

Climate change and public company disclosure

Renewable energy companies are no more impervious to climate change legislation than regular organisations. Attorneys Sahir Surmeli and Scott White present the essential details that every director needs to know.

As legislators and regulators increasingly turn their attention to greenhouse-gas emissions and their connection to climate change, publicly traded companies are coming under growing pressure to voluntarily disclose in more detail the financial and physical impacts climate change and its related regulations may have on their business. Although the Securities and Exchange Commission (SEC) has not yet provided specific guidance in regards to climate change disclosure, large institutional investors and states are clamoring for more detailed information. New York State has opened investigations with five public utilities regarding inadequate climate change disclosures, recently settling with one who agreed to provide considerably more information on this topic in its next annual report to be filed with the SEC.

Public companies, especially those with significant carbon footprints, should assess their climate change risk profile in light of the recent developments described in this article.

SEC disclosure requirements

Under SEC rules and regulations, a public company must disclose to its investors material information regarding the company – that information a reasonable investor would consider important in making its investment decision. In particular, a company is required to disclose, among other things, (i) the material effects on the company's financial performance of regulations relating to the protection of the environment; (ii) legal proceedings known to be contemplated by governmental authorities; and (iii) any known trends or uncertainties which are reasonably likely to result in a material decrease in the company's liquidity.

A growing number of investors, states and others argue that the foregoing disclosure rules require public companies to disclose detailed assessments of the effect of climate change on their financial performance. In September 2007, a group of institutional investors (including the nation's largest public pension fund, CalPERS), state officials and environmental groups, submitted a petition (the "petition") requesting the SEC to issue a statement advising public companies that risks related to climate change require "careful scrutiny" in assessing a company's financial condition. The group urged the SEC to issue an interpretive release clarifying that public companies must disclose material financial risks (and opportunities) of present or probable greenhouse-gas regulation, legal proceedings related to climate change and physical risks associated with climate change. On that same day, the coalition sent a letter to the director of the Division of Corporation Finance urging the Division to devote particular attention to reviewing the adequacy of disclosures related to climate risk.

The SEC has not yet provided a public response to the petition or any guidance specifically relating to climate change disclosures. Given that the petition has received significant public support, including the support of over fifty additional institutional investors with funds under management exceeding \$5.5 trillion, the SEC is expected to address the issue sooner rather than later.

The New York settlement

In the meantime, the Attorney General of New York has investigated several major utilities regarding the adequacy of their

climate change disclosures to investors. On August 27, 2008, Attorney General Andrew Cuomo announced a settlement with Xcel Energy Inc. that requires Xcel to disclose in its annual reports to be filed with the SEC: (1) the financial risks from climate change regulations, including identifying and discussing current and expected trends in greenhouse gas legislation; (2) the financial risks from litigation relating to relating to climate change, including any climate change-related decisions issued by the courts of any jurisdiction in which the company operates; (3) the financial risks from the physical impacts of climate change, including potential impacts from sea level increases and changes in weather conditions; and (4) a strategic analysis of climate change risk and emissions management, including the company's current statement on climate change, its strategies to reduce its climate change risk and its corporate governance actions concerning climate change.

In announcing the settlement, Attorney General Cuomo called the agreement "landmark" and noted that it "sets a new industry-wide precedent." Indeed, we believe that this settlement represents the first enforceable agreement requiring a public company to make public disclosures related to climate change.

Legislative and regulatory developments

One of the driving forces behind the movement toward detailed climate change disclosure is the recent increase in legislative and regulatory activity taking place at the federal and state levels. These developments include:

- In *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497 (2007), the United States Supreme

Court found that the EPA must regulate greenhouse-gas emissions from motor vehicles and that the EPA's basis for not regulating all greenhouse-gas emissions was inadequate. In December 2007, President Bush signed into law the Fiscal Year 2008 Consolidated Appropriations Act directing the EPA to publish a mandatory greenhouse gas reporting rule requiring the reporting of greenhouse-gas emissions in all sectors of the economy. The final rule is expected by June 2009

- In June 2008, the United States Senate considered legislation that would have established a cap-and-trade system for greenhouse-gas emissions. The bill enjoyed bipartisan support, but was pulled back for later consideration
- Several states have entered regional legislative initiatives to regulate greenhouse-gas emissions by implementing regional cap-and-trade systems. For example, the Western Climate Initiative (WIC) includes seven states and four Canadian provinces, while the Regional Greenhouse Gas Initiative and the Midwestern Greenhouse Gas Reduction Accord include seventeen states between them
- Several states, many of which are members of regional initiatives, have implemented greenhouse-gas emissions limits and reduction targets. California, a member of the WIC, passed the Global Warming Solutions Act, effective January 1, 2007, which aims to return California's greenhouse-gas emissions to 1990 levels by 2020

Current environment for public companies

Lawmakers are clearly turning their attention to climate change and companies need to be aware of new regulations as they are adopted as well as steps that make regulation probable. Investors are demanding that companies disclose the risks they are facing in the jurisdictions in which they operate. Therefore, at a minimum, public companies should consider, if they do not already, disclosing the legislation and regulation to which they are currently or

may become subject. As an illustration, Chevron Corporation, in its 10-K filing dated February 28, 2008, disclosed risks related to the Kyoto Protocol internationally, proposed carbon cap-and-trade systems introduced in the U.S. and the Global Warming Solutions Act passed in California. Disclosures related to regulations are only a start; investors are also demanding to know the potential financial and physical impacts of climate change and the company's strategic approach to dealing with such risks.

When public companies fail to disclose material business risks, shareholders can bring lawsuits seeking to recoup losses in stock prices (all the more likely when stock prices are declining significantly). The more indications of regulation of greenhouse-gas emissions or other climate change matters and the louder the calls for disclosure from investors and states, the harder it will be for public companies to defend against such shareholder claims on the basis that the climate change regulatory changes were not known or not significant. Further, the calls for disclosure from investors and states makes it difficult for such companies to claim they were not aware that investors consider these risks to be material.

Conclusion

The Xcel settlement represents a major milestone in investors' efforts to force companies to provide detailed disclosure regarding climate change and related regulations. The settlement, along with investors' demands for more disclosure and the recent legislative and regulatory developments, increases the likelihood that in the near term, companies could face litigation and/or SEC comments alleging their disclosures are inadequate.

Public companies, especially those that emit significant amounts of greenhouse-gases, should assess their risk profile relating to climate change, consider the potential financial impacts, determine whether the impacts are material, and if so, disclose such in their SEC filings. ▀



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