

REGULATORY DEVELOPMENTS

SECURITIES AND EXCHANGE COMMISSION RELEASES GUIDANCE ON CLIMATE CHANGE DISCLOSURE

The Securities and Exchange Commission (SEC) has released a guidance that could require many public companies to disclose direct and indirect impacts related to climate change (SEC Guidance). See, Release Nos. 33-9106: 340-61469; FR-82. The SEC Guidance outlined the SEC's views concerning climate change matters under the existing disclosure requirements. The guidance is intended to assist public companies in satisfying their disclosure obligations under the federal securities laws and regulations. In particular, the relevant rules that cover a company's risk factors, business description, legal proceedings and management's discussion and analysis of financial condition and results of operations and management discussion and analysis.

Recent Regulatory, Legislative and Related Developments

The SEC, in the guidance, notes the emergence of state, federal and international regulatory and legislative, and other developments related to climate change. In particular, with respect to greenhouse gas (GHG) emissions, it noted the Global Warming Solutions Act of 2006 in California, the Regional Greenhouse Gas Initiative, the Western Climate Initiative and the Midwestern Greenhouse Gas Reduction Accord. The SEC Guidance also noted pending federal legislation, such as the American Clean Energy and Security Act of 2009 and Clean Energy Jobs and American Power Act of 2009 and observed recent steps taken by the U.S. Environmental Protection Agency to regulate greenhouse gas emissions. Furthermore, the SEC discussed certain international efforts, including the Kyoto Protocol, the European Union Emissions Trading System and the United Nations Climate Conference in Copenhagen. And lastly, the SEC highlighted the insurance industry adjustments to these developments, such as the promulgation of a uniform standard for mandatory disclosure by insurance companies to state regulators of financial risks due to climate change and actions taken to miti-

gate the risks and the development of new actuarial models and design of new products to reshape coverage for green buildings, renewable energy, carbon risk management and directors' and officers' liability, among other actions.

Potential Impact of Climate Change-Related Matters on Public Companies

In the SEC Guidance, the SEC pointed out that the regulatory, legislative and other developments could significantly affect operations and financial decisions, including those involving capital expenditures to reduce emissions and, for companies subject to cap and trade laws, expenses related to purchasing allowances where reduction targets cannot be met. The SEC further stated that although some companies may not be directly affected by such developments, the companies could nonetheless be indirectly affected by changing prices for goods or service provided by companies that are directly affected. It also noted, that some companies could benefit by taking advantage of new business opportunities, such as through new trading markets for emission credits related to cap and trade programs.

The SEC further emphasized there may be significant physical effects of climate change with the potential to have a material effect on a company's business and operations. These effects could impact a company's personnel, physical assets, supply chain and distribution chain. It could include the impact of changes in weather patterns, changes in availability or quality of water or other natural resources on which the company's business depends, damage to facilities, decreased efficiency of equipment, or changes in consumer demand for products or services; for example, warmer temperatures could reduce demand for residential and commercial heating fuels, services or equipment. In addition, the SEC noted that financial risks associated with climate change may arise from physical risks to entities that are customers or supplier of the company.

Current Sources of Climate Change-Related Disclosures Regarding Public Companies

The SEC received several petitions for interpretive advice from large institutional investors and other investor groups calling for climate-related disclosures. See, *Petition for Interpretive Guidance on Climate Risk Disclosures*, dated September 19, 2007. The SEC highlighted that the New York Attorney General's office recently entered into settlement agreements with three energy companies and that the settlement agreement required enhanced disclosure relating to climate change and greenhouse gas emission in their reports filed with the SEC. Furthermore, it noted that the Climate Registry provides standards for and access to climate-related information and that additional information is available through The Carbon Disclosure Project and The Global Reporting Initiative.

Historical Background of SEC Environmental Disclosure

The SEC first addressed disclosure of material environmental issues in the early 1970s; and in 1971, issued an interpretive release stating that companies should consider disclosing in their SEC filings the financial impact of compliance with environmental laws, based on the materiality of the information. After several rulemaking efforts, extensive litigation and public hearings, the final and current form of the rules were adopted in 1982.

Overview of Rules Requiring Disclosure of Climate Change Issues

Under current regulations, when a public company is required to file a disclosure document with the SEC, the form is dictated by the disclosure requirements of Regulation S-K and Regulation S-X. These rules require a company to disclose, in addition to the information expressly required by SEC regulation:

...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.

In the guidance, the SEC pointed out the most pertinent non-financial statement disclosure rules that may require disclosure related to climate change,

including: "Description of Business" (Item 101(c)(1)(xii) of Regulation S-K); "Legal Proceedings" (Item 103 of Regulation S-K); "Risk Factors" (Item 503(c) of Regulation S-K); "Management's Discussion and Analysis" (Item 303 of Regulation S-K). The SEC also noted that companies should 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 EPA and other bodies, and whether any of that information may be required to be included in SEC filings.

Climate Change-Related Disclosures

Given the rules and regulations described above, the SEC pointed out that each of those items may require disclosure regarding the impact of climate change, depending on the facts and circumstances of the particular company.

In particular, the SEC emphasized the following topics as some of the ways climate change may trigger disclosure obligations and are topics that a company may need to consider.

The Impact of Legislation and Regulation

Companies are to consider and to disclose, when material, the impact on their businesses of significant developments in federal and state legislation and regulations regarding climate change. Depending upon a company's particular sensitivity to greenhouse gas legislation or regulation disclosure may be required as risk factors, capital expenditures, and known trends and uncertainties. The SEC also noted that the disclosures should not be limited to negative consequences and may include disclosure of new opportunities, such as cap and trade type systems and selling of offset credits.

International Accords

Companies are to consider and disclose material impacts on their business from treaties or international accords relating to climate change. Companies whose businesses are reasonably likely to be affected by such agreements are to monitor the progress of any potential agreements and consider the possible impact in satisfying their disclosure obligations based on the "Management's Discussion and Analysis" and materiality principles.

Indirect Consequences of Regulation or Business Trends

Companies are to consider and disclose, when material, the legal, technological, political and scientific developments regarding climate change that create new opportunities or risks for companies and if these developments have significant enough impact on the business, disclosure may be required under the rules. Two examples provided by the SEC are: (1) repositioning to take advantage of a potential opportunity; and (2) the impact on a company's reputation from public perception of publicly available data relating to its greenhouse gas emissions.

Physical Impacts of Climate Change

Companies are to consider and disclose, when material, the significant physical effects of climate change, such as effects on the severity of weather (for example, floods or hurricanes), sea levels, the arability of farmland, and water availability and quality, that

have the potential to affect a company's operations and results. The release cites examples of property damage and disruptions to coastline operations; disruptions to the operations of major customers or suppliers from severe weather; decreased agricultural production capacity and increased insurance premiums and deductibles or a decrease in the availability of insurance coverage.

Conclusion and Implications

The SEC Guidance was intended to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as these companies prepare disclosure documents filed with the SEC and provided to investors. The SEC will monitor the impact of the SEC Guidance on company filings. It also plans to hold a public roundtable on disclosure regarding climate change matters this spring. (C. Calzacorta, B. Flanagan)

CALIFORNIA ADOPTS ENVIRONMENTAL REVIEW GUIDELINES FOR GREENHOUSE GAS EMISSIONS

The California Resources Agency (Resources Agency) adopted environmental review guidelines under the California Environmental Quality Act (CEQA) establishing a framework for reviewing agencies to evaluate a project's greenhouse gas (GHG) emissions and potential impacts related to climate change. The guidelines represent the first set of environmental review regulations by any state or federal agency addressing the analysis and mitigation of climate change impacts.

Background

CEQA was adopted in 1970 and applies to most California public agency decisions to carry out, authorize, or approve projects that could have adverse effects on the environment. CEQA requires that agencies inform themselves about the environmental effects of their proposed actions, carefully consider all relevant information before they act, give the public an opportunity to comment on the environmental issues, and avoid or reduce significant environmental impacts when it is feasible to do so. Air quality

impacts always have figured prominently in CEQA documents but, until a few years ago, CEQA analyses rarely covered GHGs or the impacts of climate change.

After California's passage of the Global Warming Solutions Act of 2006 (AB 32), which established GHG reduction targets and reduction strategies, questions quickly arose regarding whether and how lead agencies should account for climate change impacts in documents prepared under CEQA. Agencies struggled to understand, for example, what GHG emissions should be attributed to the project and what GHG levels should be deemed "significant." Compounding the problem is that CEQA documents typically discuss impacts "in the vicinity of the project," and do not typically address contributions toward global impacts.

Around the same time as passage of AB 32, California Attorney General Jerry Brown began submitting comment letters on pending projects, litigating when a project's CEQA documents remained silent on the issue of climate change, and securing settle-