JENNER&BLOCK

SEC and Climate and Clean Technology Law

Corporate Client Advisory

February 10, 2010

What You Need To Know About The New SEC Guidance on Climate Change Disclosure

by Jerry J. Burgdoerfer, Gabrielle Sigel, William L. Tolbert, Jr., Elaine Wolff , and Lee E. Dionne

On February 2, 2010, the Securities and Exchange Commission ("SEC") issued guidance, in the form of an interpretive release (the "Release"), as to a public company's disclosure requirements on climate change issues.[1] The SEC puts companies on notice that it will review the effect of the Release on companies' filings through its disclosure review program. This Release should be considered in the context of the SEC staff's recent reminders that their review will look beyond the four corners of a company's SEC filings, including considering disclosures in a company's earnings calls, earnings releases, website and press releases.[2] The SEC expects to hold a public "roundtable" on climate change disclosures in the spring of 2010.

Summary

The Release discusses four non-exclusive categories of climate change information that companies should evaluate for materiality in order to determine whether disclosure is required:

- the impact of legislation and regulation
- the impact of international accords
- the indirect consequences of regulation or business trends
- the physical impacts of climate change

The SEC emphasizes that the Release does not supplant the current rules regarding environmental disclosure, which date from 1982,[3] or the standards by which the materiality of information is examined. The Release features a discussion of the state, national, and international response to climate change, particularly through the restriction or disclosure of greenhouse gas ("GHG") emissions. The Release advises companies to take note of these developments, particularly because government action to address GHGs can have a material impact, both positive and negative, on their financial condition and operations. This is so even in cases where companies may be affected only indirectly, such as when companies must incur cost increases from companies that are directly regulated. The SEC notes that many companies already are publicizing climate change information about their businesses, often in documents other than SEC filings. The Release is a reminder that for some companies, regulatory, legislative and other developments could have a significant effect on results of operations and operating and financial decisions, and should be disclosed or considered for disclosure in SEC filings.

This Jenner & Block Client Advisory supplements a January 28, 2010 Jenner & Block Client Alert distributed when the SEC voted to issue the

Release.[4] Now that the SEC has published the Release, this Client Advisory discusses the Release's presentation of: (A) its purpose and context; (B) disclosure obligations existing under current law; and (C) the climate change information companies should consider disclosing in their filings. The Client Advisory concludes with points for public companies to consider in light of the new guidance.

A. The Release's Purpose and Context

The SEC's objective in issuing the Release is not to effect a rule change, but rather "to remind companies of their obligations" and to encourage them to give proper consideration to climate change matters that are material to the company.[5] The Release is a response to the increasing intensity of the climate change dialogue. Notably, the Release reviews recent legislative and regulatory developments, domestically and internationally, which result in actual and potential regulation of GHG emissions. These developments include:

1. *Federal Legislation*. The U.S. House of Representatives passed GHG cap-and-trade legislation in June 2009, and the Senate is considering its version of cap-and-trade legislation.[6] The Senate version was voted out by the Environment and Public Works Committee on November 5, 2009. Four other Senate committees need to consider the bill before it reaches the floor of the Senate.

2. *EPA Regulation*. In 2009, the U.S. Environmental Protection Agency ("EPA") issued a regulation requiring large emitters of GHGs to collect and report data about GHG emissions, beginning with their 2010 emissions.[7] On December 15, 2009, EPA issued an "endangerment finding" under the Clean Air Act, which allows EPA to issue further regulation of GHG emissions.[8]

3. *State Initiatives*. States, individually and collectively, have undertaken legislative and regulatory action to regulate GHG emissions.[9] For example, ten northeastern states have formed a mandatory cap-and-trade program for the power sector operating in their region.[10]

4. *International Developments*. The SEC's Release also describes several international events addressing global warming that "can have a material impact on companies that report with the Commission."[11] Those events include the Kyoto Protocol, with binding targets for GHG emissions; the European Union Emissions Trading System ("ETS"), an international cap-and-trade system; and ongoing U.S. diplomatic efforts which "may lead" to future treaties.[12] Although not ratified by the United States, the SEC observes that the Kyoto Protocol's binding targets, including as implemented through the ETS, can affect reporting companies with overseas operations.

The Release discusses that these domestic and international developments can have a significant impact on a company's results of operations and financial decisions. With respect to capped emissions or tradable allowances, companies may be forced to increase their capital expenditures in an effort to reduce emissions or purchase more GHG allowances. Other companies may gain a substantial benefit through the new opportunities presented by cap-and-trade mechanisms.

The physical effects of climate change present another set of risks that companies must take into account. The Release specifically notes that the insurance industry views climate change as the greatest risk to its business.[13] Severe weather, storm intensity, and temperature extremes count among the potentially material threats to a business' property and supply networks. Even for a company that would be otherwise unaffected, regulatory or physical changes may cause significant shifts in the market price of certain goods that could indirectly result in material effects on the business.

The Release describes the expanding demand for disclosure of climate change impacts, including through numerous petitions for interpretive advice filed by large institutional investors and investment groups and in Congressional hearings.[14] The Release notes that some companies are disclosing climate change impacts in their SEC filings, but asserts that "much more information is publicly available outside of . . . documents filed with the SEC . . . "[15] In particular, the SEC refers to companies' reporting of GHG emissions to the Climate Registry and the Carbon Disclosure Project, and notes that the insurance industry is required to disclose financial risks from climate change in that industry's required reports.[16] The Release cautions that although a company's disclosures of GHG information can be voluntary in those other forums, that same information may be required to be disclosed in SEC filings.[17]

B. The Release's Discussion of Current Disclosure Obligations

In 1971, the SEC issued an interpretive release (the "1971 Release") that addressed environmental disclosures for the first time in the SEC's history.[18] The 1971 Release urged reporting companies to evaluate the costs of compliance with new environmental laws and to disclose costs determined to be material. The SEC continued to study the effects of environmental compliance throughout the remainder of the 1970s. After a decade of public hearings and research, the SEC put the current disclosure rules into effect in 1982.[19] Under the current rules, company disclosures of environmental and climate change matters may be required in several filing sections, including: (1) the description of the business; (2) legal proceedings; (3) risk factors; and (4) Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A").[20]

1. *Description of business*. Item 101 of Regulation S-K requires a reporting company to provide a description of its business and that of its subsidiaries, including information about its key products and services, principal customers, and its competitive position in the marketplace. Item 101 imposes an explicit obligation on the part of companies to report certain costs relating to environmental compliance that are material with respect to capital expenditures, earnings, and competitive position.[21] With respect to capital expenditures, companies must report any material expenditures for "environmental control facilities" in the current and succeeding years and "for such further periods as the registrant may deem material."[22]

2. *Legal proceedings*. Item 103 of Regulation S-K guides the disclosure of pending legal proceedings. Companies must disclose any such proceedings that are material and involve it or its subsidiaries as a party. Item 103 also compels disclosure where the reporting company's property is the subject of material litigation. A company need not disclose "ordinary routine litigation incidental to the business."[23] However, the instructions to Item 103 state that reporting companies cannot deem proceedings arising under environmental provisions "ordinary routine litigation" if the proceedings are material to the company, the remedy sought exceeds ten percent of the consolidated assets of the company and its subsidiaries, or the action involves a governmental authority and a sanction of $100,000 or more.[24]

3. *Risk factors*. Item 503(c) of Regulation S-K requires reporting companies to highlight the most significant risk factors that an investor should consider in evaluating an investment's degree of risk. Item 503 does not explicitly mention the environment or the costs of compliance; however, reporting companies must disclose significant risk factors pertaining to environmental matters and explain any effects they may have on the business. Risks may not be stated in generic terms applicable to "any issuer or any offering."[25]

4. *MD&A*. Item 303 of Regulation S-K governs the MD&A disclosures in a filing. Item 303 disclosure is broad, including historical and prospective information,[26] any "known trends, events, demands, commitments and uncertainties" that are "reasonably likely" to materially impact the company's financial condition or operations, and other information necessary for investors to understand the company's condition and operations. Companies must disclose any climate change factors to the extent that such factors are "reasonably likely" to affect the company in a material way.[27]

The Release notes that disclosures on climate change should be made according to sufficient disclosure controls and procedures.[28] Information pertaining to climate change, as well as any other information that could affect the financial condition or operations of a company, should be disclosed if it is material: A fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important or if it would significantly affect the "total mix" of information on the market.[29] The SEC takes notice of the wide latitude Regulation S-K grants management in determining whether a fact is material and needs to be disclosed. The SEC intends that the guidance in the Release will assist reporting companies in making judgments about disclosure obligations when drafting their MD&A.

C. The Release's Examples of Climate Change Information To Be Considered

The Release states that each company's disclosure obligations will vary based on the facts and circumstances of each registrant. The SEC developed a list of four categories of consequences relating to climate change and climate change regulation that companies should take into consideration: (1) the impact of legislation and regulation; (2) international accords; (3) indirect consequences of regulation or business trends; and (4) physical impacts of climate change.

With respect to legislative and regulatory developments, which the Release describes as a "known uncertainty," the SEC prescribes a two-step analysis for MD&A disclosure requirements.[30] First, the company must "proceed on the assumption that the legislation or regulation will be enacted," unless management "determines that it is not reasonably likely to be enacted."[31] Then, management must make disclosures unless it determines that the legislation or regulation is not reasonably likely to have a material effect on its financial condition or results of operations.[32] A similar materiality analysis is required with respect to international developments.[33] Moreover, companies' analyses must consider positive and negative consequences. As an example, the Release cites to profits that a company may be able to obtain by selling offset credits qualifying for sale under cap-and-trade programs.[34]

Companies also should consider legal, technological, political and scientific developments regarding climate change that may create new opportunities or risks for companies. For example, new legislation and regulation could cause a shift in consumer demand for products that create or reduce GHGs and/or increase competition to develop innovative new products. The SEC counts reputational harm as potentially material information, observing that the public's perception of a company's practices with respect to GHGs may affect business operations and financial condition. Similarly, any environmental litigation that affects an entity's reputation may also be material.[35]

Management must also disclose material information about the physical consequences of climate change. Examples of physical consequences include disruptions caused by varying sea levels, changing weather patterns, and the availability and quality of water. These phenomena may disrupt a company's supply lines, affect the cost of and access to resources, and could result in damage to property and equipment.

D. Jenner & Block's Points for Consideration by Public Companies

Public companies should consider the following points when considering their climate change disclosures in light of the new SEC guidance:

- The Release is immediately effective upon publication in the Federal Register; thus, it should be considered for current and future filings, including upcoming Annual Reports on Form 10-K.
- Consider climate change related disclosures in earnings calls, earnings releases, websites and in press releases to ensure consistency with SEC filings.
- Consider whether the company has in place disclosure controls and procedures that ensure timely collection and evaluation of "information potentially subject to [required] disclosure."[36]

- Analyze the need to discuss pending domestic and international legislation or regulation in MD&A through a two step process applicable to "known uncertainties." First, evaluate whether the pending legislation or regulation is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, proceed under the assumption that it will be enacted. Second, determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the company's financial condition or results of operations. Unless management determines that a material effect is not reasonably likely, the company will need to discuss in its MD&A the impacts from such legislation or regulation and, if material, the difficulties involved in assessing the timing and effect of the pending legislation or regulation.
- Review the risk factor disclosure to ensure that any risks related to climate change are not overly broad so as to apply to any company. Revise, if necessary, to specify how the risk presented relates specifically to the company's business, such as how any pending legislation or capital expenditures impacts its financial condition and results of operations.
- Consider whether reputational risks relating to GHG emissions have exposed the company to potential adverse consequences from negative publicity, for example, adverse consequences that may result from a potential boycott or disruptions in production.

---

[1] Commission Guidance Regarding Disclosure Related to Climate Change, Exchange Act Release Nos. 33-9106, 34-61469 (Feb. 2, 2010) [hereinafter "Release"].

[2] *See* Exchange Act Release No. 33-8350 (Dec. 29, 2003) (stating that "if companies disclose material information . . . other than in their filed documents [such as in earnings releases or publicly accessible analysts' calls or companion website postings] they also should evaluate that material information to determine whether it is required to be included in MD&A"); *see also* Elisse B. Walter, Comm'r, Keynote Address to the 48th Annual Corporate Counsel Institute: SEC Rulemaking-- "Advancing the Law" to Protect Investors (Oct. 2, 2009) (observing that "it strikes me that [climate change] is one area where, if I were drafting disclosure for a registrant today, I would carefully consider whether that company's particular facts and circumstances raise any disclosure obligations under the current rules, and in particular, under the MD&A requirements").

[3] *See* Exchange Act Release No. 33-6383 (March 3, 1982) [47 Fed. Reg. 11380] [hereinafter "1982 Release"].

[4] Jenner & Block SEC and Climate and Clean Technology Law Client Alert: *SEC Issues New Guidance Regarding Climate Change Disclosures*, January 28, 2010.

[5] Release at 27.

[6] *See* American Clean Energy and Security Act of 2009, H.R. 2454, and Clean Energy Jobs and American Power Act of 2009, S. 1733. *See generally*, "Climate Change 2009 Year in Review: Building Foundations for Change or Just Castles in the Sand?" Emerging Issues Analysis, *LexisNexis*, January 2010 [hereinafter "*Year in Review*"], pages 18-22.

[7] *See* Mandatory Reporting of Greenhouse Gases, 74 Fed. Reg. 56,260 (final rule Oct. 30, 2009).

[8] Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(e) of the Clean Air Act, 74 Fed. Reg. 66, 496 (final rule Dec. 15, 2009). Further regulatory proposals include EPA's Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule, 74 Fed. Reg. 55,292 (proposed Oct. 27, 2009). For further discussion of these GHG regulatory initiatives see, Jenner & Block Climate and Clean Technology Law Client Advisories: *U.S. EPA Requires Mandatory Reporting Beginning with Next Year's Greenhouse Gas Emissions*, Sept. 23, 2009; *EPA Proposes Rule For Applying Clean Air Act Permit Requirements to GHG Stationary Sources*, October 6, 2009; and *Year in Review*, pages 4-18.

[9] Release at 3, n. 7; *see generally*, *Year in Review*, pages 25-28.

[10] The Regional Greenhouse Gas Initiative has required electricity generators to purchase or obtain carbon dioxide emission allowances since 2008. RGGI member states are Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont. *See* www.rggi.org

[11] Release at 4-5.

[12] *Id.*

[13] *Id.* at 5.

[14] *Id. at 7, n. 20.*

[15] *Id.* at 8-9.

[16] *Id.* at 5, 8-10.

[17] *Id.* at 10.

[18] Exchange Act Release No. 33-5170 (July 19, 1971) [36 Fed. Reg. 13989] [hereinafter "1971 Release"].

[19] 1982 Release, *supra* note 3.

[20] *See* 17 C.F.R. §§ 229.101, 229.103, 229.303, and 229.503(c).

[21] 17 C.F.R. § 229.101(c)(1)(xii).

[22] *Id.*

[23] Release at 14.

[24] 17 C.F.R. § 229.103, *Instructions to Item 103.* Note that a reporting company is permitted to group and generalize the discussion of proceedings involving a government authority if the proceedings are similar in nature.

[25] 17 C.F.R. § 229.503(c).

[26] Exchange Act Release No. 33-6835 (May 18, 1989) [54 Fed. Reg. 22427].

[27] *See* Release at 17, n. 54 (quoting 2002 comment that "Reasonably likely" is a lower standard than "more likely than not," Exchange Act Release No. 33-8056 [Jan. 22, 2002] [67 Fed. Reg. 3746]).

[28] The Release specifically states: "[A]s we have stated before, a company's disclosure controls and procedures should not be limited to disclosure specifically required, but should also ensure timely collection and evaluation of 'information potentially subject to [required] disclosure,' 'information that is relevant to an assessment of the need to disclose developments and risks that pertain to the [company's] businesses,' and 'information that must be evaluated in the context of the disclosure requirement of Exchange Act Rule 12b-20.'" Release at 19, n. 62.

[29] *TSC Industries v. Northway*, 426 U.S. 438, 449 (1976).

[30] Release at 23.

[31] *Id.*

[32] *Id.*

[33] *Id.* at 24.

[34] *Id.*

[35] Notably, on September 21, 2009, the U.S. Court of Appeals for the Second Circuit held that eight states, New York City, and three land trusts could bring public nuisance claims against owners of some of the largest U.S. electric power plants, alleging that the plants' GHG emissions contribute to global warming. *Connecticut v. American Electric Power Co.*, 582 F.3d 309 (2nd Cir. 2009). Consistent with the decision of the Second Circuit, on October 16, 2009, the United States Court of Appeals for the Fifth Circuit declined to dismiss claims brought by a class of Mississippi landowners that certain corporations' GHG emissions constitute a private and public nuisance under Mississippi law, holding that plaintiffs have standing to sue and that the case does not pose a non-justiciable political question. *Comer v. Murphy Oil USA*, 585 F.3d 855 (5th Cir. 2009). *See also* Jenner & Block Client Advisory: *Federal Appellate Court Allows Public Nuisance Claims for Greenhouse Gas Emissions*, September 25, 2009.

[36] Release at 19, n. 62.

For more information, please contact the following Jenner & Block attorneys:

Joseph P. Gromacki
Chair, Corporate Practice
Tel: 312 923-2637
Email: jgromacki@jenner.com

William L. Tolbert
Co-Chair, Securities Practice
Tel: 202 639-6038
Email: wtolbert@jenner.com

Jerry J. Burgdoerfer
Co-Chair, Securities Practice
Tel: 312 923-2820
Email: jburgdoerfer@jenner.com

Elaine Wolff
Partner, Securities Practice
Tel: 202 637-6389
Email: ewolff@jenner.com

Gabrielle Sigel
Co-Chair, Climate and Clean Technology Law Practice
Tel: 312 923-2758
Email: gsigel@jenner.com