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SEC GUIDANCE ON CLIMATE CHANGE DISCLOSURE

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The Securities and Exchange Commission (the "SEC") recently published an interpretive release (the "Release") regarding climate change matters.

The Release followed increasing calls by institutional shareholders for interpretive advice about climate-related disclosure as well as enforcement action by the New York attorney general's office against three energy companies regarding the companies' insufficient disclosures about greenhouse gas emissions and potential liabilities resulting from climate change and related regulation.

Specifically, the SEC indicated that the physical effects of climate change, ramifications of new legislation and regulations, and modified business trends may affect (i) the description of a registrant's business, (ii) legal proceedings to which a registrant may be subject, (iii) the risk factors related to a registrant, and (iv) the management discussion and analysis of the financial condition and results of operations ("MD&A"). Among the possible physical effects from climate change, the SEC included "changes in weather patterns," "increases in storm intensity," "sea-level rise," "[c]hanges in the availability or quality of water,"

and decreased efficiency of equipment." For companies for which physical effects may not be a material concern, the SEC stated that "[c]ompanies that may not be directly affected by such developments could nonetheless be indirectly affected by changing prices for goods or services provided by companies that are directly affected and that seek to reflect some or all of their changes in costs of goods in the prices they charge." While the Release provides guidance about climate-related disclosure, it does not create new or additional disclosure obligations.

Existing Disclosure Requirements *Description of Business*

Regulation S-K (Item 101) requires a registrant to describe its business and that of its subsidiaries. Included within that description is disclosure regarding "the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated

capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material."

Legal Proceedings

Regulation S-K (Item 103) requires that the registrant "[d]escribe briefly any material pending legal proceedings, ... to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject." Proceedings "under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary for the purpose of protecting the environment shall ... be described if:

- such proceeding is material to the business or financial condition of the registrant;
- such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount

involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or

- a governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than \$100,000.”

MD&A

Regulation S-K (Item 303), among other things, requires registrants to disclose their “financial condition, changes in financial condition and results of operations.” In addition, the discussion is to include “such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations.”

Risk Factors

Regulation S-K (Item 503(c)) requires that a registrant discuss “the most significant factors that make the offering speculative or risky.”

Climate Change–Related Disclosures

In the Release, the SEC focused on the following issues with respect to the way that climate change may trigger

disclosure required by the existing rules: (i) impact of legislation and regulation, (ii) international accords, (iii) indirect consequences of regulation or business trends, and (iv) physical impacts of climate change.

With respect to these topics, the SEC provided examples of possible consequences that companies should consider disclosing and discussing, as appropriate. Included in these examples were:

Impact of Legislation and Regulation (Both Domestically and Internationally)

- costs to purchase, or profits from sales of, allowances or credits under a “cap and trade” system;
- costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a “cap and trade” regime; and
- changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

Indirect Consequences of Regulation or Business Trends

- 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 innovative new products;
- increased demand for generation and transmission of energy from alternative energy sources; and
- decreased demand for services related to carbon-based energy sources, such as drilling services or equipment maintenance services.

Physical Impact of Climate Change

- any property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products, for registrants with operations concentrated on coastlines;
- indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
- increased insurance claims and liabilities for insurance and reinsurance companies;
- decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
- increased insurance premiums and deductibles, or a decrease in the availability of coverage, for registrants with plants or operations in areas subject to severe weather.

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Conclusion

While the Release does not impose new disclosure obligations on registrants, it does highlight areas that registrants need to consider as they prepare disclosure in the future. In light of the Release, companies need to review their existing disclosure and consider its completeness and accuracy. In addition, registrants should develop processes, as part of the preparation of disclosure documents, to gather information about the impact of legislation and regulation, international accords, indirect consequences of regulation or business trends, and physical impacts of climate change.

**Please contact any of the
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