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ABA Section of Environment, Energy and Resources

Environmental Disclosure Committee Newsletter

Vol. 8, No. 1 March 2011

MESSAGE FROM THE CHAIR

Scott Deatherage

Environmental issues have become a focus of the press and politics through the Gulf of Mexico oil spill, mid-term elections, and climate change legislative and regulatory developments at the state and federal level. The offshore oil spill may raise issues of disclosure with new regulations for offshore oil and gas companies and service companies. Mining companies face new disclosure obligations regarding safety issues through the financial reform legislation. Climate change legislation did not pass the Senate, but the Environmental Protection Agency has moved forward with issuing regulations under the federal Clean Air Act. California is moving ahead with a state program, and New Mexico has adopted a cap-and-trade program. The elections may result in some pull back of some of these developments, but significant uncertainty exists as to how climate change and greenhouse gas regulations will develop at the state, federal, and even international level.

We have the good fortune to have excellent articles to publish in our Newsletter. The first article discusses growing demands from stakeholders for disclosure regarding supply chain and product sustainability. How products are developed and produced and what carbon footprint and other environmental impacts they may have are the source of this disclosure pressure. Some of these pressures are market based, such as Walmart's sustainability requirements for its suppliers. This area of disclosure may see significant growth over the coming years.

The second article reviews the Securities and Exchange Commission's (SEC) guidance document on climate risk disclosure that was issued in 2010. The article reviews the issues that the SEC has identified that companies should consider in preparing disclosures under existing SEC rules relevant to environmental disclosure. The SEC guidance is important for companies with significant greenhouse gas emissions or those who may be impacted by climate change to consider in developing their SEC filings.

The third article provides some interesting analysis of climate risk disclosure following the SEC's issuance of its guidance on the topic. The author observes that companies may be disclosing less as many perceive that the ability to evaluate and make disclosure on several of the topics identified as climate risks may be too speculative. Thus, companies may be disclosing less on the issue as a result of the inability to predict with any certainty the impact on their companies. This is a very interesting observation and worth consideration by companies and practitioners.

The last discusses the request by the Carbon Disclosure Project for companies to disclose information about water management and governance, risks and opportunities, and water accounting. It will be interesting to see how companies respond to these inquiries on their "water footprint."

Environmental Disclosure Committee Newsletter
Vol. 8, No. 1, March 2011
Kevin J. Klesh, Editor

In this issue:

AMERICAN BAR ASSOCIATION
Section of Environment, Energy, and Resources

CALL FOR NOMINATIONS

The Section invites nominations for three awards:

The Environment, Energy, and Resources Government Attorney of the Year Award will recognize exceptional achievement by federal, state, tribal, or local government attorneys who have worked or are working in the field of environment, energy, or natural resources and are esteemed by their peers and viewed as having consistently achieved distinction in an exemplary way. The award will be for sustained career achievement, not simply individual projects or recent accomplishments. Nominees are likely to be currently serving, or recently retired, career attorneys for federal, state, tribal, or local governmental entities.

The Law Student Environment, Energy, and Resources Program of the Year Award will recognize the best student-organized educational program or public service project of the year addressing issues in the field of environmental, energy, or natural resources law. Nominees are likely to be law student societies, groups, or committees focused on these three areas of law.

The State or Local Bar Environment, Energy, and Resources Program of the Year Award will recognize the best CLE program or public service project of the year focused on issues in the field of environmental, energy, or natural resources law. Nominees are likely to be state or local bar sections or committees focused on these practice areas.

Nominations for all three awards are due at the ABA Section office by May 16, 2011. The awards will be presented at the ABA Annual Meeting in Toronto in August 2011. Award recipients should plan to be present at the award presentation.

For more information, visit www.abanet.org/environ/sectaward/

ENTERING THE NEXT ERA: NEW DEMANDS AND FRAMEWORKS FOR PRODUCT AND SUPPLY CHAIN SUSTAINABILITY DISCLOSURE

Michael Berg

Consumers, corporate purchasers, investors, lenders, private equity, activist organizations, employees, and regulators are increasingly requesting that companies report on environmental and broader sustainability performance.

In the 2000s, the first wave of mainstream corporate sustainability disclosure greatly emphasized the reporting of carbon emissions from operations known as Scope 1 (direct emissions) and Scope 2 (emissions from purchase of electricity for operations). We are now entering a new era of disclosure and transparency in which companies and their suppliers will begin to report with greater specificity and rigor on upstream and downstream environmental and social responsibility metrics from across the value chain and the entire life cycle of products and services sold, known as Scope 3.

Two recent developments are watershed moments:

1. In July 2009, Walmart announced its plan to provide sustainability labeling on all products within five years. The announcement of Walmart's Sustainability Index for products was referred to by the *Harvard Business Review* as "Wal-Mart's environmental game changer."
2. Additionally, in November 2009, the Greenhouse Gas Protocols—the internationally recognized standard for carbon accounting—released draft standards for reporting on products and Scope 3 carbon accounting, the scope in which supply chain emissions are measured and accounted for.

New Demands for Product and Supply Chain Transparency

Walmart is not alone in requesting sustainability performance data from its suppliers. Safeway, Disney, and Best Buy have recently partnered with Walmart to measure the sustainability attributes of their suppliers' products. Over 50 leading corporations including Dell, Google, IBM, Johnson & Johnson, and Pepsi have requested information from suppliers on their carbon performance through a disclosure initiative backed by investors representing US$64 trillion in assets.

So why do these leading companies care? They care because supply chain is a major component of total sustainability performance. For example, supply chain carbon emissions (Scope 3 emissions) typically outweigh operational carbon emissions (Scopes 1 and 2 emissions) combined. Thus, the public is holding companies accountable for the environmental and social impacts from their supply chains.

Ultimately, Walmart's desire to collect and report on the environmental performance of its supply chain and the products sold in its stores is correlated to the following opportunities:

- Improvement of total environmental stewardship (which includes its suppliers)
- Identification of most efficient suppliers to maintain positioning as a low-cost leader
- Provision of value to consumers who now consider sustainability to be a quality issue alongside price when selecting goods and services
- Understanding and management of environmental externalities to support long-term strategic planning, and
- Evolvement of brand and operations to reflect a changing socioeconomic landscape

Walmart's more than 100,000 suppliers can benefit from internalizing these above opportunities as well. As such, many Walmart suppliers (both small and large) are beginning to request environmental performance data from *their* suppliers, creating a "domino effect."

Investors—including private equity—are also seeking increased transparency on product and supply chain sustainability performance to (1) reduce environmental and social risk in their portfolios, and (2) identify the companies with the best overall management and governance structures.

Increased Specificity and Rigor to Product and Supply Chain Reporting

A result of the growing demand for product and supply chain reporting is the emergence of new reporting standards and frameworks. While these standards and frameworks are in varied stages of development, there is momentum toward increased specificity and rigor in the requirements that will be placed on companies. So what are some of the important emerging frameworks for product and supply chain reporting?

The GHG Protocols

The Greenhouse Gas (GHG) Protocols are a series of internationally recognized standards for carbon accounting. Established in 1998 by the World Resources Institute and the World Business Council for Sustainable Development, the GHG Protocols are often referenced as a leading standard by voluntary carbon registries and regulatory frameworks for carbon disclosure.

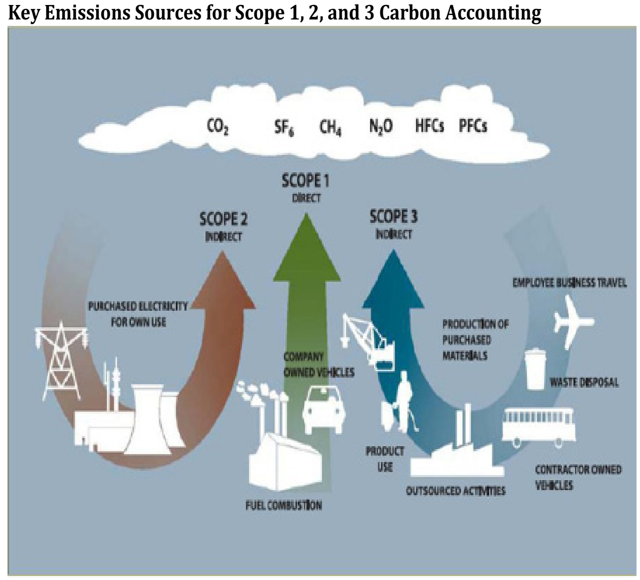
Supply chain reporting within the GHG Protocols has historically been optional, limited in definition, and subsequently underreported. The new GHG Scope 3 protocols are designed to address largely unreported corporate Scope 3 emissions, which typically outweigh Scopes 1 and 2 combined.

The new Scope 3 (a catchall category for enterprise carbon accounting which includes supply chain) and product standards (to measure emissions from the entire product life cycle) will be an enhancement to the existing GHG Protocols' Corporate Standards.

Per the new guidance, companies are expected to report on the "largest Scope 3 sources that collectively account for <u>at least 80% of total anticipated Scope 3 emissions</u>." Key examples of Scope 3 emission sources are (1) production of purchased materials, (2) product use, (3) outsourced activities, (4) employee business travel, (5) waste disposal, and (6) contractor-owned vehicles. These key Scope 3 emission sources are illustrated in figure 1.

FIGURE 1

Key Emissions Sources for Scope 1, 2, and 3 Carbon Accounting



<u>Source</u>: Scope 3 Accounting and Reporting Standard (Draft), The GHG Protocols, 2009.

Both the new Scope 3 and product standards request that organizations map their emissions across their value chains, and provide resources to guide organizations with reporting. The product life cycle is an important part of the analysis for product and supply chain reporting within the new GHG Protocols standards. Essentially, the product life cycle encompasses the following stages: (1) sourcing, (2) manufacturing, (3) distribution, (4) use, and (5) end of life.

Within these product life cycles, the new GHG Protocol standard for products will require companies to familiarize themselves with new concepts and terminologies, such as "functional units," "reference flow," "foreground processes," "background processes," "process subdivision," "direct system expansion," "temporal representativeness," and "geographical representativeness."

Carbon Disclosure Project and Global Reporting Initiative

Two leading reporting frameworks—the Global Reporting Initiative and the Carbon Disclosure Project—also provide opportunity to report on product and supply chain impacts.

The Global Reporting Initiative (GRI), often referred to as the "de facto" standard for sustainability reporting, has a category devoted to product responsibility. Additionally, product and supply chain impacts can be communicated to investors, corporate purchasers, and other key stakeholders from within the 79 GRI performance indicators and through the GRI's standard profile disclosures. The GRI also regularly brings multi-stakeholder groups together to create "sector supplements," which address specific reporting issues for sectors such as oil and gas, automotive, mining and metals, and food processing. Additionally, the GRI has a working group and other resources related to supply chain reporting.

The Carbon Disclosure Project (CDP), which represents US$64 trillion in investor capital and has been endorsed by Walmart, has a supply chain disclosure program in which information on supplier carbon emissions is requested annually on behalf of leading companies. Each year, the CDP releases a report which publicly assesses both the level of and quality of disclosure among suppliers.

The Sustainability Consortium

While the Sustainability Consortium has yet to release clear standards on broader product sustainability reporting, the Sustainability Consortium is an important entity, due to its partnership with Walmart to develop its Sustainability Index for products. However, the scope of the Sustainability Consortium is larger even than Walmart. Its members include dozens of large corporate purchasers including BASF, Best Buy, Cargill, Disney, and Safeway. Established in 2009, the Sustainability Consortium's goal is to serve as an independent, global multi-stakeholder group that will "build a scientific foundation that drives innovation to improve consumer product sustainability through all stages of a product's life cycle." A key mandate is to create rules and standards on (1) what data to collect, (2) how to collect it, and (3) how it should be reported.

Product Certification Standards

In addition to the CDP and the GRI, there are more than 800 product certifications estimated to exist. Many of these certifications have reporting requirements. The large quantity of and varying credibility among certifications is confusing both to consumers and companies. Additionally, many of the certifications only address certain sectors. Some certifications only address discrete sustainability issues, such as those related to carbon or labor practices. A new initiative entitled People4Earth seeks to address the current confusion by creating open-source foundational standards to complement existing standards based on the four pillars given in figure 2.

FIGURE 2

Proposed Product Reporting Pillar	**Selected Attributes**
Pure	▪ Healthy and safe products ▪ Authenticity ▪ Transparency
Fair	▪ Workers' rights ▪ Education and personal development ▪ Fair price and value
Life	▪ Biodiversity ▪ Animal welfare ▪ Ecological product quality
Renew	▪ Energy and greenhouse gas conservation ▪ Waste reduction ▪ Clean air ▪ Clean water ▪ Clean soil

<u>Source:</u> Allen L. White, "Consumption, Commerce and Citizenship: Values Transformation to Build a Sustainable World," People4Earth, 2009.

Other International Standards

The International Organization for Standards (ISO) also addresses product life-cycle analysis within its ISO 14000 environmental management standards. In the United Kingdom, the PAS 2050 standards began development in 2007 to provide a method for measuring the embodied greenhouse gas emissions from goods and services.

In summary, clear reporting standards and frameworks exist to report on environmental performance at the corporate level, such as the Global Reporting Initiative), the Greenhouse Gas Protocols' Corporate Standards, the Carbon Disclosure Project, and the Climate Registry. Product and supply chain standards will continue to develop and are projected to become more consistent and integrated.

What Risks Do Non-Reporters Face?

Voluntary environmental disclosure from the lens of sustainability is now a mainstream practice. A recent study from the Social Investment Research Analyst Network, which includes 220 members from 35 firms, found that 93 percent of S&P 100 companies provide some form of reporting on sustainability policies and performance on their Web sites. *See* Social Investment Research Analyst Network, S&P 100 Sustainability Reporting Comparison, 2010 (citing 2008 reporting data). Additionally, many companies have begun to make "green" and "sustainable" claims related to products, services, and operations.

Companies who do not appropriately communicate on their environmental performance and impacts (both positive and negative) face a series of potential legal, financial, and reputational risks (*see* figure 3), which, for example, include the following:

Legal Risks

Federal regulators are increasingly monitoring the quality of corporate claims related to environmental performance. The U.S. Environmental Protection Agency (EPA) recently targeted a popular apparel company for making false environmental claims. The potential fine from EPA: approximately $1 million. Press Release, U.S. Environmental Protection Agency, "The North Face" Clothing Parent Company Facing Nearly $1M in Federal Fines Following Unsubstantiated Product Claims (Sept. 29, 2009). The Federal Trade Commission (FTC) also recently brought charges against a large U.S. retailer for making false environmental claims. The FTC affirmed its increased commitment to rigorous oversight in 2009 House testimony, stating that the agency will "continue its efforts to ensure that environmental marketing is truthful, substantiated, and not confusing to consumers." Press Release, Federal Trade Commission, FTC Announces Actions Against Kmart, Tender and Dyna-E Alleging Deceptive "Biodegradable" Claims (June 9, 2009).

Additionally, the U.S. Securities and Exchange Commission (SEC) voted in January 2010 to provide public companies with interpretive guidance on existing disclosure requirements as they apply to climate

FIGURE 3

Legal Risks	▪ Increased regulatory interest from U.S. SEC, EPA, FTC, and Congress ▪ Increased litigation related to climate change ▪ Potential director and officer liability
Financial Risks	▪ Reduced access to capital from customers, investors, lenders, and private equity ▪ Inability to quantify environmental expenses, and the avoided costs from efficiency improvements ▪ Reduced value of tangible and intangible assets ▪ Limited ability to understand externalities for strategic planning
Reputational Risks	▪ Diminished brand and reputation ▪ Weakened relationships with employees, customers, and business partners ▪ Stakeholder ability to question company's "license to operate" in communities

change. Press Release, Securities and Exchange Commission, SEC Issues Interpretive Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change (Jan. 27, 2010). Specifically, the SEC's interpretative guidance highlights the following areas as examples of where climate change (including water issues) may trigger disclosure requirements: (1) regulatory and legal impacts, (2) business impacts, and (3) physical impacts. A company's supply chain and product life cycle are often relevant to all disclosure categories within the SEC guidance.

ACE Insurance, a provider of D&O insurance, released in 2009 a white paper on potential director and officer liability related to climate change. The ACE white paper concluded that "where management disclosure duties exist, liability exposure for directors and officers exists as well." ACE Insurance, Climate Change Is Heating Up D&O Liability (2009). Additionally, the ACE white paper noted that:

> Climate-change-related litigation against companies has already started, and several settlements have already set unprecedented and high standards for detailed management disclosure and analysis under existing laws . . . The question is no longer *whether* there will be actions arising out of how a company and its leadership assess, quantify, and disclose climate change risks, but rather . . . *when* it will be lodged against directors and officers.

Id.

Financial Risks

The most immediate financial risk is reduced access to capital from financiers and corporate customers. There has been a proliferation of mainstream investor interest in environmental and social performance led by Goldman Sachs, Bloomberg, and several of the nation's largest pension funds. Additionally, many companies and government agencies have established environmentally preferable purchasing (EPP) programs, under which these buyers assess the environmental policies and performance of potential suppliers. Notably, Walmart has asked more than 100,000 of its suppliers whether they have established sustainability purchasing guidelines for *their* suppliers. *See* Walmart's Supplier Sustainability Assessment, retrieved at http://walmartstores.com/download/4055.pdf, Apr. 18, 2010.

There is also the opportunity cost of missed bottom-line cost savings and unrealized efficiencies for firms that do not measure and manage their environmental performance.

Reputational Risks

If a company or client does not report on sustainability performance, a perception may be created that:

1. the company or client is not organized to proactively address these issues;
2. the company or client does not care that these issues are important to its major customers and financiers; and
3. the company or client does not have strong management and governance systems in place.

These perceptions are compounded by the numerous public venues, such as the Good Guide and the Newsweek Greenest U.S. Companies rankings, in which sustainability performance is evaluated and compared to competitors. For companies that do not report on sustainability, the rankings and ratings providers often assign values based on their own estimates, normally to the detriment of subject companies. Additionally, companies that do not report in accordance with leading sustainability frameworks often find themselves subject to negative publicity and targeted activism from investors, nongovernmental organizations, and other societal influencers.

How Should Companies Navigate These Disclosure Issues?

There is a learning curve to measuring, analyzing, and reporting on sustainability performance. At present, the practice is largely voluntary and still evolving. However, the weight of the legal, financial, and reputational risks supports the notion that organizations should take some form of action to prepare for disclosure. Smart organizations will execute strategically to maximize the return on investment from their efforts.

In preparation for disclosure, organizations often benefit from taking a tempered approach with incremental steps. It is helpful to at least get a stake in the ground. Otherwise, organizations may find themselves continuously lagging "behind the curve" and investing time and resources to catch up while new local, state, and national standards emerge and as industry peers capture a competitive advantage.

Demands and standards related to operational and supply chain reporting continue to evolve. So how should companies navigate the changing market and regulatory landscape? The following steps are suggested:

1. Develop an informed strategy
2. Measure and report credibly and consistently
3. Monitor performance and engage for added benefit

1. Develop an informed strategy

Know the landscape: The following are some key questions for companies to consider: What is our exposure to product and supply chain sustainability issues? Which customers and investors are focused on these issues? What type of environmental and social performance data is most important to them? What are the standards and frameworks that are most applicable to our organization? What are our specific legal, financial, and reputational risks?

Look inward: Internally, it is helpful to know the following: What type of data is currently collected? What information technology systems currently exist? What individuals within the organization should be engaged? How do these disclosure requirements align to our core business goals?

Define an informed approach and proceed accordingly: Once you have developed an understanding of your organization's specific external pressures and internal capabilities, your management team will be empowered to proceed with an informed, realistic, and results-oriented strategy.

2. Measure and report credibly and consistently

Beware of the "Catch 22 of disclosure": Organizations face the following Catch 22: If they do not report, they will be penalized. However, if they report but do not report correctly, they are also exposed to risk and penalties. Thus, it is important for organizations to be certain that they are providing the correct level of transparency, accuracy, and adherence to reporting standards and best practice for their industry. Additionally, due diligence processes should both be implemented and documented.

Understand your audiences: There is a granularity to the internal and external audiences for sustainability reporting. As such, effective reporting will consider the varying perspectives and needs of distinct audiences. While the information that is reported should be consistent across all communications, organizations should understand who their audiences are to enable value-added reporting and communications.

3. Monitor performance and engage for added benefit

Maintain broad awareness: The market and regulatory landscape for sustainability is rapidly changing daily. Organizations should develop the right teams to monitor risks, opportunities, best practices, and changes to competitive positioning. Additionally, organizations should approach disclosure from the broader lens of core business goals to develop effective strategies.

Reap disclosure rewards: Companies who execute based on sound strategic principles—rather than applying a baseline compliance approach—will reap the rewards of disclosure. The most immediate rewards are cost savings, increased efficiency, reduced legal and reputational risk, retention of revenue and working capital, and increased employee productivity. Engagement with key internal and external audiences is essential to reap these rewards of disclosure.

Conclusion: How Can Companies Turn Risk into Opportunity?

Companies that collect and report information on key sustainability metrics will begin to capitalize on the following adages: “What gets measured gets managed” and “With knowledge comes power.”

The synergistic benefits of quantifying your environmental impacts include the centralization of enterprise-wide data; advancement of top-line and bottom-line strategies through the disclosure process; and the opportunity to use reporting as a means to engage with and strengthen your positioning among key audiences, such as investors, customers, and other business partners.

Thus, collection and management of data are essential to develop enhanced strategies, enable informed decision making, and create opportunities for top-line and bottom-line growth.

Corporate sustainability is a mainstream but not yet mature discipline. Opportunities exist for companies of all sizes and in all sectors to innovate, advance the field of sustainability, and create lasting reputational value and market differentiation.

Michael Berg *works with law firms and companies to intelligently respond to market and regulatory requirements for increased disclosure on corporate sustainability. He has advised industry leaders across sectors on leading-edge sustainability initiatives, and is an author of the forthcoming book,* MANAGING CLIMATE CHANGE: A GUIDE TO VOLUNTARY AND REQUIRED ACTIONS. *Berg is a graduate of the University of Texas School of Law. He can be reached at berg@bergandassoc.com.*

40th Annual Conference on Environmental Law

March 17-19, 2011
Salt Lake City

This year we celebrate 40 years! This conference continues to be one of the most important educational and professional gatherings available for environmental law practitioners including academics, nonprofit lawyers, in-house counsel, and government lawyers. The conference, formerly residing in Keystone, has grown over the years into three days of cutting-edge plenary and breakout sessions, packed with keynote speakers, expert panels, and an abundance of networking opportunities. But don’t worry— we are still near the fabulous ski hills around Salt Lake City, Utah! Along with these outstanding sessions, meeting highlights include networking opportunities, public service activities, and a ruby red anniversary celebration of the 40th anniversary of the Annual Conference on Environmental Law.

Important Deadlines:

- Law Student Scholarship Opportunity Deadline: Tuesday, February 8, 2011
- Tuition Assistance Deadline: Tuesday, February 8, 2011
- Early Bird Deadline: Thursday, February 17, 2011
- Housing Deadline: Tuesday, February 22, 2011

For a complete schedule of events, CLE descriptions, online registration, and further program details, please visit

www.abanet.org/environ/envlaw/

ENHANCING CLIMATE CHANGE DISCLOSURES AFTER THE SEC ISSUES CLIMATE CHANGE DISCLOSURE GUIDANCE

Stephen J. Humes and Shawn S. Smith

With the U.S. Securities and Exchange Commission (SEC) issuing official guidance on applying existing disclosure requirements to climate change matters in February 2010, publicly traded companies have yet another reason to consider carefully whether their public filings contain adequate disclosures about the degree to which operations contribute to climate change and the risks associated therewith. *See* SEC Interpretive Release No. 33-9106, Commission Guidance Regarding Disclosure Related to Climate Change (Feb. 2, 2010). The SEC's guidance document, the issuance of which coincided with the U.S. Environmental Protection Agency's (EPA) recent regulations addressing the emission of carbon dioxide and greenhouse gases (GHGs), strongly suggests that public companies (in particular large emitters of GHGs) can expect greater scrutiny of environmental disclosure statements provided in public filings issued in connection with securities offerings or transactions. Furthermore, companies should consider frequently reevaluating their disclosure obligations associated with climate change given the rapidly changing GHG regulatory landscape.

Although federal regulators have only recently begun to address GHG emissions and the risks of climate change, the influence of international actions, and state and local governments, as well as socially responsible investor groups, have long since impacted public companies' disclosure of the risks associated with climate change. First, international actions taken to address climate change such as the Kyoto Protocol and the European Union Emissions Trading System (EU ETS), an international cap-and-trade system, remain a source of potential disclosure. For instance, if a company is likely to be affected by the EU ETS, that company should consider the risks and opportunities under the cap-and-trade system in its disclosures.

In addition, a number of states and regions have begun to address climate change on the local and regional levels. For example, the Regional Greenhouse Gas Initiative (RGGI), consisting of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, New Jersey, Rhode Island, and Vermont (with Pennsylvania observing) represents a regional effort among coordinating states to address the climate change issue. These state and local initiatives also may trigger disclosure obligations for public companies.

For many years, environmental and socially responsible investor groups have been advocating for public companies to make enhanced SEC disclosures relating to the risks and opportunities posed by climate change. The Investor Network on Climate Risk reported that in 2009 there were sixty-eight shareholder resolutions in the United States and Canada seeking disclosure from public companies on the financial exposure and need for response strategies regarding climate change. *See* Climate Resolutions Toolkit-2009, *available at* http://www.incr.com/Page.aspx?pid=1220. Of the sixty-eight shareholder resolutions, thirty-one were withdrawn after the companies agreed to modifications relating to climate change disclosures. Significantly, in 2010 shareholders filed a record 101 climate and energy-related resolutions. *See* Investors Achieve Record Results on Climate Change, July 7, 2010 *available at* http://www.incr.com/Page.aspx?pid=1262. Furthermore, 51 resolutions in 2010 were withdrawn after the companies agreed to constructive changes in policies affecting climate change. For instance, Procter & Gamble agreed to disclose the percentage of sustainably sourced palm oil secured annually in part because palm oil production is a significant contributor of GHG emissions. In addition, a majority of shareholders for Massey Energy voted in favor of a measure filed by New York City's Comptroller's Office demanding an adoption of quantitative goals for reducing GHG emissions. In 2010, resolutions were also filed by a diverse group of shareholders, such as state and city pension funds, foundations, and religious and labor shareholders. As the executive director of Interfaith Center on Corporate Responsibility noted, "The robust response from such a wide spectrum of investors is gratifying as it acknowledges the growing urgency to address the role corporate decisions play in alleviating climate change." Thus, even absent clear guidance from the SEC, shareholders have enjoyed increasing success in pressuring companies to fully disclose the risks associated with climate change.

In addition to shareholders, the New York State Attorney General's Office has also persistently attempted to promote greater disclosure of climate change risk by utilizing state law. On September 17, 2007, the attorney general issued subpoenas under the state's Martin Act to evaluate whether risks associated with climate change were appropriately disclosed for new construction of coal-fired power plants. Recipients of the subpoenas were the chief executive officers of AES Corp., Dominion Resources, Inc., Dynegy Inc., Peabody Energy, and Xcel Energy. The transmittal provided that

> [A] public company must disclose information material to a shareholder's investment decision. We are concerned that [the company] has failed to disclose material information about the increased climate risks [the company's] business faces. In its 2006 Form 10-K, [the company] made no disclosure of projected CO_2 emissions from its power plants. Further, [the company] did not attempt to evaluate or quantify the possible effects of future greenhouse gas regulations, or discuss their impact on the company. These omissions make it difficult for investors to make informed decisions.

Since issuing the subpoenas, the attorney general has entered into settlement agreements with three of the five companies: Xcel Energy and Dynegy in 2008 and AES most recently in 2009. *See* Attorney General Cuomo Announces Agreement with AES to Disclose Climate Change Risks to Investors, Nov. 19, 2009, *available at* http://www.ag.ny.gov/media_center/2009/nov/nov19a_09.html. All three settlements require the companies to disclose their analyses of material financial risks associated with climate change. In addition, AES was required to disclose its analysis of strategies to manage climate risk and GHG emissions. The attorney general's inquiries into Dominion Resources and Peabody Energy remain ongoing.

An increasingly sizable number of companies have also voluntarily disclosed climate change risks. In response to the Carbon Disclosure Project's survey of 500 of the world's largest corporations, 409 companies reported GHG emissions data in 2009. *See* 2009 Annual Report, ENV. DISCLOSURE 64 (2009). As a result of organizations such as ASTM International (ASTM), a voluntary standards organization, voluntary reporting of climate change risk also has become more reliable. ASTM published a guide for financial disclosure of climate change risk in March 2010. *See* STANDARD GUIDE FOR FINANCIAL DISCLOSURES ATTRIBUTED TO CLIMATE CHANGE (E2718-10). The standard identifies circumstances that might be subject to disclosure as a result of potential financial impacts related to climate change, such as enforcement of laws or regulations, changes or trends in resource costs or availability, physical costs, and potential litigation. ASTM's guide mirrors the guidance provided by the SEC, discussed below. Furthermore, the accounting and insurance industries, both of which have already been affected by the risks associated with climate change, have taken action with regard to climate change disclosure. For instance, the Climate Disclosure Standards Board, which represents the big four accounting firms, circulated a draft framework requesting disclosure of GHG emissions and the risk of climate change in financial reports. *See* CLIMATE DISCLOSURE STANDARDS BOARD REPORTING FRAMEWORK EXPOSURE DRAFT, *available at* http://www.cdsb-global.org/reporting-framework/. The National Association of Insurance Companies (NAIC) adopted a resolution requiring that all insurance companies with annual premiums of $300 million or more in 2010 and $500 million or morein subsequent years complete an Insurer Climate Risk Discovery Survey annually. *See* NAIC INSURER CLIMATE RISK DISCLOSURE SURVEY, *available at* http://naic.org/documents/committees_ex_climate_climate_risk_disclosure_survey.pdf. The NAIC subsequently adopted a revised version of the survey specifying that the requirement for completing the survey is at the discretion of each state, and that survey responses are confidential. *Id.*

The U.S. Supreme Court, in the landmark 2007 decision *Massachusetts v. EPA*, spurred long-awaited federal regulatory action concerning GHG emissions. In *Massachusetts v. EPA*, the U.S. Supreme Court held that carbon dioxide and other GHGs are "air pollutants" under the Clean Air Act (CAA) and, absent new legislation, EPA was required to regulate them under the CAA. *Massachusetts v. EPA*, 549 U.S. 497 (2007). Specifically, the Court indicated that EPA has to treat GHGs as pollutants under the Clean Air Act unless EPA can issue endangerment findings that GHGs are not harmful to human health and the environment.

In response to *Massachusetts v. EPA*, EPA Administrator Lisa Jackson signed two separate findings regarding GHGs in December 2009. First, EPA found that GHGs threaten the public health and welfare. Second, EPA found that GHG emissions from new motor vehicles and new motor vehicle engines contribute to the GHG pollution that threatens public health and welfare. *See* Press Release, U.S. Environmental Protection Agency, Greenhouse Gases Threaten Public Health and the Environment (Dec. 7, 2009). For the first time, EPA also began requiring large emitters of GHGs to collect and report GHG emissions data effective January 1, 2010. *See* Mandatory Reporting of Greenhouse Gases, 74 Fed. Reg. 56,260 (Oct. 30, 2009). EPA next issued the final GHG Tailoring Rule on May 13, 2010, a "common sense approach" to regulating GHG emissions from stationary sources under the CAA. The Tailoring Rule "tailors" which facilities are required to obtain permits for GHG emissions. In doing so, the Tailoring Rule establishes a schedule that will initially focus the CAA permitting programs on the largest emitters of GHGs, beginning January 2, 2011. *See* Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule, 40 C.F.R. pts. 51, 52, 70, and 71 (May 13, 2010). These sources, including power plants, industrial boilers, and oil refineries, are responsible for approximately 70 percent of the GHGs from stationary sources. *See* SUMMARY OF CLEAN AIR ACT PERMITTING BURDENS WITH AND WITHOUT THE TAILORING RULE, *available at* http://www.epa.gov/NSR/actions.html. Beginning in 2011, these facilities will have to account for their GHG emissions in obtaining CAA permits if they increase their carbon dioxide emissions by 75,000 tons per year. In the next phase, beginning on July 1, 2011, the permitting requirements will cover new facilities with GHG emissions of at least 100,000 tons a year. Furthermore, modifications at an existing facility that increase GHG emissions by at least 75,000 per year are also covered by this phase.

EPA most recently unveiled two proposed rules to further prepare for the regulation of GHGs, which fill certain regulatory gaps as the GHG Tailoring Rule takes effect. The first proposal requires 13 states to make changes to their EPA-approved state implementation plans (SIP) to ensure that GHG emissions are covered. *See* Action to Ensure Authority to Issue Permits Under the Prevention of Significant Deterioration Program to Sources of Greenhouse Gas Emissions: Finding of Substantial Inadequacy and SIP Call, 40 C.F.R. pt. 52 (Aug. 12, 2010). Other states are also required to review their existing SIPs and inform EPA if their programs do not address GHG emissions. In addition, the second proposal sets forth a federal implementation plan (FIP) to allow EPA to issue permits for large GHG emitters located in states that may not be able to develop and submit revisions to their plans before the Tailoring Rule becomes effective in 2011. Furthermore, EPA is expediting its rulemaking process to ensure these two new rules are finalized before the January 2, 2011, effective date for the GHG Tailoring Rule. For large emitters of GHGs—particularly those located or conducting business in the thirteen states with deficient SIP plans and potentially affected by the FIP—these recent regulatory developments could have a significant effect on their public disclosures.

Energy practitioners and corporate and securities lawyers must also recognize that existing disclosure requirements exist outside of typical environmental or securities regulations. For example, section 1503 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act) creates additional disclosure requirements for any public company that is an operator, or that has a subsidiary that is an operator, of a "coal or other mine." Pub. L. No. 111-203, H.R. 4173 (July 21, 2010). The Financial Reform Act requires companies to file a Form 8-K with the SEC disclosing, among other things, the number of violations of mandatory health or safety standards that could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards resulting in a citation from the Mine Safety and Health Administration (MSHA), the total number of imminent danger orders and flagrant violations issued by the MSHA, and total number of fatalities.

Considering the rapidly evolving regulatory framework as well as the pressure that environmental groups and investors have placed on public companies to provide greater disclosure, the SEC's guidance on how companies should disclose risks associated with climate change appears much needed and well-timed. The guidance does not create new requirements, but instead is intended to clarify "the commission's existing disclosure requirements as they apply to climate change matters." SEC Interpretive Release No. 33-9106, Commission Guidance Regarding Disclosure Related to Climate Change (Feb. 2, 2010) at 3. In discussing the existing disclosure requirements as they apply to climate change matters, the SEC emphasized four items in SEC Regulation S-K:

- **Item 101: Description of Business**. Item 101 requires a public company to describe its business and address its "form of organization, principal products and services, major customers, and competitive conditions." *Id.* at 12. Pursuant thereto, public companies are explicitly required to disclose certain costs of complying with environmental laws. *Id.* at 13.
- **Item 103: Legal Proceedings.** Item 103 requires a public company to "briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party." In addition, a public company must disclose any material pending legal actions in which the company's property is the subject of litigation. Disclosure is also required if a public company's discharge of materials into the environment has resulted in a governmental proceeding and such proceeding will involve monetary sanctions in excess of $100,000. *Id.* at 14.
- **Item 503(c): Risk Factors.** This item requires "a discussion of the most significant factors that make an investment in the registrant speculative." *Id.* at 15.
- **Item 303: Management's Discussion and Analysis.** This item provides a variety of disclosure items in which public companies must address their liquidity, capital resources, and results of operation. In addition, the public company must also disclose "known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance." *Id.* at 15–16.

Based on the foregoing disclosure obligations, the SEC identified four climate change disclosure topics. First, the SEC discussed the impact of legislation and regulation, noting that the possible consequences—both positive and negative—of pending legislation and regulation related to climate change include:

- the costs or profits under a cap-and-trade system;
- costs of compliance with new regulations; and
- "changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold." *Id.* at 24.

The SEC next highlighted the potential impact of international accords, such as the Kyoto Protocol, as discussed previously. Third, the SEC described the indirect consequences or opportunities of regulation or business trends resulting from climate change. *Id.* at 25. Finally, the SEC discussed the risks associated with the physical impacts of climate change. In its discussion, the SEC emphasized that "severe weather can have a devastating effect on the financial condition of affected businesses." *Id.* at 26. As such, "[r]egistrants whose business may be vulnerable to severe weather or climate-related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents." *Id.* at 27. Although the SEC's guidance does not create new obligations or new disclosure requirements, it nevertheless emphasizes for the first time that public companies have an obligation to disclose climate change-related risk.

Given the increasing pressures public companies face on accepting climate change as a problem that cannot be ignored, including recent federal measures to address GHGs and local and regional public policy initiatives, energy and environmental practitioners and corporate and securities lawyers involved with advising major carbon dioxide emitters (or others, such as insurers or commercial real estate interests likely to be impacted by climate change) have to recognize that existing SEC disclosure requirements mandate that climate change not be ignored. The SEC's guidance document provides further reinforcement that prudent companies should seriously consider including complete disclosures in their SEC filings that discuss the potential impact of GHG emissions reduction measures on their businesses, and steps that they are taking to address the issue.

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SEC CLIMATE CHANGE DISCLOSURE COOLING OFF

Tom Karol

In February 2010, the Securities and Exchange Commission (SEC) issued its Commission Guidance Regarding Disclosure Related to Climate Change "to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents to be filed with us and provided to investors." The guidance specifically called for registrants to address the impact of legislation and regulation, as well as the consequences of regulation or business trends from climate change.

This guidance came, in large part, from the efforts of a group of concerned investors who contended that "the financial markets have judged that climate risk is important to investors' ability to assess corporate operations and performance." A recent study by Ceres found that half of all asset managers believe that some sectors have significant exposure to climate risks. Large investment funds like CalSTRS are now requiring their asset managers to have expertise in climate change and other sustainable investment analysis and to adapt their corporate governance voting practices to address climate risks.

In 2009, prior to the guidance, approximately 75,000 annual reports on Form 10-K were filed with the SEC and roughly 800 of those included some reference to climate change or greenhouse gas. This works out to about 1.8 percent of filings referencing climate change in some fashion. Following the guidance in the first three quarters of 2010, approximately 60,000 Form 10-Ks have been filed and roughly 1370 of these filings referenced climate change or greenhouse gas in some fashion, increasing the rate of climate change filings one half of 1 percent to 2.3 percent of filings. The largest increase in climate change disclosure came in the first quarter of 2010, with the SEC guidance, up to a whopping 2.7%. During the rest of 2010, the disclosure seems to have cooled off, with only 1.6 percent of third quarter Form-10Ks including any reference to climate change or greenhouse gas—actually lower than the 1.8 percent reporting rate prior to the guidance.

Looking at month-by-month reporting, there was a spike in the percentage of registrants reporting in February 2010 when the SEC guidance was issued, but a drop immediately thereafter. There was another rise in the summer of 2010, when there was significant enthusiasm for climate change legislation in the Congress, but another sharp drop in the percentage of registrants referencing climate change when it became clear that no climate change bill would go forward. See Chart 1 and 2.

Why has the level of climate change disclosure remained low? We spoke with our clients and outside companies and found that many companies see little upside in reporting on climate change and less downside in making no disclosures. Contrary to the assertions of the SEC and the petitioners for the guidance, the businesses we spoke with saw no real business opportunities from climate change—only risks. Making disclosures on uncertain climate change

Chart 1.

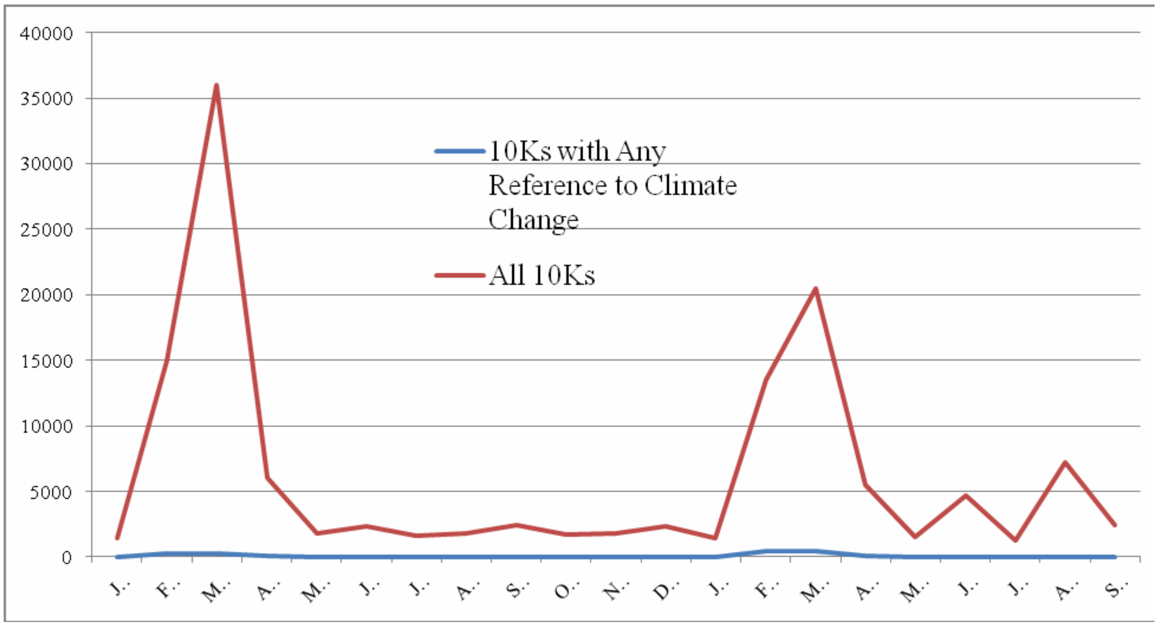
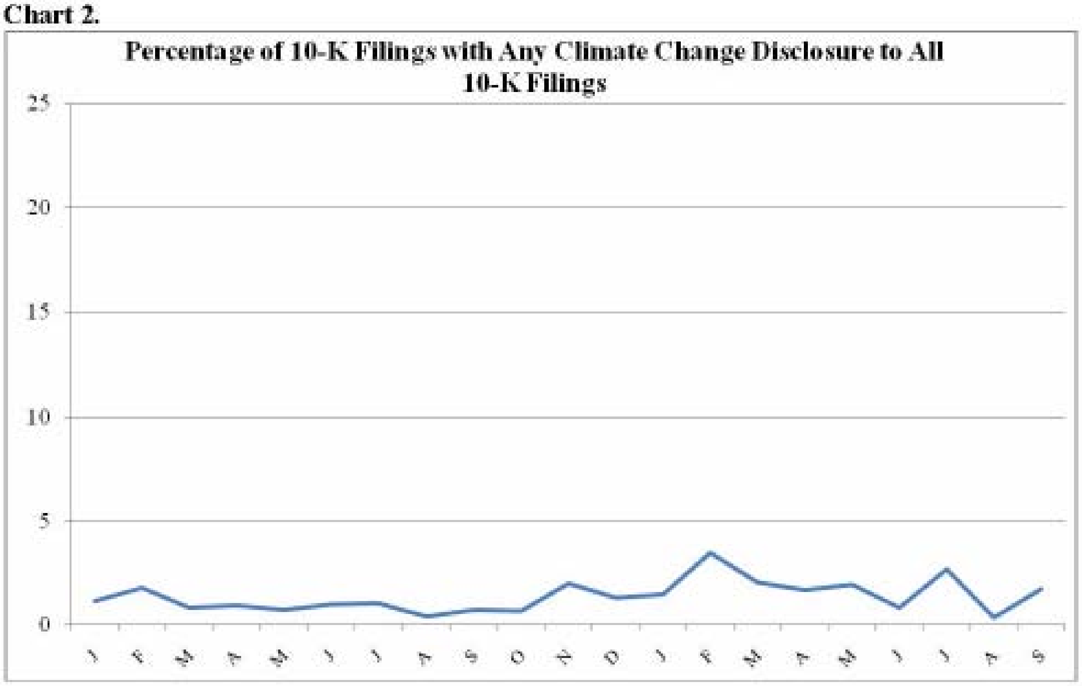


Chart 2.



risks was generally viewed as speculative and not based on any recognized standards or practices.

Investor relations professionals have seen little interest in climate change from the financial community or other constituencies, and financial analysts have generally shown little if any interest in climate change-related issues. Investment advisers don't have standardized tools to evaluate climate change investment issues. Public interest in climate change has waned in 2010 and roughly half of asset managers say that they do not analyze climate risks because no investor clients have asked them to.

The industry understands that there are few, if any, penalties for nondisclosure of climate change matters. No one expects the SEC to pursue any enforcement actions in this area. The SEC reviewers of Forms 10-K have accepted numerous filings without any mention of climate change, even when other companies in the same industry have made such disclosures. In the guidance, the SEC promised a follow-up round table on disclosure regarding climate change matters in the spring of 2010 and related action by the Investor Advisory Committee, but neither has occurred.

On the positive side, we found that most registrants—whether making climate change disclosures or not—are aware of the issue and are undertaking some analysis of the attendant physical, litigation, regulatory, and competitive risks related to climate change. Of these risks, most of the concerns are related to regulatory and competitive risks.

Physical risks attributed to climate change, such as rising temperatures and sea levels in the future, are not presently a direct influence on annual operations or finances of the vast majority of SEC registrants, who generally avoid speculative and uncertain disclosures, including those related to climate change. Like physical risk, the risk of climate change-related litigation is also seen as very uncertain at this time and company officers generally see litigation risk related to climate change as rather low.

We did find that companies are concerned about competitive and regulatory risks from climate change. Concerns over competitive risk were also found in a 2010 survey by Zurich in North America and the Professional Risk Managers' International Association, which found that competitive risk was the greatest concern relating to climate change for risk managers, and that competitive risk either currently existed or was forthcoming in the near future. All risk managers surveyed—even those who did not anticipate their firms being directly affected by regulatory risk—perceived that climate change would pose a competitive risk to their business.

New laws and regulations related to climate change are the other major risk analysis focus of companies we spoke with. The SEC guidance specifically calls for registrants to address the impact of legislation and regulation, as well as the consequences of regulation or business trends from climate change. Our contacts told us that climate change regulation was the greatest risk factor to their business, which was validated by the increases in Chart 2 corresponding to congressional action on the subject. The risk managers in the Zurich survey were clearly most concerned about the regulatory environment—both in general and when asked specifically about climate risks—and the potential direct costs of regulation. Risk managers who did not expect their firms to be affected by regulation nonetheless responded that climate regulation was imminent—further reflecting general awareness of the climate regulatory environment.

Although few companies are making climate change disclosures in SEC filings, our experience has been that the vast majority of SEC registrants are aware of what the SEC guidance requires and have taken some steps to ensure that they are making informed decisions. ASTM International has issued a guidance for companies regarding financial impacts attributed to climate change, ASTM E2718-10 Standard Guide for Financial Disclosures Attributed to Climate Change, which suggests that companies obtain the commercially available information to make an informed decision on whether to disclose climate change issues. Registrants interested in regulatory and competitive analysis of climate change disclosure have been able to review our quarterly reports at www.delraygrp.com to understand the range of information that prudent registrants can consult and retain for their records.

It has been about one year since the SEC guidance was issued, but the level of climate change reporting has not substantially increased. To date, neither the advocates for that reporting, nor the SEC, which directs that reporting, has indicated that they know of or care about this continued low level of reporting. Responsible SEC registrants, however, appear to be keenly aware of the requirement, and appreciative of their responsibilities to shareholders and the markets. Their level of attention to the issue has exceeded the limited growth in actual reporting to date and they remain watchful of developments, particularly on the regulatory front. Prudent companies will be familiar with regulatory proposals and how their competition may be using climate change disclosure, but we do not anticipate any significant growth in the number and quality of climate change disclosures.

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CDP'S WATER DISCLOSURE 2010

E. Lynn Grayson

The Carbon Disclosure Project (CDP) has issued its first water-related information request to 302 of the world's largest companies in sectors that are water intensive or face particular water risks. Since 2003, the CDP has issued carbon and climate change information requests on behalf of investors. With the launch of the CDP Water Disclosure in late 2009, the organization acknowledged that much of the impact of climate change will be manifested through increasingly scarce water resources and that these possible water risks needed to be better understood by investors. *See* http://www.cdproject.net/water-disclosure.

According to the 2009 Ceres report, Water Scarcity and Climate Change: Growing Risks for Business and Investors, decreasing water availability, declining water quality, and growing water demands are immense challenges to businesses who have historically taken clean, reliable, and inexpensive water for granted. Jason Morrison, Mari Morikawa, Michael Murphy, and Peter Schulte, Ceres and Pacific Institute, Water Scarcity and Climate Change: Growing Risks for Business and Investors (2009). The report concludes that climate change will exacerbate these growing water risks and that reduced water supplies from shrinking glaciers and melting snowcaps that sustain key rivers already are adversely impacting growth and new development. In a new report issued by the National Resources Defense Council (NRDC) in July 2010 titled Evaluating Sustainability of Projected Water Demands Under Future Climate Change Scenarios, the NRDC concludes that over 1,100 U.S. counties will see greater risks of water shortages due to climate change and 400 of these counties will face extremely high risks of water shortages. *See* http://rd.tetratech.com/climatechange/projects/nrdc_climate.asp. These reports provide the latest support for the growing consensus that water scarcity is a critical concern facing businesses, both now and into the future.

In its latest disclosure request, the CDP is asking companies to report on water use and water-related issues in order to increase the availability of high quality business information about this potential risk and raise awareness of water-related risks. The CDP Water Disclosure specifically seeks responses addressing:

1. Water Management and Governance
   - water-related plans
   - company actions
   - special initiatives

2. Risks and Opportunities
   - water stress
   - physical, regulatory, and other risks
   - supply chain water use
   - water-related opportunities

3. Water Accounting
   - withdrawals
   - recycling and reuse
   - water discharges
   - financial intensity measurements

The CDP requested that companies respond by July 31, 2010, using the CDP's online response system. Companies that were not specifically invited to respond to the questionnaire are still welcome to submit the CDP's Water Disclosure.

According to the CDP, 137 financial institutions globally with a combined $16 trillion in assets have signed the 2010 Water Disclosure seeking key water risk-related data from companies. These financial institutions share in the concerns voiced by Brooke Barton in a Ceres report, MURKY WATERS? CORPORATE REPORTING ON WATER RISK (2010), that global water scarcity is one emerging risk that all companies should be focused on and about which investors need information. *See* http://www.ceres.org/waterreport. These water disclosure advocates contend corporations that measure water usage are better able to manage any potential water risks. According to the CDP, disclosing water data to investors, banks, and insurers provides opportunities for companies to demonstrate

1. an ability to provide comparable and relevant data about water usage in response to shareholder requests;

2. increased awareness of water hot spots so steps may be taken to minimize any risks;

3. business leadership through understanding and planning to address water use and risks;

4. creation of innovative approaches and best practices focused on water usage; and

5. protection of your company's long term viability and financial interests by future proofing the business from adverse water impacts.

In its new interpretative guidance issued in 2010, the U.S. Securities and Exchange Commission clarified what public companies need to disclose to investors about climate change-related risks specifically including changes in the availability or quality of water that may have material effects on companies. Commission Guidance Regarding Disclosure Related to Climate Change, Exchange Act Release, Nos. 33-9106, 34-61469 (Feb. 2, 2010). The newly developed CDP Water Disclosure supports this growing momentum for companies to assess and disclose water risks.

Water is the world's most critical resource and global water scarcity is a significant risk that all companies must fully evaluate. It is often said that what is measured matters. For Ceres, the CDP, and their supporting financial institutions, water risks should be not only measured but also disclosed.

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