The Metropolitan Corporate Counsel®

www.metrocorpcounsel.com

Volume 18, No. 4 April 2010

The Push For Climate Change Business Impacts Analysis And Disclosure

Steven L. Humphreys

KELLEY DRYE & WARREN LLP

Companies that have something to lose or gain from climate change, whether from actual physical consequences of global warming and associated weather events or from increased regulation or liability exposure, are facing increased pressure from different quarters to track and report how those impacts may affect their business. A coalescence of interests including consumers, strategic business partners, investors and governmental agencies are pouring on the pressure, making the task of climate change risk assessment an increasingly important component of business planning. And while it's unclear for now exactly how far this movement will go, it is certain to become a fixture in the schedules of corporate EHS managers of public companies for some time.

Perhaps as a harbinger of things to come, earlier this month retail giant Walmart, whose decisions largely shape the course of consumer product supply chain manufacturing in the United States, announced plans to reduce its supply chain CO2 emissions by 20 million metric tons by the end of 2015 – largely by mandating reductions among its suppliers. While estimated to be the equivalent to taking 3.8 million cars off the road, Walmart acknowledged that the overall reduction was modest in comparison with the total CO2 output of its supply chain. Although the company currently does not have data tracking the CO2 output of its major suppliers, its action will require detailed CO2 emissions tracking and accounting of reductions by its suppliers, beginning with the product categories that have the highest embedded carbon and largest sales. The accounting process will be subject to third-party verification by ClearCarbon and Pricewaterhouse-Coopers. Walmart is but one of many companies that are beginning to demand reporting and reductions of CO2, which is considered to be the primary greenhouse gas.

Steven L. Humphreys

On another front, investors also have been stepping up the pressure on public companies to analyze and report a host of varied risks to their businesses stemming from climate change. Earlier this month, a coalition of leading investors in the United States announced that they have filed climate change shareholder resolutions with 82 large U.S. and Canadian companies requiring them to undertake such programs. This represented a 40 percent increase in the number of resolutions that were filed last year. The targeted companies included coal companies, electric power and oil producers, homebuilders, retailers, and financial institutions.

And, finally, the U.S. Securities and Exchange Commission ("SEC") last month entered the fray with a clarification of existing regulatory requirements that may affect how companies track and report climate change business impacts, issuing interpretive guidance on February 2, 2010, outlining its views as to how its disclosure requirements apply to a panoply of business risks associated with climate change. While not technically a change in law, the interpretive guidance is widely expected to bolster the case for those seeking greater transparency in public company quarterly and annual reports on climate change impacts.

The SEC guidance also coincides with a rapidly evolving regulatory landscape primarily affecting companies with significant carbon (or carbon equivalent) footprints. Congress is currently considering legislation that would establish a national "cap and trade" program designed to reduce greenhouse gas emissions through mandatory limits on emissions, coupled with a system of tradable allowances to incentivize reductions. A similar program already has been put into effect for electric power generating facil-

Steven L. Humphreys *is Special Counsel with the law firm of Kelley Drye & Warren LLP and works in the firm's Parsippany, New Jersey office, where he concentrates in all aspects of environmental law and related counseling of businesses.*

Please email shumphreys@kelleydrye.com with questions about this article.

ities under a regional consortium of Northeastern states, known as the Regional Greenhouse Gas Initiative. The U.S. Environmental Protection Agency and Department of Transportation are also developing a greenhouse gas emissions standard for light duty vehicles (rule proposed on September 15, 2009), and a mandatory greenhouse gas emissions rule for facilities emitting more than 25,000 metric tons of greenhouse gas emissions went into effect on December 29, 2009.

In addition to disclosures that may be triggered by the costs of complying with the foregoing emerging legal requirements, the SEC guidance contains a useful roadmap of the types of climate change-related impacts that may befall a company whose operations are dependent to some extent on carbon emissions or are otherwise vulnerable to business disruptions resulting from expected physical impacts of climate change. These impacts include, for example, changes in supply chain costs (such as the cost and availability of certain fuels) and direct and indirect effects of physical impacts to facilities and operations due to changing weather patterns.

Below is a summary of the primary areas of climate change business impacts that may rise to the level of a disclosure obligation for a public company, which should prove useful to any company, public or private, in developing a program for analyzing and reporting such impacts, to the extent deemed necessary by the company. Other than financial statement disclosures, the pertinent rules covered in the guidance are: Item 101 (certain costs of complying with regulations); Item 103 (material pending legal proceedings to which the registrant or any of its subsidiaries is a party); Item 503(c) (risk factors that make an investment in the registrant speculative or risky); and Item 303 (management's discussion and analysis).

The SEC guidance groups potential climate change business impacts into four general categories, which may be summarized as follows:

Impact Of Legislation And Regulation

Material capital expenditures needed to comply with regulations may need to be disclosed pursuant to Item 101. The business impacts of existing or pending legislation or regulation also may need to be disclosed as part of the risk factors discussion under Item 503(c) if the impact is of sufficient magnitude to render investment in the registrant speculative or risky, or in management's discussion and analysis pursuant to Item 303 if it is reasonably likely to have a material adverse effect on the registrant's financial condition or results of operation. In the case of pending legislation or regulation whose passage or adoption is, in SEC parlance, a "known uncertainty," the Commission stated that unless management determines that it is not reasonably likely to be enacted or adopted, it should proceed on the assumption that it will be. Examples of impacts that potentially could require disclosure include: costs to purchase allowances or credits under a cap and trade program; costs required to improve facilities to reduce emissions; and changes to profit or loss arising from increased or decreased demand for goods and services arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

The effects of requirements adopted pursuant to international treaties, such as the Kyoto Treaty or international accords being considered in Copenhagen, may need to be disclosed by registrants whose businesses are "likely to be affected" by such agreements, according to the guidance. This language presumably would mean that domestic U.S. companies would have no such disclosure obligation for the most part, inasmuch as these treaties have not been ratified by the U.S. Senate and therefore have no legal force in the United States. However, companies with overseas operations presumably would be required to disclose the impacts of these laws on their operations overall if the materiality thresholds in Items 103, 503(c) and 303 are met.

Indirect Consequences Of Regulation Or Business Trends

The guidance also discusses disclosure that may be required under Item 503(c) or Item 303 due to adverse business impacts from developments in legal requirements, technology, political trends and science that may indirectly increase demand for new products or services and decrease demand for existing products or services. Among the specific examples pointed to by the SEC of such impacts are: decreased demand for goods that require significant greenhouse gases to manufacture; increased demand for products offered by competing businesses that require lower emissions to manufacture; increased demand for generation and transmission of energy from alternative energy sources; and decreased demand for services related to carbon-based energy sources, such as drilling services or equipment maintenance activities. Item 101 disclosure also could be required in some cases, according to the guidance, such as if a registrant plans to reposition itself to take advantage of potential opportunities resulting from these developments. The guidance also discusses the potential loss of reputation as a risk factor that may need to be disclosed under Item 503(c) if the public's perception of publicly available data relating to the registrant's greenhouse gas emissions could expose it to potential adverse consequences to its business operations or financial condition.

Physical Impacts Of Climate Change

The final category of business risk addressed in the SEC guidance involves direct and indirect physical effects of climate change that potentially could affect a registrant's financial condition or operations. Examples of such risks pointed to in the guidance include: property damage to facilities or operations located on coastlines; disruptions to customers or suppliers from increased weather severity, such as hurricanes and floods; increased claims for insurance and reinsurance companies; decreased agricultural production capacity in areas affected by drought or other weather-related changes; and increased insurance premiums and deductibles or decrease in coverage availability.

Public companies that previously have not considered the types of business risks associated with climate change may need to assess when making a public filing whether their businesses are susceptible to any such risks and, if so, whether those risks are of a sufficient magnitude to require disclosure. Likewise, private companies not subject to SEC disclosure and reporting requirements may nonetheless find themselves under increasing pressure from consumers and their strategic business partners for conducting such analyses. In such case, the factors outlined in the SEC guidance provide a useful starting point for doing so.