Challenges in Implementing the SEC's New Interpretive Guidance on Climate Change

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At no point in this nation's history has climate change been a more hotly and publicly debated topic than it is today. Although it may be said that most Americans accept the scientific evidence that climate change poses a serious threat to human health, development and even existence, there is widespread disagreement about how the threat should be addressed, and there is a vocal minority that asserts it does not even exist (or that its severity has been exaggerated).[1]

These debates are being played out in the public sphere and in the proceedings of all three branches of U.S. government, creating a frequently changing vision of an American future that may include a "low-carbon economy" vastly different from the economy we see today.

In 2007, pushed by certain state governments that had already grown concerned about climate change, the U.S. Supreme Court opened the door to federal regulatory action with its 5-4 ruling in *Massachusetts v. EPA*.[2] In that decision, the court ruled that carbon dioxide and other greenhouse gases are, "without a doubt," "air pollutants" within the meaning of the Clean Air Act and that (absent new legislation) the Environmental Protection Agency was required to regulate them as such.

REUTERS/Jonathan Ernst

EPA Administrator Lisa Jackson announced a new Obama administration position that greenhouse gases are a threat to public health Dec. 7.

In December EPA Administrator Lisa Jackson announced a finding that greenhouse gases endanger the public health and welfare of the American people, thereby requiring the EPA and many states to regulate their emissions by means of federal Clean Air Act permits.[5]

Most observers thought that the Supreme Court's decision, the EPA's subsequent action, many states' enactment of their own regulations addressing greenhouse gas emissions and the highly anticipated global climate change conference in Copenhagen in December would spur enactment of federal climate change legislation in Congress. Thousands of venture capitalists and eco-financiers stood by, eagerly anticipating a federal cap-and-trade program that would create an estimated $2 trillion carbon trading market and expanded new opportunities for investment in "green" and "clean" technologies.[6]

> At the federal level in the United States, considerable uncertainty remains about what will happen in terms of climate change legislation and regulation.

THE EPA WALKS IN

Walking through that open door, the EPA proposed new regulations under its Clean Air Act authority last year, initially by requiring large facilities emitting more than 25,000 tons of carbon dioxide per year to collect data and report on their greenhouse gas emissions.[3] The EPA planned to require these facilities to obtain permits that would demonstrate they are using the best practices and technologies to minimize greenhouse gas emissions.[4]

The Copenhagen conference, however, did not result in a binding global treaty addressing climate change.[7] This year, political blowback and gridlock amidst the recession and the health care debate have dampened the prospect of sweeping federal climate change legislation in the near term.

And even the EPA has scaled back its initial plans for regulation of greenhouse gas emissions. Jackson recently announced that the new regulations will not go into effect until 2011 and that in the first two years the threshold for permitting will be at least 75,000 tons per year. She said the EPA "does not intend to subject the smallest sources to Clean Air Act permitting for greenhouse gas emissions any sooner than 2016."[8]

THE SEC ARRIVES

Meanwhile, the Securities and Exchange Commission entered the fray in early 2010, years after investor groups started urging the agency to issue mandatory climate change risk reporting requirements. On Feb. 2 a 3-2 majority of the SEC approved the release of official guidance to public companies "regarding the commission's existing disclosure requirements as they apply to climate change matters."[9] Like all "interpretive guidance" issued by the SEC, this release states that it is meant to clarify, not change, the disclosure requirements that public companies are already required to follow.[10]

As discussed below, however, the climate guidance creates a number of challenges that a public company will face when determining the specific "risks" that it must disclose in its SEC filings. The difficulty in answering this question is compounded, given the current uncertainty surrounding exactly what the possible physical effects of climate change may be, when they may occur, and the range of possible government legislative and regulatory measures that may be enacted to address climate change.

READING THE SEC'S SIGNALS

This article will review what the SEC may be signaling with this new guidance, and what it may be overlooking, regarding climate change risks public companies are *required* to disclose.[11]

A FOCUS ON MD&A

Unlike the voluntary disclosure standards that many investor groups and accounting organizations have been advocating for years, the SEC climate guidance addresses what climate-change-related disclosures public companies are *required* to make, primarily under Item 303 of SEC Regulation S-K.[12]

Under Item 303, each annual Form 10-K and quarterly Form 10-Q must include a section on "Management's Discussion and Analysis of Financial Condition and Results of Operations" to "provide material historical and prospective textual disclosure enabling investors to assess the financial condition and results of operations of the registrant."[13]

One of the primary goals of the MD&A is to elicit disclosure that enables investors to see the company "through the eyes of management."[14] As a practical matter, however, constructing an appropriate MD&A is a balancing act. Investors and the SEC want information on a wide range of topics, now including climate change, but excessively comprehensive MD&As "tend to overwhelm readers and act as an obstacle to identifying and understanding material matters."[15]

In fact, in earlier interpretive guidance, the SEC said companies "should avoid the unnecessary information overload for investors that can result from disclosure of information that is not required, is immaterial, and does not promote understanding."[16]

When it comes to identifying possible future developments, including the possible effects of climate change, the SEC has, as a general matter, instructed companies to limit their disclosures to "*known* trends, events, demands, commitments and uncertainties that are *reasonably likely* to have a *material* effect on financial condition or operating performance."[17]

THE SEC'S PREVIOUS GUIDELINES

In considering what, if anything, to disclose about climate change, one would think it might be useful to consider that the SEC has previously provided companies with a framework for determining whether to disclose a possible future development and what to say about it:

As explained in a 1989 SEC interpretive release on MD&A, when a trend, demand, commitment, event or uncertainty is "known," management must assess whether the known trend, demand, commitment, event or uncertainty is "likely to come to fruition."[18] No disclosure is required if management determines that the "known" trend, demand, commitment, event or uncertainty is "not reasonably likely to occur."[19]

The SEC has stated its position that "reasonably likely" is a lower disclosure standard than "more likely than not," but it has not clarified how much lower.[20] In theory, therefore, management could determine that a given trend, demand, commitment, event or uncertainty has a 40 percent chance of occurring, without necessarily being able to conclude that the trend, demand, commitment, event or uncertainty is "not reasonably likely to occur."

The agency has further stated that if management cannot determine that the known trend, demand, commitment, event or uncertainty "is not reasonably likely to occur," it must assume that it will come to fruition and evaluate its consequences objectively. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is "not reasonably likely to occur."[21] Accordingly, public companies must engage in two layers of arguably speculative analysis, assessing the likelihood of the occurrence of an event as well as the likely effects of that event.

> It is next to impossible for most companies to predict where they may end up under any one piece of pending legislation, as there are numerous combinations of possible outcomes.

DO THE SEC RULES WORK?

One must question whether the SEC's framework for MD&A disclosure is of any practical utility, however, when it comes to an issue like climate change. The agency's climate guidance appears to interpret this disclosure framework as requiring management to determine whether any of the serious effects of climate change that most of the scientific community believes will

The effects of severe weather on a company's climate disclosures include:

- Catastrophic harm to physical plants and facilities;
- Disruption of manufacturing and distribution processes;
- Changes in the availability or quality of water, or other natural resources on which the registrant's business depends;
- Decreased efficiency of equipment;
- Decreased demand for certain products or services;
- For registrants with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products;
- Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
- For insurance and reinsurance companies, increased insurance claims and liabilities;
- Decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
- Increased insurance and premiums and deductibles, or a decrease in the availability of insurance coverage, for registrants with plants or operations subject to severe weather.

come to pass are "likely" or "not reasonably likely" to come to fruition.

It also appears to require management to make the same kind of judgment call about the likelihood of passage or adoption of legislative or regulatory measures designed to mitigate those effects.

The climate guidance might have been more useful to public companies if it allowed management, at least in the near term, to choose a third option; "We have no idea whether any particular physical or regulatory climate-change-related trends or uncertainties are 'known' or 'likely to come to fruition,' or when they may come to fruition. We will get back to you when the various governmental bodies have sorted that question out, but as of right now even they cannot make that determination." Unfortunately, it does not seem to provide for this.

Fortunately, not all public companies are going to be scratching their heads to ascertain what climate-related risks they currently must or should be sure to disclose. Companies already subject to specific existing climate-related legal and regulatory requirements, such as rules under the European Union's Emissions Trading System or a statewide program such as the Regional Greenhouse Gas Initiative in the Northeast, can make reasonable assessments as to whether those requirements create material risks or have a material impact on their financial condition, liquidity or results of operations.

Companies that have received "demands" or made specific "commitments" regarding the reduction of greenhouse gases (for example from/to industry peer groups, supply chain partners, consumers, employees, shareholders or adversaries in litigation) can assess whether those demands and commitments create material risks and impose material costs or cash requirements.

Accordingly, these public companies are in a position to evaluate the effects of these requirements, demands and commitments under the SEC's MD&A disclosure framework to determine whether disclosure is required.

HARD TO PIGEONHOLE

Most public companies, however, likely do not fall into the above categories. The "trends" and "uncertainties" related to climate change that may affect them in the future involve laws that do not yet exist, regulations that remain to be specified, and weather pattern and related physical changes that scientists are still in the process of defining with any reasonable particularity.

And yet the SEC has emphasized in its climate guidance that it does not want companies to include speculative disclosure in their MD&A, reiterating its position that "the effectiveness of MD&A decreases with the accumulation of unnecessary detail or duplicative or uninformative disclosure that obscures material information."[22]

> In many cases, the true EFFECT of SEC interpretive guidance is not on the disclosures that could be made, but on changes in company behavior and internal processes.

In light of the current state of the science and law surrounding climate change, at least in the near term it may be challenging for most companies to identify specific climate-related disclosures they are to include in their MD&As without creating the "unnecessary information overload" that the SEC and the courts have long advised them to avoid.[23]

PHYSICAL EFFECTS OF CLIMATE CHANGE

It would seem that the physical effects of climate change would be a straightforward "risk" for a company to consider. The SEC climate guidance provides:

> Significant physical effects of climate change, such as effects on the severity of weather (for example, floods or hurricanes), sea levels, the arability of farmland, and water availability and quality, have the potential to affect a registrant's operations and results. ... A 2007 Government Accountability Office report ... cites a number of sources to support the view that severe weather scenarios will increase as a result of climate change brought on by an overabundance of greenhouse gases.[24]

In further reliance upon the 2007 GAO report, the new climate guidance says "severe weather can have a devastating effect on the financial condition of affected businesses," and it recites a list of "possible consequences of severe weather."[25]

The guidance then says "[r]egistrants whose businesses may be vulnerable to severe weather or climate-related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents."[26]

PREDICTING 'THE BIG ONE'

What is interesting about this directive is that it represents a new approach to disclosing risks related to the weather and similar events. Setting aside the loaded concept of "climate change" for a moment, "severe weather" such as hurricanes, floods and droughts has always affected businesses. Even the most secular have long called them "acts of God," and companies generally were not expected to disclose what might happen to their financial conditions or results of operations if they (or their suppliers or customers) were unexpectedly hit with a flood, tornado, hurricane, drought, heat wave, "the big one," terrorist attack, and the like.

The SEC's new guidance requiring disclosure of risks related to "severe weather," however, signals that some of these events should no longer be treated as "acts of God" (a legal term, meaning "events outside of human control, such as sudden floods or other natural disasters, for which no one can be held responsible").[27]

Rather, it appears that the SEC wants companies to treat significant increases in severe weather ("brought on by an overabundance of greenhouse gases") and other unspecified "climate-related events" as a "known trend" that may or may not be "likely to come to fruition" within the meaning of Regulation S-K Item 303.

Accordingly, it appears the SEC expects management to "evaluate objectively" the consequences of these "climate-related events" and determine the likelihood that those consequences will materially affect the registrant's financial condition or results of operations.

If management cannot determine that a particular material effect is "not reasonably likely to occur," that effect must be disclosed. Under the SEC's interpretation of Item 303, to assess a company's exposure to the physical effects of climate change, management would need to consider the following types of questions:

- Is the company aware of any scientific studies that conclude that a specific geographic region where the company has critical facilities or operations is susceptible to increased "severe weather" or other effects of climate change?
- What types of climate-related events are expected to occur in each of those regions, and when?
- Has the company taken action or made plans to mitigate the effects of damage or disruption to its facilities or operations in particular geographical regions because of the expected types of severe weather events?
- Are there likely areas of disruption in the company's supply chain (*e.g.*, suppliers, shippers, vendors, distributors) in the event of the types of severe weather incidents expected in various geographical regions?
- In what ways are significant customers or suppliers susceptible to severe weather?
- Is the company aware of any increases in its cost structure (*e.g.*, insurance premiums, transportation) that would occur as a result of the threat of severe weather?

IS MANAGEMENT GETTING ENOUGH INFO?

This materiality assessment appears to require companies to identify specific climate-related events, including but not limited to "severe weather," that are expected to be increasingly occurring in specific geographical regions. However, it is unclear that even the world's top climate scientists could provide that information at this point in time.

Nevertheless, the SEC has stated that companies undergoing an evaluation of the physical effects of climate change may need to strengthen their internal disclosure processes to ensure that management is provided with sufficient information about the risks the company faces.

Larger companies may have an advantage when assessing the physical effects of climate change. Some companies have the internal resources, such as "sustainability departments" or at least a budget for hiring outside consultants, that will keep them apprised of the latest trends in climate change issues.

The key is for those involved in drafting the company's annual and quarterly reports, such as securities lawyers, management and financial reporting personnel, to collaborate with those types of experts in order to effectively evaluate climate-related risks. Once the company is able to collect the information, management should make informed judgments about whether disclosure is required under the "reasonably likely" framework.

IT COULD HAVE BEEN SIMPLER

The SEC climate guidance might have made it easier on companies if it had provided a definitive near-term time horizon, such as a three-year period, beyond which companies are not expected to divine what specific types of climate-related events and any physical changes may come about as a result of climate change, where they may occur, and how they may affect business. To the contrary, it states:

> The commission has not quantified, in Item 303 or otherwise, a specific future time period that must be considered in assessing the impact of a known trend … that is reasonably likely to occur. As with any other judgment required by Item 303, the necessary time period will depend on a registrant's particular circumstances and the particular trend … under consideration.

This places the burden on companies to make important disclosure decisions based on scientific analysis outside their control and expertise, in stark contrast to an avowal made by SEC chief Mary Schapiro in discussing the climate guidance: "The Commission is *not* making any kind of statement regarding the *facts* as they relate to the topic of 'climate change' or 'global warming.' And, we are not opining on whether the world's climate *is* changing; at what pace it might be changing; or due to what causes."[28]

This appears to be the same agnosticism the climate guidance tells companies they may no longer rely upon.

THE EFFECT OF LEGISLATION AND REGULATION

Perhaps even more difficult to consider than the likely physical effects of climate change are the political trends informing the pace, and substantive impact, of climate-related legislation and regulation. Separate from the question of whether, how, when, where and why the climate is changing and what that could mean for humankind, there is the question of what, if anything, the government is going to do about it.

As discussed above, there are, of course, existing laws and regulations that impose specific climate-related requirements upon some companies. As the SEC climate guidance points out, "a number of state and local governments have enacted legislation and regulations that result in greater regulation of greenhouse gas emissions."[29]

And "[s]ome members of the international community … have taken actions to address climate change issues, [including] the European Union Emissions Trading System, which was launched as an international 'cap and trade' system of allowances for emitting carbon dioxide and other greenhouse gases."[30]

Companies subject to specific existing requirements, and that know what those requirements are, can be expected to make reasonable assessments as to whether they create material risks.

FORECAST: CLOUDY WITH PERIODS OF UNCERTAINTY

The SEC's climate guidance acknowledges, however, that at the federal level in the United States, considerable uncertainty remains about what will happen in terms of climate change legislation and regulation.

It mentions "cap-and-trade" legislation that had been approved by the House of Representatives and "a similar bill [that] was introduced in the Senate in the fall of 2009," but it makes no predictions concerning whether or when a federal climate change bill will be enacted, let alone what it might require or whom it might impact the most.[31]

It mentions the EPA's December 2009 finding of "endangerment" as to greenhouse gases under the Clean Air Act, "which will allow the EPA to craft rules that directly regulate greenhouse gas emissions," but is careful not to guess the pace, scope, manifestations or economic effects of those rules.[32]

It also mentions that the U.S. government "is participating in ongoing discussions with other nations, including the recent United Nations Climate Conference in Copenhagen, which may lead to future international treaties focused on remedying environmental damage caused by greenhouse gas emissions," but implicitly acknowledges the uncertainties surrounding such international compacts and whether they will actually be binding on the nations that enter into them.[33]

At the time of this writing, there are vast uncertainties surrounding whether, when and to what extent these or any other measures will result in federal government action imposing specific, material requirements on greenhouse gas emitters.

Rather than allowing companies to wait until the political process has arrived at those requirements, however, the SEC climate guidance somewhat aggressively instructs public companies to treat "pending legislation or regulation" as "a known uncertainty" within the meaning of Item 303. The guidance states explicitly that public company management is expected to "evaluate whether pending [climate change] legislation or regulation is reasonably likely to be enacted."[34]

PREDICTING LEGISLATION

In her statement regarding the SEC climate guidance, Schapiro said, "It is neither surprising nor especially remarkable for us to conclude that *of course* a company must consider whether potential legislation — whether that legislation concerns climate change or new licensing requirements — is likely to occur."[35] But, upon further reflection, it actually is pretty surprising.

By the SEC's own long-standing definition, the MD&A is intended to "communicate to shareholders management's view of the company's financial condition and prospects."[36] It is not intended to communicate management's view on the prospects of various pieces of legislation and items of proposed regulation that may be winding their way through the political process.

The release of the climate guidance, however, appears to require companies to do just that, notwithstanding the obvious challenges inherent in predicting the outcome of federal legislative and regulatory efforts while they are still being incubated.

Especially given the recent health care legislation saga, which as of this writing is still unfolding, it is hard to imagine that the management of any public company is going to be able to say that any particular piece of legislation is "likely" or "not likely" to be enacted, let alone what its specific provisions may be.[37]

Indeed, it is next to impossible for most companies to predict where they may end up under any one piece of pending legislation, as there are numerous combinations of possible outcomes.

> Companies should consider whether the "pollution exclusion" in their D&O liability insurance policy is worded in such a way that there may be gaps in coverage for shareholder litigation or SEC enforcement actions related to climate change.

Multiply that, then, by the amount of legislation and regulation pending at any given time. If a company were to discuss all those possible outcomes in its MD&A disclosures, those disclosures likely would turn into fairly meaningless disclaimers, based on speculation layered upon speculation.

RISKY ASSUMPTIONS

It arguably would have been helpful for the SEC climate guidance to have instructed companies to assume any pending legislation or regulation is "not likely to be enacted" until a specific bill is approved by both houses of Congress or a final rule is scheduled for publication in the Federal Register. However, the guidance actually does the opposite: "Unless management determines that [a particular piece of pending legislation or a draft regulation] is not reasonably likely to be enacted, it must proceed on the assumption that the legislation or regulation will be enacted."[38]

In light of the SEC's stringent interpretation of the term "not reasonably likely," at some points this could mean that companies will have to proceed with their materiality determinations on the assumption that several different simultaneously pending climate-related laws and regulations, each with different frameworks and requirements, will be enacted.[39]

QUESTIONS FOR MANAGEMENT

Under the SEC's interpretation of Item 303, to assess a company's exposure to pending legislation and evolving regulation, management would need to consider the following types of questions:

- What specific legislative and regulatory responses to climate change are pending? Which of those are not likely to come to fruition?
- As for any pending legislation or regulation that could come to fruition, what are the specific provisions of the proposed law or regulation?
- When and how might any of those provisions begin to affect the company? What are the emissions thresholds involved, and what is the company emitting by comparison?
- By the time the new law would be applicable, will the company be in a position to avoid a serious impact, for example by acquiring companies with a low-carbon profile that would generate excess allowances? Will new technologies such as carbon capture and storage be developed by that point, vastly reducing the amount of carbon being emitted and/or the cost of reducing emissions?
- By the time the proposed new law would be applicable, might a change of presidential administration or makeup of Congress result in the law being repealed, suspended or rolled back?
- By the time the new law would be applicable, will the company be in a position to capitalize on a material benefit of climate change legislation?

With regard to the last point, the SEC climate guidance, like most disclosure "frameworks" proposed by investor groups over the years, suggests that management should disclose the material positive effects that climate-related legislation and regulation could have on their companies.[40] "For example, if a 'cap and trade' type system is put in place, registrants may be able to profit from the sale of allowances if their emissions levels end up being below their emissions allotment."[41]

Before a company touts the projected business benefits of climate-related legislation and regulation, however, it should consider the shareholder litigation risk in the event that the benefits are never realized. Any positive effects of climate change should be considered and maximized, but companies should tread very carefully in disclosing any of them prematurely.

PRACTICAL IMPACT AND CONSIDERATIONS

In many cases, the true effect of SEC interpretive guidance is not on the disclosures that could be made, but on changes in company behavior and internal processes. The SEC has limited ability to directly regulate public companies' behavior wholesale, but it can do so indirectly through disclosure requirements.

The climate guidance may not result in many companies disclosing anything they were not disclosing before, but it may require them to take measurements that were not being taken before, ask questions of supply chain partners that were not being asked before or monitor developing areas of the law that were not being monitored before.

The most important point of the guidance today appears to be that, when crafting disclosure that enables investors to see the company through the "eyes of management," management cannot turn a blind eye to the effect that climate-related issues may have on the company's finances and operations. The following are some additional considerations for public companies in evaluating the SEC climate guidance.

A FOGGY HORIZON

Under the current state of affairs as of this writing, it will be difficult for most companies to make meaningful, company-specific disclosures regarding climate-related risk without resorting to the type of boilerplate that the SEC has instructed them to avoid. There is no particular near-term horizon when it looks like the climate change landscape will be different from the current state of affairs, but that horizon will appear at some point. It is a good idea for companies to keep apprised of developments at the local, state, federal legislative, federal regulatory and international levels, as those developments may trigger additional disclosure requirements.

It appears that one of the SEC's primary goals with its climate guidance is to encourage companies to augment their internal analyses to confirm that there is nothing material to disclose at this time regarding climate-related risk. "In identifying, discussing, and analyzing known material trends and uncertainties, registrants are expected to consider all relevant information even if that information is not required to be disclosed, and, as with any other disclosure judgments, they should consider whether they have sufficient disclosure controls and procedures to process this information."[42]

Management may want to consider what the company is doing to measure its emissions, carbon footprint, supply chain effects and so forth and whether there is more that should be done at this time.

RECOMMENDATIONS

In terms of disclosure, companies should work with their attorneys and accountants to be clear regarding what, if any, climate-related risk disclosures the company is required to make in each quarterly or annual filing under SEC regulations and what disclosures would be voluntary.

So long as the landscape remains as it is today, most *required* climate-related disclosures are going to be forward-looking statements, which are protected under the safe harbor of the Private Securities Litigation Reform Act of 1995 if accompanied by meaningful cautions.[43]

To maximize the chance of coming within the safe harbor, disclosures should be plainly worded as forward-looking, and each accompanying caution should be company-specific and tailored to closely fit the related disclosure.

Management should determine what *voluntary* climate-related disclosures the company is making outside of SEC filings, such as in corporate sustainability reports and answers to questionnaires circulated by the Carbon Disclosure Project. Those disclosures, too, often can be stated as forward-looking statements accompanied by meaningful cautions. And it is important to confirm that the company's voluntary disclosures do not contradict disclosures made in SEC filings or identify material risks that are not also disclosed in the company's MD&A.

Wherever the company discloses current information — voluntarily or otherwise — regarding climate change, that information is most useful when accompanied by details about how the information was determined/calculated, what methods and assumptions were used, and similar relevant analytical information. Any public disclosure that a company makes is potential fodder for future shareholder class-action suits of a nature that cannot reasonably be predicted today.

THE MOST IMPORTANT DISCLOSURE

Particularly with respect to climate change, where there are no uniform standards and many uncertainties, it would not be surprising to find that certain information provided today is, with perfect hindsight, in some way incorrect. Disclosing *how* current information was arrived at is often as important as, if not more important than, disclosing the information itself.

Many public companies today have risk management functions both at the management level and at the board level. Companies may want to consider adding climate change to the list of risks those functions are periodically assessing, monitoring and reassessing.

Finally, companies should consider whether the "pollution exclusion" in their D&O liability insurance policy is worded in such a way that there may be gaps in coverage for shareholder litigation or SEC enforcement actions related to climate change. Now that the Supreme Court has ruled that greenhouse gases are "pollutants" within the meaning of the Clean Air Act, insurers looking for reasons to deny coverage could point to the "pollution exclusion" and argue that something like a shareholder class action based on inadequate climate-related disclosures is not covered under the policy.

NOTES

1 *See, e.g.,* Jim Snyder & Silla Brush, Senate continues with debate on climate change legislation but hurdles remain, The Hill, Nov. 10, 2009; Friends of the Earth, Subprime Carbon? (March 2009); H. Comm. on Energy and Commerce staff, Climate Change Legislation Design White Paper: Appropriate Roles for Different Levels of Government (February 2008).

2 *Massachusetts v. EPA*, 549 U.S. 497 (2007). In his dissent, Justice Antonin Scalia maintained that the EPA had full discretion to interpret the Clean Air Act as not including greenhouse gases, where the agency had found that "there continue to be important uncertainties in our understanding of the factors that may affect future climate change and how it should be addressed." *Id.* at 554.

3 Press Release, EPA, EPA Finalizes the Nation's First Greenhouse Gas Reporting System (Sept. 22, 2009).

4 Press Release, EPA, New EPA Rule Will Require Use of Best Technologies to Reduce Greenhouse Gases from Large Facilities (Sept. 30, 2009).

5 Press Release, EPA, Greenhouse Gases Threaten Public Health and the Environment (Dec. 7, 2009).

6 *See, e.g.,* Jeremy Warner, Here comes the next bubble – carbon trading, Daily Telegraph, Feb. 19, 2010; Mark Shapiro, Conning the Climate: Inside the

Carbon-Trading Shell Game, Harper's, February 2010; Three Investment Trends Benefiting from Cap and Trade, http://zachstocks.com/2009/06/cap-and-trade (June 27, 2009); see also New Energy Economy Legislation to Create Opportunities for Cleantech Investors, Producers and Adopters, According to PricewaterhouseCoopers, Globe Newswire, Feb. 25, 2009.

7 *See John Vidal et al.,* Low targets, goals dropped: Copenhagen ends in failure, Guardian, Dec. 19, 2009.

8 Letter from Lisa P. Jackson, Administrator, EPA, to Sen. Jay Rockefeller IV (Feb. 22, 2010); *see also* Ian Talley and Stephen Power, EPA Delays Emissions Regulations, Wall St. J., Feb. 23, 2010. Four influential coal-state Democrats have introduced companion bills in the House and Senate that would block the EPA from implementing any climate-related stationary-source rules for two years. See Darren Samuelsohn, Coal-State Dems Unveil Bills Stalling EPA Emission Curbs, N.Y. Times, Mar. 4, 2010.

9 SEC Interpretive Release No. 33-9106, Commission Guidance Regarding Disclosure Related to Climate Change (Feb. 2, 2010).

10 *Id.* at 3.

11 The question of what risks companies could disclose voluntarily is a different one not addressed in this article. Because of pressure from non-governmental organizations such as the Carbon Disclosure Project and investor coalitions such as Ceres, public companies are voluntarily disclosing an increasingly comprehensive amount of information about their greenhouse gas emissions and possible future ramifications of those emissions. These disclosures appear both in the responses to annual questionnaires created by these organizations (and the responses are published on the organizations' Web sites) and in glossy corporate sustainability and responsibility reports published by many public companies alongside their annual reports to shareholders. Public companies supply this information because customers and employees may be concerned about it, because they want to demonstrate that they are aware of and addressing climate-related issues, because they will face shareholder activism if they do not supply it, and, for many companies, because management has decided it is "the right thing to do." *See* Mia Mazza & Priya Huskins, A Look at Climate Change-Related Disclosures, Law360, June 25, 2009.

12 The climate guidance also references Regulation S-K Item 101(c)(i)(xii), which requires disclosure of material effects of compliance with "laws that have been enacted or adopted" regulating the discharge of materials into the environment; Item 103, Instruction 5, which requires a registrant to "describe any material pending legal proceeding to which it or any of its subsidiaries is a party," including environmental litigation; and Item 503(c), which requires disclosure of risk factors, which are "the most significant factors that make an investment in the registrant speculative or risky." 17 CFR §§ 229.101(c)(i)(xii), 229.103, and 229.503(c). Those requirements, which likely will be applicable in significantly more obvious situations, are not discussed in this article.

13 SEC Climate Guidance at 15.

14 SEC Interpretive Release No. 33-8350, Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations (Dec. 19, 2003).

15 *Id.*

16 *Id.* at 3.

17 *Id.* (emphasis added); SEC Climate Guidance at 22–23.

18 SEC Interpretive Release No. 33-6835, Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures (May 18, 1989).

19 *Id.*

20 2003 Release at n. 54.

21 1989 Release at 22430.

22 SEC Climate Guidance at 18.

23 One SEC commissioner who dissented to the climate guidance said, "if as a result of this release, issuers increase climate-change-related disclosures that are not truly decision-useful for investors, ironically we will have harmed investors by increasing registrants' regulatory burden and diverting company resources, making disclosure more cumbersome, and diverting the resources of the commission itself." SEC Commissioner Kathleen L. Casey, Statement at Open Meeting on Interpretive Release Regarding Disclosure of Climate Change Matters (Jan. 27, 2010).

24 SEC Climate Change Guidance at 26.

25 *Id.* at 6–7, 26–27.

26 *Id.* at 27.

27 *See* http://en.wikipedia.org/wiki/Act_of_God (citing Henry Campbell Black, Black's Law Dictionary 33 (6th ed. 1990)).

28 Mary Schapiro, Chairman, SEC, Statement Before the Open Commission Meeting on Disclosure Related to Business or Legislative Events on the Issue of Climate Change (Jan. 27, 2010).

29 SEC Climate Guidance at 3.

30 *Id.* at 4.

31 *Id.* at 3.

32 *Id.* at 3–4.

33 *Id.* at 4–5.

34 *Id.* at 23.

35 Schapiro Statement.

36 SEC Climate Guidance at 16.

37 One of the two dissenting SEC commissioners criticized the climate guidance's "fail[ure] to recognize that the climate change debate remains unsettled and that many have questioned the appropriateness of the regulatory, legislative and other initiatives aimed at reducing emissions that the release features." Troy A. Paredes, Commissioner, SEC, Statement Regarding Commission Guidance Regarding Disclosure Related to Climate Change (Jan. 27, 2010). The other "conclude[d] that the purpose of this release is to place the imprimatur of the commission on the agenda of the social and environmental policy lobby, an agenda that falls outside of our expertise and beyond our fundamental mission of investor protection." Kathleen L. Casey, Commissioner, SEC, Statement at Open Meeting on Interpretive Release Regarding Disclosure of Climate Change Matters (Jan. 27, 2010).

38 SEC Climate Guidance at 23.

39 Under the SEC's rubric, it is unclear what assumptions companies should make regarding the prospects of the Maintaining Agency Direction on Financial Fraud Act, S. 3032, introduced Feb. 24, which would block the climate guidance itself from having any force or effect. See Press Release, U.S. Sen. John Barrasso, Barrasso Bill Blocks SEC Climate Change Regulations (Feb. 24, 2010).

40 SEC Climate Guidance at 23.

41 *Id.*

42 *Id.* at 19–20.

43 15 U.S.C. § 78u-5.

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