WHAT ARE WE TALKING ABOUT HERE?

SECURITIES DISCLOSURE REQUIREMENTS AND CLIMATE CHANGE

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In September of 2007, a coalition of environmental advocacy groups, state officials with regulatory and fiscal management responsibilities, and investors filed a Petition for Interpretive Guidance on Climate Risk Disclosure ("*Petition*") with the Securities and Exchange Commission ("*SEC*"). The Petition asserts that climate change, particularly by the warming of the climate system through emissions of greenhouse gasses ("*GHG*") such as carbon dioxide, has been proven by an overwhelming body of scientific evidence. The resulting effects of climate change – such as sea level rise, increasingly severe weather, greater incidence of floods, fires and droughts, and expanded risk of disease and pest vectors – along with public policy initiatives to deal with the situation, will, according to the petitioners, present far-reaching implications for businesses. These include potential effects on the performance and operations of individual companies that can range from physical risk to facilities, to new regulatory costs and other financial burdens, to shifts in markets for the company's products. Not all the effects will be negative, however, as a carbon-constrained regulatory scheme may well offer opportunities for businesses to capitalize on a changing business environment.

The thesis of the Petition is that climate change has become a significant factor bearing on companies' financial condition, particularly as it may be affected by long-term capital investments that are currently being made by companies. As such, climate risk has assumed a particular significant to investors' decisions.

The Petition also sets forth the case that climate risk is not being adequately disclosed by public companies under federal securities laws and that interpretive guidance from the SEC is needed to clarify the application of existing law to corporate climate risks and to set forth the elements of climate risk disclosure.

The Petition[1], and a supplemental filing[2] dated June 12, 2008 covering developments since the Petition was filed, contain a wealth of information about the scientific community's

[1] 2007 Request for Interpretive Guidance on Climate Risk Disclosure, *available at* http://www.sec.gov/rules/petitions/2007/petn4-547.pdf.
[2] June 2008 supplement to Request for Interpretive Guidance on Climate Risk Disclosure, *available at* http://www.sec.gov/rules/petitions/2008/petn4-547-supp.pdf .

view of climate change, regional and state regulatory actions concerning GHG emissions, and international and proposed federal regulation of GHG emissions.

This paper will consider (i) existing SEC regulatory provisions that govern disclosure and how they may apply to climate risk, (ii) the elements of climate risk disclosure requested in the Petition, and (iii) the implication of a recently resolved investigation by the Attorney General of the State of New York that compelled climate risk disclosure.

I. SECURITIES AND EXCHANGE COMMISSION ENVIRONMENTAL DISCLOSURE REQUIREMENTS

A. The Duty to Disclose

The SEC imposes certain specific and implied disclosure obligations, with registration statement and prospectus disclosure requirements for companies registering securities for sale or for issuance in business combination transactions under the Securities Act of 1933 (the "*1933 Act*"), and with periodic and other reporting requirements for companies under the Securities Exchange Act of 1934 (the "*1934 Act*"). Reporting requirements must be addressed in quarterly reports on Form 10-Q and annual reports on Form 10-K under the 1934 Act. The filing and reporting requirements arise sooner in the event of a specifically required current report on Form 8-K and in connection with the registration of securities for sale or for issuance in business combination transactions (such as mergers and exchange offers), tender offers or proxy solicitations.

Although timing may vary, sooner or later a public company must assess its disclosure obligations and consider both those disclosure requirements in which the SEC calls for specific information and the disclosure requirements that are driven by a registrants' duty not to mislead, generally relating to the need to disclose all "material" information and to provide "complete" disclosure. A registrant's failure to comply with its SEC disclosure obligations can result in administrative actions or civil or criminal liabilities under the federal securities laws, including private causes of action.

B. Materiality

Despite the pivotal role that the materiality standard plays in the determination of what information is required to be disclosed under federal securities laws, it is an exclusive concept. The Supreme Court set forth the applicable standard in *TSC Industries, Inc. v. Northway, Inc.* (426 U.S. 438 (1976)). In that case, the court held that information is deemed material if there is "a substantial likelihood" that it "would have been viewed by the reasonable investor as having significantly altered the total mix of information" available to the public.

One commentator[3] recently referred to the *TSC Industries* standard as "establishing a framework for analysis rather than a formula for deciding specific cases." It provides no numeric thresholds and no list of prescriptively material items. It defers to the "reasonable investor" with no guidance as to how to obtain the view of that hypothetical being. Staff Accounting Bulletin No. 99[4], which was issued by the SEC to clarify the materiality standard, confirmed that materiality is not just a determination of magnitude; materiality determination involves qualitative as well as quantitative factors. Consequently, determining materiality of information, whether individually or in the aggregate, is an exercise in subjectivity, with the correctness of that subjective determination not confirmed or challenged until considered by a trier of fact with the benefit of 20-20 hindsight.

C. *Specific Environmental Disclosure Requirements Under Regulation S-K*

SEC Regulation S-K (17 C.F.R. § 229) sets forth the so-called "line item" requirements that describe the scope of disclosure for certain specified information in documents filed with the SEC. Regulation S-K includes provisions that either specifically require disclosure, or can be interpreted to require disclosure, related to environmental matters.

1. S-K Item 101 – Description of Business. Paragraph (c)(xii) of S-K Item 101 requires disclosure of the cost of complying with environmental laws.

> "(xii) Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material."

More generally, S-K Item 101 also requires a description of the general development of the business of the registrant, including any material acquisition of plant and equipment and the capacity thereof and other material areas which may be peculiar to the registrant's business, and a narrative description of the business, including competitive conditions.

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[3] Sauer, "The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws," 62 *The Business Lawyer* 317, February 2007 at p. 313.

[4] 64 Fed. Reg. 45150 (August 19, 1999).

2. S-K Item 103 – Legal Proceedings. S-K Item 103 requires that a registrant describe

> "any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities."

Instruction 5 to S-K Item 103 provides as follows:

> "5. Notwithstanding the foregoing, an administrative or judicial proceeding (including . . . proceedings which present in large degree the same issues) arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary [sic] for the purpose of protecting the environment shall not be deemed ordinary routine litigation incidental to the business and shall be described if:
>
> A. Such proceeding is material to the business or financial condition to the registrant;
>
> B. Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or
>
> C. A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically."

3. S-K Item 303 – MD&A Disclosure. Regulation S-K also includes, in S-K Item 303, a disclosure entitled Management's Discussion and Analysis of Financial Condition and Results of Operations ("*MD&A*") which, because of its scope, can also require disclosure related to environmental matters.

a. Scope of Disclosure. S-K Item 303 (17 C.F.R. § 229.303(a)) is a "flexible and general" set of guidelines that apply to a registrant's required discussion of liquidity, capital resources, results of operations, and other information necessary to an understanding of the registrant's financial conditions, changes in financial condition and results of operations. The discussion regarding results of operations is to describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenue or income from continuing operations. (17 C.F.R. § 229.303(a)(3)(ii)). The instructions to S-K Item 303(a) provide that:

> "The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past, and (B) matters that have had an impact on reported operations and are not expected to have an impact upon future operations."

b. Impact on Environmental Disclosures. Examples of potential disclosures could include the following:

(i) commitments for expenditures for additional pollution control equipment to upgrade systems or meet newly promulgated requirements and availability of financing therefor if not out of cash flow ("liquidity and capital resources");

(ii) the impact of promulgated environmental regulations on the registrant's operations ("results of operations"); and

(iii) the impact of such regulations on future performance ("other information necessary").

c. Interpretive Guidance.

The staff of the SEC's Division of Corporation Finance in response to their concern regarding the perceived inadequacy of MD&A disclosure practices provided interpretative guidance in a May 1989 interpretative release (the "*Interpretative Release*").[5] The discussion regarding prospective information disclosure in the Interpretative Release is particularly pertinent to environmental matters. Specific provisions in S-K Item 303 require disclosure of forward-looking information. The registrant must discuss "known trends or other known demands, commitments, events or uncertainties that will result in or are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way." The registrant must describe both known "material trends in the registrant's capital resources and expected changes in the mix and relative cost of such resources, as well as "known trends or uncertainties that the registrant reasonably expects will have a material impact on net sales, revenues or income from continuing operations." MD&A is to "focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition."

Disclosure of prospective information pursuant to the specific provisions in S-K Item 303 is required where both elements of a two step test (the "*MD&A Disclosure Test*") are met:

(x) The trend, demand, commitment, event or uncertainty is presently known to management; and

(y) The trend, demand, commitment, event or uncertainty is reasonably likely to have a material effect on the registrant's financial condition or results of operations.

The Interpretative Release overlays the first element of the MD&A Disclosure Test with a "likelihood" caveat: if management determines that the trend, demand, commitment, event or uncertainty, though known, is not reasonably likely to occur, no disclosure is required. Under this caveat, no disclosure would be required of an event that could greatly impact the registrant if the management determined the event was not reasonably likely to occur.

If the registrant cannot make the determination that a trend, demand, commitment, event or uncertainty is "not reasonably likely to occur," management must assume that it will occur and "evaluate objectively the consequences."

[5] Securities Act Release No. 6835, 54 Fed. Reg. 22427 (1989).

> Disclosure will be required unless management determines that a material effect on the registrant's financial condition or results of operations is not likely to occur (*i.e.*, it fails the second element of the MD&A Disclosure Test). According to the Interpretative Release each determination with respect to the analysis discussed above must be "objectively reasonable [assessments] viewed as of the time the determination is made."

D. Implied Disclosure Requirements

In addition to the specific disclosure requirements discussed above that may apply with respect to environmental matters, there are additional "implied" disclosure requirements that apply generally and may require disclosure concerning environmental matters, such as the antifraud provisions contained in the federal securities laws and the materiality standards that have evolved thereunder.

The primary implied disclosure obligation arising under the antifraud provisions of the federal securities laws is Rule 10b-5. (17 C.F.R. § 240.10b-5) Rule 10b-5 prohibits deceptive or manipulative practices in connection with the purchase or sale of securities. In particular, issuers are prohibited from disseminating public information that is false or that fails to include material facts necessary to make the statements, in light of the circumstances in which they are made, not misleading.

In the administrative proceeding *In re United States Steel Corp.*, Exchange Act Release No. 16223, the SEC noted that "compliance with the [SEC's] specific environmental disclosure rules does not necessarily constitute full compliance with the disclosure requirements of the federal securities laws." It cites its general disclosure rules (*i.e.*, 1933 Act Rule 408 and 1934 Act Rules 12b-20 and 14a-9), which require disclosure of any material information beyond that for which disclosure is specifically required necessary to make required statements not misleading. The SEC goes on to note that:

> "In the context of its environmental releases, the Commission has interpreted these rules as requiring that *all* material information relating to environmental matters must be disclosed. *See*, Release 5171, *supra*, at 1; Securities Exchange Act Release No. 5627 (Oct. 14, 1975, at 2). This approach reflects the [SEC's] belief that omissions of material environmental information would render misleading the required disclosures concerning financial matters and the nature of a registrant's business."

The disclosure obligation arises only if information is "material." The general materiality standard to be used in the context of the need to disclose certain "soft information" (such as contingent liabilities arising under environmental laws) was addressed by the Supreme

Court in *Basic v. Levinson*, 485 U.S. 224 (1988). According to the Interpretative Release, this materiality standard differs from the materiality standard used for the disclosure of specific forward-looking information for MD&A disclosure. The material standard adopted by the court can be paraphrased as follows: a contingency or uncertainty is material if a reasonable investor would consider it to be important after balancing the potential magnitude of the contingency or uncertainty against the likelihood of its occurrence in the context of the totality of the company's activities. The Court declined to provide any "bright line test," noting instead that the determination of whether the contingency in any particular case is material depends on the facts. The approach is consistent with the Court's recognition that determinations of materiality involve "a mixed question of law and fact, involving as [they do] the application of a legal standard to a particular set of facts" and "require delicate assessments of the inferences a 'reasonable shareholder would draw from a given set of facts and the significance of those inferences to him."

II. INTERPRETATIVE GUIDANCE REQUESTED IN THE PETITION

The Petition filed in 2007 asserts that, even though Regulation S-K spells out requirements for disclosure, public companies have a demonstrably low rate of meaningful climate risk disclosure and that inadequacy, and the inconsistency in how companies are addressing the subject in their filings, are denying investors the information they need about climate risk. That includes information critical to investors' ability to assess firms' preparations for the regulatory and physical implications of climate change and to make informed investment decisions. The Petition requests the SEC set forth the elements of disclosure appropriate for those companies that determine that climate risk has a material impact on their performance and operations.

The Petition, in Part 6, requests the following clarification from the SEC:

1. that registrants, in preparing for their periodic mandatory public disclosures, must carefully review the implications of climate change for their financial condition and operations, and must disclose climate risks that are material.

2. that registrants should review the adequacy of their internal mechanisms for gathering information about, and assessing, climate risk, and should establish institutional mechanisms necessary to ensure careful and well-informed review of potential climate risks.

3. that registrants determine the current and projected greenhouse gas emissions associated not only with their facilities and operations, but also with their entire production cycle.

4. that registrants review the requirements of any international, national, state, or local greenhouse gas regulations that are in place, or probable, in the jurisdictions in which they operate, and assess the impact of those regulations upon their financial condition and operations

5. that registrants disclose risks that are found to be material, including:

   - physical risks associated with climate change.
   - financial risks and opportunities associated with present or probable greenhouse gas regulation.
   - legal proceedings relating to climate change.

Each of these numbered points will be referred to below as a "*Petition-requested Item.*"

The Petition request is fashioned as a request for clarification of existing regulatory requirements. However, with respect to most of the Petition-requested Items, it appears to call for more than that.

Two of the Petition-requested Items appear to ask for information already required by existing S-K items: S-K Item 303 with respect to Petition-requested Item 1, and S-K Items 101 and 303 with respect to Petition-required Item 4. In each case, material impacts on financial conditions and operations are required to be considered and disclosed by Item S-K. Clearly, where a registrant has operations in countries outside the U.S. where GHG regulatory regimes are in place, or in those states in the U.S. that have enacted GHG restrictions, a registrant would need to consider the impact of these regulations on its capital expenditures, earnings and competitive position. If the impact is determined to be material, disclosure would be required by Item 101. Although federal GHG legislation has been proposed in a number of bills, none of them has yet become law. Consequently, it will be difficult for companies to speculate upon the manner in which the federal law will affect it. Most commentators have considered a federal GHG regulatory regime as inevitable following the 2008 presidential election. However, the sudden, sharp economic downturn preceding the election may postpone federal action and could conceivably roll back existing state and regional initiatives. The details of a proposed federal regulatory regime are still to be determined, and the impacts on any company could vary widely. A cap and trade approach appears to be the current favorite among politicians, although economists favor a carbon tax, which, as a tax, is unpalatable to the politicians. Also, the regulatory aspects will vary significantly depending upon which industrial sectors are subject to the regulatory regime: only those with high GHG emissions, such as utilities, petrochemical and refinery operators, and transportation, or a broader spectrum of the economy? And how will the regulatory scheme impact companies indirectly: by increasing costs in their supply chain or decreasing markets as companies attempt to pass along increased costs? However, it still should

be difficult for a registrant to take the position that GHG regulation is an event that is not reasonably likely to occur and does not have to be addressed under S-K Item 303.

The detail in Petition-requested Item 3 would appear to be outside the current S-K requirements, although, as the Petition points out that "an understanding both of current and projected greenhouse gas emissions levels, and of present and probable regulations concerning greenhouse emissions, is a necessary prerequisite for the registrant to determine whether it faces "material opportunities, challenges and risks relating to climate change, and to inform the analysis in its disclosures." Many companies are already gathering that type of data and presenting it voluntarily. For example, the Carbon Disclosure Project collects climate change-related information from major corporations around the world. Its most recent report, issued in September 2008[6], indicated that 63% of S&P 500 companies responded. Of the responding companies, 73% reported their GHG emissions. Smaller percentages indicated that they disclose emissions reduction target and forecasts. Companies also voluntarily present climate change-related data through other avenues, such as state, federal and NGO climate registry programs and corporate sustainability reports.

Petition-requested Item 5 would appear to fall with the current coverage of S-K Item 303 for the first two bullets and S-K Item 103 for the third, to the extent the risks are determined to be material with respect to the registrant. Petition-requested Item 2 would appear to be a request for a corporate governance overlay that goes beyond regulatory considerations called out in Regulation S-K.

III. COMPELLED DISCLOSURE

A. The Cuomo Initiative

On August 27, 2008, the Attorney General of the State of New York, Andrew Cuomo, announced what was characterized as "the first-ever binding and enforceable agreement requiring a major national energy company to disclose the financial risks that climate changes poses to its investors." Cuomo further characterized the agreement as setting "a new industry-wide precedent."

The agreement is with Xcel Energy, a New York Stock Exchange-listed company that was one of five energy companies that had received letters with subpoenas from the Attorney General's office in September of 2007[7]. Xcel is a major U.S. electricity and natural gas company with regulated operations in eight western and midwestern states, serving 3.3 million electricity customers and 1.8 million natural gas customers. The subpoenas that Xcel and the other companies received were based on the broad investigatory authority granted to the

[6] Carbon Disclosure Project Report, *available at* http://www.cdproject.net/reports.asp.
[7] Letters from Attorney General Cuomo, a*vailable at* http://www.oag.state.ny.us/media_center/2007/sep/sep17a_07.html.

Attorney General under New York General Business Law § 352 (allowing the Attorney General to compel disclosure with regard to alleged fraudulent practice where he believes it in the public interest to investigate) and New York Executive Law § 63(12) (allowing the Attorney General to seek injunction for repeated fraudulent or illegal activities).

The September 2007 letter focuses on the fact that Xcel was beginning construction of a new coal-fired electricity generating unit at an existing station in Pueblo, Colorado that would generate 750 megawatts of electricity using largely conventional technology without current plans to capture and sequester the resulting carbon dioxide emissions. According to the letter, the increase in CO_2 emissions from the operation of the unit, in combination with Xcel's other coal-fired power plants, "will subject Xcel to increased financial, regulatory and litigation risks." The Attorney General asserted its concern that Xcel had not adequately disclosed the risks to its shareholders, identifying in particular the New York State Common Retirement Fund, which the letter characterized as a significant holder of Xcel stock. The letter goes on to indicate the Attorney General's concern with climate change and notes that "emissions from U.S. powers plants constitute 30% of total U.S. carbon emissions." The letter indicates that the emissions from the new Xcel plant will "exacerbate global warming harm and undermine the concerted efforts to be undertaken by New York and other states to address global warming."

The letter also asserts that "Xcel has failed to disclose material information about the increased climate risks Xcel's business faces. For example, any one of the several new or likely regulatory initiatives for CO_2 emissions from power plants – including state carbon controls, EPA's regulations under the Clean Air Act, or the enactment of federal global warming legislation – would add a significant cost to carbon-intensive coal generation such as the new coal plant proposed by Xcel." The letter goes on to say that "in its 2006 Form 10-K, Xcel made no disclosure of projected CO_2 emissions from the proposed plant or its current plant. Further, Xcel did not attempt to evaluate or quantify the possible effects of future greenhouse gas regulations, or discuss their impact on the company." The Attorney General takes the position that it is "difficult for investors to make informed decisions" without that information.

The letter does not explicitly indicate wrongdoing on the part of Xcel. It concludes by saying that "under federal and state laws and regulations, Xcel's disclosures to investors must be complete and not misleading. Selective disclosure of favorable information or omission of unfavorable information concerning climate change is misleading. Xcel cannot excuse its failure to provide disclosure and analysis by claiming there is insufficient information concerning known climate change trends and uncertainties."

In its press release announcing the resolution of the matter, Xcel indicated that in its response to the 2007 subpoena, it had provided Cuomo with various documents providing disclosure outside of securities filings. Those included a 2006 response to a questionnaire from the Carbon Disclosure Project, the company's "Triple Bottom Line report" describing the company's social, environmental and economic impact, and information filed with the Colorado

Public Utilities Commission about its plant addition. It also indicated that it had voluntarily reduced its greenhouse gas emissions by a cumulative total of over 18 million tons since 2003.

B. The Xcel Resolution

To resolve the Attorney General's investigation, Xcel and the Attorney General entered into an Assurance of Discontinuance[8] in which Xcel agreed to make the following climate change risk disclosures in its SEC 10-K filings over a four-year period:

1. *Analysis of Financial Risks from Regulation.* The material financial risks to Xcel associated with the regulation of GHG emissions, including at a minimum:

- Present Laws. Identification of GHG legislation or regulation in effect in states and countries in which Xcel operates and an analysis of the material financial effect of the legislation or regulations.

- Probable Future Laws. Discussion of expected trends in GHG legislation or regulations likely to be adopted that would have a material financial effect on Xcel's business and an assessment of the potential material financial effect of the legislation or regulations, including a discussion of the factors that may affect the Company's business.

2. *Analysis of Financial Risks from Litigation.*

- Litigation regarding Xcel. A description of any litigation related to climate change involving Xcel the outcome of which will likely have a material financial effect on Xcel.

- Litigation not involving Xcel. A description of any climate change-related decisions issued by the United States Supreme Court, any United States Court of Appeals, or any court in any jurisdiction in which the Company operates that the Company concludes may have a material financial effect on its business.

3. *Analysis of Financial Risks from Physical Impacts of Climate Change.* The material financial risks to Xcel's operations from the physical impacts associated with climate change, including the impact, if any, of an increase in sea level and changes in weather conditions, such as increases in extreme weather events, changes in precipitation resulting in drought or water shortages, and changes in temperature.

[8] Assurance of Discontinuance Pursuant to Executive Law § 63(15), a*vailable at* http://www.oag.state.ny.us/media_center/2008/aug/xcel_aod.pdf .

4. *Strategic Analysis of Climate Change Risk and Emissions Management.* To the extent Xcel's GHG emissions materially affect its financial exposure from climate change risk, Xcel shall include:

- Xcel's current position on climate change.
- estimated GHG emissions for the reporting year.
- expected increases in GHG emissions from planned projects.
- strategies to reduce its climate change risk and to adapt to the physical impacts of climate change, including actions Xcel is taking to reduce, offset, or limit GHG emissions (such as emission reduction programs, energy efficiency and conservation programs, renewable energy development, diversification of electricity resources, improvements in energy infrastructure, and participation in research and development of new technologies to reduce GHG emissions).
- the results of strategies undertaken to date.
- the expected effect of such strategies on future GHG emissions, including the GHG emission reduction goals (as a percentage of aggregate emissions) the Company seeks to achieve from such strategies.
- Xcel's corporate governance actions concerning climate change, including the role of the Board of Directors, and a statement regarding whether environmental performance, including meeting climate change objectives, is incorporated into officer compensation.

The agreement with the Attorney General also allows Xcel to reference other documents or reports like its sustainability report, Carbon Disclosure Project report, and submittals to state agencies relating to GHG emissions and climate change risks, in its Form 10-K filing with the SEC to provide further details on climate change risk.

C. Disclosure Comparison

The disclosures compelled by the Attorney General (referred to below as "*AG Items*") in its agreement with Xcel appear to go well beyond the line item requirements in Regulation S-K and also beyond the disclosure clarifications requested in the Petition. The first and third AG Items arguably fall under the broad language of S-K Item 303. The first bullet

under the second AG Item relating to litigation would be covered by S-K Item 102 if the litigation involved the company and was material. With respect to the second bullet under the second AG Item, it would appear that the Attorney General is expecting Xcel to consider existing climate change litigation, even though the company may not be a party to it, if a plaintiff's attorney could make a similar claim. Those types of litigation could include the potential for challenges to proposed projects based on their GHG emissions or climate change concerns and for common law nuisance suits relating to global warming. The components of the fourth AG Item appear to require a type of detailed analysis and metrics that the activist investment community wants to impose on reporting companies, but would not be the type of disclosures typically required under one of the Regulation S-K Items. Data regarding emissions and projected increases in emissions may prove helpful to financial analysts, but the usefulness might be limited by an inconsistent method of gathering and reporting data and lack of comparable data from other companies. Voluntary initiatives, such as the Carbon Disclosure Project, are attempting to bring a consistent framework to that data, albeit outside the context of SEC reporting. The discussion of scenario planning would appear to require detail that would extend far beyond the kind of analysis that reporting companies would expect to provide in their SEC reports. Finally, the last bullet in the fourth AG Item looks at corporate governance issues, and appears to be an attempt to determine whether management takes the existence of climate change seriously and has built those beliefs into the governing structure of the company to mitigate risk and pursue opportunities.

D. Potential Implications of the Xcel Agreement

There are a number of questions that arise out of Xcel's agreement with the New York Attorney General:

- Will the disclosure requirements that the New York Attorney General has compelled be considered a *de facto* disclosure framework for all utilities, or for that matter for all reporting companies that may be affected by climate change?

- Will disclosure made in accordance with Regulation S-K, with or without interpretative guidance from the SEC, not provide a safe harbor against state officials wielding broad powers under general state anti-fraud statutory provisions to compel similar disclosures, even if the company does not have operations in those states?

- With a push for securities disclosure coming from outside the SEC, do public companies face the possibility of providing too much forward-looking information, which, if things do not develop as discussed in the SEC report, can result in liability imposed by Monday-morning quarterbacking judges?

- By listing items not called out by Regulation S-K, has the Xcel agreement essentially bootstrapped certain considerations and constructively made them "known trends" and considered "material" notwithstanding the standard traditionally used for determining disclosure under Regulation S-K?

- By allowing Xcel to reference other disclosure vehicles, including its sustainability report and its response to the Carbon Disclosure Project, does that allow companies to continue to take a more general approach to MD&A disclosures so long as they are providing detailed information to the investing public outside the SEC reporting framework?

- Does the agreement with Xcel embed, by implication, the positions taken in the Petition for Interpretative Guidance, to which the New York Attorney General was a listed petitioner, in the expected disclosure framework even though those positions have not been confirmed by court ruling or responded to by the SEC?

- Will the resolution of the Attorney General's complaint, which is based on allegations of misleading "selective disclosure" and omission of unfavorable information, increase the investment communities' expectation of disclosure, whether voluntary or compelled, and increase the risk of private lawsuits based on similar allegations?

- If a company's management does not buy into the prevailing "scientific consensus" regarding the causes of climate change and their anticipated effects, does that create a corporate governance question for the investment community?

IV. CONCLUDING THOUGHTS

The Petition and the Cuomo initiative, on the one hand, and the existing Regulation S-K approach to disclosure, on the other, present two different dynamics. In the first instance, a demand is being made on companies for very detailed data and analysis where the legislative/regulatory framework that will determine how individual companies are affected is, by and large, still developing. Climate change is being considered to impose a paradigm shift on the way businesses will need to be run and, as such, is thought to necessitate a different approach to disclosure. In the second instance, climate change would be treated no differently than other potential global events that may pose a material risk to a company, such as an avian flu pandemic or the impact of increasing populations with middle class aspirations on the world's finite resources. Such risks, to the extent they may have a material effect on a company, are expected to be considered for corporate disclosure, but traditionally that disclosure would not be made in the detail that is the focus of the Petition and the Cuomo initiative.

The SEC had not acted in response to previous requests from investor groups that it require reporting companies to disclose climate risk.[9] As of the date of this paper, the SEC has not acted with respect to the Petition and may not act without a mandate to do so from Congress. In the meantime, reporting companies are left with the question of whether it is in their interest, and in the interest of their shareholders, to provide a detailed analysis of climate risk matters.

Clearly, companies with operations outside of the United States, where regulatory provisions driven by countries' ratification of the Kyoto Protocol already impact carbon costs and limit GHG emissions, are being affected by those provisions. Similarly, clients with domestic operations in states that have adopted legislative or regulatory regimes dealing with GHG emissions are also impacted. The additional costs of proposed regulatory changes, particularly on the federal level, cannot be currently determined until those regulatory schemes are implemented, but it would appear that it should be considered an uncertainty, if not a trend. The direct costs will, of course, differ by industry and the energy inputs and outputs of that industry, but direct and indirect reports from a carbon regulation regime would be expected to ripple throughout our carbon-based economy. Physical risks identified by the scientific community are more speculative and, again, will depend on the industry in which the company operates and the location of its operations.

Many companies are already providing voluntary disclosure to the investing public through vehicles such as the Carbon Disclosure Project, but the information provided does not necessarily tie back to the investment communities' desire to be able to see the impact of climate change on a company's financial performance and competitiveness. Because companies use different formats and different ways of measuring GHG emissions, voluntary disclosure does not necessarily create a metric that can be readily used to compare between and among individual companies or against an established benchmark.

Given the shareholder activism in this arena, it would appear that corporate self-interest would encourage management to provide more, rather than less, information to the public. Decisions by the shareholder activists can play a significant part in rewarding or punishing a company's stock price. Also, companies may face potential reputational risks by not providing the transparency being requested by groups such as those that submitted the Petition. In considering expanded disclosure, however, companies will be faced with the question of what is the "right stuff" to provide, since the type and detail of information requested by the Petition and required by the Xcel agreement are substantially more extensive than disclosure typically provided by public companies pursuant Regulation S-K.

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[9]In addition to requests made prior to the Petition, Senators Christopher Dodd and Jack Reed sent a letter dated December 6, 2007 to the Chairman of the SEC, Christopher Cox, wherein they expressed their belief that the SEC should issue definitive guidance in the form of an interpretative release.

As reporting companies determine how best to provide relevant disclosure about how they may be affected by climate change issues, it remains to be seen if the resulting information will flow to the voluntary side, essentially creating a privatized approach to disclosure, or whether the SEC will step forward to create a framework for climate risk disclosure under the disclosure principals already embedded in the federal securities law, or perhaps a hybrid of the two approaches will emerge to bridge the differences between the two different dynamics. During that transitional period, corporations will want to make sure that their disclosures concerning climate risk in SEC filings are consistent with the voluntary disclosures they make to the public.

Carbon regulation, which is the issue at the heart of a number of the disclosure items called for by the Petition and the Xcel agreement, is a political matter. Both Presidential candidates and Democratic congressional leadership have promised legislation regulating GHG emissions in 2009, but that was before the economy was hammered by the global financial crisis. Politicians may find themselves hard-pressed to add additional financial burdens on corporate America and on consumers, particularly by imposing significant regulatory costs on GHG emissions that will ripple through America's energy-intensive economy. While it may be a matter of when, not if, federal carbon regulation is put into place, current economic circumstances add more uncertainty to the analytical framework that reporting companies will need to use in considering their federal securities law disclosure obligations.

V. For Further Reading

This paper focused on recent developments regarding disclosure of climate change risks in SEC filings by public companies. There are numerous ancillary issues that touch, directly or indirectly, on corporate disclosure practice, and I point out the following as examples of sources for additional information, discussion and analysis of those issues.

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- The Newsletter of the Environmental Disclosure Committee of the American Bar Association Section of Environment, Energy, and Resources, *available at* http://abanet.org/environ/committees/environdisclosures/newsletter/, has timely articles about the issues.

- The "resources" section of the Tackling Global Warming.com website, *available at* http://www.tacklingglobalwarming.com/areas/resources.html, has links to numerous articles, memos, blogs and law firm newsletters covering climate change and global warming topics.

- As mentioned earlier in this paper, there is a wealth of information in the 2007 Request for Interpretive Guidance on Climate Risk Disclosure, *available at* http://www.sed.gov/rules/petitions/2007/petn4-547.pdf, and the June 2008 supplement thereto, *available at* http://www.sec.gov/rules/petitions/2008/petn4-547.supp.pdf.

- Three articles published in 2008 also provide insightful analysis of various issues arising out of corporate disclosure practices:

  - Mounteer, Tom, Kevin Welsh, Michael Lukens, and Jeff Allmon, "Disclosing Effects of Climate Change in Energy, Financial Companies' 10-Ks." EHS Strategies: The Business Impacts of Climate Change, (BNA) May 2008: Vol. 2008, No. 3

  - Smith, Jeffrey A., Matthew Morreale, and Michael E. Mariani. "Climate Change Disclosure: Moving Towards a Brave New World." Capital Markets Law Journal, August 19, 2008

  - Siros, Steven and Michael Strong. "Environmental Disclosures: What Risks Lie Unseen Beneath the Surface?" Bloomberg Corporate Law Journal, Vol. 3:338 (2008).

- This paper has not addressed accounting issues, such as contingent liabilities, that may arise under generally accepted accounting principles and SEC Regulation S-X. For more information on environmental accounting and related disclosure issues, see Greg Rogers' book, *Financial Reporting of Environmental Liabilities and Risks after Sarbanes-Oxley* (Wiley, 2005). Also, regular updates of those issues are available on a list serve from Advanced Environmental Dimensions, LLC. You may subscribe to that list serve at www.advancedenvironmentaldimensions.com/list_sign-up.htm.

This paper was prepared in October 2008 as a general discussion of the issues presented and is not to serve as, or to be relied upon as, legal advice. The views expressed in the paper are those of the author, and not of the author's firm or its clients.