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SEC Publishes Interpretive Guidance on Climate Change Disclosure

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On February 8, 2010, the Securities and Exchange Commission (the "Commission") published its new interpretive release (the "Release") on the application of existing public company disclosure requirements to climate change. The Commission adopted the Release at an open meeting held on January 27, 2010 (the "Open Meeting"). Our earlier client alert detailed the Commission's guidance on those topics related to climate change that may trigger disclosure requirements and the identification of those requirements.

The Release itself provides additional detail not discussed at the Open Meeting, including, in particular, on assessing what information to file with the Commission and the legislative and regulatory developments which prompted the Release and which public companies should consider when preparing their disclosure regarding climate change. We summarize these points below.

Determining What Information to File With The Commission

The Release is intended to outline the Commission's views with respect to existing disclosure requirements as they apply to climate change matters — it is not intended to modify or add to those disclosure requirements. Therefore, public companies are not required to disclose any more or less information than they were required to disclose prior to the Release. The Release did, however, emphasize certain aspects of those existing

disclosure requirements:

- **Including Otherwise Publicly Available Information In Filing With The Commission** — The Release notes the existence of voluntary disclosure initiatives and state or regulatory agency requirements to disclose information related to greenhouse gas emissions and climate change. While the Release approves of these additional disclosures as providing important information to investors, it also cautions companies to consider whether some of the information reported under these mechanisms may be required in Commission filings. The disclosure requirements therefore remain the same, but public companies should ensure that they have procedures in place to review all publicly available information and determine if it should also be filed with the Commission. Two disclosure requirements in particular may apply:
 - The Management's Discussion and Analysis in companies' quarterly and annual reports should include all information "necessary to an understanding of [a company's] financial condition, changes in financial condition and results of operations."^[1]
 - Disclosure should be made of any additional material information "as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."^[2]
- **Assessing the Materiality of Climate Change Disclosure** — As the Commission and the Supreme Court have stated, "information is material if there is a substantial likelihood that a reasonable investor would consider it important" or "if the information would alter the total mix of available information."^[3] While the Release also notes Supreme Court statements on the resolution of doubts regarding the materiality of information,^[4] the Release does not alter the standard under which companies currently assess materiality but simply adds background regarding the establishment of the "substantial likelihood" standard.

How Climate Change Affects Routine Disclosures

The Release discussed recent regulatory, legislative, and other developments that prompted the Commission to publish the Release and that the Commission recommends a company consider when evaluating its disclosures. In particular, the Release makes clear that a company should evaluate both enacted regulation and legislation and also anticipated regulation and legislation. When assessing the materiality of anticipated regulation and legislation, a company should consider "both the indicated probability that the event will occur and the anticipated magnitude of the

event in light of the totality of the company activity." [5]

The Release noted these recent regulatory, legislative, and other developments relating to climate change in particular:

- The House of Representatives has passed a greenhouse gas ("GHG") "cap and trade" bill and similar legislation is being considered by the Senate.
- The United States Environmental Protection Agency has begun requiring large GHG emitters to collect and report GHG emissions data and, in December 2009, it issued an "endangerment finding" paving the way for direct regulation of GHGs under the Clean Air Act.
- International efforts to curb GHG emissions under the Kyoto Protocol and the EU Emissions Trading System and the ongoing talks, including the recent United Nations Climate Conference in Copenhagen, aimed at establishing a post-2012 global framework for GHG reductions. The Release states that all of these developments could have a significant effect on operating and financial decisions.
- The increased pressure for climate-related disclosure from investors, states, and NGOs. As examples, the Release notes a recent settlement between the New York Attorney General's Office and three energy companies which requires the companies to enhance their disclosures relating to climate change and GHG emissions and the widespread voluntary disclosure of GHG and sustainability-related information by companies participating in the Carbon Disclosure Project and the Global Reporting Initiative.

The Practical Impact of the Release

In light of the Release, public companies will want to review their existing climate change disclosure and reassess whether that disclosure fulfills all of their obligations. The Release indicates that the Commission is focused in this area — public companies will want to be prepared to respond to questions from Commission staff and be able to explain company materiality and disclosure assessments. In preparation, companies may want to:

- Examine disclosure controls and procedures to ensure the thorough reporting of the potential impact of climate change and the proper assessment of its materiality to the company.
- Assess public climate change disclosures made voluntarily or as mandated by other government or regulatory entities and determine

whether that information is material and should be included in Commission filings.

- Confirm that material environmental legislative and regulatory developments, both domestically and, if applicable, internationally, are reported to the proper people at the company and evaluated for their potential impact on the company.
- Consider the business risks presented by a shift to a lower carbon economy, such as a decreased demand for products that produce significant greenhouse gas emissions, increased competition to develop "greener" products, or a decreased demand for services relating to carbon-based energy production.
- Review the risks presented by the physical effects of climate change, such as sea level rise and severe weather events. These risks could include not only direct damage to facilities, but supply chain disruptions, damage to customers' operations, and increased insurance premiums.

It is important to stay current with climate change disclosure requirements as further developments in this area can be expected. A number of trade groups, states and other consortia have this month filed suits in the DC Circuit challenging EPA's endangerment finding and its authority to issue GHG regulations. In addition, some states have sought to impose requirements in advance of federal regulation while others have introduced or passed resolutions opposing application of a federal cap and trade approach or other GHG control measures. The Release also indicates that the Commission plans to hold a public roundtable on climate change disclosure this year and that further guidance or rulemaking relating to climate change disclosure is possible in the future.

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

The Commission's interpretive guidance may 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] Regulation S-K, Item 303(a) [17 CFR 229.303(a)].

[2] Securities Act Rule 408 [17 CFR 230.408] and Exchange Act Rule 12b-20 [17 CFR 240.12b-20].

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

[4] That doubts should "be resolved in favor of those the statute is designed to protect." *TSC Industries* at 448.

[5] *Basic* at 238, quoting *Securities and Exchange Commission v. Texas Gulf Sulfur Co.*, 401 F. 2d 833 (2d Cir. 1968) at 849.

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