

Alert

SEC Issues Guidance on Climate Change-Related Disclosure by Public Companies

February 8, 2010

Last November, we wrote about developments that suggested the SEC would soon act to further clarify the obligation of public companies to disclose risks related to climate change and green house gas (“GHG”) emissions in their public filings.¹ On Feb. 2, 2010, the SEC issued an interpretive release—“Commission Guidance Regarding Disclosure Related to Climate Change”—which provides guidance to public companies on the application of existing SEC disclosure requirements to climate change matters.² Although the interpretive release does not create new disclosure requirements, in many cases it will require registrants to think about their disclosure obligations more expansively.

Environmental disclosure is nothing new for public companies. Under existing disclosure rules, domestic public companies need to consider environmental-related disclosures pursuant to several items of Regulation S-K. Items under which disclosure may be required include (i) Item 101 of Regulation S-K, which requires a description of a registrant’s business, including specifically the material effects of compliance with environmental laws and disclosure of material estimated capital expenditures for environmental control facilities, (ii) Item 103 of Regulation S-K, which requires disclosure of material pending legal proceedings and contains specific guidance in the instructions to that Item as to when environmental proceedings must be disclosed, (iii) Item 303 of Regulation S-K, which requires the MD&A to discuss known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on the registrant’s financial condition or operating performance, and (iv) Item 503 of Regulation S-K, which contains the risk factor disclosure requirement. Environmental disclosures also may be required under general principles of materiality.

Many of the same disclosure requirements also apply to foreign private issuers. Although the disclosure obligations of foreign private issuers are governed principally by the requirements of Form 20-F rather than Regulation S-K, most of the S-K disclosure requirements relating to climate change have parallels under Form 20-F, although some of the Form 20-F requirements are not as extensive as those applicable to domestic registrants.

Topics Highlighted in the Release

In the interpretive release, the SEC highlighted four climate change-related topics that public companies should consider in preparing their disclosure, as well as examples of the types of information that may require disclosure. The guidance in the interpretive release should be considered in the context of existing disclosure requirements and standards of materiality.

¹ See [“SEC Mandatory Climate Change Risk Disclosure is on the Horizon,”](#) BNA Securities Regulation & Law, Nov. 16, 2009.

² See [“Commission Guidance Regarding Disclosure Related to Climate Change,”](#) SEC Release No. 33-9106, Feb. 2, 2010

- **Impact of Legislation and Regulation**

Existing and/or pending environmental legislation may require disclosure in the Business section, under Legal Proceedings, in MD&A and/or Risk Factors. Registrants tend to have their arms around disclosure pertaining to existing legislation, since its impact and relevance is usually apparent. Therefore, as might be expected, the interpretive release spends more time focused on pending legislation, which often receives less attention in public company filings due to the inherent uncertainties of the legislative process and the more speculative nature of the attendant disclosure.

For purposes of assessing MD&A disclosure under Item 303 of Regulation S-K, the interpretive release indicates that registrants must proceed on the assumption that pending regulations or legislation will be enacted unless management determines that is not reasonably likely to be the case. In addition to disclosing the potential effect of material pending legislation, the registrant needs to consider disclosure, if material, of the difficulties involved in assessing the timing and effect of the legislation. Finally, registrants should not limit their evaluation of disclosure of a proposed law only to negative consequences; disclosure of the positive effects of legislation also should be considered.

Examples cited in the interpretive release of possible consequences of pending legislation and regulation related to climate change that may require disclosure include (i) costs to purchase, or profits from sales of, allowances or credits under a cap and trade system, (ii) costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a cap and trade regime and (iii) changes to profit or loss arising from increased or decreased demand for goods and services arising directly from legislation or regulation and indirectly from changes in costs of goods sold.

- **International Accords**

Registrants should consider, and disclose when material, the impact on their business of international accords and treaties relating to climate change, such as the Kyoto Protocol. The disclosure considerations relating to international accords and treaties are the same as those discussed above with respect to U.S. climate change regulation.

- **Indirect Consequences of Regulations and Business Trends**

Registrants should consider the materiality of business trends and risks arising out of legal, technological, political and scientific developments concerning climate change. Indirect consequences or opportunities that may merit disclosure include (i) decreased demand for goods that produce significant GHG emissions, (ii) increased demand for goods that result in lower emissions than competing products, (iii) increased competition to develop innovative new products, (iv) increased demand for generation and transmission of energy from alternative energy sources, (v) decreased demand for services related to carbon based energy sources, such as drilling services or equipment maintenance services, and (vi) changing prices for goods or services purchased from companies that are directly affected by climate change. In addition, the materiality of disclosure of the ramifications of a registrant's plan to reposition itself to take advantage of potential opportunities, such as through the acquisition of plants or equipment, should be considered. As the final example under this topic, the interpretive release highlights the need to consider risk factor disclosure relating to the adverse consequences of reputational damage arising out of the public perception of any publicly available data relating to the registrant's GHG emissions.

- **Physical Impacts of Climate Change**

Registrants whose business may be vulnerable, whether directly or indirectly, to severe weather or climate related events need to consider the risks of or consequences from these events and whether they are material. Possible consequences of severe weather that may merit disclosure that are cited in the interpretive release include (i) for registrants with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing and transport of products, (ii) indirect financial and operational impact from disruptions to the operations of major customers or suppliers from severe weather, (iii) other material impact on a registrant's personnel, physical assets, supply chain or distribution chain, including changes in the availability or quality of natural resources, damages to facilities or decreased efficiency of equipment, (iv) decrease in the demand for products or services, (v) increased insurance claims and liabilities for insurance and reinsurance companies, (vi) decreased agricultural production capacity in areas affected by drought or other weather-related changes, (vii) increased insurance

premiums and deductibles or a decrease in the availability of coverage for registrants with operations in areas subject to severe weather and (viii) financial risk arising from physical risks to other companies.

Action Items

In light of the interpretive release, registrants, especially those in industries that are environmentally sensitive from a legislative or risk standpoint, should consider the following action items.

- **Assess Knowledge Base**

Registrants should consider whether they need to enhance their knowledge base, through either external or internal resources, to make informed environmental disclosure decisions. For example, in many cases, registrants are not as familiar with pending environmental legislation or international accords as they are with current domestic legislation. In addition, they may not have sufficient information concerning their GHG emissions or other operational matters to assess the materiality of pending legislation. Registrants also may not have sufficient internal expertise to assess the indirect consequences of regulation or business trends or the physical impacts of climate change.

- **Revisit Existing Disclosure Practices**

Although the interpretive guidance is likely to disproportionately affect registrants in a fairly narrow range of industries, such as the energy production and distribution, heavy manufacturing and insurance industries, all registrants need to consider the SEC's guidance against their current disclosure practices. The interpretive release is not industry or geography specific and applies to all public companies. In many cases, registrants will need to focus on their environmental disclosure quickly given upcoming Form 10-K filings over the next several weeks.

Registrants should carefully consider their environmental disclosures. At environmentally sensitive companies, these disclosures will be closely followed by environmental constituencies, who are likely to benchmark the adequacy of the disclosure against the interpretive release. In today's era of heightened environmental scrutiny and turbulent equity markets, class-action lawyers (both on the environmental and the securities side) and states' attorneys general also will in many instances focus closely on the perceived adequacy of environmental disclosure. In addition, in the interpretive release, the SEC indicates that they intend to monitor the impact of the release on filings as part of their disclosure review program. As in other contexts, to the extent risk factor or other disclosure is appropriate, registrants should avoid generic boilerplate disclosure and should tailor the disclosure to their particular circumstances.

- **Regularly Assess Disclosure Obligations**

Because climate change is a developing area from a legal, technological, political and scientific standpoint, registrants should put in place protocols to regularly reassess their disclosure to ensure that it takes into account new developments.

- **Consider Impact of Other Disclosures**

When preparing disclosure under the Securities Act and the Exchange Act, registrants should consider their other environmental disclosures, whether made publicly or to regulators. Disclosure across all forms of communication should be consistent, and disclosure made in other fora, even if voluntary, may be required to be included in SEC filings. In addition, as earlier discussed, registrants should consider the need for risk factor disclosure relating to the potential impact on their business from reputational harm arising out of their other public environmental disclosures.

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