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SEC INTERPRETIVE GUIDANCE FOR CLIMATE-RELATED DISCLOSURES

By Nickolas M. Boecher*

On January 27, 2010, the Securities and Exchange Commission (“SEC”) provided public companies with interpretive guidance for climate change related disclosure requirements.¹ In light of recent legislation and investor demand,² the SEC acted prudently because the interpretive guidance will probably encourage more complete disclosure of the risks and opportunities faced by publicly traded businesses. In turn, increased disclosure should foster greater transparency, provide incentive for cleaner technologies,³ and facilitate dialogue concerning the effects of climate change on the business world.⁴

Established disclosure requirements oblige publicly traded companies to report the reasonably likely material costs of complying with environmental statutes and regulations.⁵ The newly issued interpretive guidance highlights four areas where climate change may trigger disclosure requirements: Legislation and Regulation; International Accords; Indirect Consequences of Regulation or Business Trends; and Physical Impacts of Climate Change.⁶ The interpretive guidance does not create new legal requirements or change established ones, but rather it clarifies what public companies need to disclose.⁷

The release of the interpretive guidance has received criticism from within the SEC.⁸ One commissioner has argued that the physical risks of climate change are not relevant for disclosure because they are not reasonably foreseeable and often only occur over the course of decades or centuries.⁹ She has also pointed out that climate change concerns are outside the expertise of the SEC, which was established to ensure investor protection.¹⁰

Investors have submitted reports suggesting that current climate-related disclosure is insufficient.¹¹ A 2008 report, submitted by an institutional investor, surveyed over six thousand annual filings by Standard & Poor’s 500 companies and found that 76.3% of 2008 filings failed to mention climate change.¹² In January 2010, the world’s largest investors, holding over thirteen trillion dollars in assets, released a statement demanding action by world leaders in regard to climate change.¹³ Among their demands was a request that the SEC require greater climate-related disclosure.¹⁴

In addition, numerous examples, both domestic and international, suggest a changing legislative and regulatory space requiring more complete disclosure.¹⁵ Recent requirements from the Environmental Protection Agency as well as legislation in state and local governments regulating greenhouse gas emissions constitute active legislation that may require disclosure.¹⁶ Additionally, Congress is considering a national cap-and-trade system for the regulation of emissions.¹⁷ Furthermore, the Kyoto Protocol and the related European Union Emissions Trading System, which many SEC registrants operating in international business must follow, also may have material effect.¹⁸

Commentators have suggested that legal problems could arise if disclosure requirements are extended.¹⁹ Hostile shareholders could file frivolous lawsuits by taking advantage of imperious disclosure requirements.²⁰ Additionally, businesses may have trouble accurately disclosing the outcome of pending litigation resulting from climate change.²¹ Legal disclosure requirements could also weaken legal positions in pending litigation, undermining the attorney-client privilege and the work product doctrine.²²

By limiting itself to providing interpretive guidance on climate change disclosure, the SEC has likely avoided these types of legal problems. SEC Rule 10b-5 permits individual shareholders an action against companies failing to make required disclosures.²³ Rule 10b-5 actions provide companies an incentive to comply with disclosure requirements and to reduce activity that would be unfavorable to share value if publicly disclosed.²⁴ Successful 10b-5 actions require a duty to disclose, something which the SEC has never expressly required for environmental issues.²⁵ Thus, while the interpretive guidance provides some further basis for insufficient disclosure arguments under rule 10b-5, the fact that it does not create an express duty to disclose should work to limit the number of frivolous lawsuits.²⁶ Additionally, the interpretive guidance does not require detailed reporting of pending litigation.²⁷ Moreover, as a policy matter, the interpretive guidance probably will not be interpreted as obliging companies to compromise pending litigation by disclosing pertinent information.

The SEC acted evenhandedly in its release of the interpretive guidance. Although companies may have difficulty in predicting the physical effects of climate change,²⁸ legislative, regulatory, and investment trends suggest a need for more complete disclosure.²⁹ The interpretive guidance suggests that the SEC will be more likely to enforce disclosure on climate-related issues than it has in the past.³⁰ However, by stopping short of creating an express duty to disclose, the SEC has limited potential abuse of Rule 10b-5 litigation.³¹ Increased disclosure can provide more information to investors and also create an incentive for companies to invest in cleaner technology as an alternative to disclosing damaging information.³² Increased disclosure might also provide legislators with a feedback mechanism for evaluating the effects of climate change legislation. The new interpretive guidance should help stream the flow of information concerning climate-related matters and facilitate ongoing dialogue in this area of increasing attention.³³

Endnotes: SEC Interpretive Guidance for Climate-Related Disclosures *continued on page 62*

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¹ Press Release, U.S. Sec. & Exch. Comm'n, SEC Issues Interpretive Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change (Jan. 27, 2010), *available at* <http://sec.gov/news/press/2010/2010-15.htm>.

² See Comm'n Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106; 34-61469; FR-82, 75 Fed. Reg. 6,295-97 (Feb. 8, 2010) (to be codified at 17 C.F.R. pt. 211, 231, 241) [hereinafter Comm'n Guidance], *available at* <http://frwebgate5.access.gpo.gov/cgi-bin/PDFgate.cgi?WAISdocID=103875523539+1+2+0&WAIAction=retrieve>.

³ See Perry E. Wallace, *Disclosure of Environmental Liabilities Under the Securities Laws: The Potential of Securities-Market Based Incentives for Pollution Control*, 50 WASH. & LEE L. REV. 1093, 1124-29, 1144 (1993) (illustrating that environmental disclosure can foster environmental protection by creating an incentive to solve environmental problems to preserve the market value of securities).

⁴ Cf. Andrea M. Matwyshyn, *Material Vulnerabilities: Data Privacy, Corporate Information Security, and Securities Regulation*, 3 BERKLEY BUS. L.J. 129, 202-3 (2005) (arguing, in the context of information security, that requiring disclosure helps increase awareness of problems that society faces and supports system-wide learning of better practices for both corporations and consumers through feedback loops and information sharing).

⁵ See 17 C.F.R. §§ 229.101, 229.103, 229.303, 229.503 (2010) (detailing Regulation S-K Items 101, 103, 303, and 503 which, respectively, require the disclosure of any material effect environmental compliance costs may have on earnings and competitive position; the disclosure of pending material legal proceedings; the disclosure of management's discussion and analysis of known trends or uncertainties reasonably expected to have a material impact on sales, liquidity, revenues, or income; and the disclosure of investment risks and how they may affect the investor).

⁶ Comm'n Guidance, *supra* note 2, at 6,295-97.

⁷ See Comm'r Mary Schapiro, Chairman, Statement Before Open Commission Meeting on Disclosure Related to Business or Legislative Events on the Issue of Climate Change (Jan. 27, 2010), *available at* <http://sec.gov/news/speech/2010/spch012710mls-climate.htm>.

⁸ Comm'r Kathleen L. Casey, Statement at Open Meeting – Interpretive Release Regarding Disclosure of Climate Change Matters (Jan. 27, 2010) [hereinafter Comm'r Casey], *available at* <http://www.sec.gov/news/speech/2010/spch012710klc-climate.htm>.

⁹ See *id.* See also Tom Munteer, *Incremental Changes in Soon-to-be-Released Disclosures Unlikely to Satisfy Advocates*, 39 ENVTL. L. REP. NEWS & ANALYSIS 11145 (2009) (discussing several recent studies predicting climate change to occur over the course of the coming decades and the difficulty of