

## SEC Issues Interpretive Guidance on Climate Change Disclosure

February 10, 2010

Last week the Securities and Exchange Commission (the “SEC”) issued an interpretive release reminding companies of their obligations to disclose risks and trends regarding climate change and related legislative and regulatory developments (the “Release”).<sup>1</sup> Since the Release became effective February 8, 2010, public companies should immediately consider the impact of the SEC’s guidance on their public filings and other statements, including with respect to disclosures for the current Form 10-K season. The remainder of this client alert addresses key aspects of the SEC’s guidance.

The SEC recognizes that there is growing global support for both control of greenhouse gas emissions and the transparent reporting of climate change risk, as evidenced by pending U.S. Congress legislation, the “cap and trade” regulatory system for greenhouse gas emission allowances that is in place in the European Union, recent regulatory and legal actions, and the development of a number of non-governmental climate change reporting organizations. In an effort to strengthen climate change-related disclosures in SEC filings, the guidance expands upon past SEC guidance to address several areas in which issuers should consider additional disclosure of climate change developments and risks, such as the following:

### **Summary of Applicable Disclosure Regulations**

The Release emphasizes that various existing regulations and associated SEC guidance already require disclosure of environmental trends and liabilities. The most pertinent, non-financial statement disclosure rules that could require disclosure of climate change trends and risks include:

- **Business Description.** Item 101 of Regulation S-K requires each issuer to provide a detailed, written description of its business, including any material financial effects of compliance with environmental regulation, as well as any costs of environmental control facilities to be incurred in the current and next succeeding fiscal years, and thereafter as deemed material by the issuer.
- **Legal Proceedings.** Item 103 of Regulation S-K requires each issuer to disclose any legal or administrative proceeding with respect to environmental compliance if such action is material, involves a claim for damages, sanctions or remediation costs in excess of 10% of the company’s current assets, or in which a governmental authority is a party to such action and the action involves potential monetary sanctions, subject to certain limited exceptions.

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<sup>1</sup> See “Commission Guidance Regarding Disclosure Related to Climate Change,” Interpretive Release No. 33-9106 (February 2, 2010), which is available at: <http://www.sec.gov/rules/interp/2010/33-9106.pdf>.

- Risk Factors. Item 503(c) of Regulation S-K requires each issuer to include a discussion of the most significant risks to its business, which may include material risks associated with climate change.

- Management Discussion & Analysis. Item 303 of Regulation S-K requires each issuer to disclose trends and uncertainties that could materially impact an issuer's future financial results, liquidity or capital resources, which may include trends and uncertainties arising from climate change and related regulation unless management had a basis to believe such trends or uncertainties to be immaterial.

### **Interpretive Guidance on Future Climate Change Disclosure**

The Release also describes several climate change topics that issuers might be required to address in SEC filings under existing regulations, depending on the business of each issuer, such as the following:

- Impact of Climate Change Legislation and Regulation. The business and financial impact of newly enacted or pending climate change legislation, if material, may be required to be disclosed in compliance with the SEC disclosure requirements cited above. For instance, Item 101 of Regulation S-K requires disclosure of any material estimated capital expenditure for environmental control facilities to be incurred during the current and the next succeeding fiscal year. Passage of new "cap and trade" or other climate change legislation could impose significant compliance costs on some issuers that would be required to be disclosed under this item. In addition, an issuer may be required to include disclosure in MD&A with respect to *pending* legislation if the legislation would have a material impact on its financial results, prospects, liquidity or capital resources, unless management concludes that the legislation is not reasonably likely to be enacted. Such disclosures should reflect both negative consequences and possible positive business opportunities (e.g., "cap and trade" opportunities) for the issuer arising from legislation and should be based on an issuer's specific circumstances -- in other words, issuers should avoid generic risk disclosures.

- International Accords. Given the global nature of certain climate change protocols and other initiatives, issuers whose businesses are reasonably likely to be impacted by such international initiatives should include disclosure in their SEC filings similar to that required with respect to climate change legislation.

- Indirect Consequences of Regulation and Business Trends. Issuers may, depending upon the facts and circumstances, be required to disclose the indirect risks and opportunities created by legal, technological, political and scientific developments in the area of climate change. Such risks or opportunities include:

- Decreased demand for goods that produce significant greenhouse gas emissions;
- Increased demand for goods that result in lower emissions than competing products;
- Increased competition to develop innovative products;
- Increased demand for generation and transmission of energy from alternative energy sources;

- Decreased demand for services related to carbon-based energy sources, such as drilling services or equipment maintenance services; and
- Other risks, such as risk to an issuer's reputation (e.g., due to its production of greenhouse gas emissions).
- Physical Impacts of Climate Change. The SEC also notes that the physical impact of climate change, particularly arising from severe weather, could pose a significant risk to issuers in the future that may need to be disclosed. Possible risks to issuers arising from severe weather include:
  - Property damage and disruptions to operations, particularly for issuers with significant operations concentrated on coastlines;
  - Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers;
  - Increased insurance claims and liabilities for insurance and reinsurance companies;
  - Decreased agricultural production capacity in areas affected by severe weather; and
  - Increased insurance premiums and deductibles, or a decrease in the availability of coverage, for registrants with plants or operations in areas subject to severe weather.

### **Conclusion; Contact Information**

Issuers should consider whether additional climate change-related disclosures will be required (or whether current disclosures should be expanded) in their SEC filings, starting with the Form 10-K disclosures currently being prepared by calendar-year filers. Issuers also will need to consider whether their disclosure controls and procedures should be modified to process any required disclosures. If you have any questions about these recent SEC developments, please contact Benjamin R. Preston (<http://www.wcsr.com/lawyers/benjamin-preston>), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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