

## Securities/Sustainability and Climate Change

February 11, 2010

### Preparing Your Form 10-K? Here Are Some Action Items to Comply with New SEC Climate Change Disclosure Guidance

#### SEC Issues Interpretive Guidance on Disclosure Related to Climate Change

At a January 27 open meeting, the Securities and Exchange Commission (SEC), by a 3-2 vote, approved guidance on disclosure related to the effects on public companies of climate change and regulation concerning climate change.

On February 2, the SEC issued its formal interpretive release on the disclosure guidance, which was effective immediately. Thus, companies preparing their annual Form 10-K reports should consider the new guidance in evaluating their disclosures in response to the following Items of Regulation S-K:

- **Item 101**—requires a registrant to describe its business, which could include disclosure of material estimated capital expenditures for environmental control facilities or changes in business practices necessary to comply with applicable climate change regulations of federal, state, local and foreign government agencies.
- **Item 103**—requires disclosure of any material legal proceedings or similar actions contemplated by any governmental authority, which could include suits arising out of climate related issues.
- **Item 503(c)**—requires disclosure of the registrant's most significant risk factors, which could include disclosure of existing or pending regulation that relates to climate change or perceived risk associated with reputational damage or physical changes.
- **Item 303**—requires disclosure in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) of a known uncertainty, such as the impact of pending climate change legislation or regulations, under certain circumstances. The registrant must determine first whether the pending legislation or regulation is likely and, if the registrant concludes it is likely, whether such legislation or regulation, if enacted, is likely to have a material effect on the registrant.

The SEC's guidance points out that companies should already be considering issues relating to climate change as part of their required disclosures in response to these items. The SEC's guidance also noted that disclosures should consider the potential indirect consequences of regulation or business trends related to climate change. The SEC's guidance does not amend or expand existing disclosure requirements or change any materiality thresholds.

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In particular, the guidance seeks to clarify the responsibility of companies to disclose, where material:

- the direct and indirect effects on a registrant's business, financial condition and results of operations of, and the risks related to, existing and pending environmental regulation and legislation;
- the effects on a registrant's business of, and the risks related to, international accords and treaties related to climate change;
- the actual and potential, direct and indirect consequences (or opportunities) resulting from climate change and legal, business, political and scientific developments related to climate change, such as the effect on demand for a company's products of "green" technologies and products used or sold by the registrant or its competitors and the effect of such developments on a company's reputation; and
- the effect on a company's business and operations related to physical changes to the planet caused by climate change, such as rising seas, stronger storms and increased drought—the effects may be impaired production or distribution of products or damage to a company's property, plant or equipment.

The staff of the SEC noted that, in order to evaluate whether disclosure regarding the effects of pending climate change regulation (such as the federal cap and trade legislation) is required, registrants need to consider whether they have effective systems for collecting information about their emissions. Therefore, "management should ensure that it has sufficient information regarding the registrant's greenhouse gas emissions and other operational matters to evaluate the likelihood of a material effect arising from the subject legislation or regulation."

## What Should Companies Do Now in Response to the SEC Climate Change Guidance?

Based on the SEC's statements to date, companies should take the following steps to ensure compliance:

- **Identify and analyze actual and proposed climate change and emissions legislation and regulations, including international treaties or accords, that apply to the business.**<sup>1</sup> This is a very fact-specific and business-specific analysis. For example, a company that owns buildings or businesses will need to identify existing and pending regulations, such as green building retrofit requirements or local carbon trading schemes, in each jurisdiction in which it has investments. Companies that invest in or produce products used in the international marketplace must consider the extent to which the most stringent standards, such as certain European Union requirements, may affect overall corporate performance. Does the company intend to make different products to meet varying standards that apply in markets with non-uniform requirements, or will the company retrofit all of its plants or change all of its products?
- **If the business is subject to enacted legislation or regulations or is likely to be affected by pending legislation or regulations regarding emissions, determine actual emissions from the business.** Companies must know their greenhouse gas emissions and other relevant aspects of their "environmental footprint" in order to evaluate the risks. Without such basic information, management cannot meet its threshold obligation to evaluate the likelihood of a material effect arising from its emissions. Note that some companies, such as owners of office buildings, will need to consider for the first time that their business does generate emissions.
- **Identify and analyze the physical impacts of climate change on the business.** Companies should evaluate the actual and potential material impacts of climate-related matters on their business—e.g., changing weather patterns that could affect production or distribution of products, or damage corporate facilities or equipment. One example might be a trend showing increased frequency and intensity of storms in certain areas.
- **Identify and analyze the indirect consequences of regulation or business trends.** Climate change regulation and consumer perception regarding the desirability of "greener" products may alter the demand for certain items or production methods. For example, a company that owns car dealerships selling low-mileage, gasoline-fueled SUVs would need to evaluate potential negative effects from climate change, while the owner of a chain of "green" cleaning services might determine that climate change will produce an indirect business benefit to the company.

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<sup>1</sup> For a listing of state and local government laws and regulations in this field, click [here](#). Two significant international accords related to this topic are the Kyoto Protocol, which was adopted in Kyoto, Japan, on December 11, 1997, and became effective on February 16, 2005, and the European Union Emissions Trading System (EU ETS), which was launched as an international "cap and trade" system of allowances for emitting carbon dioxide and other greenhouse gases, built on the mechanisms set up under the Kyoto Protocol.

- **Review disclosures made in prior SEC filings to determine if they are adequate or need to be revised or updated, or if new disclosures should be made.** Companies in the energy industry, for example, have included disclosures and risk factors regarding climate change in their SEC filings for some time. Companies in other industries may be contemplating such disclosures for the first time. All companies should consider the impact on their business reputation as it relates to climate change. Companies should also consider the physical effects of climate change—such as severe weather or arability of farmland—that could potentially impact their businesses.
- **Avoid making statements or claims in other contexts that could suggest a failure to make required SEC climate disclosures.** Commissioner Walter expressed her concern that “many public companies are in fact providing disclosure about significant climate change related matters through mechanisms outside of the disclosure documents they file with the Commission.” The danger of making corporate climate change-related claims that are not included in the company’s SEC filings are likely to be significant, and could result in shareholder claims, direct action by the SEC or greenwashing claims by consumers. As Commissioner Walter admonished, companies should “step up their disclosure efforts immediately.”

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Click [here](#) to view the SEC’s interpretive release on climate change disclosure.

Click [here](#) to view the SEC’s press release regarding the guidance described above.

Click [here](#) to view the text of Chairman Schapiro’s remarks regarding the guidance described above.

Click [here](#) to view the text of Commissioner Walter’s remarks regarding the guidance described above.



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