

Climate Change and Clean Technology Blog

Posted at 4:19 AM on March 30, 2010 by Sheppard Mullin

SEC Interpretive Release On Climate Change Disclosure

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On February 2, 2010, the Securities and Exchange Commission (the "SEC") issued an interpretive release (the "Release"), previously approved by a 3-2 vote on January 27, 2010, to provide guidance to public companies as to how the SEC's existing disclosure requirements apply to climate change matters. The Release was issued after requests were made over several years by a variety of environmental, investor and business groups. A copy of the Release can be found at <http://www.sec.gov/rules/interp/2010/33-9106.pdf>.

In the Release, the SEC provides that it views Item 101 (Description of Business), Item 103 (Legal Proceedings), Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations or MD&A) and Item 503(c) (Risk Factors) of Regulation S-K as the most pertinent non-financial statement disclosure rules that may require climate change disclosure. The Release describes four specific topics of climate change disclosure that may need to be addressed under these rules, each of which are outlined below.

Impact of Domestic Legislation and Regulation

The Release notes that recent legislative and regulatory developments could have a significant effect on company operations and financial decisions, including the recent steps taken by the Environmental Protection Agency to regulate greenhouse gas emissions by requiring large emitters of greenhouse gases to collect and report data with respect to their greenhouse gas emissions.

MD&A –Unless company management determines that a material effect is not reasonably likely, it should evaluate whether pending legislation and regulation regarding climate change is likely to be enacted and determine the impact such enacted legislation and regulation might have on the company, its financial condition, or results of operations. If the impact is material, management

should consider discussing the difficulties that may be involved in assessing the timing and effect of the pending legislation and regulation. The Release reminds companies that both positive and negative consequences of a proposed law should be disclosed.

Risk Factors –Company management should consider providing risk factor disclosure regarding existing or pending legislation or regulation that relates to climate change and in doing so should consider the specific risks the company faces as a result; the company should avoid generic risk factor disclosure that could apply to any company.

In addressing this topic, the SEC also provided specific examples of possible consequences of pending climate change legislation and regulation, which could include: costs to purchase or profits from sales of allowances of greenhouse gas emissions credits trading; costs required to improve equipment and facilities to reduce greenhouse gas emissions in order to comply with regulatory limits; impacts on profits and losses from increased or decreased demand for good and services and changes in the costs of certain goods.

Impacts of International Accords

The Release notes that recent actions have been taken by international regulatory agencies and groups, including the Kyoto Protocol and the European Union Emissions Trading Systems, to address climate change issues on a global basis and such actions and any future actions that may be taken by these agencies and groups could have a material impact on companies involved in international business. The SEC expects companies to provide disclosure if it is likely to be, or is, materially impacted by international agreements related to climate change.

MD&A –Companies that are likely to be affected by international accords should monitor the progress of any potential agreements and consider the impact that may arise on the business of the company if such agreements are executed. The SEC noted in the release that the United States is continuing to participate in ongoing discussions with other nations, including its participation in the recent United Nations Climate Change Conference in Copenhagen, which may lead to future international treaties focused on reducing the environmental damages caused by greenhouse gases.

Indirect Consequences of Regulation or Business Trends

Even if companies are not directly affected by legislation and regulation regarding climate change, they may still be required to provide climate change disclosure if they are indirectly affected by such legislation and regulation. For example, companies may be affected if prices of goods and services of another company are increased or decreased as a result of legislation and regulation regarding climate change.

Description of Business –Legal, technological, political or scientific developments may create new opportunities or risks if the demand for new products and services is increased or if the demand for existing products and services are decreased. Disclosure may be required if there is a significant impact on the company's business.

Risk Factors –Changes in business trends due to legislation and regulation regarding climate change may require a risk factor disclosure. For example, potential indirect risks from climate change may include: the impact on a company's reputation from publicly available data regarding its greenhouse gas emissions; a decrease in the demand for goods that produce significant greenhouse gas emissions; a decrease in demand for services related to carbon-based energy sources; or an increase in competition to develop innovative new products.

Physical Impacts of Climate Change

The Release notes that there may be significant physical effects of climate change that could potentially have a material effect on a company's business and operations. Such physical effects may include an increase in the severity of the weather, change in availability, quantity, and quality of water and other natural resources, or extreme changes in temperature. These types of changes could create disruptions to operation of major customers or suppliers; increase insurance claims, liabilities, premiums, and deductibles; decrease the availability of insurance; and decrease the production of agricultural products.

Risk Factors–Companies with businesses that are vulnerable to severe weather or climate-related events should consider disclosing material risks of, or consequences from, such events.

Other Considerations

Even though the Release identified Item 103 (Legal Proceedings) of Regulation S-K as one of the most pertinent non-financial rules for climate disclosure, the Release does not address in detail the disclosure that may be required under such rule. Instruction 5 to Item 103 specifically states that proceedings involving environmental matters will not be considered "ordinary routine litigation incidental to business" and therefore such proceedings will be required to be disclosed if they meet the specified materiality thresholds. Companies should continue to review and assess legal proceedings and disclose environmental litigations and/or proceedings where appropriate.

Conclusion

The SEC is focused on climate change disclosure and plans to monitor the impact of the Release on corporate filings through its ongoing disclosure review process. In this regard, public companies will want to review their existing climate change disclosure and reassess whether, in light of the Release, such disclosure fulfills their obligations under the SEC rules. Public companies may also want to examine their disclosure controls and procedures to ensure the thorough reporting of the potential impact of climate change and the proper assessment of its materiality. Many companies are already voluntarily providing information about their greenhouse gas emissions and other climate change matters to organizations, such as the Carbon Disclosure Project (the "CDP"),^[1] which make the information available to the public. These companies should carefully consider whether the information provided to such organizations is consistent with its disclosure in SEC filings. And although the SEC has advised that it does not want companies to dilute the usefulness of their disclosure with immaterial information, companies operating in business sectors that could conceivably be sensitive to climate change

should be prepared to address any questions the SEC staff may have regarding its assessments of materiality and the company should have sufficient information to support its conclusions.

The SEC has scheduled a public roundtable on climate change disclosure issues to be held in the spring of 2010. Further guidance, or rulemaking concerning climate change disclosure, may follow.

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[1] The Carbon Disclosure Project publishes the results of the information it obtains from companies that voluntarily fill out and submit questionnaires relating to climate change issues. A copy of the reports can be found on the Carbon Disclosure Project website at www.cdproject.net.