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Corporate Alert

December 9, 2009

www.klgates.com

Authors:

Kristy T. Harlan
kristy.harlan@klgates.com
+1.206.370.6651

Sean M. Jones
sean.jones@klgates.com
+1.704.331.7406

Stephen K. Rhyne
steve.rhyne@klgates.com
+1.704.331.7441

Holly K. Vance
holly.vance@klgates.com
+1.206.370.7678

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Climate Change Disclosure Through U.S. Public Companies

Public attention to climate change continues to increase globally, as do governmental and corporate initiatives related to climate change. U.S. public companies therefore face new challenges in determining whether, and to what extent, they should include climate change disclosures in their filings with the Securities and Exchange Commission (SEC). Due to the significant climate change developments that have occurred in 2009 and those that seem likely to occur in the future, all U.S. companies should consider whether, based on their specific circumstances, climate change disclosures should be included in their filings. Even those companies already making climate change disclosures should consider revising and in some cases expanding their disclosures in light of these recent and likely future developments.

2009 Climate Change Developments
During 2009, the pace of federal climate change actions quickened substantially. In June the House of Representatives passed the American Clean Energy and Security Act (also known as the Waxman-Markey bill), the first climate change legislation ever adopted by either house of Congress. Although Senate consideration of climate change legislation has been deferred until next year, a number of events seem likely to ensure that the Senate will expeditiously address the legislation in 2010. Chief among these is President Obama's recent pledge in advance of the Copenhagen Conference of a provisional target in the range of 17%, the amount by which 2020 U.S. greenhouse gas emissions are to be reduced below 2005 levels.

Some of the other 2009 developments that may bear on a company's assessment of its disclosure obligations include:

- Unprecedented actions by the Environmental Protection Agency (EPA). These actions include final rules to require greenhouse gas reporting by large emitters beginning in 2010; proposed rules that would require permits stipulating the best available control technologies for new facilities (or existing facilities undergoing major modifications) that emit over 25,000 tons of greenhouse gases annually; and on December 7, 2009, the "endangerment finding" under the Clean Air Act that greenhouse gas emissions endanger public health and welfare, a predicate for the finalization of the proposed rules for permits and which could possibly portend even broader greenhouse gas regulation by the EPA.
- Significant court decisions by two U.S. Circuit Courts of Appeals finding that the federal common law of public nuisance applies to claims to abate global warming.

- Significant support by many members of the business community for greater governmental and corporate efforts to reduce greenhouse gas emissions. Walmart announced in July 2009, for example, that it was requiring sustainability reports by its suppliers (over 100,000 globally) so that Walmart can begin developing sustainability ratings for its products.
- The SEC staff, in a reversal of its prior position, issued a bulletin on October 27, 2009, that is expected to facilitate and encourage shareholder proposals to require companies to provide greater disclosure about their climate change risks.

In addition, investor groups continued to press in 2009 for improved climate change disclosure in SEC filings. In June, members of the Investor Network on Climate Risk and other large global investors sent a letter to the SEC Chairman requesting that the SEC issue formal interpretive guidance on the materiality of risks posed by climate change and enforce existing disclosure requirements for climate change risks. On November 23, 2009, a group of investors, including the California Public Employees' Retirement System, filed a supplemental petition with the SEC asking it to provide interpretive guidance outlining climate-related material risks that public companies should disclose to investors.

SEC Commissioner Elisse Walter stated in several public comments in October 2009 that the SEC staff is reviewing recommendations about such guidance and that in her view the SEC should consider issuing such guidance. Commissioner Walter in her public comments also observed: "Even without any further guidance, however, it strikes me that this is one area where, if I were drafting disclosure for a registrant today, I would carefully consider whether that company's particular facts and circumstances raise any disclosure obligations under the current rules, and in particular, under the MD&A requirements."

Current SEC Disclosure Requirements

Even without any specific guidance, existing SEC disclosure rules and regulations, as noted by Commissioner Walter, bear on a company's climate change disclosure obligations. Registration statements filed under the Securities Act of 1933 and periodic reports filed under the Securities Exchange Act of 1934 must disclose all information that is material to an investment decision. In addition, Rule 10b-5 provides that it is unlawful to make an untrue statement of material fact or to omit to state a material fact necessary to make the statements, in light of the circumstances under which they are being made, not misleading in connection with the purchase or sale of a security.

The touchstone for determining whether disclosure is required under SEC rules is materiality—whether there is a substantial likelihood that a reasonable investor would consider the information important in making his or her investment or voting decision. Whether omitted information is material is determined on the basis of whether there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the "total mix" of information available. The materiality of contingent or speculative events such as proposed climate change legislation is to be assessed by balancing the probability of an event occurring against its anticipated magnitude to the company.

The provisions of Regulation S-K more specifically prescribe the subject matter of certain items required to be disclosed in SEC filings. Several of these rules may require a company to address climate change-related issues, particularly Item 303 governing a company's Management Discussion & Analysis (MD&A). Item 303 requires that a company describe in its MD&A any known "trends, uncertainties or other factors" that are reasonably likely to affect the company's earnings, liquidity or capital expenditures. Item 303 is intended to allow investors to view the company through the eyes of management and create increased transparency. Specifically, forward-looking information is required in the MD&A where there are known "trends, uncertainties or other factors" that will result in, or that are reasonably likely to result in, a material impact on the company's liquidity, capital resources, revenues and continuing operations. The SEC has repeatedly stressed the importance of addressing factors that are likely to impact a company's business in the future.

Other Items in Regulation S-K may apply to a company as it considers climate change disclosures, including the following:

- Item 101(c)(x) requires a company to disclose competitive conditions in its business. For some companies, sustainability performance may have a material impact on competitive conditions, and therefore require disclosure.
- Item 101(c)(xii) requires a company to disclose any material effect of environmental compliance associated with enacted laws. The cost of complying with any adopted greenhouse gas emissions regulations is the type of cost, if material, required to be disclosed in Item 101(c)(xii).
- Item 103 requires disclosure of any material pending administrative or judicial proceeding to which a company is, or may become, a party. In addition, any such proceeding arising under any laws regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment must be described if it falls within certain parameters specified in Item 103. In addition, a company should focus not only on any proceeding to which it is a party but on any third party proceedings if the outcome could materially affect the company's financial condition or competitive position. As noted, two federal circuit court decisions have ruled that plaintiffs, relying on federal common law of public nuisance and other common law tort theories, have standing to pursue causes of action against defendants that have emitted greenhouse gases (for a further discussion of these decisions, see "Emissions of Greenhouse Gases & Global Warming—Regulation through Litigation? Who is Liable for Damages Arising from Global Warming?").
- Item 503 requires a discussion of significant risk factors that apply to a company. Companies with businesses that may be impacted by climate change or climate change-related regulation should consider including appropriate disclosure addressing these risks and their potential effect on the company.
- In addition, Regulation FD prohibits certain selective disclosures of material nonpublic information. Consequently, disclosure of material climate change information to third parties may violate Regulation FD if not also disclosed by the company in an SEC filing.

Considerations in Evaluating Disclosure

Against this backdrop of SEC disclosure rules, a corporation should consider what climate change disclosures may be appropriate in its SEC filings. To do so, a corporation should analyze the ways in which it is impacted, and is expected in the future to be impacted, by climate change and its consequences. If the effects of climate change and its consequences are expected to be material to the corporation's operations, financial condition or its business, then disclosure is required.

A corporation's analysis of the impact of climate change should consider several general factors applicable to a broad range of companies, as well as factors more specific to the corporation's particular circumstances. These general factors will include the possible actions that may emanate from the Copenhagen Conference, both in the U.S. as well as other countries and regions key to the corporation's business. For U.S. companies, the prospect of federal legislation and its potential consequences, as well as actions by the EPA, will be critical considerations in evaluating whether climate change disclosures are necessary. These consequences are expected to affect energy costs, building standards, land use practices, various regulatory regimes, and even the availability and costs of raw materials in some cases.

A company also should consider the state statutory and regulatory schemes in the states in which it operates. A number of states already have adopted various climate change measures, including renewable portfolio standards, greenhouse gas inventorying, green building standards and multi-state compacts to limit greenhouse gas emissions. Some states, such as California, have been particularly active in adopting climate change measures.

A company should consider whether any of its strategic locations are expected to be impacted by the physical or climatic effects of climate change. For example, are any of these locations vulnerable to climate change events, such as flooding and hurricanes, and, if so, will an increase in such events result in higher insurance costs and local taxes?

The nature of a company's industry, of course, is another key factor, and corporations should generally be mindful of what disclosures are being made by others in their industry. Climate change is a critical matter for electric utilities, energy producers, energy-intensive companies and the insurance industry. Other industries, of course, are also impacted. Companies in consumer-oriented industries increasingly have been promoting their "green" efforts, recognizing the importance of the issue to many members of the public. As noted, Walmart announced this July that its suppliers must provide sustainability reports about their products and supply chains.

When analyzing the impact of climate change, a company should not overlook that climate change and its consequences may present opportunities and, if material, these opportunities should be disclosed. This would be true for cleantech and energy efficiency companies, but can also be true in other circumstances such as when superior sustainability performance may provide a company a competitive advantage.

Lastly, as part of its analysis, a company should be aware of what it has already disclosed regarding climate change in its SEC filings and other public climate change disclosures, such as on a website, in responses to questionnaires, through interviews, or through participation on panels. A company will generally want to ensure that it is consistent in its disclosures and, regardless, will not want to be "selectively disclosing" material climate change information through certain channels without including it in SEC filings.

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