

Keeping current: securities

By Bernie Hawkins, Cory Manning, and Mike Bryan

New SEC Guidance on Disclosing Risks Related to Climate Change

On February 2, 2010, the Securities and Exchange Commission issued an interpretative release that provides guidance to public companies on existing disclosure requirements regarding risks relating to climate change and greenhouse gas emissions. SEC Release No. 33-9106, February 2, 2010. Last July, the authors wrote about then-recent developments in this area. See *Disclosing Environmental Liabilities: Recent Developments in Legal and Accounting Standards*, 61 *BUSINESS LAW TODAY* (July/August 2009). The commission's guidance is the latest development and will likely have the greatest effect thus far on disclosure practices in this area. Although the guidance does not create any new requirements, it is likely to force companies to consider disclosures more carefully and to provide broader disclosures.

The commission's stated goal in issuing the guidance was to foster consistency. Many companies are disclosing their climate change-related risks in an inconsistent manner, making it difficult to compare companies against one another. SEC Chair Mary Shapiro, who stressed that the commission was "not opining on whether the world's climate is changing, at what pace it might be changing, or due to what

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causes," stated that the "guidance will help to ensure that . . . disclosure rules are consistently applied."

Existing Disclosure Requirements

Regulation S-K requires public companies to consider the potential impact of environmental laws and regulations.

Item 101 (Disclosure of Capital Expenditures). Item 101 requires companies to disclose any material effect that compliance with federal, state, and local laws and regulations may have on the capital expenditures, earnings, and competitive position of the company.

Item 103 (Disclosure of Legal Proceedings). Item 103 requires disclosure of pending or contemplated administrative or judicial proceedings that meet one of three criteria. First, companies must disclose a proceeding that includes a claim that is material to its business or financial condition. Second, companies must disclose a proceeding that involves a claim for damages or involves potential monetary sanctions or capital expenditures that exceed 10 percent of the assets of the company's consolidated balance sheet. Finally, companies must disclose proceedings where a government entity is a party and the proceeding involves potential monetary sanctions, unless there is a reasonable basis to believe that the sanctions will be less than \$100,000.

Item 303 (Management's Discussion and Analysis). Item 303 requires a company to disclose "any known trends . . . or uncertainties" that are "reasonably likely" to affect the company's liquidity or capital expenditures.

Item 503(c) (Risk Factors). Item 503(c) requires a discussion of the

most significant risks that could affect the company's business, financial condition, or future results.

The new guidance does not change these requirements, but it expands the universe of relevant risk markers that companies should consider when making disclosures relating to climate change and greenhouse gas emissions.

New Disclosure Considerations

The guidance suggests that companies consider whether legislation relating to climate change or other environmental issues, pending legislation, and climate accords expose the company to financial risk. The commission's guidance also suggests that companies consider disclosing any physical impacts from climate change, including the risk of increased insurance claims in particular geographical areas due to shifts in weather patterns or changes in sea level.

Furthermore, the guidance suggests, "Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for registrants." Such "possible indirect consequences or opportunities" could include the following:

- 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 new products;
- Decreased demand for services related to carbon-based energy sources; and
- Whether public perception of available data relating to a registrant's greenhouse gas emissions could

expose it to adverse consequences to its business operations or financial condition due to reputational damage.

More than Guidance in Reality

In its January press release, the commission stated that its “interpretative releases do not create new legal requirements nor modify existing ones, but are intended to provide clarity and enhance consistency for public companies and their investors.” Although the guidance does not create a “legal requirement,” public companies consider such statements by the commission to be binding.

Strategies for Incorporating Guidance

Although an analysis of possible material risks relating to climate change and greenhouse gas emission is beyond the scope of this article, given the new SEC guidance, public companies, particularly those in environmentally sensitive industries, may be wise to consider taking the following actions:

Analyze Information and Knowledge. Companies may want to assess their knowledge (and their ability to gather the relevant information) regarding

(1) existing legislation and regulations, pending environmental legislation and regulations, and international accords; (2) greenhouse gas emissions; (3) internal controls and expertise regarding indirect consequences of regulation or business trends; and (4) potential physical consequences of climate change.

Analyze Disclosure Practices. Because the guidance is not tailored to a specific industry or geographic area, all companies may want to consider carefully their environmental disclosure practices. That the guidance is likely to affect a small set of public companies (e.g., energy producers and distributors) disproportionately when compared to other industries is of little consequence. In its interpretative release, the commission stated that it “will monitor the impact of this interpretative release on company filings” in connection with its “ongoing disclosure review program.”

Analyze the Impact of Other Disclosures. Companies may want to consider all disclosures (to regulators or otherwise) regarding environmental issues in order to make sure such disclosures are consistent.

Challenging Road Ahead

Given the amorphous risk markers identified in the commission’s guidance (e.g., pending legislation), the practice of disclosing risks relating to climate change and other environmental issues is now more complex. The fact that companies consider the guidance binding only exacerbates this complexity. These factors, together with the uncertainty surrounding the climate-change debate, make it difficult to identify, with any degree of certainty, the best practices in this area. Companies can take the following actions to increase the likelihood that their risk disclosures relating to climate change will conform to the new guidance:

1. Develop robust processes for gathering and analyzing developments regarding climate-change issues and initiatives, including legislative and regulatory developments, and

2. Review disclosure practices as a whole through the lens of the new guidance.

One thing is certain: the new SEC guidance appears aimed at forcing companies to spend more time and effort examining the risk (real or imagined) relating to climate change and other environmental issues.