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SEC Climate Change Disclosure: Is Your Company's Carbon Footprint a "Material" Risk?

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Securities law requires publicly-traded companies to report material risks. Does the Securities Exchange Commission (SEC) currently stipulate that material climate risks be disclosed under existing law? No - at least not yet. Should publicly-traded companies evaluate whether climate change is reasonably likely to impact their future financial performance? Yes - especially as the Obama administration attempts to position the U.S. for a low-carbon future. While the SEC has yet to draft specific guidelines for assessing and measuring climate-related issues, companies can perform a basic assessment of the environmental risks and opportunities that could materially affect their operations.

The SEC defines "material" broadly: "A fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 12, 1999) (quoting* TSC Industries, Inc. v. Northway, Inc., *426 U.S. 438 (1976))*. The issues involved with environmental disclosure, especially those that address material corporate risks related to climate change, have gained momentum with the U.S. House of Representatives' passage of the American Clean Energy and Security Act (ACESA) on June 26, 2009. The ACESA calls for reducing U.S. emissions 17% below 2005 levels by 2020, and 83% below 2005 levels by 2050 by establishing a cap-and-trade system for greenhouse gas (GHG) emissions, and it would require electric utilities to meet 20% of their electricity demand through renewable energy sources by 2020. Meeting emissions quotas, buying and selling emissions permits, finding alternative energy sources - these all qualify as "material" risks to a company's earnings.

Last month, several leading global investors sent a letter to the SEC requesting that the Commission issue formal guidance on material climate-related risks. Despite the lack of direction on how to measure environmental impacts, companies can assess the risks they face regarding climate change by considering inclusion of the following in their regular SEC filings:

- Report GHG emissions
- State position on climate change
- Identify the climate risks faced
- Identify actions being taken to address climate change
- Quantify the costs of compliance

If carbon is fundamental to your operation, quantify the GHG emissions and evaluate the cost of complying with proposed GHG emissions limits. Per the carbon cap-and-trade language in the ACESA, operations that are unsuccessful in reducing their carbon output risk exceeding their emissions quotas and having to purchase permits from other companies at a cost yet to be determined by the marketplace. (Also bear in mind that cap-and-trade will not apply to entities that emit less than 25,000 tons of carbon dioxide.) Depending on the level of emissions found at a particular company, the cost of compliance could be very material to its stakeholders. To the extent applicable (and feasible), quantify and disclose the costs associated with developing carbon inventories, carbon emission abatement strategies, low carbon/renewable energy solutions, and any other actions taken to address climate change.

While operations will undoubtedly incur costs in complying with cap-and-trade, climate change may also create opportunities for proactive businesses. Cap-and-trade will boost solar, wind, and other renewable technologies. With carbon disclosure requirements possibly on the horizon, investors could be looking for opportunities to funnel capital toward green building initiatives and clean energy technologies. The more climate change data included in your company's filings (including an assessment of compliance opportunities as well as costs), the more confident investors may feel in investing in your company over one that is less transparent.

Reasonable minds may differ on the likelihood of Congress passing climate change legislation into law. The U.S. House barely approved the ACESA by a razor-thin vote of 219-212, and its supporters will encounter more difficult odds when the U.S. Senate considers climate legislation this fall. Even if the position in your filing is that climate change will lose its momentum, it would be wise to publicly acknowledge *the risks* related to climate-related laws and regulatory developments. With regard to such laws and regulations, consider identifying them in your filing, indicate whether your operation is in compliance, or will be in compliance, and the opportunities and costs (to the extent they can be quantified) associated with compliance on a going-forward basis.

Issues involving climate change are probably not going away any time soon. Even if the Senate does not pass climate change legislation this fall, a myriad of state and local climate change initiatives are already in effect or are presently under consideration for passage. While no mandatory reporting requirement for GHGs exist, companies already evaluating (and reducing) their carbon footprints will achieve short-term and long-term benefits for their stakeholders. For these proactive companies, greater transparency in the area of climate-related matters today may lead to more business opportunities tomorrow.