

SEC Reporting Companies: Are Your Disclosures About Climate Change Risks Adequate?

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Public disclosure regarding climate change risks has experienced a sea change over the last 18 months. So far this year, the 2009 proxy season has seen more than 60 climate-related resolutions filed by investors against more than 50 major U.S. companies. The resolutions follow the settlements by Xcel Energy Inc. and Dynegy Inc. with the New York State Attorney General Andrew Cuomo with respect to disclosure of information in their filings with the Securities and Exchange Commission concerning climate change risks. These settlements came on the heels of the receipt, in June 2008, by the SEC of more than 3,000 people asking the commission to require public companies to disclose more information about climate change risks.

Much of this was sparked by the issuance of subpoenas by Cuomo in September 2007 to five energy companies requesting documents relating to the companies' internal analyses and disclosures of climate change risks. Around the same time, state pension fund managers and environmental organizations began to assert pressure on the SEC to provide interpretive guidance regarding corporate disclosures by SEC reporting companies relating to the risks associated with climate change. Since then, the changing climate continues to dominate headlines and has grown to be a major factor affecting companies and business environments throughout the world.

Why the Focus?

As evidenced during the presidential campaign, climate change is a critical issue in the United States and across the globe. The Obama administration has already made protecting and preserving the environment a priority. Not surprisingly, the awareness and concerns over climate change have impacted the corporate environment. In particular, companies must grapple with the key issues that climate change poses: financial risks, opportunities and potential costs, as well as physical risks to corporate facilities and operations. As a result, SEC reporting companies must assess how these issues will impact their securities filings.

In recent years, there has been a dramatic increase in voluntary corporate disclosures tied to climate change. However, according to state officials, pension fund managers and environmental organizations, the public disclosures in SEC reporting documents such as Forms 10-K up until now have been "scant and inconsistent." Such constituents have for years pressured companies to provide clearer and more useful disclosures regarding risk, opportunities and costs related to how climate change is expected to affect the companies' operations and financial conditions. Investors and government officials alike believe that such information is imperative in order to make a reasoned and careful investment decision regarding a particular company. Certainly, the information is more relevant to those companies in industries most affected by climate change, like automobile/transportation, building, coal, electric power, and oil and gas. However, even industries such as banking and insurance are being judged with respect to climate change disclosures. Hence, all companies would be well-advised to pay attention to the climate change disclosure revolution as it unfolds.

Where Did the Focus Come From?

On Sept. 14, 2007, Cuomo subpoenaed five energy companies, requesting documents relating to the companies' internal analyses of climate change risks and their disclosure of such risks to investors. In letters to the energy companies accompanying the subpoenas, Cuomo asserted that the companies "did not attempt to evaluate or quantify the possible effects of future greenhouse gas," or GHG, "regulations, or discuss their impact on the company," which, in turn, impeded the ability of a reasonable investor to make an informed investment decision. The letters further stated that this type of an omission would not be excused by merely asserting that there was not enough information available concerning climate change. Lastly, the letters reminded companies that the securities laws require corporate disclosures to be "complete" and "not misleading."

Quickly thereafter, on Sept. 18, 2007, a group of institutional investors, environmental advocates and state pension fund managers (petitioners) petitioned the SEC to clarify how reporting companies should disclose the effects of climate change on their financial and operating performance. The petitioners argued that climate change had become "material" to investors and to corporate performance, and therefore it must be included in corporate disclosures. The petitioners advocated full-disclosure by all public companies, although the petitioners mainly focused on energy companies. The petitioners demonstrated facts that reasonable investors considered climate risk information when making an investment decision and requested that the SEC issue an interpretative release that would construe existing regulations to require that material climate risk information be disclosed under specific rules and regulations of the SEC, namely Item 101 (Disclosure of Capital Expenditures), Item 103 (Disclosure of Legal Proceedings) and Item 303 (Management Discussion and Analysis) of Regulation S-K promulgated under the Securities Act of 1933, as amended. In addition, the petitioners noted that, under certain circumstances, climate risk information may also be required under Statement of Financial Accounting Standards No. 5. Finally, the petitioners urged the SEC to compare disclosures of companies within an industry and to make further inquiries of registrants that have not disclosed material climate-change related risks.

Not surprisingly, the 2008 proxy season experienced a surge of shareholder resolutions related to climate change and environmental matters. Ceres, a national network of investors, environmental organizations and other public interest groups working with companies and investors to address

sustainability challenges such as global climate change, reported that 57 shareholder resolutions were filed in 2008 — a number that doubled over the prior five years. Examples of resolutions received by companies consisted of resolutions to ConocoPhillips and Chevron, Ford and ExxonMobil requesting disclosure on the establishment of GHG reduction targets for operations and products, and disclosure regarding GHG emission reductions goals.

In August 2008, after a year of investigation and discussion with New York state officials, both Xcel Energy and Dynegy agreed to provide information in their public filings with the SEC regarding climate change. As a result of Cuomo's investigations, both Xcel Energy and Dynegy have agreed to expand or continue to provide a discussion of climate change and possible attendant risks in their Form 10-K filings with the SEC. The settlement with Xcel, for example, specifically provides that future disclosures by Xcel will consist of an analysis of material financial risks resulting from GHG emissions regulations including identification of such regulations and a discussion of potential regulations to be adopted and how they may affect the company's business, an analysis of the material financial risks from litigation related to climate change, an analysis of material financial risks from physical impacts of climate change, including the impact of weather conditions such as extreme changes in temperature and a strategic analysis of climate change risk and emissions management to the extent GHG emissions materially affect the company's financial exposure, including a statement on the company's position on climate change, estimated GHG emissions, future GHG emissions from planned coal-fired plants, strategies to decrease climate change risk, analysis regarding such strategies and corporate governance measures related to climate change matters such as the effect of meeting climate change objectives on executive compensation decisions.

Many commentators suggest the settlements could lead to new standards in reporting environmental risks, while others suggest that the terms simply go to the level of specificity that will occur rather than a change in disclosure rules and regulations. The former commentators note that the settlement agreements require these companies to disclose information that is not typically reported in SEC filings such as management plans to reduce GHG emissions and corporate governance measures tied to climate change. However, the existing SEC rules and regulations do require disclosure regarding "material" financial risks with respect to any aspect of a company's business, which would include climate change risks. Under the settlements, the companies simply agreed to provide more specificity about climate change and how it relates to material financial risks.

As we enter the 2009 proxy season, companies are already seeing a record 63 climate change resolutions filed with more than 50 U.S. companies. The resolutions request more disclosure regarding financial risks and exposures as they relate to climate change matters. In addition, resolutions include requests for sustainability reports to investors, which should include information regarding management of climate change risk by companies through social, environmental and governance avenues.

Where to Go From Here?

As shareholder resolutions and state officials continue to scrutinize these issues, it is prudent for companies to consider the potential risks, costs and opportunities associated with climate change for purposes of their SEC disclosure requirements. Reporting companies can expect to see not

only an increase in their climate change costs and risk exposure in the near future, but also heightened scrutiny from the SEC for their climate-related disclosures.

To date, the SEC has yet to issue any specific formal guidance, interpretation or clarification as to how disclosure standards should be applied to climate change. However, the current rules require that reporting companies disclose any information that would be "material" to an investment decision in their corporate disclosures. Many companies particularly in certain industries such as coal and energy will be hard pressed to claim climate related matters are not material. As the investor outcry for increased disclosure demonstrates, all companies should assess and disclose the resulting impact of climate change on their securities filings as climate change continues to garner more attention in the future.