LEGAL UPDATES

PUBLISHED: FEBRUARY 17, 2010

SEC Issues Interpretive Guidance on Disclosure of Business or Legal Developments Regarding Climate Change and Related Issues

Services

Environmental

Securities & Corporate Governance

Professionals

CRAIG A. ADOOR
ST. LOUIS:
314.345.6407
CRAIG.ADOOR@
HUSCHBLACKWELL.COM

JAMES M. ASH
KANSAS CITY:
816.983.8000
JAMES.ASH@
HUSCHBLACKWELL.COM

STEVEN R. BARRETT
CHATTANOOGA:
423.757.5905
STEVE.BARRETT@
HUSCHBLACKWELL.COM

DAVID E. GARDELS
OMAHA:
402.964.5027
DAVID.GARDELS@
HUSCHBLACKWELL.COM

MARY ANNE O'CONNELL

On February 2, 2010, the SEC issued an Interpretive Release to provide guidance to public reporting companies on how the SEC believes its existing disclosurerequirements apply to business or regulatory developments related to climate change. SEC Commissioner Luis Aguilar described this guidance, which became effective February 8, 2010, as the Commission's "first step" in an area where it intends to play a "more proactive role," consistent with the SEC's mandate under the National Environmental Policy Act of 1969 to consider the environment in its regulatory actions. The Interpretive Release does not impose additional reporting requirements on covered entities, but merely clarifies the application of existing requirements to legal and business issues related to climate change.

Legal Basis for the SEC's Guidance

The Interpretive Release primarily addresses how existing disclosure rules under certain items of SEC Regulation S-K may require additional disclosures related to the impacts of climate change. Specifically, the SEC focused on how climate change issues may affect a company's description of its business under Item 101, its disclosure of legal proceedings under Item 103, its discussion of risk factors under Item 503, and management's discussion and analysis of financial condition and results of operations (MD&A) under Item 303. The SEC also reminded reporting companies to consider such issues in relation to the general requirement to disclose, in addition to information expressly called for by its rules, "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."

© 2024 HUSCH BLACKWELL LLP. ALL RIGHTS RESERVED

Potential Disclosure Triggers Addressed in the Interpretive Release

The Interpretive Release highlighted the following four categories of issues related to climate change that could trigger disclosures under one or more of these items:

Impact of Existing or Proposed Legislation and Regulations

The Interpretive Release urges reporting companies to consider the potential impacts of both existing and proposed laws and regulations related to climate change. Companies should determine whether any consequences of these regulations – such as increased capital expenditures to improve energy efficiencies or to install emissions control equipment – could have a sufficiently material impact on the company's operations or financial condition to require enhanced disclosures. This will require an assessment of the effects of compliance with existing Federal rules, such as the EPA's greenhouse gas (GHG) emission reporting rules that took effect December 29, 2009, as well as any state and local statutes or regulations that apply to any of the company's operations or facilities.

In an environment of evolving proposals concerning "cap and trade" legislation in Congress, as well as possible EPA regulation of GHG under the Clean Air Act and related matters, the SEC suggested that companies should, in preparing their MD&A disclosures, conduct an ongoing evaluation of any potential legislation or regulation using the same two-step analysis they apply to other potentially material events. First, they must evaluate whether pending legislation or regulations are likely to be enacted, assuming that they will be unless such action appears "not reasonably likely." Second, they must determine whether such enactment is reasonably likely to have a material effect on the company, its financial condition or results of operations, and provide disclosure on these issues unless management determines that no material effect is reasonably likely.

The SEC cited the following examples of possible consequences of climate change legislation or regulations that could trigger disclosure

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, to comply with regulatory limits or to mitigate the financial consequences of a "cap and trade" regime; and

changes to a company's profit or loss arising from increased or decreased demand for goods and services produced by the company, arising either directly from legislation or regulation or indirectly from changes in costs of goods sold.

Impact of International Accords

© 2024 HUSCH BLACKWELL LLP. ALL RIGHTS RESERVED

Reporting companies also should consider, and disclose when material, the risks to or effects on their business of international accords and treaties relating to climate change. In this regard, while noting that the United States has not ratified the Kyoto Protocol, the Interpretive Release suggested that companies with operations in countries that may be subject to its standards, or to those of the European Union Emissions Trading System, should consider potentially material effects on their business and financial condition of these or any other applicable foreign regulations and determine whether any such effects could require enhanced disclosures.

Indirect Consequences of Regulation or Business Trends

The Interpretive Release encourages companies to consider both potential risks and potential opportunities created by existing or anticipated legal, technological, political and scientific developments and related business trends revolving around climate change issues. The SEC cited the following examples of risks or opportunities that could trigger disclosure obligations

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; and

possible “reputational risks” for a company, such as negative perceptions created by public disclosure of data concerning its greenhouse gas emissions and any resulting consequences (such as lost market share or environmental tort litigation related to climate change issues).

Physical Impacts of Climate Change

Companies should also evaluate the actual and potential material impacts of the physical effects of climate change on their business, such as effects caused by severe weather events (such as hurricanes or floods), sea level changes, impacts on the arability of farmland, and water availability and quality. Examples cited by the SEC of disclosure triggers included:

material risks of property damage and disruptions to operations, manufacturing or the transport of manufactured products;

© 2024 HUSCH BLACKWELL LLP. ALL RIGHTS RESERVED

indirect financial and operational impacts from disruptions to the operations of a company's major customers or suppliers;

increased insurance claims and liabilities for insurance and reinsurance companies;

decreased agricultural production capacity in areas affected by drought or other weather-related changes; and

increased insurance premiums and deductibles, or a decrease in the availability of coverage.

Disclosures Governed by Existing SEC Standards for Materiality

The basic premise remains that disclosure under all SEC rules – including those addressed in the Interpretive Release – is only required for matters that management determines are "material" to the company. The well known materiality standard of *TSC Industries, Inc. v. Northway, Inc.* and *Basic Inc. v. Levinson* (whether a "reasonable investor" would view a given piece of information as having materially altered the "total mix" of publicly available information concerning the company) is the same for climate change issues as for all other disclosures. The Interpretive Release reiterated the importance of maintaining disclosure controls and procedures to provide management with sufficient information regarding matters related to climate change, such as a company's greenhouse gas emissions or other related operational matters, to enable management to evaluate the materiality of these issues in making disclosure decisions.

While determining the impacts of existing rules such as current environmental regulations may be fairly straightforward, more challenging is identifying and measuring the risks associated with potential enactment of new regulations or potential treaty ratifications. Similarly, there is no precise yardstick for measuring the risk to a company's reputation associated with these issues, or for making predictions about the effects of potential severe weather on a company's operations. Assessing the materiality of information and events involving contingent or speculative matters requires a balancing of the expected probability that an event will occur and the expected magnitude/impact of the event for the company, in light of all the company's circumstances.

What This Means to You

In the final analysis, the very nature of climate change and the state-of-flux in current regulations makes gauging the materiality of climate change risk a speculative endeavor, and there may be significant ramifications from any new disclosures triggered by the application of this guidance. Public companies, particularly those whose businesses are directly subject to the environmental and regulatory contingencies cited by the SEC or with operations in jurisdictions with more aggressive regulations in place on these issues, should review their historical approach to climate change disclosures in light of this guidance to determine whether changes or enhancements may be required.

© 2024 HUSCH BLACKWELL LLP. ALL RIGHTS RESERVED

Companies that have not provided disclosures related to climate change in the past should consider whether new disclosures may be required concerning the issues highlighted by the SEC. In either event, companies are encouraged to avail themselves of assistance from both environmental and securities law experts as they evaluate their obligations and prepare any responsive disclosures in future filings.

Contact Info
Should you have any questions, please contact your Husch Blackwell Sanders attorney.

Husch Blackwell Sanders LLP regularly publishes updates on industry trends and new developments in the law for our clients and friends. Please contact us if you would like to receive updates and newsletters, or request a printed copy.

Husch Blackwell Sanders encourages you to reprint this material. Please include the statement, "Reprinted with permission from Husch Blackwell Sanders, copyright 2010, www.huschblackwell.com." at the end of any reprints. Please also email info@huschblackwell.com to tell us of your reprint.

This information is intended only to provide general information in summary form on legal and business topics of the day. The contents hereof do not constitute legal advice and should not be relied on as such. Specific legal advice should be sought in particular matters.

© 2024 HUSCH BLACKWELL LLP. ALL RIGHTS RESERVED