ALERTS AND UPDATES

SEC Gives Guidance for Public Companies' Disclosures Related to Climate Change

March 5, 2010

The U.S. Securities and Exchange Commission (the "SEC") published Release Nos. 33-9106; 34-61469; FR-82 (the "Release")—effective on February 8, 2010—which outlines the SEC's views concerning disclosure requirements for climate change issues. The interpretive Release, titled "Commission Guidance Regarding Disclosure Related to Climate Change," is intended to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents to file with the SEC and provide to investors.

Background

In 1971, the SEC issued its first interpretive release advising what should be disclosed in SEC filings regarding the financial impact of compliance with environmental laws. Throughout the 1970s and early-1980s, the SEC developed rules for mandatory disclosure of information relating to litigation and other business costs arising from compliance with environmental laws. These rules were finalized and adopted by the SEC in 1982.

The Release does not formally modify the existing rules or create any new rules and is intended to provide guidance. It discusses:

- Various regulatory, legislative and other developments that may have a significant effect on a company's operating and financial decisions;
- Existing rules pertaining to business description, legal proceedings, a business' risk factors, and management discussion and analysis that may potentially require disclosure of climate change issues; and
- How existing or pending legislation or international accords, or the physical impacts of climate change itself, may prompt disclosure requirements.

Recent Regulatory, Legislative and Other Developments Related to Climate Change

The Release highlights the ever-increasing climate change–related body of legislation and regulations enacted by local and state governments[1] and pending federal legislation, which, if enacted, would limit and reduce greenhouse gas emissions through a "cap and trade" system of allowances and credits, among other provisions.[2] The Release also notes that the U.S. Environmental Protection Agency has taken steps to regulate greenhouse gases and has imposed requirements on large emitters of greenhouse gases to collect and report data with respect to their greenhouse gas emissions.[3] In addition, the Release states that U.S. companies with operations outside the United States may be subject to existing international climate change agreements to which the United States is not a party, such as the Kyoto Protocol and the European Union Emissions Trading System, or other future international treaties focused on remedying environmental damage caused by greenhouse gas emissions.

The Release points out that existing and pending regulations and legislation may have a significant effect on operating and financial decisions. For example, companies may have to make decisions about undertaking capital expenditures to reduce emissions. Companies subject to "cap and trade" laws may face expenses related to purchasing allowances where reduction targets cannot be met. Even though some companies may not directly be affected by regulatory and legislative developments, they could still be impacted by increased prices for goods or services caused by climate change measures.

The Release also discusses the possibility of significant physical effects of climate change that may have a material effect on a company's business and operations. Changes in weather patterns, increased sea levels, and temperature extremes may impact a company's personnel, physical assets, supply chain and distribution chain. Physical changes associated with climate change may decrease demand for products or services.

Rules Requiring Disclosure of Climate Change Issues

The SEC identifies in the Release what it considers to be the most-pertinent nonfinancial statement disclosure rules that may require disclosures related to climate change. These rules include:

Description of Business. Item 101 of Regulation S-K,[4] which requires a company to describe its business and that of its subsidiaries, mandates disclosure regarding certain costs of complying with environmental laws. This includes those costs that have a material effect on capital expenditures, earnings and competitive position of the registrant and its subsidiaries.

Legal Proceedings. Item 103 of Regulation S-K[5] requires a company to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party. A company also must describe material pending legal actions in which its property is the subject of the litigation. If a company is aware of similar actions contemplated by governmental authorities, Item 103 also requires disclosure of those proceedings. The company does not have to disclose ordinary routine litigation incidental to its business or other types of proceedings when the amount in controversy is below designated thresholds.

Risk Factors. Item 503(c) of Regulation S-K[6] requires a company to provide a discussion of the most-specific significant factors that make an investment in the registrant speculative or risky. The Release advises that the company making the disclosures should be as specific as possible in detailing how a climate change risk applies to the particular company.

Management's Discussion and Analysis. Item 303 of Regulation S-K[7] requires disclosure known as the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). The Release states that MD&A disclosure should provide material historical and prospective information, which enables investors to assess the financial condition and results of operations of the company. The Release also notes that the MD&A disclosure should place particular emphasis on the company's prospects for the future.

Climate Change–Related Disclosures

The Release also discusses some of the ways climate change may elicit disclosure required by the rules discussed above. These topics are prime examples of climate change–related issues that a company may wish to consider.

Impact of Legislation and Regulation. The Release notes that Item 101 of Regulation S-K requires disclosure of any material, estimated capital expenditures for environmental-control facilities for such future periods as the company may deem material. If a company is required to undertake capital expenditures by existing federal, state and local greenhouse gas provisions, then the company would have to disclose this information. The Release states that the disclosures should consider specific risks the company faces as a result of climate change legislation or regulation, and should avoid making generic risk-factor disclosures.

International Accords. The Release maintains that a company should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change. The rules requiring disclosure pertaining to international climate change laws are the same as those discussed above for U.S. climate change regulations.

Indirect Consequences of Regulation or Business Trends. The Release also points out how legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies. The Release notes that these developments may create demands for new products or services, but may also decrease demands for existing products or services. For example, there could be decreased demand for goods that produce significant greenhouse-gas emissions and an increased demand for goods that result in lower emissions than competing products. The Release indicates that these business trends or risks may be required to be disclosed as risk factors or in the MD&A. If developments substantially alter the way a company does business, then disclosure may be required in a company's business description.

Physical Impacts of Climate Change. According to the Release, companies may also want to evaluate for disclosure purposes the actual and potential material impacts of environmental matters on their business. Significant physical effects of climate change, such as severe weather (*e.g.*, floods or hurricanes), changes in sea levels, the arability of farmland, and water availability and quality have the potential to affect a company's operations and results. Therefore, companies whose businesses may be vulnerable to severe weather or climate-related events may wish to consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents.

What This Means for Publicly Traded Companies

In light of the SEC's newly effective Release, a publicly traded company may want to undertake the following:

1. Analyze existing and track pending domestic and international climate change regulations and legislation to determine whether they affect the company's operating and financial decisions, thus prompting a disclosure obligation;
2. Analyze supply and distribution chains to determine whether developments in technologies and processes to lower greenhouse gas emissions would increase or decrease the company's profitability; and
3. Analyze the potential for the physical impacts of climate change to impact the company.

For Further Information

If you have any questions regarding the SEC's new Release, including whether your company may have a disclosure obligation or how the guidance may affect your company, please contact one of the members of the Securities Law Practice Group or the lawyer in the firm with whom you are regularly in contact.

Notes

1. For example, in California, the Global Warming Solutions Act of 2006 and regulatory actions by the California Air Resources Board have resulted in restrictions on greenhouse gas emissions. In addition, state and regional

programs, such as the Regional Greenhouse Gas Initiative (including 10 Northeast and Mid-Atlantic states), the Western Climate Initiative (including seven Western states and four Canadian provinces) and the Midwestern Greenhouse Gas Reduction Accord (including six states and one Canadian province), have been developed to restrict greenhouse gas emissions. For a more detailed list of state action on climate change, see the Pew Center on Global Climate Change (available at www.pewclimate.org/what_s_being_done/in_the_states/state_action_maps.cfm).

2. *See, e.g.,* American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong., 1st Sess. (2009) (passed by U.S. House of Representatives on June 26, 2009), and Clean Energy Jobs and American Power Act of 2009, S. 1733, 111th Cong., 1st Session (2009) (introduced in U.S. Senate on September 30, 2009).
3. *See* Press Release, EPA, EPA Finalizes the Nation's First Greenhouse Gas Reporting System / Monitoring to Begin in 2010 (Sept. 22, 2009) (available at http://yosemite.epa.gov/opa/admpress.nsf/d985312f6895893b852574ac005f1e40/194e412153fcffea8525763900530d75!OpenDocument).
4. 17 C.F.R. § 229.101.
5. 17 C.F.R. § 229.103.
6. 17 C.F.R. § 229.503(c).
7. 17 C.F.R. § 229.303.