Incremental Changes in Soon-to-Be-Released Disclosures Unlikely to Satisfy Advocates

by Tom Mounteer

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In the coming months, U.S. companies that sell their shares on public stock exchanges will be filing annual reports with the Securities and Exchange Commission (SEC). In part, those SEC filings aim to allow investors to see the company's prospects from management's perspective. In their filings, management describes developments it sees on the horizon that have the potential to affect their companies' operations—and profits.

Many will be intently reading the filings to see what insights they shed on managements' perception of how climate change will affect their businesses. The smart money is on marginally greater disclosure than in preceding years. This will continue a trend we have seen in each of the past few years' disclosures.

What more might we reasonably expect to read in those disclosures? And will those disclosures satisfy those that have asked the SEC to provide guidance on what those disclosures should reveal?

In §7.4 of our *Climate Change Deskbook*, we describe two factors that drive the trend toward more fulsome disclosure: (1) greater clarity about the contours of the legal regime that will apply to greenhouse gas (GHG) emissions; and (2) the continuing tide of scientific reports detailing the effects of climate change. It is unlikely that developments on either front in 2009 will bring about a sea change in the upcoming SEC annual reports.

As to certainty with respect to the governing legal regime, enactment of comprehensive federal legislation would certainly result in more specific disclosures. In the absence of federal legislation, however, it tends to be electric power generators subject to the dictates of the Regional Greenhouse Gas Initiative (RGGI) (*see* §4.2 of our *Deskbook*) that have had the most specific things to say about the carbon constraints on their operations. The disclosures of others in the power-generation sector but operating outside the Northeast (and so not subject to RGGI) have generally noted the U.S. Supreme Court's decision in *Massachusetts v. EPA*, 549 U.S. 497, 37 ELR 20075 (2007), holding that carbon dioxide is a "pollutant" subject to regulation under the Clean Air Act, and the potential ramifications of that decision in terms of cascading regulation of stationary sources (*see* §§3.1.1.1.1 and 3.2.2.2 of our *Deskbook*).

What about the scientific front? What advances in understanding have come about in 2009 that might make their impact felt in SEC disclosures? In preparing their upcoming filings, companies subject to disclosure obligations likely need to reckon with two major reports issued in 2009.

On May 27, the National Center for Atmospheric Research released a study indicating that temperature increases brought about by climate change may cause an even higher sea-level rise along the Atlantic coast than previously thought. The Center now predicts the north Atlantic sea-level rise caused by Greenland's melting glaciers could be one to two feet along the northeastern Atlantic coast by the end of the century.

On June 16, a collective of U.S. government agencies, operating as the U.S. Global Change Research Project, issued a report that found, among other things, that parts of the Southeast that currently experience about 60 days per year of temperatures greater than 90 degrees could experience as many as 150 such days by the end of the century. The report also projects potential drought concerns in Great Plains states caused by temperature increases, as well as increased insect outbreaks, wildfires, and changing species composition in forests in the Northwest.

Will these new reports necessarily translate into more specific SEC disclosures? Candidly, it is hard to see how they will. Would it be reasonable for businesses affected by a sea-level change in 90 years to identify it as a trend they are preparing for? One could imagine that electricity suppliers to the Southeast might project increased demand to run air conditioners longer, but will that be material to their financial positions, even in a carbon-constrained world? Will pesticide manufacturers crow about the opportunity to sell more product as a result of changed climatic conditions? One doubts so, but we will have to see.

Against this backdrop of evolving legal standards and scientific understanding, interest groups continue to push for more disclosure and for the SEC to step into the breach and issue guidance on just what companies should be disclosing. In §7.4.2 of the *Deskbook*, we describe the Global Framework for Climate Risk Disclosure's four-part voluntary standard. Two reports issued in June of this year appear to be aimed both at bolstering use of the Global Framework's approach and encouraging SEC action.

In June 2009, the Coalition for Environmentally Responsible Economies (CERES), Environmental Defense, and the Center for Energy and Environmental Security released two reports—*Reclaiming Transparency in a Changing Climate* and *Climate Risk Disclosure in SEC Filings*—to support their position that the SEC needs to provide guidance. Their survey of 6,400 annual filings by Standard & Poor's 500 companies found that 76.3% of the 2008 filings failed to mention climate change. A more focused study of one calendar quarter's SEC filings by 100 companies in the electric utility, coal, oil and gas, transportation, and insurance sectors found that 59 filings made no mention of their GHG emissions or the companies' position on climate change, 28 had no discussion of climate risks the companies may face, and 52 failed to disclose actions to address climate change.

Trade press reports suggest SEC Chair Mary Schapiro may be willing to step into this breach. That would come as something of a surprise to many observers of the Commission. The closest analogue to such guidance might be the 1993 SEC Staff Accounting Bulletin that directed stock issuers to abide by Financial Accounting Standards Board Statements Nos. 5 and 11 for accruing contingent remedial liabilities. That pronouncement came after years of a spotlight being shown on perceived inadequate disclosure of cleanup liabilities.

The 1993 action may not, however, provide a true analogue for the type of SEC guidance for which the Global Framework, CERES, and other advocates are hankering. The 1993 guidance admonished stock issuers not to await absolute certainty before accruing for contingent remedial liabilities. Advocates for climate change guidance seem to want the Commission to opine more directly about the substance of disclosure. For example, the Global Framework's approach asks companies to describe how climate change impacts their competitiveness and what physical effects climate change will have on the company's business and supply chain. SEC guidance of this sort would be different *in kind* from the earlier application of accounting standards.

All that is not to say that the SEC is turning a blind eye to the issue of disclosure of climate change. On the contrary, in late October, the SEC issued Staff Legal Bulletin 14E, reversing an earlier policy that was widely regarded as helping companies prevent shareholder climate change resolutions from coming up for a vote. The effect of that policy change will not be felt in companies' soon-to-be-filed annual reports.

So, while we should expect to see yet another year in which companies' climate change disclosures in SEC annual reports become incrementally more meaningful, it would be foolhardy to expect that those incremental improvements will satisfy the demands of those seeking to have the SEC issue guidance.