

To: Our Clients and Friends

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SEC Publishes Interpretative Release on Climate Change Matters

Yesterday, the SEC published its interpretative release regarding disclosure requirements applicable to climate change matters. The release provides guidance on certain existing disclosure rules that may require a company to disclose the impact that business or legal developments related to climate change may have on its business. The relevant rules cover a company's risk factors, business description, legal proceedings, and MD&A.

The SEC approved the release in a controversial 3-2 vote last week, with Commissioners Casey and Paredes objecting. Commissioner Casey believes that the release addresses concerns unrelated to investor protection, and questioned the allocation of staff resources to the issue in the wake of the economic crisis. Commissioner Paredes believes the release may create confusion, due to its focus on arguably vague terms such as "reputational damage" or "physical effects." Both expressed concern that the release fails to sufficiently address the scientific and political uncertainties involved with the topic, and may harm investors by promoting speculative disclosures that distract from more important information.

By contrast, in Chairman Schapiro's view, the guidance does not take sides in the climate change debate, but will "help to ensure that our disclosure rules are consistently applied, regardless of the political sensitivity of the issue at hand, so that investors get reliable information."

The interpretative release, which is effective upon publication in the Federal Register, is available [here](#).

Specific Disclosure Requirements

The SEC release addresses the following Regulation S-K rules that may require climate change disclosure, noting that, in addition to specific requirements, companies must disclose "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."

- **Description of Business** - disclosure of the material effects that compliance with environmental requirements may have upon the company's capital expenditures, earnings and competitive position, as well as material estimated capital expenditures for environmental control facilities for the remainder of the current fiscal year and the succeeding fiscal year, and for such further periods as deemed material. If material to a particular segment, that segment must be identified. (*Item 101(c)(1)(xii)*).
- **Legal Proceedings** - disclosure of material legal proceedings to which a company or its property is subject, including actions contemplated by governmental authorities. An instruction provides that disclosure of a proceeding arising under environmental laws is required if:
 - material to the business or financial condition of the company;
 - involving primarily a claim for damages, or involving potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10% of consolidated current assets; or
 - a governmental entity is a party and such proceeding involves potential monetary sanctions, unless the company reasonably believes the proceeding will result in no monetary sanctions, or in monetary sanctions of less than \$100,000, exclusive of interest and costs (with similar proceedings permitted to be grouped and described generically). (*Instruction 5 to Item 103*).
- **Risk Factors** - disclosure of the most significant factors that make an investment in the company speculative or risky, and how they specifically affect the particular company. (*Item 503(c)*).
- **Management's Discussion & Analysis** - disclosure of information affecting liquidity, capital resources and results of operations. The SEC noted that MD&A encompasses trends, events, demands, commitments and uncertainties that are "reasonably likely" to have a material effect on financial condition or operating performance - a lower standard than "more likely than not." (*Item 303*). In addition, the SEC reminded companies that when assessing known trends and uncertainties:
 - The relevant time frame depends on the particular circumstances, including their probability and anticipated magnitude; and
 - They should apply a two-part test for purposes of MD&A:
 - Is the known trend or uncertainty reasonably likely to occur?
 - If the company cannot determine it is not reasonably likely to occur, then the company must assess its effect on the assumption it will come to fruition, with disclosure required unless the company can determine that a material effect is not reasonably likely to occur.

Additionally, the SEC cautioned that MD&A should focus on material information and eliminate immaterial matters that do not promote investor understanding. However, it indicated that while such materiality determinations may limit disclosures, they should not limit the information considered in making such determinations, and that companies should ensure they have sufficient disclosure controls and procedures to process such information.

Further, the SEC noted that companies should also consider any financial statement implications of climate change issues. The SEC also encouraged companies to consider what additional disclosures they

may make outside their SEC filings, such as to states, the U.S. EPA and other bodies, and whether any of that information may be required to be included in SEC filings.

Climate Change Related Disclosures

The SEC release reviews recent regulatory, legislative and other developments, and highlights the following areas as examples of where climate change may trigger disclosure requirements:

- **Impact of Legislation and Regulation:** When assessing potential disclosure obligations, a company should consider whether the impact of existing laws and regulations regarding climate change is material, including both negative and positive consequences. In some cases, a company should also evaluate the potential impact of pending legislation and regulations.
- **Impact of International Accords:** A company should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change.
- **Indirect Consequences of Regulation or Business Trends:** Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies. For instance, a company may face decreased demand for goods that produce significant greenhouse gas emissions, increased demand for goods that result in lower emissions than competing products, or increased competition to develop innovative new products. The SEC also cited the impact on a company's reputation as a potential indirect risk. In any such cases, a company should consider, for disclosure purposes, the actual or potential indirect consequences it may face due to climate change related regulatory or business trends.
- **Physical Impacts of Climate Change:** Companies should also evaluate for disclosure purposes the actual and potential material physical impacts of environmental matters on their business. The release cites as examples property damage to coastline operations; disruptions to borrowers, customers or suppliers from severe weather; decreased agricultural production and increased insurance premiums and deductibles.

Ongoing SEC Review

The SEC announced that it plans to monitor the impact of the release on company filings as part of its ongoing review. It also plans to hold a public roundtable on disclosure regarding climate change matters this Spring.

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