

Disclosures of Climate Change Impacts: A Look at the SEC's Recent Ruling

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Upcoming ACCO Events

▪ March 2010 Webinars

- **An End to Oil Subsidies:** What are the National Security and Renewable Energy Production Implications of President Obama's Proposed Budget?
- **External Relations:** Developing Strategies for Engaging Suppliers, Partners, NGOs and Government Entities
- **National Security and Climate Change:** The Role of the Defense Community in Developing Clean Energy and Energy Efficiency Solutions

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**Disclosures of Climate Change Impacts: A Look at the SEC's Recent Ruling
ACCO Webinar Series (February 22, 2010)**



Association of Climate Change Officers

Disclosure of Climate Change Impacts: The
SEC's Recent Ruling

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Background: Petitioning the SEC

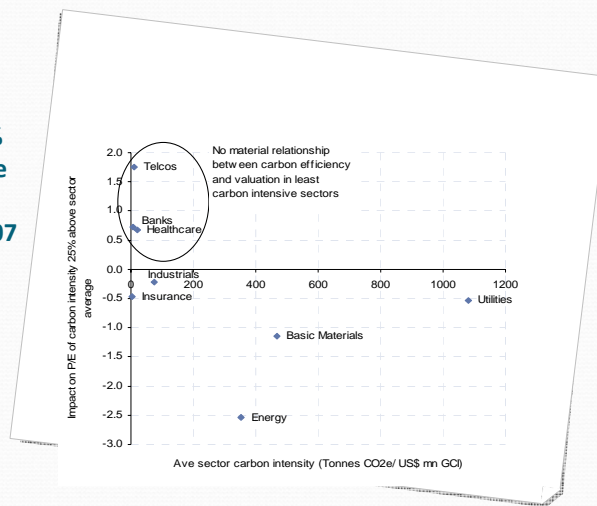
- Petition submitted in 2007 by members of the Investor Network on Climate Risk
- Context
 - Followed two bad hurricane seasons
 - Association of British Insurers report
 - Sell side investment research providers beginning to cover climate change—GS Sustain launched June 2007

Supporting the Petition

- Meetings with SEC Commissioners and staff
- NAIC decision in March 2009
- EPA requirements issued in 2009; in effect in 2010
- Market analyses increasingly reach conclusions regarding materiality
 - Meeting targets may “require significant behavioral change”
 - Impacts “will affect all sectors” with particular impact in energy, utilities, materials and industrials
 - Sell-side reports begin showing effects on valuations and P/E ratios
 - 2009: “Our analysis of ~800 global companies with a combined market capitalization equivalent to ~90% of the MSCI World shows that 60% of those companies have established board or senior management responsibility for climate change performance. In contrast, we believe the equity market is only beginning to recognize the magnitude of impact the transition to a low carbon global economy will have on companies’ competitive positions and long-term valuations.” (Source: Goldman Sachs Sustain, “Change is Coming: A Framework for Climate Change – A Defining Issue for the 21st Century”, May 21, 2009.

**Goldman Sachs:
Impact on P/E of
carbon intensity 25%
above sector average
vs. sector average
carbon intensity, 2007**

Source: Goldman Sachs
Sustain, "Climate Change: A
Rising Investment Climate,"
2008.



What Investors Expect

- Disclosure of material issues
 - Materiality: while doubts about materiality may be commonplace, they should be resolved in favor of those the statute is designed to protect: investors
 - Securities laws address issues prophylactically
- Not certainty. That is rarely possible, but preparation for reasonably likely possibilities has value.
- Recognition that risks do not necessarily apply only to high emitters (physical and reputational risks)
- Illumination, not boilerplate

Salient Points

- Places to disclose

- Description of Business
- Legal Proceedings
- Risk Factors
- MD&A
- 20-F

- Types of Disclosure

- Impact of legislation and regulation
- Impact of international accords
- Indirect consequences of regulation or business trends
- Physical impacts of climate change (including impacts on insurance coverage and premiums)

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Climate Change and the NAIC

- Insurance regulation is about consumer protection
 - Ensuring insurer solvency
 - Regulation of investments
 - Securities and real estate
 - Mitigation of risk exposure
- Climate change affects all of these areas for insurers because of the unique nature of their business.

Climate Change and the NAIC

- Climate Change and Global Warming Task Force created in 2007
- Task force created and the NAIC adopted white paper: The Potential Impact of Climate Change on Insurance Regulation
- Whitepaper recommended the need for increased disclosure by insurers about their climate change risk exposure.

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Insurer Climate Risk Disclosure

- NAIC adopted Climate Risk Disclosure Survey
 - Adopted in March 2009
 - Reporting required:
 - 2009 >\$500 million in premium
 - 2010 >\$300 million in premium
- Advantages of NAIC Regulatory Framework
 - Foster uniformity
 - Efficiency
 - Develop information based best practices

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Insurer Climate Risk Disclosure

- Climate Risk Disclosure Survey
 - Provide substantive information about climate risk
 - Eight questions for assessing risk:
 - Operations
 - Investment portfolio
 - Policyholder risk
 - Measuring degree of risk, investment strategies
- Provide consumers and investors with information on insurer assessment of risk

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Insurer Climate Risk Disclosure

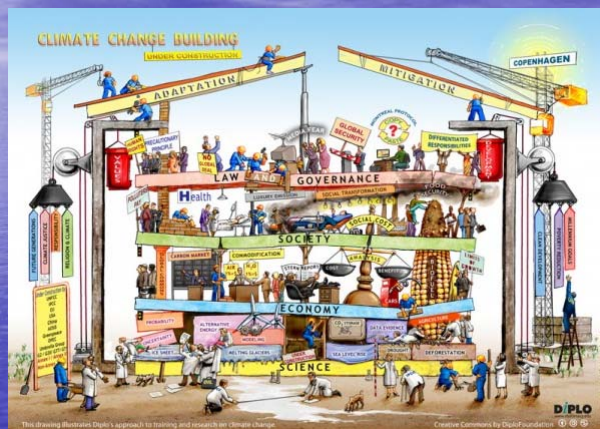
- Insurer responses due May 1, 2010.
- NAIC and state regulators to assess responses
 - Gauge insurer activities
 - Revisions to survey
 - Next steps

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FEDERAL REGISTER

Monday,
February 8, 2010

**SECURITIES AND EXCHANGE
COMMISSION**

**17 CFR Parts 211, 231 and
241**

**Commission Guidance
Regarding
Disclosure Related to Climate
Change;
Final Rule**

What is covered?

- **Impact of Legislation and Regulation:** When assessing potential disclosure obligations, a company should consider whether the impact of certain existing laws and regulations regarding climate change is material. In certain circumstances, a company should also evaluate the potential impact of pending legislation and regulation related to this topic.
- **Impact of International Accords:** A company should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change.

What is covered?

- **Indirect Consequences of Regulation or Business Trends:** Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies. For instance, a company may face decreased demand for goods that produce significant greenhouse gas emissions or increased demand for goods that result in lower emissions than competing products.
- **Physical Impacts of Climate Change:** Companies should also evaluate for disclosure purposes the actual and potential material impacts of environmental matters on their business.

LEGAL EFFECT?

This release outlines our views with respect to our existing disclosure requirements as they apply to climate change matters. This guidance is intended to assist companies in satisfying their disclosure obligations under the federal securities laws and regulations.

Guidance was not adopted through notice and comment rulemaking process under the Administrative Procedure Act.

Guidance does not purport to create new rights or obligations.

Accordingly, Guidance probably does not have the force of law and is not enforceable by third parties.

Nevertheless it will inform the SEC staff's review of filings in light of existing disclosure requirements and may trigger enforcement actions.

Existing Requirements

- Registrants are currently required to disclose the material effects of environmental compliance "on capital expenditures, earnings and competitive position of the registrant and its subsidiaries;" material pending legal proceedings; and known trends or uncertainties that the registrant "expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. 17 C.F.R. §229.101
- Registrants also have a duty under the Securities Exchange Act not to make material misstatements or omissions in their SEC filings. 17 C.F.R. §240.10b-5.

*THE GREATEST RISK WE FACE IS THE STROKE
OF A PEN RISK, THE RISK THAT A REGULATOR
OR CONGRESSMAN SIGNING A LAW CAN
CHANGE THE VALUE OF OUR ASSETS
OVERNIGHT.*

JIM ROGERS, CEO DUKE POWER

REGULATION S-K

- Item 101 requires a registrant to describe its business and that of its subsidiaries;
- Item 103 requires a registrant to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party and any material pending legal actions in which its property is the subject of the litigation;
- Item 503(c) requires a registrant to provide a discussion of the most significant factors that make an investment in the registrant speculative or risky;
- Item 303 requires disclosure known as the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)

Staff Legal Bulletin No. 14E (CF)

October 27, 2009

Shareholder Petitions

In those cases in which a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote, the proposal generally will not be excludable under Rule 14a-8(i)(7) as long as a sufficient nexus exists between the nature of the proposal and the company.

In determining whether the subject matter raises significant policy issues and has a sufficient nexus to the company, as described above, we will apply the same standards that we apply to other types of proposals under Rule 14a-8(i)(7).

Legislative Risk

- Unlikely that comprehensive climate and energy legislation will be enacted this year.
- Potential exists for pieces of legislation related to clean energy, jobs, and infrastructure investments will pass.
- Unlikely that legislative efforts to derail EPA regulatory authority under the Clean Act will succeed.
- Legislation putting a price on carbon is inevitable but the form it may take is hard to predict. Cap and trade remains the most likely instrument but other approaches including tax and rebate, or cap and dividend, or hybrid versions cannot be ruled out.

Cap and Trade Programs

- Regional Greenhouse Gas Initiative (RGGI)



Regulatory Risk

- EPA Endangerment and Cause or Contribute Findings
 - Reasonable likelihood that six GHG's threaten public health and welfare
 - Emissions of GHG's may cause or contribute to air pollution
 - Ruling triggers other requirements relating to stationary sources (e.g. BACT for new sources)
 - A number of petitions to review the rule have been filed in the DC Circuit
- EPA GHG Reporting Rule
 - Covers all six greenhouse gases plus others
 - Effective date: Dec 29, 2009
 - Covers 10,000 sources (85% of GHG)
 - First reports due in 2011 but data collection must begin now

Regulatory Risks cont.

- Light-Duty Vehicle Greenhouse Gas Emissions Standards and Corporate Average Fuel Economy Standards
- The combined EPA and NHTSA standards apply to passenger cars, light-duty trucks, and medium-duty passenger vehicles, covering model years 2012 through 2016. These vehicles must meet an estimated combined average emissions level of 250 grams of carbon dioxide per mile, equivalent to 35.5 miles per gallon (MPG).
- Together, these proposed standards would cut carbon dioxide emissions by an estimated 950 million metric tons and 1.8 billion barrels of oil over the lifetime of the vehicles sold under the program.
- Rule scheduled to take effect in March 2010 but could be delayed.
- Represents first CO2 regulation under the CAA

Regulatory Risks cont

- New Source Performance Standards
- Coal-fired Powerplants
- Oil Refineries
- Cement Plants
- Nitric Acid Plants
- Landfills

Regulatory Risks

- New Source Review
 - New plants or major modifications
 - Best Available Control Technology
 - IGCC
 - Carbon capture and storage

Litigation Risks

- Public Nuisance
 - Connecticut v AEP
 - Injunctive relief against coal-fired powerplants
 - Murphy v Comer Oil
 - Damage action against oil companies for Katrina
 - Native Village of Kivalina v Exxon Mobil
 - Cost recovery against oil and coal companies

International Regimes

- UNFCCC
 - Common but differentiated responsibilities
 - Dangerous anthropogenic interference with climate system
 - IPCC 2007: 2°C (450 PPM)
- Kyoto
 - Annex 1 Countries
 - EU ETS Carbon Market
 - Clean Development Mechanism
- Copenhagen Accord
 - Political commitments (US 17% reduction in GHG from 2005 baseline by 2020)
 - Monitoring, reporting & verification

Physical Risks

- Sea level rise (1-6 meters this century)
- Tropical storm intensity
- Extreme weather
 - Floods
 - Drought
 - Catastrophic Wildfires

Conclusion

- Publicly traded companies must continue to evaluate the impact of climate change on their results and to assess what type of disclosure in SEC filings is appropriate in light of changing legal and regulatory requirements as well as investor expectations.

Further Information

- Global Framework for Climate Risk Disclosure
- http://www.calstrs.com/INVESTMENTS/UsingTheFramework_Climate.pdf

SEC'S Guidance on Climate Change: Practical Impacts

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Washington, DC

ACCO Webinar, Feb. 22, 2010

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SEC Guidance: Key Points

- Issued Feb. 2, 2010 as interpretation of existing disclosure rules, not a new regulation
- SEC focused on investors, not social policy
- Controversial for SEC to take on climate change disclosure while so many issues confront financial markets
- Guidance very general
- SEC staff will refine over next year on company-by-company basis



What Disclosure Is Required

- Material effects Environmental Laws may have on capital expenditures, earnings and competitive position (Item 101c(1)(xii) of Reg S-K)
- Impact of prospective legislation and regulation – domestic and international – e.g., cap and trade legislation (Item 303 of Reg S-K)
 - Assuming management cannot state that proposed law or regulation is “not reasonably likely to be enacted,” it must proceed on the assumption that it will be enacted. (Item 303 of Reg. SK)
 - Issue then is whether such law or regulation is reasonably likely to have a material effect on financial condition or results of operations
 - If management cannot determine answer is no, must discuss
 - SEC guidance notes discussion should include timing and effects, carbon credit trading costs, effects on supply of goods and services, and opportunities presented as well



Disclosure of Impact of Prospective Legislation Raises Numerous Issues

- Content of federal legislation anything but clear – cap and trade not certain
- State laws in effect, but may be preempted
- EPA Clean Air Act rulemaking uncertain, and may be superseded by federal legislation
- Numerous bills before state houses, esp. CA
- Most companies lack resources to evaluate prospective laws and regulations

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Other Disclosure Items (also subject to probability/materiality test)

- International laws and treaties
- Indirect consequences of climate change and new laws – e.g., consumer demand for hybrid autos or alternative energy
- Physical impacts of climate change, including:
 - Weather severity, such as heavier snow/rain, drought and windstorms
 - Water scarcity
 - Rising sea levels and polar ice melt, ocean acidification
 - Other long-term effects

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Open Issues:

- How much must management do to evaluate impacts?
 - SEC: “management must ensure that it has sufficient information regarding the company’s greenhouse gas emissions and other operational matters to evaluate the likelihood of a material effect.”
 - Comm’r Walter: company need not disclose its “carbon footprint” or what it is doing about climate change
 - Comm’r Aguilar: a greenhouse gas inventory is arguably required to evaluate whether new laws, physical changes or climate change generally is a “risk factor” to be discussed (see Item 503)
- How far must company drill down to evaluate/quantify impacts?



Practical Advice

- Focus on the big issues and knock-on effects significant to the particular company
- Review SEC’s approach to executive comp and other recent issues as guidance
- SEC will object to over-disclosure or generalities
- NY State Martin Act settlements with Xcel, Dynegy, AES provide guidance
- Designate chief corporate climate change officer
- Seek peer advice, especially on SEC comments on disclosure in filed documents



D&O Insurance Impact

- Guidance raises issues about corporate and individual exposure to State, SEC and shareholder suits
- Such suits generally insured under D&O insurance policies
- Many policies exclude claims based on “pollution,” raising issue of potential gap in coverage
- CO2 emission resulting from energy use probably not a “pollutant” within meaning of insurance
- However, best practice is to modify policy exclusion to carve back coverage for issues of disclosure and shareholder claims



SEC's Guidance on Disclosure of Climate Change: Practical Impacts

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