

Client Alert

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For more information, the interpretive guidance can be found at:

<http://www.sec.gov/rules/interp/2010/33-9106.pdf>

Public Company Disclosure Considerations Relating to Global Climate Change

Media coverage of the United Nations Climate Change Conference held in Copenhagen in December 2009, together with the Environmental Protection Agency's recent administrative finding that current and projected levels of greenhouse gases in the atmosphere endanger the public health and welfare, have created an increased focus on the effects of global climate change and the likelihood of future governmental action to address climate change risk.

These developments are likely to present challenges for many public companies in providing appropriate disclosure regarding the potential impact of global climate change on their businesses in their periodic reports filed with the Securities and Exchange Commission. While a number of energy companies, utilities and other firms with a clear stake in the climate change debate now include climate change disclosures in their SEC filings, many public companies in other industries have not yet focused on the disclosure implications of these developments. In the foreseeable future, however, it is expected that many more public companies will need to begin considering issues relating to climate change as part of their SEC disclosure process.

On February 2, 2010, the SEC published an interpretive release intended to provide public companies with guidance on existing SEC disclosure requirements as they apply to business and legal developments relating to global climate change. While the SEC's interpretive release stresses that the guidance is not intended to create new legal requirements or modify existing rules relating to climate change disclosure, it appears probable that scrutiny by the SEC staff of disclosure – or lack of disclosure – relating to the impact of climate change will increase in the future. In addition, groups advocating for socially and environmentally responsible investment have already announced their intention to seek SEC intervention and enforcement in cases where they believe public companies have not adequately disclosed climate change information or risks.

This Client Alert provides a brief overview of the SEC's recent interpretive release and discusses other recent developments relating to climate change that may impact public company disclosure and corporate governance practices. The Client Alert also discusses a number of practical considerations for developing and implementing appropriate climate change disclosure practices.

Overview of the SEC's interpretive release

The SEC's recent interpretive release on climate change disclosure states that the purpose of the release is to provide guidance to public companies regarding the SEC's existing disclosure requirements as they apply to climate change matters. Chairman Shapiro's remarks at the open meeting of the Commission held on January 27, 2010 – at which the interpretive release was approved on a 3-2 party line vote – stressed that the release was not intended to create new requirements or modify existing SEC disclosure rules or principles. Chairman Shapiro also indicated that in publishing its interpretive release, the SEC was not adopting any position on “whether the world's climate is changing, at what pace it might be changing, or due to what causes.”

The interpretive release notes that the SEC's existing disclosure rules may require companies to include disclosure relating to climate change in their reports filed with the SEC. The release specifically identifies potential disclosure requirements for domestic issuers arising under:

- Item 101 of Regulation S-K – which requires reporting companies to include disclosure regarding the material effects of compliance with federal, state and local laws and regulations relating to the protection of the environment. This provision also requires the disclosure of material estimated capital expenditures for environmental control facilities;
- Item 103 of Regulation S-K – which requires disclosure of material pending legal proceedings other than routine litigation incidental to the issuer's business, including any proceedings “known to be contemplated” by governmental authorities. The instructions to Item 103 make clear that proceedings arising under the environmental laws may not be considered “routine” if they meet certain materiality thresholds;
- Item 303 of Regulation S-K – which prescribes the information to be included in the “management's discussion and analysis” section of SEC reports and requires reporting companies to discuss “known trends, events, demands, commitments and uncertainties” that are “reasonably likely” to have a material impact on financial condition or operating performance. The release notes specifically that “reasonably likely” is a lower disclosure standard than “more likely than not.”
- Item 503(c) of Regulation S-K – which requires disclosure in SEC reports and registration statements of the most significant risks factors that a company faces; and
- Rule 408 under the Securities Act of 1933 and Rule 12b-20 under the Securities Exchange Act of 1934, which require reporting companies to disclose, in addition to information expressly required by SEC regulation, “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 notes that similar disclosure requirements are applicable to foreign private issuers under Form 20-F.

The SEC's interpretive release identifies four general topics under which disclosure regarding climate change may be triggered under the existing SEC rules highlighted in the release:

- the impact of existing and pending laws and regulations regarding climate change – including an assessment under Item 303 of Regulation S-K of the potential impact of pending legislation or regulation. In the case of pending legislation or regulation, the release applies the SEC's traditional two-step Item 303 analysis relating to "known uncertainties" under which management is first required to 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 pending legislation or regulation will be enacted and determine whether the legislation or regulation is reasonably likely to have a material effect on the reporting company, its financial condition or results of operations. Unless management determines that a material effect is not reasonably likely, disclosure pursuant to Item 303 is required;
- the impact of international accords and treaties relating to climate change – based on similar Item 303 principles as applied to domestic legislation and regulation;
- indirect consequences of regulation or business trends – including legal, technological, political and scientific developments regarding climate change that may create new opportunities or risk, such as decreased demand for goods that produce significant greenhouse emissions or increased demand for goods that result in lower emissions than competing products. The release notes that business trends or risks of this type, if material, may be required to be disclosed as part of the reporting company's business description under Item 1.01, management's discussion and analysis under Item 303 or as a risk factor under Item 5.03(c); and
- the actual and potential physical impact of climate change – including possible harm to properties or facilities resulting from severe weather, financial or operational disruptions to the operations of major customers or suppliers resulting from hurricanes or floods, and increases in insurance costs.

The interpretative release concluded by noting that the SEC and its Investor Advisory Committee, which was formed in June 2009 to advise the Commission on matters of concern to investors in the securities markets, would be continuing to monitor the impact of the interpretive release on company filings as part of the SEC's ongoing disclosure review program and would be holding a public roundtable on climate change disclosure in the spring of 2010. The release expressly left open the possibility of further Commission guidance or rulemaking relating to climate change disclosure.

Other recent developments relating to climate change

In addition to the SEC's recent interpretive release, the SEC and its staff have recently taken other steps that suggest an increased focus on climate change-related issues affecting public companies. In late October 2009, the staff of the Division of Corporation Finance issued Staff Legal Bulletin No. 14E (CF), modifying the staff's interpretation of Rule 14a-8(i)(7) under the Securities Exchange Act. Rule 14a-8(i)(7) generally permits a public company to exclude shareholder proposals from their annual meeting proxy materials if they concern the company's "ordinary business operations." In order to exclude a

shareholder proposal pursuant to the ordinary business operation exemption, a company is required to send a no-action request to the SEC staff detailing its reasons for exclusion.

Prior to the publication of the SLB, the SEC staff generally followed a policy of permitting public companies to exclude climate change-related proposals on the basis that they involved primarily an internal assessment of business risk, which the staff viewed as constituting part of a company's ordinary business operations. Consequently, in the past, climate change-related shareholder proposals have often been excluded from the proxy materials of public companies. The staff's recent interpretation signals a change in this approach. The staff will now focus on the underlying subject matter of shareholder proposals, rather than simply considering whether the proposal involves management's internal assessment of risk. If a proposal raises major social policy issues that transcend day-to-day business matters, then it is likely that a no action request seeking to exclude the proposal will be denied by the SEC staff. It is expected that this policy shift will result in a significant increase in the number of climate change-related shareholder proposals during the 2010 proxy season.

Finally, on the enforcement front, the New York Attorney General's office has initiated investigations against five U.S.-based energy companies with respect to their disclosures regarding climate change risk. Three of the investigations have resulted in settlements, while the remaining two investigations are ongoing. While none of the settling companies have conceded wrongdoing, the settlement agreements require that future annual reports filed with the SEC by the companies disclose material risks arising from the physical impact that climate change could have on the companies' operations as well as risks relating to present and probable future greenhouse gas legislation and regulations and climate change litigation. The agreements also require the settling companies to provide information on current greenhouse gas emissions, anticipated future emission increases and corporate strategies for curbing and managing those emissions.

Other disclosures of climate change information

As the SEC's recent interpretive release notes, many public companies currently provide information regarding their greenhouse gas emissions to the EPA and other environmental regulatory agencies. Based on recent EPA rulemaking proposals, it is expected that governmental reporting requirements will increase significantly in the future, particularly for industrial manufacturers and energy companies.

In addition to complying with governmental reporting requirements, a growing number of U.S. public companies now voluntarily provide information regarding their current and projected greenhouse gas emissions, and their corporate strategies for reducing these emissions, to non-governmental organizations such as the Carbon Disclosure Project, Climate Registry and Global Reporting Initiative. The CDP distributes its investor questionnaire annually to more than 3,000 companies worldwide. In addition to seeking specific emissions numbers for the reporting year, the CDP solicits information about the breakdown of those emissions by business division or facility, the methodologies used to calculate emissions, and the sources of uncertainty in making these determinations. The CDP also requests information about each company's plans to reduce greenhouse gas emissions, the investments required to achieve those emission reduction targets, and its estimated emissions for the next five years. Finally, the investor questionnaire asks companies to explain how future emissions costs are factored into capital expenditures and what impact those costs have on investment decisions.

While many companies provide detailed answers to all of CDP's questions, they may decline to respond to certain inquiries. In 2009, more than 2000 of the world's largest corporations voluntarily responded to the CDP questionnaire, including 300 of the S&P 500 companies.

Many companies have also prepared extensive internal studies regarding the anticipated future impact of climate change and related governmental actions on their businesses. Some companies have made information from their internal studies publicly available in the form of sustainability reports or similar information provided to environmental groups, the media or the public.

Next steps and practical considerations

Public companies considering the possible disclosure of climate change-related information and risks often have concluded in the past that disclosure was not required or appropriate – either because the impact of climate change and related governmental action was not material to their business or because the impact was too uncertain and speculative to permit meaningful disclosure to investors. In view of these recent developments relating to climate change disclosure, however, many public companies may find it increasingly difficult to continue to take this position.

Based on the recent interpretative guidance by the SEC, we recommend that public companies consider the following steps relating to their possible disclosure of climate change-related information and risks:

- determine the extent to which the board of directors and senior management of your company are including consideration of climate change issues as part of their strategic, business planning and risk management processes. If these issues are beginning to influence your company's business strategies or decisions, the issues may arguably be considered to be material for disclosure purposes;
- determine whether your company has prepared internal reports or studies, some of which may contain detailed projections of costs and other quantitative information regarding the expected impact of climate change on your company. If so, consider whether the information available in these reports or studies may affect the disclosure included in your company's SEC reports, particularly with respect to discussions of regulatory matters, risk factors and "management's discussion and analysis;"
- evaluate the informal or "soft" disclosures regarding climate change your company may be making as part of media advertisements, speeches or other statements by senior executives, governmental lobbying efforts on behalf of your company or information provided on your company's internet website. Consider whether these disclosures are consistent with the formal disclosures included in your company's SEC reports;
- consider how your company is reporting on these issues in other venues, including reports and information provided to governmental regulators or the Carbon Disclosure Project and other groups promoting corporate social responsibility and environmental protection. Information reported to governmental regulators and other groups may in some cases be publicly available, and may therefore give rise to potential issues concerning selective or inconsistent disclosure;

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- if climate change-related issues are now or are expected to become material to your company's business, consider including senior managers responsible for these issues as part of the disclosure committee that participates in the preparation and review of your company's SEC reports;
- consider the approach to disclosure being taken by other companies in your industry;
- identify potential stakeholders with respect to your company, including institutional investors, individual shareholders, labor organizations and industry groups of which your company may be a member, and determine whether they have taken positions with respect to climate change disclosure; and
- work with the senior executives, investor relations staff and others at your company who regularly interact with investors, securities analysts, the media and the public to ensure that they are aware of the disclosures – both formal and informal – that your company has made with respect to climate change issues and that their public statements are consistent with these disclosures.

Significant uncertainty remains with respect to understanding the future implications of climate change and determining the timing and scope of the expected governmental response to climate change risk. Given, however, the increased focus on climate change risks, the probability of more climate-related shareholder proposals during the upcoming proxy season, and the likelihood of future governmental action impacting a large number of companies in a broad range of industries, it is appropriate for public companies to begin to consider these issues as part of their ongoing effort to evaluate and enhance their public disclosure process.

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