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SHOULD WE TELL OUR SHAREHOLDERS ABOUT CLIMATE CHANGE?

Matthew H. Ahrens

Climate change is an issue of public concern, and is increasingly likely to be highly regulated. Lawmakers, organizations and companies are fully engaged in a discussion of climate change at national, state, and international levels. On April 17, 2009, the U.S. Environmental Protection Agency issued a proposed finding that greenhouse gases, or GHGs, may endanger human health or welfare. 74 Fed. Reg. 18,886 (proposed Apr. 17, 2009) (to be codified at 40 C.F.R. Ch. 1). President Obama has placed a high priority on, and there are bills before Congress that would require, climate change regulation. In 2007, the U.S. Supreme Court found that the Clean Air Act authorized the regulation of GHG, and that GHGs "fit well within the Clean Air Act's capacious definition of air pollutant." *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497, 532 (2007). Several states have enacted laws or entered regional initiatives to regulate GHG emissions, including the Regional Greenhouse Gas Initiative (RGGI) and the Western Climate Initiative. Although not party to the Kyoto Protocol (Kyoto), the United States is participating in discussions regarding what will replace Kyoto after expiration in 2012.

Companies throughout many industries could incur material compliance costs and liabilities, both direct and indirect, from future climate change regulation. However, until the timing and scope of regulation become known, it remains difficult for many companies to assess the timing and scope of the impact from future regulation. In spite of this uncertainty, public companies may need to inform investors of any probable future impact. While the Securities and Exchange Commission, or SEC, has not provided guidance or taken a public position regarding climate change disclosure, recent investor petitions to the SEC, actions by the State of New York, and bills before Congress provide some guidance. In-house counsel at public companies need to assess whether, when, and how to disclose climate change risks.

Current Disclosure Requirements

Investors may want to know the likely extent of the impact from climate change matters when making their investment decisions, especially in industries likely to face material risks—both physical risks due to climate change and financial risks and opportunities from regulation. As these risks increase and become more imminent, investor interest increases and climate risk becomes increasingly important when determining share value. Nonetheless, climate change disclosure has been inconsistent. Disclosure of climate change risks and liabilities by companies within the same industry can range from non-disclosure to a passing reference to several pages of discussion.

Federal securities laws require public companies to provide investors with access to material information necessary for informed decision-making. This can require disclosure of information about a company's financial condition and business practices in a company's annual 10-K and quarterly 10-Q filings with the SEC.

Regulation S-K contains three items relevant to climate change disclosure. Item 101 requires disclosure of the material effects on a company from compliance with enacted or adopted regulations. Item 103 requires disclosure of material pending legal proceedings, including proceedings "known to be contemplated by government entities." Items 101 and 103 apply most directly to companies subject to existing climate change regulations (such as RGGI or Kyoto) or to pending climate change litigation.

Item 303 is broader, and can require disclosure of certain "known trends, events and uncertainties" related to climate change, unless not reasonably likely to occur or, if they occur, not reasonably likely to have

a material effect on the company. The physical impact from climate change itself and the financial impact from future climate change regulations can both arguably be interpreted as uncertainties, and the likelihood of future climate change regulation as a trend.

As a result, when determining whether to disclose, in-house counsel will need to focus on whether this impact will be material. Of course, the impact of climate change will vary widely from industry to industry, and from company to company within each industry. SEC Rule 12b-2 defines "material" as information "to which there is a substantial likelihood that a reasonable investor would attach importance in deciding to buy or sell the securities registered." As interest by reasonable investors in the financial, as opposed to environmental, consequences from climate change increases, then climate change matters become more material.

Requests for Action by the SEC

A coalition of twenty-two environmental advocates, institutional investors, and states filed a Petition for Interpretative Guidance on Climate Change Risk Disclosure with the SEC on Sept. 18, 2007 and supplemented the petition on June 12, 2008. *See* www.incr.com/Document.Doc?id=187 and www.ceres.org/Document.Doc?id=358. The petition describes alleged climate change-related risks to various public companies (including risks from future regulation of GHG emissions and the impact of climate change itself), and states that the petitioners believe that disclosure of these risks is currently required. The petition requests prompt issuance of interpretive guidance by the SEC to clarify that material climate change risks "must be included in corporate disclosures under existing law." Petitioners also had requested action related to climate change disclosure, including in letters sent to the SEC on Oct. 22, 2008 and June 14, 2006 and to President Bush on March 19, 2007. *See* www.ceres.org/Document.Doc?id=376, www.incr.com//Document.Doc?id=48, and http://216.235.201.250//Document.Doc?id=142. In addition, on Oct. 31, 2007, a Senate subcommittee held a hearing on the adequacy of the SEC's climate change disclosure requirements, and, on Dec. 6, 2007, Sens. Dodd and Reed wrote a letter urging the SEC to issue disclosure guidance. *See* http://dodd.senate.gov/multimedia/2007/120607_CoxLetter.pdf. Neither the SEC nor President Bush publicly responded to these petitions or letters.

Bills Seeking Climate Change Disclosure

Several bills were introduced, but not enacted, in the 110th Congress (including the Global Warming Pollution Reduction Act (S.309) and the Global Warming Reduction Act of 2007 (S. 485)) that, as one of many means to regulate climate change risks, would require the SEC to issue climate change disclosure rules. These bills would have required public companies to disclose the "financial exposure" they face as a result of their GHG emissions as well as the "potential economic impacts of global warming" on the companies themselves. Similar disclosure requirements could arise in future federal climate change bills.

In California, Senate Bill 1550, "Corporations: climate risk disclosure," would require the state controller to develop a voluntary climate change disclosure standard for listed companies doing business in California. The voluntary standard would seek disclosure similar to what might be required under federal law (i.e., the physical impact of climate change and the potential impact of governmental regulation), but would also seek disclosure of other matters unlikely to be required under federal law (such as whether a link exists between executive compensation and achievement of corporate climate objectives). The bill would also require the use of "globally accepted climate change disclosure standards."

Settlements with the State of New York

On Sept. 14, 2007, the Office of the Attorney General for the State of New York (New York AG) issued subpoenas to five energy companies (AES Corp., Dominion Resources, Dynegy Inc., Xcel Energy Inc., and Peabody Energy Corp.) to investigate the adequacy of disclosure of climate change risks by public energy companies. *See* www.oag.state.ny.us/media_center/2007/sep/sep17a_07.html. The New York AG did not file related complaints. All five

companies had disclosed certain climate change matters in previous SEC filings.

The letters accompanying four of the subpoenas described a concern about inadequate disclosure of "increased financial, regulatory and litigation risks." The letter accompanying the fifth subpoena described a concern about inadequate disclosure of "financial risks" related to current GHG emissions. Each also stated that a company "cannot excuse its failure to provide disclosure and analysis by claiming there is insufficient information concerning known climate change trends and uncertainties."

The New York AG entered into settlements with Xcel in August 2008 and with Dynegy in October 2008. *See* www.oag.state.ny.us/media_center/2008/aug/xcel_aod.pdf and www.oag.state.ny.us/media_center/2008/oct/dynegy_aod.pdf. Both settlements require increased disclosure in future SEC filings. The settling companies agreed to include an analysis and disclosure in their annual SEC filings of material financial risks from (1) existing (and future) GHG laws and regulations, (2) climate change litigation, (3) the physical impacts associated with climate change, and (4) climate change financial risks and emission management. The first two requirements are similar to Items 101 and 103 respectively, although the settlements expressly require disclosures regarding expected trends in climate change laws and judicial decisions that could impact the company. The second two requirements are similar to Item 303, but require comprehensive disclosure.

On May 4, 2009, the New York AG sent a letter to Chevron Corporation alleging material misstatements in Chevron's disclosure of environmental litigation. Although not related to climate change matters, this is an indication that there may be a higher risk of future claims from the New York AG.

Conclusion

As the likelihood of climate change regulation increases, the need for public companies to disclose climate change risks and liabilities increases. However, unless the SEC issues climate change disclosure guidance, determining whether any specific industry or company needs to disclose may be decided on a case by case basis. Even if disclosure is not currently required and was not required for some time, many public companies should consider disclosure due to the rising level of investor interest in climate change matters and of scrutiny by large shareholders, state governmental agencies, and Congress.

Unlike many energy companies or companies with international operations, most companies have not yet incurred, or are not yet planning for future, material climate change costs or liabilities. For some, until federal climate change regulation is implemented, climate change risks arguably remain too speculative to require meaningful disclosure. Until the SEC issues guidance or climate change disclosure regulations, the recent Xcel and Dynegy settlements can serve as an example of how to proceed. The greater the likelihood that any of the risks identified in these settlements materially affect a company, the greater the need for disclosure.

When disclosing, a company needs to consider both a qualitative and, if sufficient information exists, a quantitative analysis, as well as the likelihood that investors would be interested from a financial, and not just an environmental, perspective. As the timing and scope of future federal regulation becomes clearer, companies will be able to more accurately assess, and, as a result, disclose, climate change risks and liabilities. Nonetheless, given the high level of investor interest, disclosure may be prudent by companies most likely to be directly or indirectly impacted.

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