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ENVIRONMENTAL LAW ALERT

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SEC Guidance on Climate Change Disclosure

On February 2, 2010, the Securities and Exchange Commission ("SEC") released interpretive guidance regarding the application of SEC's disclosure requirements to climate change issues. The guidance document does not expressly change the existing disclosure rules, but rather "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." The reality is that the detailed discussion in the interpretive guidance suggests that more climate change related disclosure is required in most corporate disclosure documents. The guidelines are likely to also influence unregulated disclosure that is effectively governed by public company disclosure rules.

SEC Disclosure Requirements Pertinent to Climate Change Risks

Under Securities Act Rule 408 and Exchange Act Rule 12b-20, a public company must disclose, in addition to the information expressly required by SEC regulation, "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading." Below is a brief summary of the non-financial statement disclosure rules the SEC identified in the guidance document as most pertinent to climate change related disclosure.

Business Description: Item 101 of Regulation S-K. Item 101 requires a general description of a company's business and requires disclosure as to the "material effects that compliance with federal, state and local provisions … relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the company."

Legal Proceedings: Item 103 of Regulation S-K. Item 103 requires disclosure as to "any material pending legal proceedings, other than ordinary routine litigation incidental to the business." This requirement applies in the environmental context, requiring disclosure of "an administrative or judicial proceeding …" arising under environmental laws and regulations.

Risk Factors: Item 503(c) of Regulation S-K. Item 503(c) provides for the disclosure of the most significant risk factors to the extent that they are not generally applicable to any issuer. The disclosure must clearly state the risk and specify effects on the company.

MD&A: Item 303 of Regulation S-K. Item 303 governs the management's discussion and analysis ("MD&A") of the company's financial condition and requires disclosure of "known trends or uncertainties" that are likely to result in material changes to the company's liquidity, net sales, revenues or income.

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Foreign Private Issuers. The disclosure obligations of foreign private issuers are governed principally by Form 20-F, which may also require a foreign private issuer to provide disclosure covering climate change matters that are material to its business. Securities Act registration statement forms F-1 and F-3 may also apply to climate change matters because they require foreign private issuers to provide disclosure under Regulation S-K 503.

Accounting Standards. The SEC noted that companies must consider any financial statement implications of climate change issues in accordance with applicable accounting standards such as Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 450 (Contingencies) and Topic 275 (Risks and Uncertainties).

The SEC is therefore suggesting that climate change related risks may arise under each of these disclosure requirements. Currently, few companies report or disclose issues under more than one or two of the above rules or categories.

Summary of Climate Change Related Risks

The SEC identified four categories of climate change risks companies should consider when preparing their disclosure documents: (1) the impact of legislation and regulation in the United States, (2) the impact of international agreements, (3) the indirect effects of legislation, regulation or international agreements, and (4) the physical effects of climate change. These issues should be considered as follows:

Impact of Climate Change Related Legislation, Regulation and Agreements

Business Description Capital Expenditures. Item 101 requires disclosure of any material estimated capital expenditures for environmental control facilities required under existing federal, state and local environmental protection provisions.

Effect on Financial Condition or Results of Operation. Item 303 requires companies to assess whether any enacted climate change legislation or regulation is reasonably likely to have a material effect on the company's financial condition or results of operation.

Risk Factor. Item 503(c) may require a risk factor disclosure regarding existing or pending legislation or regulation relating to climate change if the company faces specific risks under such legislation or regulation. The company must avoid providing only a generic risk factor disclosure that could apply to any company.

Known Uncertainty. When there is a known uncertainty, such as pending climate change legislation or regulation, the company must determine whether disclosure is required in the MD&A. That determination consists of two steps. First, management must evaluate whether the pending legislation or regulation is reasonably likely to be enacted. If management can determine that it is not reasonably likely to be enacted, then disclosure is not required. If management cannot determine the likelihood, it must proceed on the assumption that the legislation or regulation will be enacted. Second, management must then determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the company, its financial condition or results of operations. If management determines that a material effect is reasonably likely, MD&A disclosure is required.

Impact of International Accords. Companies also should consider, and disclose when material, the impact on their business of treaties or international accords relating to climate change. For example, the Kyoto Protocol, the European Union Emission Trading Scheme and other international activities could have a material effect on certain reporting companies, particularly those with operations outside the United States.

Indirect Consequences of Regulation or Business Trends

The guidance document also briefly identifies examples of potential indirect consequences arising from the legal, technological, political and scientific developments related to climate change. Such examples include a decreased demand for goods that produce significant greenhouse gas emissions, an 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, or decreased demand for services related to carbon based energy sources, such as drilling services.

MD&A. These business trends or risks may be required to be disclosed in MD&A.

Business Description. Such developments could be significant enough that Item 101 may require disclosure in the business description. A company that plans to reposition itself to take advantage of potential opportunities may be required by Item 101(a)(1) to disclose this shift in plan of operation. Each company would have to evaluate the materiality of these opportunities and obligations.

Risk Factor. The SEC identifies reputational risks as a potential indirect risk from climate change that would need to be considered for risk factor disclosure under Item 503(c). Depending on the nature of a business and its sensitivity to public opinion, a company may have to consider whether the public's perception of any publicly available data relating to its greenhouse gas emissions could expose it to potential adverse consequences to its business operations or financial condition resulting from reputational damage.

Physical Impacts of Climate Change

The guidance document identifies several significant physical effects of climate change that should be considered for disclosure, such as an increase in the severity of weather events such as floods or hurricanes, a change in sea levels, the arability of farmland, and water availability and quality. Examples of possible consequences of severe weather include property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products, especially for companies located along coastlines, as well as indirect impacts from disruptions to the operations of major customers or suppliers.

While many of these effects may have been considered or disclosed in the past, the SEC's emphasis upon the specific requirements and the linkage the SEC has established between climate change and specific disclosure requirements may require a fresh look at the issue for companies subject to the SEC disclosure requirements and those that use such requirements as a guideline for non-regulated disclosure.