



Disclosure of Climate Change Risk in SEC Filings

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▶ **INTRODUCTION**

The question of whether, and to what extent, companies should disclose climate change risks in their filings with the Securities and Exchange Commission (SEC) is the focus of increasing attention from a number of stakeholders. Actions over the last several years by the New York State Attorney General and by coalitions of institutional investors, environmental groups and state government agencies with regard to climate change disclosure have received considerable media coverage. Other recent developments that have received less attention include the issuance of draft standards for climate change disclosure by ASTM International and proposed revisions by the Financial Accounting Standards Board (FASB) to its FAS 5, Accounting for Contingencies.

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▶ **CLIMATE CHANGE RISKS**

As consensus builds that global warming is a significant threat, initiatives seeking to address climate change through regulation of greenhouse gas emissions have been adopted by, are pending or have been proposed before international, federal, state, and regional regulatory authorities. Many industries (*e.g.*, electrical power, mining, manufacturing, transportation, and insurance) face various climate change risks, many of which could conceivably materially impact them. Such risks include:

- regulatory/litigation risk (*e.g.*, changing legal requirements that could result in increased permitting and compliance costs, changes in business operations, the discontinuance of certain operations, and related litigation);
- market risk (*e.g.*, declining market for products and services seen as greenhouse gas intensive); and
- physical risk (*e.g.*, risks to plants or property owned, operated or insured by a company posed by rising sea levels, increased frequency or severity of storms, drought, and other physical occurrences attributable to climate change).

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► CURRENT REGULATORY BACKGROUND

Although SEC regulations do not explicitly address climate change-related disclosure, existing rules require disclosure of all material risks faced by a reporting company. In addition, registrants are currently required to disclose the material effects of environmental compliance "on capital expenditures, earnings and competitive position of the registrant and its subsidiaries;" material pending legal proceedings; and known trends or uncertainties that the registrant "expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."¹ Registrants also have a duty under the Securities Exchange Act not to make material misstatements or omissions in their SEC filings.² Whether or not a company is currently required to disclose the potential impact of climate change on its business depends on whether, taking into account all relevant facts and circumstances, such disclosure would be material to investors. A registrant's determination in that regard requires the application of a significant amount of informed judgment and, in many situations, involves considerable subjectivity.

¹ See 17 C.F.R. §229.101 (material effects of compliance); 17 C.F.R. §229.103 (legal proceedings); and 17 C.F.R. §229.303 (known trends or uncertainties).

² See 17 C.F.R. §240.10b-5.

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► RISING PRESSURE FROM INVESTORS, ENVIRONMENTAL GROUPS AND STATES

In September 2007, a coalition of environmental groups (led by Ceres, an alliance of environmental groups, investors, and other public interest groups, and the Environmental Defense Fund, a nonprofit environmental advocacy group), state officials, investment advisers and institutional investors that collectively managed more than \$1.5 trillion in assets petitioned the SEC for "an interpretive release clarifying that material climate-related information must be included in corporate disclosures under existing law."³ The coalition also urged the SEC to begin examining the adequacy of registrants' financial disclosures regarding climate change. In June 2008, the same coalition filed a supplemental petition, discussing developments since its initial petition and reiterating its request that the SEC develop interpretive guidance. The SEC has not yet acted on either petition.

Investor members of the coalition have also campaigned for including express climate change disclosure provisions in any general revision of SEC disclosure requirements.⁴ The issue is also attracting US Congressional attention: The Lieberman-Warner Climate Security Act of 2008, a leading climate change bill Congress considered this year, included provisions requiring the SEC to adopt rules mandating the disclosure of climate change risks, as did several other bills.

Major institutional investors have also announced policies regarding climate change disclosure. For example, two large California pension funds, California Public Employees' Retirement System (CalPERS) and California State Teachers' Retirement System (CalSTRS), have signed on to the Global Framework for Climate Risk Disclosure,⁵ and CalPERS has amended its corporate governance policy to require climate change disclosure by companies in which it invests. The Florida Division of Treasury announced in September 2008 that it will be the first treasury in the nation to analyze its investments for the financial impacts of climate change.

State enforcement has added further pressure. In September 2007, New York State Attorney General Andrew Cuomo, investigating whether investors were receiving adequate information regarding climate change risk, issued subpoenas to five energy companies under the state's Martin Act.⁶ Two of the five, Xcel Energy Inc. and Dynegy, Inc., agreed in recent settlements to address specifically climate change risk in their SEC filings, including financial risks from regulation, litigation, and the physical impacts of climate change, and a strategic analysis of each company's climate change risk and emissions management.⁷ Attorney General Cuomo stated in press releases regarding the settlements that his office's investigation of the three other energy companies that received subpoenas continues. Additional investigations of other registrants, or other industries, cannot be ruled out.

Voluntary disclosure initiatives and the development of voluntary disclosure standards, in addition to the Global Framework for Climate Risk Disclosure referenced above, are being undertaken by a number of organizations. ASTM International, a voluntary standards development organization, recently circulated for comment within committee a draft guide for climate change disclosures.⁸ International organizations such as the Carbon Disclosure Project are surveying companies regarding greenhouse gas emissions and corporate

strategies. A framework for more robust climate change disclosure is beginning to emerge, independent of regulatory requirements.

If a material liability resulting from climate change risk may be involved, a registrant should also consider disclosure obligations under GAAP. FASB's FAS 5 requires establishment of an accrual for contingent liabilities that are deemed probable and reasonably estimable, and disclosure for contingent liabilities that are either probable or reasonably possible, but not yet estimable. FASB is in the process of amending FAS 5, citing concerns raised by "investors and other users of financial information" that disclosures under the existing guidelines are inadequate. The draft amendment does not explicitly address disclosure of climate change risk, but instead aims to broaden disclosure generally. Among the numerous comments FASB received on the draft proposal, however, were those submitted by investor and environmental groups seeking to expand the proposed disclosure requirements to cover long-term risks, including climate change risk.⁹

³ *Request for Interpretive Guidance on Climate Risk Disclosure*, SEC File No. 4-547 (Sept. 18, 2007), available at <http://www.sec.gov/rules/petitions/2007/petn4-547.pdf>.

⁴ See, e.g., Investor Network on Climate Risk, *Comments on Modernizing the SEC's Disclosure System*, SEC File No. 4-567 (Oct. 22, 2008), available at <http://www.sec.gov/comments/4-567/4567-20.pdf>.

⁵ Released by a group of leading institutional investors in October 2006. Available at <http://www.incr.com//Document.Doc?id=167>.

⁶ N.Y. Gen. Bus. Law §§ 352 *et seq.* The Martin Act empowers the Attorney General to investigate fraudulent practices in respect of securities.

⁷ In the Matter of Xcel Energy Inc., AOD No. 08-012, N.Y. Att'y Gen. Envtl. Prot. Bureau (Aug. 26, 2008); In the Matter of Dynegy, Inc., AOD No. 08-132, N.Y. Att'y Gen. Envtl. Prot. Bureau (Oct. 23, 2008).

⁸ ASTM Int'l, *Draft Guide for Disclosures Related to Climate Change Exposure Risks* (ASTM WK21096, Aug. 1, 2008); see <http://www.astm.org/DATABASE.CART/WORKITEMS/WK21096.htm>.

⁹ Comments were filed by, *inter alia*, Ceres, Investor Environmental Health Network, Rose Foundation for Communities and the Environment (in cooperation with ten other funds/foundations), and Trillium Asset Management, and are available at <http://www.fasb.org/ocl/fasb-getletters.php?project=1600-100>.



CONCLUSION

Rising concern about global warming and the increasing attention paid by policy-makers and investors to the financial impact of climate change on companies are affecting expectations regarding disclosure requirements in SEC filings. Reporting companies should stay apprised of rapid developments on many different fronts. In addition, public companies must continue to evaluate the impact of climate change on their results and to assess what type of disclosure in SEC filings is appropriate in light of changing legal and regulatory requirements as well as investor expectations.

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