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SEC Provides Guidance for Existing Public Company Disclosure Requirements Regarding the Impact of Climate Change

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On February 2, 2010, the Securities and Exchange Commission (“SEC”) published an interpretive release (available here on SEC’s website) intended to provide guidance on certain existing disclosure rules that may require a company to disclose the impact that business or legal developments related to climate change may have on its business. The release states that it is not intended to create new disclosure obligations, but rather is designed to clarify already existing SEC disclosure rules that require public companies to describe impacts of climate change and climate change related issues.

SEC Deliberation

The interpretive release was approved by a narrow 3-2 vote; drawing dissent from Commissioners Kathleen Casey¹ and Troy Paredes.² Commissioner Casey expressed concern that, by issuing this interpretive release, the SEC was indirectly taking a position on the debate over global warming.³ Commissioner Paredes, on the other hand, noted concern with the requirement that registrants take into account reputational damage resulting from climate change matters. In his opinion such a requirement would only “foster confusion and uncertainty about a company’s required disclosures.”⁴ In an SEC press release, Chairman Mary Schapiro reiterated that the SEC has not taken a stance on the issue of global warming, and that this release is intended to assist public companies in satisfying their existing disclosure obligations as they apply to climate change.

An Overview of the SEC’s Guidance on Climate Change Related Disclosures

The interpretive release states that it is intended only to clarify already existing disclosure rules and prefacing the guidance with a lengthy description of existing legislative and regulatory developments related to climate change. The release then goes on to briefly discuss current disclosure rules under Regulation S-K that could require an issuer to discuss climate change matters, including: Item 101 (Description of

Business); Item 103 (Legal Proceedings); Item 303 (Management's Discussion and Analysis); and Item 503(c) (Risk Factors). The interpretive release follows with a discussion of four topic areas that may trigger climate change disclosures pursuant to these existing requirements.

1. **Impact of legislation and regulation.** The interpretive release states that public companies should disclose the effects of both existing and pending environmental legislation and regulation on their business.
 - Such disclosures may be required under Item 101 (Description of Business), and could include the material effects that compliance with Federal, State and local environmental laws may have on capital expenditures, earnings and the competitive position of the registrant and its subsidiaries.
 - Depending on the registrant's particular circumstances, new or revised risk factors may also be required under Item 503(c) (Risk Factors). These disclosures should address specific risks faced by the individual registrant as a result of climate change legislation or regulation.
 - Item 303, (MD&A), is another area where disclosure regarding the impact of climate change legislation and regulation may be required. The MD&A disclosures require registrants to discuss whether enacted climate change legislation or regulation is reasonably likely to have a material effect on their financial conditions or results of operations. In the case of a known uncertainty, such as pending legislation or regulation, the analysis of whether disclosure is required in the MD&A consists of two steps. First, registrants must determine whether the pending legislation or regulation is reasonably likely to be enacted. Unless it is determined that the legislation or regulation is not reasonably likely to be enacted, registrants must presume the legislation or regulation will be enacted. Second, registrants must determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the registrant, its financial condition or results of operations. MD&A disclosure is required, unless it is determined that a material effect is not reasonably likely. In addition to disclosure of the potential effect of pending legislation or regulation, registrants must also consider disclosure of the difficulties involved in assessing the timing and effect of the pending legislation or regulation, to the extent it is material.
 - Registrants should consider both positive and negative effects of such legislation or regulation, since changes in the law or in the business practices of some registrants in response to the law may provide new opportunities.
 - Examples of possible consequences of pending legislation and regulation include profits, losses, or increased costs related to implementation of a "cap and trade" system,

potential capital expenditures required to improve facilities in order to reduce emissions, and changes to profit or loss arising from increased or decreased demand for goods and services.

2. **International accords.** Although the United States is not a signatory to the Kyoto Protocol, some American companies or their subsidiaries may operate in signatory countries. Registrants are advised to consider, and disclose the impact of international accords relating to climate change, to the extent material.
3. **Indirect consequences of regulation or business trends.** Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks by either creating demand for new products or services, or reducing demand for existing products or services. Such trends or risks may require disclosure in the description of business, MD&A or risk factors. The SEC provides the following examples of developments for consideration by registrants:
 - Decreased demand for goods that produce significant greenhouse gas emissions;
 - Increased demand for goods resulting in lower emissions than other competitive products;
 - Increased competition to develop innovative new products;
 - Increased demand for generation and transmission of energy from alternative sources;
 - Decreased demand for services related to carbon-based energy sources;
 - Increased material acquisitions of plants or equipment to take advantage of potential opportunities related to climate change; and
 - Risks arising from reputational damage related to climate change.
4. **Physical impacts of climate change.** The fourth topic addressed by the release is the physical impact of climate change such as increased storm severity, rising sea levels, changes in arability of farmland, and changes in water availability and quality. The SEC provides the following as examples of these impacts:
 - Property damage and disruption of operations
 - Indirect financial and operational impacts from disruption to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
 - Decrease in agricultural production; and
 - Increase in the number of insurance claims, leading to an increase in insurance premiums and deductibles.

Conclusion

The SEC emphasized that it was adopting this interpretive guidance to remind companies of their existing obligations to consider climate change and its consequences as they prepare disclosure documents to be filed.

Although the SEC had been petitioned by advocacy groups to specifically require disclosure of an issuer's "carbon footprint," the SEC declined to adopt such a requirement. However, the SEC reminds issuers that such disclosure may be necessary, however, to the extent that it is material. The SEC also reminds registrants that where there is a close question as to materiality, registrants should decide in favor of those whom the regulation was designed to protect. Finally, the SEC reminds issuers that climate change regulation is a rapidly developing area and registrants need to regularly assess their potential disclosure obligations given new developments.

The SEC is planning to hold a public roundtable on disclosure regarding climate change matters in the spring of 2010. The results of the roundtable will be used by the SEC in determining whether additional guidance or rulemaking is appropriate.

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1. Speech by SEC Commissioner: Statement at Open Meeting – Interpretive Release Regarding Disclosure of Climate Change Matters by Commissioner Kathleen L. Casey, dated January 27, 2010 (<http://www.sec.gov/news/speech/2010/spch012710klc-climate.htm>).
2. Speech by SEC Commissioner: Statement at Open Meeting – Interpretive Release Regarding Disclosure of Climate Change Matters by Commissioner Troy A. Paredes, dated January 27, 2010 (<http://www.sec.gov/news/speech/2010/spch012710tap-climate.htm>).
3. Commissioner Casey states, "this guidance assumes that man made global warming and climate change are occurring as a result of greenhouse gas emissions and are likely to result in physical effects that will affect the businesses of registrants."
4. Commissioner Paredes states, "reputational damage... can be quite speculative" and such a requirement will encourage disclosures "that are unlikely to improve investor decision making and may actually distract investors from focusing on more important information."

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