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Energy Sector Alert Series: Climate Change Disclosures in 2016

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A sweeping federal rule from the Environmental Protection Agency, aggressive enforcement by a state attorney general, a landmark international accord, and the persistent demands of investors are combining to bring increased scrutiny to public companies' climate-change-related disclosures.

The Securities and Exchange Commission (SEC) published "Commission Guidance Regarding Disclosure Related to Climate Change" on February 8, 2010.[1] Although lauded by certain stakeholders at the time, the SEC's interpretive release has, since then, generally been perceived as having a limited impact on the quantity and quality of environmental disclosures. Recently, some stakeholders called on the SEC to do more to push companies to both include and improve their discussion of climate change in corporate filings. And according to a representative from Ceres, a nonprofit organization that has been a long-standing proponent of greater corporate climate-change-related disclosures, the SEC has fallen off its early pace in identifying concerns with the content of those disclosures; while the SEC issued 49 comment letters on climate change disclosures in 2010 and 2011, it issued only three over the next two years.[2] A recent Government Accountability Office report suggests that the SEC's priorities have shifted since the guidance came out in 2010. The report, released February 8, 2016, notes conversations with SEC staff in which the staff say that "the agency has no plans to specifically determine if additional actions related to disclosure of climate-related risks are necessary."[3] Nevertheless, even absent increased attention from the SEC, changes to the risks and regulatory burdens facing companies, like the recently promulgated (and more recently stayed) Clean Power Plan, the commitments made by the United States and the rest of the world in Paris to address climate change, and the physical changes brought on by climate change itself may obligate companies to increase their climate change-related disclosures in accordance with the 2010 guidance.

The Framework: Regulation S-K and the 2010 Release

Regulation S-K generally governs the non-financial statement disclosure obligations of domestic companies subject to the SEC's reporting requirements. The general guidelines of Regulation S-K implicitly and, in some cases, explicitly encompass environmental matters—especially Items 101 (which requires disclosure of any material effects of complying with environmental laws), 103 (which requires disclosure of material legal proceedings and includes specific guidance with respect to environmental legal proceedings), 303 (which requires identification of material trends and uncertainties affecting the business), and 503(c) (which requires disclosure of the most significant risk factors the company faces).[4]

The 2010 guidance doesn't revise or add new regulations to this existing framework. But it does clarify that companies may well be required to make climate change-related disclosures under the existing Regulation S-K. The guidance describes the intersection between climate change and Regulation S-K by identifying four potential triggers for disclosure: (1) developments in federal and state legislation and regulations regarding climate change, (2) treaties and other international accords, (3) the indirect consequences and business trends brought on by climate change, and (4) the physical effects of climate change.

Trigger 1: The Clean Power Plan

The Clean Power Plan directly addresses the first trigger. While the Clean Power Plan was dealt a blow yesterday when the Supreme Court ordered a stay pending the outcome of litigation challenging the rule, if it survives the legal challenges, it will have a substantial practical impact that will likely translate to a broad impact on corporate climate change disclosures as well. The Clean Power Plan is made up of two primary components. First, it sets tight limits on the greenhouse gas emissions from any new, modified, or reconstructed power plant. Second, it sets a greenhouse gas emissions guideline that applies to states; the state is then responsible for devising a plan to meet the emissions reduction targets that the Clean Power Plan sets. The two components, mixing federal decree and state empowerment, will result in a complex web of climate change regulation to which companies will have to respond, and about which those companies will have to report to their investors if material.

In particular, this regulatory regime, if ultimately implemented, will affect the business model of and so likely create disclosure obligations for companies that build and operate power plants, particularly those who deal primarily in coal. The secondary effects could also place disclosure obligations on the utilities that those generation companies serve, and the mining and exploration and production companies that serve them, as well as manufacturing companies and companies from other industries that are large consumers of electricity.

Corporate disclosures, of course, are not all about the restrictive impact of government regulation. Opportunities created by a regulatory regime are part of corporate reports, and so it is with opportunities created by climate change regulation. If the Clean Power Plan depresses the market for new natural gas- and, especially, coal-fired power plants, it may at the same time make new generation from renewable energy sources more attractive and economically feasible. Renewable energy companies and companies engaged in the research and development of carbon capture and other clean coal technologies may see a favorable business trend where energy companies that deal in fossil fuels do not. State plans that adopt a flexible approach—for example, an approach similar to the carbon trading regimes in California and the Northeast—may also create opportunities for energy companies dealing in fossil fuels that are better able than their competitors to reduce the carbon emissions of their fleet and utilities that can position themselves to earn credits for creating end-user energy efficiency gains.

Trigger 2: The Paris Agreement

The climate change agreement reached in Paris on December 12 of last year is the most sweeping example of an international accord that implicates the second trigger of the SEC guidance. Each country is expected to define its own “nationally determined contribution” to emissions reduction, so individual nations will have autonomy to determine how they will meet their commitment. As each country develops its policies and, potentially, implements new regulatory action to meet its obligations under the Paris Agreement, companies may need to provide disclosure about the uncertain, but potentially material impact the Paris Agreement could have on their business.

The Paris Agreement's effect on corporate disclosures will not be limited to tracking and accounting for sovereign countries' implementation of their commitments. More than 600 private-sector companies have joined the spirit of the Paris Agreement by signing the Paris Pledge for Action. While the Paris Pledge for Action creates no enforceable commitment on the signatory companies, for those companies that are subject to the SEC's disclosure requirements, the efforts taken to put action behind their commitment may be additional fodder for their climate change disclosures.

Triggers 3 and 4: Sustainability Reporting

While the first two triggers articulated in the SEC's 2010 guidance address the anticipated uptick in national and international action to combat climate change, the third and fourth address the fact of climate change itself. Regulatory action and treaty commitments will place more of a burden on industries that inherently involve the emission of greenhouse gases. The wide range of effects that climate change may bring about, on the other hand, have the potential to present material risks and significant trends for businesses of all stripes. The cost and availability of energy, water, and other basic components of the supply chain; rising sea levels; and more volatile weather patterns are all encompassed by the 2010 guidance and should be discussed by companies that determine they present material risks or business trends.

The SEC's reminder that the physical impacts of climate change may be disclosable dovetails with the continuing push from organizations like Ceres and investor groups for greater detail in companies' sustainability reporting. The problem as they see it is not that companies are failing to make sustainability disclosures, but that those disclosures are too general and, even when lengthy, are often repetitive.

Other organizations are providing additional focus on sustainability reporting. Bloomberg tracks companies' reporting of environmental, social, and governance (ESG) data and incorporates that into its platforms. And the Sustainability Accounting Standards Board (SASB) is engaged in an effort to better define what good sustainability disclosures look like. The SASB has published a series of specific standards, each tailored to a specific industry, that provide guidance regarding what, in the

SASB's view, should be considered material and therefore disclosed in this area.[5] These standards are voluntary, but one of the SASB's goals is to move the needle on what the SEC recognizes as material in the realm of sustainability disclosures. These developments will keep sustainability disclosures in the spotlight and press companies to improve the quality of their disclosures.

Enforcement

As noted at the outset, the number of comments issued by the SEC staff on companies' climate change-related disclosures has declined significantly after an active period in the immediate wake of the 2010 interpretive release. Although the SEC has indicated that it may address climate change-related disclosures through its ongoing disclosure effectiveness project, a GAO report released this week confirms that climate change disclosures are not among the its top priorities. It remains to be seen, however, whether the combination of sweeping carbon regulation in the form of the Clean Power Plan, the historic commitments made in the Paris Agreement, and the series of letters that the SEC has received from investors and other stakeholders advocating for a more aggressive stance will push the SEC staff to issue more comments and question the adequacy of companies' disclosures under Regulation S-K and the 2010 guidance.

The New York Attorney General's office, meanwhile, has been pressing for increased disclosures. Late last year, a major US energy company resolved an outstanding subpoena issued by the New York attorney general by coming to an agreement to include in its next SEC filings broader climate change disclosures, including discussion of the effect of regulatory action in the United States and abroad on coal demand. Meanwhile, the New York attorney general, has launched a new investigation into a second major US energy company that asks whether its prior climate change disclosures have been consistent with the company's own scientific research into the effects of climate change.

Conclusion

The New York attorney general, along with certain investors and other stakeholders, are likely to continue to expect companies' disclosures to include detailed statements that link climate change impacts to business projections. Time will tell if the SEC—at the urging of investor groups and other stakeholders—will change its stance.

The year 2015 saw the rollout of the Clean Power Plan, which would comprehensively regulate America's energy generation sector, and the landmark Paris Agreement, the implementation of which will require greater regulatory efforts still, both here and abroad. As companies grapple with the business impact of all of these factors—including how to deal with the unknown impact of a warming planet—2016 is likely to see an increase in public disclosure relating to these regulatory and physical changes.

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[1] SEC Interpretive Release nos. 33-9106, 34-61469, FR-82, 75 Fed. Reg. 6290 (Feb. 8, 2010)

[2] David Gelles, "S.E.C. Is Criticized for Lax Enforcement of Climate Risk Disclosures," *New York Times*, Jan. 23, 2016.

[3] U.S. Government Accountability Office, "Supply Chain Risks: SEC's Plans to Determine If Additional Action Is Needed on Climate-Change Related Disclosure Have Evolved," at 22 (Jan. 2016).

[4] 17 C.F.R. §§ 229.101, 229.103, 229.303, 229.503(c).

[5] Sustainability Accounting Standards Board, "Standards Download."

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