Greenhouse Gas and Climate Change Disclosures

Mark Farmer
Associate

wyatt
wyatt tarrant & combs llp
On February 8, 2010, the Securities and Exchange Commission (“SEC”) released guidance regarding disclosure requirements related to climate change. The guidance does not impose new disclosure obligations, but it reminds reporting companies that many existing SEC disclosure regulations may require disclosure of the potential effects of climate change and related regulation. The guidance directly applies to publicly traded companies, but the concepts, ideas and analysis apply equally to privately held entities offering securities under a federal and state exemption.

All companies involved in the coal industry should consider the possible effects of local, state, national and international climate change legislation and regulation on their respective reporting obligations. Regulators have shown action will be taken against companies that do not make required climate change disclosures. Recently, the New York Attorney General’s Office settled litigation against three energy companies regarding their disclosures about greenhouse gas emissions and potential liabilities resulting from climate change and related regulation. As noted by the SEC, requirements and potential liabilities related to climate change are rapidly changing and companies should stay apprised of current developments in order to meet their changing disclosure obligations.

**Background**

Local, state, national and international governing bodies have generated climate change related legislation and regulation that could impact businesses. At the state level, for example, the California Global Warming Solutions Act of 2006 and related California regulatory action have resulted in restrictions on greenhouse gas emissions in California. Alliances between states have developed regional frameworks to restrict greenhouse gas emissions, including the Regional Greenhouse Gas Initiative (ten Northeast and Mid-Atlantic states), the Western Climate Initiative (seven Western states and four Canadian provinces) and the Midwestern Greenhouse Gas Reduction Accord (six states and one Canadian province). State renewable energy portfolio standards impact fossil fuel demand by requiring electricity providers in twenty-four (24) states plus the District of Columbia to obtain a minimum percentage of their electric power from renewable energy resources by a certain date.

The Second and Fifth Circuits have allowed state common law claims to proceed against several major corporations for damage allegedly caused by climate change. For example, in Comer v. Murphy Oil USA, Inc., the plaintiffs were permitted to proceed on Mississippi common-law claims of public and private nuisance, trespass and negligence against numerous corporate defendants. They claim the defendants’ operation of energy, fossil fuels, and chemical industries in the United States caused the emission of greenhouse gases that contributed to global warming that in turn caused a rise in sea levels and added to the ferocity of Hurricane Katrina, which combined to destroy the plaintiffs’ property. The Fifth Circuit held the plaintiffs had standing to sue, but the merits of the case have not been addressed.

At the national legislative level, the House of Representatives adopted the American Clean Energy and Security Act of 2009 (not yet considered in the Senate) which, among other things, created a national renewable portfolio standard and a national cap and trade system for greenhouse gas emissions. A similar bill, the Clean Energy Jobs and American Power Act of 2009, has been proposed in the Senate. The Obama Administration has publicly voiced a desire for climate change legislation.

The Environmental Protection Agency (“EPA”) has been particularly aggressive in moving toward regulating greenhouse gases. On December 15, 2009, and in response to the U.S. Supreme Court’s decision in Massachusetts v. EPA, 549 U.S. 497 (2007), the EPA issued an endangerment finding which stated that six greenhouse gases (carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulfur hexafluoride), taken
in combination, endanger the public health and welfare of the nation. This endangerment finding is a prerequisite for the EPA to regulate greenhouse gases from new motor vehicles under Section 202 of the Clean Air Act.

In late 2009, the EPA proposed the Light Duty Motor Vehicle Rule whereby the EPA would control actual greenhouse gas emissions for the first time. The Light Duty Motor Vehicle Rule, if finalized, would establish new emission standards for light-duty vehicles in order to reduce greenhouse gas emissions and improve fuel economy. Due to the implications of the Light Duty Motor Vehicle Rule, the EPA also proposed the Tailoring Rule which establishes thresholds for greenhouse gas emissions under the Prevention of Significant Deterioration program (“PSD”) and Title V of the Clean Air Act. Additionally, as of January 1, 2010, approximately 10,000 large greenhouse gas emitters are required to report greenhouse gas emission data to the EPA.

At the international level, the recent UN Climate Change Conference of 2009 in Copenhagen shows a continued international desire to regulate manmade emissions believed to cause climate change. Previous international climate change regulations include the Kyoto Protocol, which sets emission targets for 37 industrialized countries, and the European Union Emissions Trading System (EU ETS), which establishes an international cap and trade system for greenhouse gas emissions.

Overview of the rules requiring disclosure of climate change issues

Generally, companies are required to disclose climate change related items in various sections of their securities disclosures when climate change related information is material. Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or if the information would alter the total mix of available information. Companies must also disclose such further information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading. Climate change related disclosures may be required in many sections of a company’s disclosures, including in the business description, legal proceedings, risk factors and management discussion and analysis. The SEC’s guidance focused on four specific climate change related issues that could shape disclosure requirements.

1. Impact of Legislation and Regulation

Item 101 of Reg. S-K requires disclosure of any material estimated capital expenditure for environmental control facilities for the current fiscal year, the following year and any other periods where the estimated expenditure is material. The breadth of this disclosure will depend on a company’s specific circumstances, but new, pending or expected legislation may cause a required material expenditure, especially considering the numerous anticipated or possible regulatory actions.

For example, if the EPA finalizes the Light Duty Motor Vehicle Rule and the Tailoring Rule, greenhouse gas emission sources emitting more than 25,000 tpy CO\(_2\) e will be subject to the Clean Air Act’s PSD and Title V programs. Importantly, PSD requires sources to implement best available control technology (“BACT”) for emissions of each air pollutant subject to regulation. Because greenhouse gas regulation has never implicated PSD, the BACT standard for greenhouse gases has never been established. If coal powered facilities are required to implement BACT, even if the BACT standard is established, this could cause significant capital expenditures. The EPA acknowledged that determining BACT for greenhouse gases could “be a complicated, resource-intensive, time consuming, and sometimes contentious process.”

Item 303 of Reg. S-K requires companies to assess whether legislation or regulation is reasonably likely to have a material effect on the company’s financial condition or results of operation. The analysis is fairly straightforward for final and effective
regulation, because the impact can usually be predicted. On the other hand, pending legislation or regulation presents a known uncertainty. Disclosure of pending legislation or regulation is required if the pending legislation or regulation is reasonably likely to be enacted and if the pending legislation or regulation is reasonably likely to have a material effect on the company’s financial condition or results of operation. In today’s political reality, a cautious company should perform a thorough analysis of pending and potential legislative and regulatory actions because the potential impact, especially to the coal industry, could be significant.

The SEC notes that some potential legislative or regulatory action could be beneficial to certain companies. For example, some companies may profit from a cap and trade system where the company is a net seller of carbon offset credits. Some businesses could potentially benefit from additional research and development funding or government incentives related to climate change mitigation. Also, companies utilizing some advanced technologies may benefit by the burden placed on competitors that utilize older technologies subject to new regulation.

2. International Accords

Many companies in the coal industry do business internationally or, at least, are impacted by changes in the international coal market. The international market can be significantly impacted by international accords as well as country specific regulation. The Kyoto Protocol, the EU ETS and national renewable portfolio standards are just a few examples of international regulation that could impact an U.S. entity. International legislative and regulatory developments should be disclosed in the same fashion and under the same analysis as their domestic counterparts.

3. Indirect consequences of regulation or business trends

Climate change developments and related consumer habits could create increased demand for new products or services and decreased demand for existing products and services. Entities involved in the coal industry should consider the indirect impact of climate change legislation and regulation on their customers and suppliers and they should consider how potential marketing could positively or negatively impact their business. Political, reputational or image considerations should also be addressed to the extent they have a material impact on the business. These business trends and risks may be required to be discussed under risk factors, management discussion and analysis or, in some circumstances, Item 101.

4. Physical impacts of climate change

The physical effects of climate change could have a material impact on some businesses. The SEC notes that climate change could have significant effects on weather, sea levels, the arability of farmland and water availability and quality. These effects could impact companies with interests on coastlines or in offshore drilling, customers and suppliers, insurance costs and general economic conditions.

Conclusion

Climate change regulation continues to develop and a company’s disclosure requirements continue to change accordingly. Action taken by local, state, national and international governing bodies could materially impact a company’s financial condition and business outlook. Climate change related disclosures may be required in many sections of a company’s disclosures, including in the business description, legal proceedings, risk factors and management discussion and analysis. Companies impacted by climate change legislation and regulation should monitor the progress of such legislation and regulation and consider the impact on their disclosure obligations.
Mark Farmer is a member of Wyatt’s Natural Resources & Environmental Law and the Corporate & Securities Service Teams. He is located in the Firm’s Louisville office.

502.562.7352
mfarmer@wyattfirm.com
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