BNA INC.

CORPORATE ACCOUNTABILITY

VOL. 8, NO. 184 REPORT FEBRUARY 26, 2010

Disclosure

SEC Guidance Signals Need to Ramp Up Review of Climate Disclosure, Attorneys Say

Practice tip: *Companies should conduct internal reviews that assess the potential impact of climate change on their operations and financial results in light of the Securities and Exchange Commission's recent disclosure guidance.*

In response to the Securities and Exchange Commission's Feb. 2 guidance on corporate disclosures related to climate change, companies should closely examine their operations and consider the effect that the physical impacts of climate change may have on their future operations and financial results, attorneys told BNA in recent interviews.

The SEC Feb. 2 issued interpretive guidance on how companies should apply existing SEC disclosure rules when deciding whether to tell investors about the risk that climate change developments may have on their businesses (8 CARE 118, 2/5/10).

The guidance highlights four areas where climate change is most likely to affect businesses in ways that could affect shareholder and investment decisions. Those areas are the effects of existing or pending legislation and regulations that address greenhouse gas emissions, the effects of international accords and treaties on climate change, physical risk caused by changing weather patterns, and indirect consequences of regulation and business trends.

The SEC with its new guidance on disclosure of climate change risks encourages public companies to conduct a new assessment of the ways in which climate change may affect their business in the future, Andrew D. Thorpe, a securities law attorney with Morrison Foerster LLP in San Francisco, told BNA in a Feb. 23 interview. This is especially significant to companies that have not been examining such risks previously, he said.

SEC Guidance Does Not Present New Issue. The SEC's recent guidance—a nod to such groups as investor and environmental organizations and pension funds that have been demanding additional disclosure of climate change risks—does not bring up novel issues, Thorpe said. ''SEC regulations have long required public companies to disclose known trends, events, and uncertainties that are likely to have a material impact on their future financial results,'' he said.

Prior to the issuance of the SEC's guidance, some companies may have interpreted climate risk information as nonmaterial, Thorpe said. ''The SEC is now telling companies to take a second look at such risks,'' he said.

According to Thorpe, ''The SEC's Division of Corporation Finance cannot require any corporate behavior. Rather, they have the authority to require disclosure.''

''For the past 10 years or so, the SEC has been influencing corporate behavior through disclosure requirements,'' Thorpe said. ''Essentially, disclosure requirements can 'shame' companies into changing their behavior. No company wants to disclose that they do not have in place certain key corporate governance measures,'' he said.

Thus, the SEC's disclosure mechanisms encourage companies to practice conducting evaluations of climate change risks associated with financial, regulatory, physical, and other components of their businesses, Thorpe said.

Companies Should Perform Internal Reviews. Among several recommendations made by the SEC in its new guidance, the commission encourages companies to—in addition to actually making disclosures—carefully conduct an internal review to determine what information may be appropriate for disclosure, Mia

> **Key Steps for Preparing Disclosures.**
> Many companies need to reevaluate their operations in light of the Securities and Exchange Commission's new guidance on disclosure related to climate change. Attorneys told BNA in recent interviews that companies can start by taking steps that include:
>
> - conducting internal reviews,
> - taking stock of the current state of the climate change regulatory world,
> - considering the specific risks they face as a result of climate change and avoiding generic disclosure,
> - revealing information related to climate change in forward-looking statements, and
> - disclosing the potential effects of any pending legislation or regulation.

COPYRIGHT © 2010 BY THE BUREAU OF NATIONAL AFFAIRS, INC. ISSN 1542-9563

Mazza, a securities litigation partner with Morrison Foerster LLP in San Francisco, told BNA in a Feb. 23 interview.

Companies should be examining their own operations and making assessments of these conditions in light of climate and carbon related regulatory requirements—international or otherwise, Mazza said.

The assessment process for some companies may include measuring carbon emissions and conducting other internally oriented analysis, Mazza said. ''The SEC is encouraging companies to at least undergo this internal evaluation process so that they might have evidence as to why certain information may or may not be material for disclosure purposes,'' she said.

Awareness of Possible Future Requirements Is Key. It is important that companies take stock of the current state of the climate change regulatory world as it relates to their circumstances, Thorpe said. ''They need to be fully aware of possible future requirements and assess how such requirements might affect business,'' he said.

Many public companies face significant peer pressure from other companies, shareholder proposals, nongovernmental organizations, and other sources to make voluntary climate change-related disclosures regardless of the SEC's guidance, Mazza said. ''To the extent that any disclosure about climate change risks are made, wherever possible companies should reveal information through 'forward-looking' statements, accompanied by meaningful cautions, so they can be best prepared to come within the Private Securities Litigation Reform Act's safe harbor if faced with climate change disclosure-related shareholder lawsuits in the future,'' she said.

Furthermore, companies should reexamine their director and officer liability policies to ensure that their ''pollution exclusion'' clauses do not contain language that could be construed to preclude coverage for those suits, Mazza said. ''Most D&O policies have such an exclusion. Companies need to make sure they are covered for shareholder lawsuits that involve issues related to climate change,'' she said.

Activist Shareholders Can More Easily Participate. In addition to its new guidance, the SEC recently has paved the way for shareholder activists to submit shareholder proposals that would require companies to conduct climate change risk assessments, Thorpe said.

''Because climate change is considered to be a significant 'social policy issue' in SEC Rule 14a-8, the SEC will no longer allow companies to exclude these proposals from their proxy statements,'' Thorpe said. ''Rule 14a-8 addresses when a company must include a shareholder's proposal in its proxy statement and identify the proposal in its form of proxy when the company holds an annual or special meeting of shareholders,'' he said.

''The SEC has previously allowed companies to exclude risk assessment proposals related to climate change from proxy statements. However, this year, the commission has said these types of proposals will not be excluded,'' Thorpe said.

Whether companies will see additional guidance addressing climate change issues will depend on the SEC's satisfaction with overall corporate response to the current guidance, as well as the response from investor, environmental, and other interested parties, Thorpe said.

''It is likely that we will not see the SEC address climate change risk disclosure again for a long time,'' Thorpe said.

''Unless and until there are significant, concrete financial consequences imposed on American companies for the emission of carbon dioxide and other greenhouse gases at the federal—or even state—level, the SEC probably will not revisit this issue,'' Mazza added. ''The House has passed its cap-and-trade bill,'' she said, ''but, as the federal Congressional landscape currently stands, the outlook for a cap-and-trade bill being successfully passed through the Senate and landing on the President's desk in the very near future seems bleak,'' Mazza said.

''The uncertainties today caused by the economic downturn and Congressional gridlock are even greater than in previous years. This has made it difficult for companies to foresee upcoming changes,'' Mazza said.

''In the future, I think that if there is a cap-and-trade system on carbon emissions that comes to fruition and companies are required to incorporate the cost of emitting greenhouse gases into their financial statements, the SEC may have to revisit the climate change disclosure issue,'' Thorpe said.

Disclosure May Not Always Be Necessary. Public companies—including foreign private issuers—that are in the process of preparing an annual report or registration statement should respond to the SEC's guidance by evaluating carefully whether certain disclosure is necessary to reflect risks created for the company by climate change, a Feb. 16 Blank Rome LLP publication on the SEC's new guidance on disclosure related to climate change said.

It is also important for a company to review its disclosures related to the business description, legal proceedings that the company is involved in, risk factors, and MD&A, the publication said.

According to the publication, not every item of corporate information requires disclosure. ''Public companies should consider the specific risks they face as a result of climate change and avoid generic disclosure. For example, companies in the energy sector may face different risks related to climate change than companies in the transportation sector,'' it said.

Overall, ''a public company must discuss its most significant risk factors that make an investment in the company speculative or risky,'' the publication said. Companies should examine whether enacted or pending climate change legislation or regulation is reasonably likely to have a material effect, positive or negative, on the company's financial condition or results of operations, it said.

''In the case of a known uncertainty related to such legislation, the company is required to analyze (i) whether the pending legislation or regulation is reasonably likely to be enacted, and (ii) whether, if enacted, the legislation or regulation is reasonably likely to have a material effect on the company,'' the publication said.

A company should also disclose any material difficulties in assessing the timing and effect of such pending legislation or regulation in addition to disclosing the potential effects of any pending legislation or regulation, the publication said.

By Tina Chi

The SEC's guidance is available at http://www.sec.gov/rules/interp/2010/33-9106.pdf.

 COPYRIGHT © 2010 BY THE BUREAU OF NATIONAL AFFAIRS, INC. CARE ISSN 1542-9563

The Blank Rome publication is available at http://www.blankrome.com/siteFiles/Publications/0BBA91B51F34DFDF9BD020379BDD1A6B.pdf.