



March 3, 2010

Securities & Corporate Governance

Note to SEC: “reasonably likely to be enacted”? You have got to be kidding!

With Form 10-K season well on its way to being completed, we now have had the time to look back at the [SEC’s Interpretive Release on climate change disclosure](#) and give thought to its broader implications. The aspect that strikes us the most as being inconsistent with good disclosure – disclosure that benefits an investor’s understanding of a company – is the requirement that companies assess whether “pending legislation is reasonably likely to be enacted.” Further, “[u]nless management determines that it is not reasonably likely to be enacted, it must proceed on the assumption that the legislation or regulation will be enacted.” In turn, this could require disclosure in a company’s MD&A of any potential material consequences. We need not detour into the meaning of “reasonably likely” or ponder whether it is the complement of “reasonably unlikely” to appreciate the fool’s errand of tying a public company’s disclosure obligations, and hence its exposure to litigation risk, to an assessment of whether regulation or legislation will be enacted.

No less authority than the President assured us that banking, health care and climate change legislation would be passed in 2009. Obviously, none of these came to pass. Countless Congressmen and lobbyists were equally confident in the passage of one or more of these items. They were wrong as well. Yet the SEC believes that public companies somehow have the ability to access the Oracle of Washington⁽¹⁾ and assess whether pending regulation or legislation satisfies a “reasonably likely to be enacted” standard.

With over 7,000 pieces of legislation introduced so far in the current Congress, we do not understand how the SEC really expects public companies to make this assessment.⁽²⁾ Should companies now call the office of one of their Senators or Representative and solicit his or her views? (Hint to public companies: Relocating to a conservative state may simplify your disclosures.) Should companies ask their impartial primary trade association? Depend upon the Chamber of Commerce? The Business Roundtable? Maybe they should trust the editorial pages of the *New York Times*. Are all 13,000+ public companies now

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required to maintain in-house capacity to assess the likelihood of enactment of regulations and legislation? This could be a growth opportunity for consulting firms (and bookmakers). And then the audit firms will have to audit the answer because of, as the SEC reminded us (3), the implications under FASB Accounting Standards Codification Topics 450 (contingencies) and 275 (risks and uncertainties).

An aspect of the SEC's Interpretive Release that disturbs us is that while it is focused on climate change, there is nothing that limits the interpretive approach to just climate change. Fairly read, the Interpretive Release applies to banks when there is financial institution related legislation pending, to retailers and manufacturers when there is import/export legislation pending, and to industrial and transportation companies when there is labor legislation pending. There really is no limit on the breadth of its application.

Sarcasm aside, we believe the SEC made a poor decision in setting new disclosure standards with respect to pending regulations and legislation. Existing authority with respect to disclosure was working well, and would have continued to work well, without any SEC intervention. We urge the SEC to reconsider its position before any lasting damage is done.

1. If you Google "Oracle of Washington," you get only 12,100,000 hits to consider.
2. We are reminded that each piece of legislation is "just a bill." See www.schoolhouserock.tv/Bill.html.
3. Interpretive Release No. 33-9106 at 22.

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