

Proposed SEC Climate Change Disclosure Requirements for '34 Act Companies

April 30, 2007

The U.S. Congress is actively considering several comprehensive climate change bills and several other inter-related pieces of legislation aimed at reducing greenhouse gas (GHG) emissions levels in the United States. The bills generally propose cap and trade solutions that would require power generators, fuel refineries, coal mines, smelters and other industrial entities to control their emissions growth and to ultimately reduce their emissions below certain historical levels (e.g., 1990 levels). Although implementation of many aspects of the proposed bills would occur years after enactment, legislation has been proposed in Congress that sets the stage for expanding, as soon as possible after passage, certain corporate environment- and pollution-related disclosure obligations in filings with the Securities and Exchange Commission (SEC).

Corporate Disclosure of Climate Change Risks

Legislation, including the "Global Warming Pollution Act" (S.309), also known as the Sanders-Boxer bill, and the "Global Warming Reduction Act of 2007" (S.485), the Kerry-Snowe bill, if passed, would require issuers of securities under the Securities Exchange Act of 1934 to disclose to investors certain risks to the issuer related to climate change. (The Kerry-Snowe bill would impose the disclosure requirements on "issuers of securities under [the 34 Act] with a market capitalization of more than [\$1 billion] regardless of whether the issuer is publicly or privately held.")

In broad fashion, the bills would require '34 Act companies to make two disclosures. The first would require the issuer to disclose its financial exposure stemming from its own global warming pollution emissions. The second would require the issuer to disclose the impact that global warming might have on its interests even if the issuer is not an emitter subject to GHG reduction requirements implemented as a result of the bills.

The bills also would require the SEC to work with the Financial Accounting Standards Board and other appropriate organizations to establish uniform standards for these climate change disclosures.

Finally, the bills direct the SEC to issue an interpretive release, which would remain in effect until the SEC can promulgate final regulations, to clarify the disclosure obligations under Items 101 and 303 of Regulations S-K in the following ways:

- *The United States' commitments to reduce emissions of global warming pollution under the United Nations Framework Convention on Climate Change (UN Framework) are "considered to be a material effect":* Under Item 101, registrants have an obligation to make certain disclosures regarding the "material effects" that compliance with federal, state or local laws and regulations relating to the protection of the environment have on capital expenditures, earnings and the competitive position of the registrant and its subsidiaries. Thus, for example, historic environmental legislation such as Clean Air Act required many registrants that were forced to spend considerable amounts on new infrastructure to comply with this statute to disclose these costs, as well as the impact of these costs on their ability to compete, to their investors. By defining the United States' international commitment to reduce greenhouse gases as a "material effect," Congress appears to be instructing such registrants to consider whether or not its own compliance (or non-compliance) with U.S. laws relating to the discharge of materials into the environment will materially effect the ability of the United States, as a country, to meet these international commitments.
- *Global warming is deemed to be a "known trend":* Item 303(a)(1) requires registrants to make certain disclosures regarding "known trends" that will result in, or are reasonably likely to result in, a material increase or decrease in the registrant's liquidity. Similarly, under Item 303(a)(3), a registrant must make certain disclosures regarding any "known trends" that the registrant reasonably believes will have a material impact, whether favorable or unfavorable, on net sales or revenues or income from continuing operations. By classifying global warming as a known trend, the bills, if passed, would call on issuers to disclose the potentially material effects that global warming has on an issuer's liquidity and operations.