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Client Alert

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SEC Releases Interpretive Guidance on Climate Change Disclosure

On February 2, 2010, the Securities and Exchange Commission ("SEC") issued an interpretive release to provide guidance to public companies regarding existing disclosure requirements as they relate to climate change matters. The release covers the most relevant non-financial rules that may require disclosure related to the effects of climate change. The release is intended to remind reporting companies that the effects of climate change may be deemed material information subject to existing reporting requirements depending upon the nature of a registrant's business, its regulatory or legislative obligations, pending legal proceedings, or the physical impact of climate change. The SEC notes that the interpretive guidance does not create new legal requirements or modify existing ones, and it is not intended to amend the rules concerning current public company reporting obligations or to redefine long-standing interpretations of materiality.

Existing Disclosure Requirements

The interpretive release highlights certain existing rules that are relevant to the disclosure of material climate change matters:

Description of Business

Item 101 of Regulation S-K requires a registrant to describe its business and that of its subsidiaries. In particular, a registrant must disclose the material effects of compliance under Federal, state and local laws regulating the discharge of materials into the environment or otherwise protecting the environment may have upon capital expenditures, earnings and competitive position. This includes disclosure of material estimated capital expenditures for environmental control facilities for the current and succeeding fiscal year and for such further periods as a registrant deems material.

Pending Litigation

Item 103 of Regulation S-K requires a registrant to describe any material pending legal proceedings to which it, or any of its subsidiaries, is a party. A registrant must also describe any material pending legal proceedings in which its property is the subject of litigation. Instruction 5 to Item 103 pertains specifically to certain environmental litigation. It provides for disclosure of administrative and judicial proceedings arising under environmental laws, provided that the proceedings are material to the registrant's business or financial condition, and involve primarily a claim for damages, or potential monetary sanctions, capital expenditures or deferred charges or charges to income, above a prescribed threshold.

Risk Factors

Item 503(c) of Regulation S-K requires a registrant to discuss the most significant factors that create risk when investing in its securities.

Management's Discussion and Analysis

Item 303 of Regulation S-K requires a registrant to provide a narrative explanation of its financial statements, including information about the quality and potential variability of earnings and cash flow. It includes a broad range of disclosure items that address liquidity, capital resources and results of operations. The discussion is required to identify known trends, events, commitments and uncertainties that are reasonably likely to have a material impact on the registrant's financial condition or operating performance. Under long-standing guidance, a registrant must first determine if a known trend, event, commitment or uncertainty is likely to occur. If not, no disclosure is required. If management cannot make that determination, then it must assume the likelihood of occurrence and make appropriate disclosure, unless it determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur. While the SEC has not identified an appropriate time period on which a registrant must concentrate its analysis, disclosure will depend on a balancing of the indicated probability that a climate change-related event will occur with the anticipated magnitude of the event in light of the totality of the registrant's activities.

Foreign Private Issuers

Foreign private issuers must also disclose any anticipated material effects of climate change in their filings with the SEC. Please contact any of the Partners with whom you work for specific rule citations.

Examples of Climate Change Related Issues

The interpretative release emphasizes four potential material developments, or "triggers," that could require disclosure regarding the impact of climate change:

Impact of Legislation and Regulation

The SEC notes that a registrant must assess the specific risks faced as a result of existing or pending legislation and regulation. Depending on the particular circumstances, it should include information in its filings, if such legislation or regulation is reasonably likely to have a material effect on its financial condition or operations. The SEC points out that positive opportunities or consequences also may arise from changes in the laws regarding climate change. It provides three examples of possible consequences of pending legislation and regulation:

- 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 comply with regulatory limits or to mitigate "cap and trade" consequences; and
- Profit or loss related to increased or decreased demand for goods and services produced by a registrant or from changes in its cost of goods sold.

International Accords

A registrant that is reasonably likely to be affected by an international treaty or accord concerning climate change should disclose, when material, any risks or effects such international regulation would have on its business. It should also monitor the progress of any potential accords.

Indirect Consequences of Regulation or Business Trends

Legal, technological, political and scientific developments regarding climate change may generate new opportunities or risks for a registrant, which could either increase or decrease demand for certain products or services. For example, new technology could increase demand for alternative energy sources, while new climate change regulations could decrease demand for goods that produce significant greenhouse gas emissions. There may be increased competition to develop innovative products. A registrant should consider the particular facts and circumstances surrounding its business in evaluating the materiality of these new opportunities or risks. A registrant may have to consider whether the public's perception of the effects of its operations could lead to reputational damage, with potential adverse consequences to its operations and financial condition.

Physical Impact of Climate Change

Companies whose businesses may be physically vulnerable to severe weather or climate change-related effects should consider disclosing the material risks of, and the consequences from, such events. The SEC cites the occurrence of floods and hurricanes, rising sea levels, changes in the arability of farmland and the availability and quality of water sources. It notes that these events could result in property damage, disruptions in operations and changes in insurance claims, cost and availability.

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Please feel free to contact any of the Partners listed below or any Corporate Partner with whom you work if you would like to discuss this interpretative guidance as it relates to the SEC's rules and regulations and potential disclosure.

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