

SEC Interpretive Release Establishes New Guidance on Disclosure of Climate Change Matters

On February 2, 2010, the Securities and Exchange Commission issued an interpretive release to provide guidance on existing Commission disclosure requirements as they apply to climate change.

In issuing the release, the Commission stated that its objective is to provide clarity on disclosure relating to climate change, including in an issuer's risk factors, business description, legal proceedings and management's discussion and analysis. The Commission emphasized that the release does not impose any new legal requirements or modify existing ones. In particular, the release does not, in and of itself, require an issuer to disclose its carbon footprint or the steps it is taking to reduce emissions. Chairman Mary Schapiro also observed that the Commission is not taking a position on any facts relating to climate change or global warming.

It would, however, be naïve to think that Commission statements of this sort do not drive practice, and we expect all issuers to focus on this area in the current reporting season. We also expect more disclosure, given the Commission's endorsement of the principle expressed in the seminal case of TSC Industries, Inc. v. Northway, Inc. that doubts about materiality should be resolved in favor of disclosure. The release likewise foreshadows increased regulatory scrutiny not only of disclosure by issuers whose business is clearly implicated by the effects of climate change, but also by others whose business may be affected in more indirect or speculative ways. Increased disclosure will also likely attract attention from other regulators and NGOs, as well as from shareholders seeking to advance an environment-friendly agenda through the annual meeting shareholder proposal process. It is noteworthy that the Commission's action has already drawn strong criticism from Capitol Hill, with Rep. Spencer Bachus (R-Alabama), the ranking member of the House Financial Services Committee, characterizing the action as "ill-advised" and "reaching beyond the SEC's expertise."

The release highlights a number of developments supporting the issuance of guidance:

- International accords and continuing international efforts to address climate change, including the Kyoto Protocol, the EU Emissions Trading System, and the December 2009 United Nations Climate Change Conference in Copenhagen.

- Federal regulatory initiatives by the EPA and other agencies, including the EPA's new data collection and reporting requirements for large emitters of greenhouse gases, as well as its recent "endangerment" finding that ultimately could lead to direct regulation of greenhouse gas emissions under the Clean Air Act.
- The federal climate change legislation pending in Congress.
- The National Association of Insurance Commissioners' adoption of a uniform standard for mandatory disclosure by insurance companies of the financial risk of climate change and any mitigating actions.
- Actions by the business community, including position statements and assessments and reporting of greenhouse gas emissions and other climate change-related matters based on standards and guidelines issued by organizations such as the Climate Registry, the Carbon Disclosure Project and the Global Reporting Initiative. The release observes that "some of the information [reported] pursuant to these mechanisms also may be required to be disclosed in filings made with the Commission pursuant to existing disclosure requirements."
- Other sources of climate change-related disclosures, including petitions filed with the Commission by large institutional investors and other investor groups, and the New York Attorney General's entry into settlement agreements with three energy companies that impose conditions for enhanced climate change disclosure in their annual reports.

After generally summarizing the pertinent disclosure requirements of Regulation S-K and Regulation S-X of potential relevance for environmental matters, the release highlights the following four topics as examples in which climate change may trigger disclosure requirements. Although the release states that it is not intended to impose new disclosure requirements, the contemplated analyses appear in some cases to go beyond existing norms. For example, the release calls for extensive assessment of the prospects for and potential impacts of potential future climate change requirements, whether resulting from U.S. legislation or regulation or international accords. The Commission also emphasizes that, as this is a rapidly developing area, issuers should regularly assess their disclosure obligations.

Impact of Legislation and Regulation

The release notes that the financial impacts of legislation and regulation regarding climate change may implicate the following disclosure obligations:

- *Item 101.* Disclosure of material estimated capital expenditures for environmental control facilities.

- *Item 503(c) risk factor disclosure.* According to the release, a company should consider the specific risks faced by the company or its industry sector and “avoid generic risk factor disclosure that could apply to any company.”
- *Item 303 MD&A disclosure.* The release sets out a two-step analysis to the effect that a known uncertainty, such as pending climate change legislation or regulation, requires disclosure unless management determines either that the pending legislation or regulation is not reasonably likely to be enacted or that, if enacted, it would not be reasonably likely to have a material effect on the issuer, its financial condition or results of operations.

The release references the following possible consequences of pending legislation and regulation that issuers should assess:

- Costs to purchase, or profits from sales of, allowances or credits under a “cap and trade” system.
- 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.
- Changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.
- Favorable consequences, including new business opportunities and potential sale of allowances or offset credits.

Impact of International Accords

The release states that an issuer should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change (e.g., the Kyoto Protocol, the EU ETS and other international activities) just as it should do for U.S. legislation and regulation.

Indirect Consequences of Regulation or Business Trends

The release notes that indirect consequences or risks relating to climate change may need to be disclosed as risk factors, in MD&A, or, if significant enough, in the business description under Item 101. As examples, the release highlights the following possible indirect consequences or opportunities to be considered:

- Decreased demand for goods that produce significant greenhouse gas emissions.
- Increased demand for goods that result in lower emissions than competing products.

- Increased competition to develop innovative new products.
- Increased demand for generation and transmission of energy from alternative energy sources.
- Decreased demand for services related to carbon-based energy sources, such as drilling services or equipment maintenance services.
- Reputational damage related to the public's perception of any publicly available data relating to an issuer's greenhouse gas emissions.

Physical Impacts of Climate Change

The release states that issuers whose businesses may be vulnerable to severe weather or climate events should consider disclosure of material risks or consequences. Examples include property damage and operational disruptions to facilities in coastal areas; indirect effects from impact of severe weather on suppliers or customers; for insurance companies, increased claims and liabilities; decreased agricultural production; and increased insurance costs or decrease in the availability of coverage.

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The interpretive release can be found on the SEC website at the following link: <http://www.sec.gov/rules/interp/2010/33-9106.pdf>. Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Capital Markets, Corporate Governance or Environmental Law in the Practice Area section of our website (<http://www.cgsh.com/>) if you have any questions.

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