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IMPORTANT NEWS FROM JONES WALKER

JONES WALKER

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SEC ISSUES INTERPRETIVE RELEASE REGARDING CLIMATE CHANGE DISCLOSURE

On February 2, 2010, the Securities and Exchange Commission (the "SEC") published an interpretive release providing guidance to public companies regarding the SEC's existing disclosure requirements as they apply to climate change matters. The release was approved by a 3-2 vote of the SEC and is controversial. The SEC makes clear, however, that the release does not change the law, but rather reviews the relevant existing disclosure rules and discusses how they may apply. Critics warn that the release could lead to unnecessary, speculative, and trivial disclosures that will not improve investment decisions. For a copy of the full text of the release, click here.

Background

The SEC notes that the release is issued in the context of heightened public interest regarding climate change. In recent years, various groups have urged public companies to provide more disclosure in their SEC filings related to climate change. For example, following subpoenas issued in 2007, the New York Attorney General entered into settlement agreements in 2008 and 2009 with Xcel Energy, Dynegy Inc., and AES Corporation in which these large electric power generating companies agreed to enhance their disclosures relating to climate change and greenhouse gas emissions in their SEC filings. Institutional investor groups such as Ceres have also campaigned for enhanced disclosures, making demands similar to those made by the New York Attorney General. The SEC also notes that, outside of companies' SEC filings, there is increasingly more disclosure regarding companies' greenhouse gas emissions as a result of several states' laws requiring emissions disclosures and as a result of companies' voluntary participation in disclosure initiatives such as the Climate Registry, the Carbon Disclosure Project, and the Global Reporting Initiative. Also, the National Association of Insurance Commissioners has adopted a requirement that insurance companies disclose to regulators the financial risks they face from climate change and actions they are taking to respond.

Developments in Climate Change Regulation

The release contains an overview of developments relating to climate change regulation. Some laws relating to climate change have already been adopted. For example, in the U.S., the EPA issued final regulations in September 2009 requiring mandatory monitoring and reporting of greenhouse gas emissions in specified circumstances, commencing in 2010. The December 1997 Kyoto Protocol established a set of greenhouse gas emission targets for developed countries that have ratified the Protocol. The Kyoto Protocol has not been ratified by the U.S., but U.S. companies with foreign operations may be subject to foreign laws passed to comply with the Protocol.

There are also many potential legislative and regulatory changes relating to climate change. In December 2009, the EPA issued findings under the Clean Air Act that the current and projected concentrations of greenhouse gases in the atmosphere threaten the public health and welfare. While the findings themselves do not impose any requirements, they form the basis for future regulation of greenhouse gas emissions in the U.S. The EPA has already proposed rules that would require manufacturers to reduce the greenhouse gas emissions of light duty vehicles, and has drafted proposed rules that, generally speaking, would require permits for new, or major modifications to, major stationary sources of greenhouse gas emissions. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, which proposes to impose a "cap and trade" program aimed at reducing greenhouse gas emissions. Although this bill may currently be in political limbo, the Senate is pushing forward with its own American Clean Energy Leadership Act, which focuses on alternative energy and energy efficiency but not "cap and trade." The President's Council on Environmental Policy is considering issuing guidance on climate change issues in National Environmental Policy Act assessments, which may affect companies with projects requiring Federal permits. Several states have also initiated actions on their own or as part of regional organizations to limit emissions of greenhouse gases. Although the December 2009 United Nations Climate Change Conference in Copenhagen did not produce a binding agreement, the U.S. may in the future become a party to international agreements to reduce greenhouse gas emissions, which could lead to new regulations affecting U.S. operations.

SEC Rules That May Require Climate Change Disclosure

The release addresses the SEC's non-financial statement disclosure rules that may require climate change-related disclosure in SEC filings: Regulation S-K Item 101 (description of business), Item 103 (legal proceedings), Item 303 (management's discussion and analysis, or "MD&A"), and Item 503(c) (risk factors). The SEC emphasizes that the release only clarifies existing disclosure obligations and does not alter those obligations or change longstanding interpretations of materiality. The SEC also reminds companies that Rule 12b-20 requires companies to disclose, in addition to the information expressly required by SEC regulations, 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. The release does not cover any disclosure issues that may arise under generally accepted accounting principles.

Applying these well-known rules to climate change, the SEC addresses some topics it says should be considered by public companies:

- *Impact of legislation and regulation*. With respect to any enacted laws and regulations, Regulation S-K Item 101 requires disclosure of any material estimated capital expenditures for environmental control facilities for the remainder of the company's current fiscal year, its succeeding fiscal year and such further periods as the company may deem material. Disclosure is also required as to the material effects that compliance with Federal, state and local provisions enacted 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 company. Risk factor disclosure may also be required; the SEC states that companies should consider specific risks they face as a result of existing or potential climate change legislation or regulation and avoid generic disclosure. The SEC notes, for example, that companies in the energy sector face different risks compared to companies that rely on products that emit greenhouse gases, such as companies in the transportation sector.

    - *MD&A*. With respect to MD&A, the SEC states that Regulation S-K Item 303 requires companies to assess whether any enacted climate change legislation or regulation is reasonably likely to have a material effect on the company's financial condition or results of operation. The SEC reminds companies of its view that "reasonably likely" is "a lower disclosure standard than 'more likely than not.'" MD&A disclosure of pending legislation or regulation may also be required. Applying its oft-repeated two-step test to the "known uncertainty" of pending legislation, the SEC states: "In the case of a known uncertainty, such as pending legislation or regulation, the analysis of whether disclosure is required in MD&A consists of two steps. First, management must evaluate whether the pending legislation or regulation is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, it must proceed on the assumption that the legislation or regulation will be enacted. Second, management must determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the registrant, its financial condition, or results of operations. Unless management determines that a material effect is not reasonably likely, MD&A disclosure is required. In addition to disclosing the potential effect of pending legislation or regulation, the registrant would also have to consider disclosure, if material, of the difficulties involved in assessing the timing and effect of the pending legislation or regulation."

    - *Disclosure controls and procedures.* Management should have sufficient information regarding the company's greenhouse gas emissions and other operational matters to evaluate the likelihood of a material effect arising from climate change legislation or regulation, as a part of its disclosure controls and procedures.

- *Impact of international accords.* Companies should also consider and disclose where material the impact on their business of treaties or international accords relating to climate change.
- *Indirect consequences of regulation or business trends.* Climate change developments may increase or decrease demand for products or services, and these business trends or risks may be required to be disclosed as risk factors, in MD&A, or in the company's business description. Examples given include potential decreased demand for goods that produce significant greenhouse gas emissions and increased demand for goods that result in lower emissions, or decreased demand for services related to carbon based energy sources.
- *Physical effects of climate change.* The SEC's list of potential physical effects of climate change includes increases in storm intensity, sea-level rise, changes in the arability of farmland, melting of permafrost, and changes in the availability or quality of water. The release says that companies whose businesses may be vulnerable to climate related events should consider disclosing material risks of or consequences from these events. The SEC states, for example, that climate change-related physical changes related to coastal property can pose credit risks for banks whose borrowers are located in at-risk areas.

Conclusions

The release serves as a reminder that public companies should, as part of their disclosure controls and procedures, have a process for assessing the impact of climate change matters on the company and for determining what, if any, related disclosures should be made in their SEC filings. Included in the process should be input from environmental advisors, government relations personnel, securities counsel, and the company's disclosure committee. Companies should review other disclosures or statements they make regarding climate change or greenhouse gas emissions for consistency with their SEC filings and to determine whether any of this information should be included in their SEC filings. Companies should also monitor future developments in this area.

One survey of Form 10-K filings made in 2009 (with respect to fiscal year 2008) by approximately 400 issuers found that less than 20% of companies surveyed had any disclosure related to climate change, although most electric utilities and a majority of energy companies in the sample did have climate change disclosure. Because this new release has been published in time for most companies to consider it in connection with the preparation of their upcoming Form 10-Ks (with respect to fiscal year 2009), it may result in enhanced or additional climate change disclosures in these filings.

The SEC will monitor future company disclosures on climate change as part of its ongoing disclosure review program, and its Investor Advisory Committee established in June 2009 will also consider the matter further. The SEC plans to hold a public roundtable on disclosure regarding climate change matters this spring, and will consider what it learns from these experiences to determine whether additional regulation or guidance is appropriate.

—*Dionne M. Rousseau* and *Stanley A. Millan*

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

Dionne M. Rousseau
Jones Walker
8555 United Plaza Boulevard
Baton Rouge, LA 70809
225.248.2026 *tel*
225.248.3026 *fax*
drousseau@joneswalker.com

Stanley A. Millan
Jones Walker
201 St. Charles Avenue
New Orleans, LA 70170-5100
504.582.8328 *tel*
504.589.8328 *fax*
smillan@joneswalker.com

Corporate & Securities Attorneys

Lynn M. Barrett
Allison C. Bell
Sarah B. Belter
Robert B. Bieck, Jr.
William R. Bishop
John C. Blackman, IV
Robert L. Carothers, Jr.
Robert R. Casey
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Green Law & Sustainability Attorneys

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Boyd A. Bryan
Michael A. Chernekoff
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Marjorie A. McKeithen
Stanley A. Millan
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