerning known climate change trends and uncertainties.” The letters also remind the companies that state, as well as federal, securities laws require disclosures to shareholders to “be complete and not misleading.”

### **Significance of Developments**

The Petition and subpoenas are significant in many respects, most notable of which is the broad range of circumstances that both the Coalition and the New York State Attorney General contend must be considered (and disclosed) by companies. For example, the Coalition insists that climate change presents physical risks to operations that are both “obvious” (rising sea levels, more severe storms) and “subtle” (e.g., changes in water supply and “disease vectors”). Petition at 28. According to the Coalition, the potential impacts from both of these physical risks are “known or predictable, and should be disclosed if material.” *Id.* The letters from the New York State Attorney General, in turn, premise their concerns in part on “any one of several new or likely regulatory initiatives for CO<sub>2</sub> emissions [including] federal global warming legislation.” In other words, the Attorney General would have companies evaluate (and

disclose) impacts associated with legislation that has not been enacted. In addition, the Attorney General's letters specifically mention facilities that some of the companies are planning, but have not yet constructed. According to the Attorney General, those future operations could give rise to a present disclosure obligation.

Also significant is the Petition's sharp rebuke on the adequacy of disclosures that have been made to date about climate risks. Particularly attacked are companies that did not discuss climate risks in their financial reports but nonetheless provided substantial information about these risks in sustainability reports or in response to specific requests from investors or advocacy groups. The Coalition insists that the experiment with voluntary disclosures has failed, arguing instead for "standardized, transparent information that is freely available to all investors." Petition at 50.

### Going Forward

The Coalition is explicit about the interpretative guidance it seeks from the SEC. That guidance should make clear that companies must institute processes to assemble and assess their risk of climate change impact. To allow companies to perform that assessment, the Coalition seeks to have the guidance identify the information companies must obtain and evaluate, including a tabulation of their greenhouse gas emissions. According to the Coalition, the guidance should also direct registrants to disclose the following, if material:

- (1) physical risks from climate change;
- (2) financial risks associated with present or probable regulation of greenhouse gas emissions; and

- (3) legal proceedings relating to climate change.

The Coalition, and possibly the New York State Attorney General, thinks that more expansive, specific disclosures relating to climate change are required under existing law. It is not clear that the SEC shares this view. In both 2004 and 2006, several members of the current Coalition sent letters to the SEC asking it to clarify its position on climate change disclosure, and the SEC never formally responded to these requests.

Whatever the SEC's formal position, however, these developments represent a broad wake-up call: at a minimum, it may be time for some companies to reassess their approach to climate change disclosure in securities filings, including taking a close look at how information they generate internally about climate change risk – and possibly share voluntarily in response to surveys and other inquiries – comports with what is being disclosed to shareholders. Moreover, even if the SEC takes no action in response to the recent Petition, there is a growing likelihood that heightened scrutiny of climate change disclosure may come from others, including investor groups, state attorneys general and institutional investors.

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