

Alerts & Publications

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SEC Adopts Interpretive Guidance on Climate Change Disclosure

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On January 27, 2010, the Securities and Exchange Commission, by a 3-2 vote, adopted a new interpretive release on existing disclosure requirements as they relate to the effect on public companies of business or legislative events regarding climate change. The Commission indicated that the interpretive release is not intended to create new legal requirements or modify existing ones; rather, it is intended merely to provide clarity and enhance consistency in public disclosures.

The description below is based on statements made at the open meeting at which the Commission voted on the interpretive release. Upon publication of the interpretive release, we will update this Client Alert to provide additional detail.

How Climate Change Affects Routine Disclosures

The Commission's interpretive guidance highlights the following areas as examples of those situations in which climate change may trigger disclosure requirements:

- ***Impact of Legislation and Regulation*** -- A company should consider, and disclose where material, the impact of existing laws and regulations regarding the environment. Further, in certain circumstances, a company should consider, and disclose where material, the potential impact of pending legislation and regulation related to climate change.

Item 101 of Regulation S-K requires a company to disclose the material effects that compliance with federal, state, and local provisions enacted or adopted relating to the protection of the environment may have upon the capital expenditures, earnings, and competitive position of the company. However, the new guidance indicates that a company may need to provide disclosure of the potential impact of pending environmental legislation. In this regard, the Commission expressed the view that the need for this disclosure should be assessed by reference to the Regulation S-K Item 303 requirement to disclose “any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.”

- ***Impact of International Accords and Treaties*** -- A company should consider, and disclose where material, the risks or effects on the company’s business of international accords and treaties related to climate change or governing green-house gas emissions. As with the guidance regarding legislation and regulation, the need for this disclosure should be assessed by reference the Regulation S-K Item 303 requirement.
- ***Indirect Consequences of Regulation or Business Trends*** -- A company should consider, and disclose where material, the actual and potential indirect consequences of regulation or business trends relating to climate change.

The Commission’s interpretive guidance addresses its view that legal, technological, political, and scientific developments are likely to occur in response to the prospect of climate change and that these developments may change numerous competitive landscapes. For instance, technological innovations enabling the production of “greener” goods may enhance competition with already existing goods and cause demand to decrease for goods that produce greenhouse gas emissions. Therefore, companies should consider whether disclosure of these types of potential developments should be provided -- either as a trend or uncertainty that may have “a material favorable or unfavorable impact on net sales or revenues or income from continuing operations” under Item 303 of Regulation S-K or as a risk factor “the occurrence of which would have a material impact on the company” under Item 503 of Regulation S K.

The Commission’s interpretive guidance also addresses its view that harm to a registrant’s reputation may be one of the “indirect risks” of climate change that warrants disclosure. In this regard, a company may have to consider whether the public’s perception of any publicly available data relating to its greenhouse gas emissions could adversely impact the company’s reputation. Disclosure of such risk would be required if the potential damage to the company’s reputation might have a material impact on the company’s business operations or financial condition.

- ***Impact of the Physical Effects of Climate Change*** -- A company should consider, and disclose where material, the actual and potential impact of the physical effects of climate change on the company's business.

The Commission's interpretive guidance highlights the physical impact climate change may have on companies, their facilities, and their distribution capabilities. In this regard, numerous companies, depending on their location, already include disclosure in their risk factors relating to the environmental impact of earthquakes or floods. Although it is not clear from the Commission's statements, the interpretive release may simply emphasize a broader view regarding the need to include similar disclosure regarding potential environmental changes that may occur as a result of climate change.

Assessing the Materiality of Climate Change Disclosure Under the Commission's New Guidance

The Commission expressed the view that the interpretive release does not alter the standard under which companies currently assess materiality. As the Commission and the Supreme Court have stated, a matter is "material" if there is a substantial likelihood that a reasonable person would consider it important or if it would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.^[1] When applying this standard to a potential future event, such as the passage of legislation or the occurrence of climate change, Chairman Mary Schapiro stated that "of course a company must consider whether [it] is likely to occur. If so, then under our traditional framework the company must then evaluate the impact it would have on the company's liquidity, capital resources, or results of operations, and disclose to shareholders when that potential impact will be material."

In assessing existing and future disclosure on the subject of the environment and climate change, the Commission reminded companies that Securities Act Rule 408 and Exchange Act Rules 12b-20 and 10b 5 require disclosure of all information that is required to make a company's existing disclosure not materially false or misleading. At the open meeting regarding the interpretive release, individual Commissioners made reference to the statement in *TSC Industries v. Northway, Inc.* that any doubt regarding the materiality of a disclosure should be resolved in favor of the individual intended to be protected by the particular statute. Despite these references, the Chairman and other Commissioners, as well as the Commission's staff, emphasized that the interpretive release will not change the existing materiality standard.

Dissenting Commissioners' Concerns Regarding the Lack of Precision in Guidance

Commissioners Kathleen Casey and Troy Paredes both voted against the release. In their remarks at the open meeting regarding the interpretive release, Commissioners Casey and Paredes noted their concerns with the interpretive guidance, including:

- Concerns that the interpretive guidance is unnecessary, addresses concerns unrelated to investor protection, and will not result in greater availability of material information geared toward the needs of the broad majority of investors;
- Concerns that the discussions on climate change in the interpretive guidance will have the effect of joining the Commission in the ongoing debate over climate change by lending support to a particular view of climate change;
- Concerns that the interpretive guidance is premised on the false notion that companies may not recognize that disclosure related to “climate change” issues may be required;
- Concerns that the interpretive guidance relating to legal requirements and possible reputational damage would apply with equal force to any other legal and regulatory regime affecting public companies;
- Concerns that potential reputational damage and the potential impact on a company of the physical effects of climate change can be quite speculative and, as such, may encourage disclosures that are unlikely to improve investor decision making and may distract investors from focusing on information that may improve investor decision making; and
- Concerns that the interpretive guidance will foster confusion and uncertainty regarding a company’s required disclosures.

If You Have Any Questions about the Commission’s Statements Regarding the New Guidance

The Commission’s interpretive guidance may fundamentally alter the manner in which public companies are required to assess and disclose matters relating to the environment or climate change. If you have any questions, please contact the authors of this Client Alert.

[1] *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976). *See also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).