SEC Issues New Guidance Regarding Climate Change Disclosures

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At an open meeting held January 27, 2010, the Securities and Exchange Commission voted to issue an interpretive release (the "Release") to provide guidance on existing climate change disclosure obligations.[1] Specifically, the Commission's discussion identified four categories of information about climate change that companies should consider disclosing:

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

Although it does not create new legal requirements nor modify existing ones, the Commission's decision to issue the Release, passed by a three-to-two margin, generated significant debate about the effects of the Commission's action on the prevailing standard of materiality, the political neutrality of the SEC, industry compliance costs, and improving disclosure to investors.

This Jenner & Block Client Alert will discuss: A) the SEC's stated objectives; B) the effect of the Release on the standard of materiality; C) the categories of disclosure identified in the Release; and D) the views of the dissenting commissioners.

A. SEC Objectives

The SEC seeks to clarify the disclosure requirements that already apply to reporting companies in order to enhance the level of current disclosure and the consistency of disclosures. The Commission's vote reflects the view that companies need help in determining their disclosure obligations in light of the changing legislative and regulatory landscape relating to climate change. Current disclosure rules affect a company's disclosures relating to risk factors, business description, legal proceedings, and management's discussion and analysis.[2] The fact that many public companies provide disclosure about significant climate change matters outside of their SEC filings led Commissioner Walter to conclude that public companies are not doing the best job they possibly can with respect to their currently mandated disclosures, even though all of the information disclosed elsewhere is not required to be disclosed under SEC rules. However, Commissioner Walter stressed that in issuing the Release, the Commission was not responding to the requests, both formal and informal, that it received from the public concerning climate change and environmental disclosure.

B. Definition of Materiality Unchanged

The Commission's discussion indicates that the Release is not intended to affect existing rules concerning company reporting obligations nor is it intended to affect existing tests of materiality for determining whether disclosure is required. Although the Commission categorizes the climate change matters that management should consider disclosing, this is not meant to change the standard of materiality for determining whether disclosure is required that was articulated by the U.S. Supreme Court in *TSC Industries v. Northway*.[3] In *TSC Industries*, the Supreme Court stated that an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important or it would have "significantly altered the total mix of information made available."[4] Further, the Commission asserts that the Release will not impose any specific disclosure requirements. For example, as Commissioner Walter points out, it does not require companies to disclose their carbon footprints or what they are doing to reduce greenhouse gas ("GHG") emissions. Therefore, information pertaining to the categories enumerated below should be evaluated for materiality under the current standard.

C. Categories of Information Identified

The commissioners discuss four categories of information that reporting companies should take into account when deciding whether to include information in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"):

1. *Impact of Legislation and Regulation*. When assessing potential disclosure obligations, a company should consider whether the impact of certain existing laws and regulations regarding climate change is material. In certain circumstances, a company should also evaluate the potential impact of pending legislation and regulation related to this topic. Management should evaluate the impact of present and pending legislation and regulation on such factors as liquidity, cash flow, and operations. For example, the likelihood of "cap-and-trade" legislation may be a relevant factor for companies that emit GHGs. Similarly, U.S. EPA's new GHG reporting rule or its proposed rule regarding permitting for stationary sources of GHG emissions may be appropriate to evaluate.[5] In order to properly evaluate the pressure any such legislation or regulation might exert on a company's position, it may be necessary to disclose the amount of GHG emissions and/or systems the company has in place for collecting emissions data.
2. *Impact of International Accords*. A company should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change. Companies should consider any international treaties or protocols that may develop and any resulting risks or effects on its business. Commissioner Aguilar cites international developments and the expectations that accompanied the recent United Nations Framework Convention on Climate Change in Copenhagen as evidence that the effects of international efforts to ameliorate climate change may be material to investors. Notably, while the Copenhagen conference did the not result in a legally binding international agreement, the resulting Copenhagen Accord expects that developed countries will make commitments for future GHG reduction efforts.
3. *Indirect Consequences of Regulation or Business Trends*. Companies 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 greenhouse gas emissions." The Commission 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.[6]
4. *Physical Impacts of Climate Change*. 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 certain resources, and could result in damage to property and equipment.

D. Concerns of Dissenting Commissioners

The dissenting commissioners, Commissioners Casey and Parades, argue that the issuance of the Release reflects an inappropriate policy perspective and does, in fact, introduce substantive changes to the law. They fear that the SEC has "taken sides" in the policy debate about climate change and that reporting companies and investors will pay the price in terms of additional compliance costs and an inundation of information of questionable value. Commissioner Paredes views the requirement that public companies consider the possibility of potential legislation and international treaties as so speculative that the Release in effect will change the standard of materiality, noting that the Supreme Court in *TSC Industries* rejected a definition of materiality that included information that "might" be relevant. In addition, the dissenting commissioners believe that the Release is unnecessary in light of their view that no evidence of systemic deficiencies with respect to environmental disclosures exists.

The full text of the Release is not yet available.

[1] SEC Open Meeting webcast for Wednesday, January 27, 2010, available at http://www.sec.gov/news/openmeetings.shtml.

[2] See Items 101, 103, 303 and 503(c) of Regulation S-K of the Securities Act of 1933, as amended.

[3] 426 U.S. 438 (1976).

[4] *Id.* at 449.

[5] *See* Mandatory Reporting of Greenhouse Gases, 74 Fed. Reg. 56,260 (final rule Oct. 30, 2009); 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 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; *See generally* "Climate Change 2009 Year in Review: Building Foundations for Change or Just Castles in the Sand?" Emerging Issues Analysis, *LexisNexis*, January 2010.

[6] 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 plans, 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.

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