Climate Change Disclosure:
Out with the Old; In with the New?

McGuireWoods LLP Releases Baseline Survey Results on 2008 Disclosures; Discusses Influences Affecting 2009 Disclosures

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Climate change disclosure practices of U.S. public companies have become the subject of considerable discussion over the past several years. However, the Securities and Exchange Commission has not yet called for any specific disclosures in this arena, nor has it provided interpretative guidance regarding the application of existing disclosure requirements to climate change-related matters. Consequently, public companies must vet these issues through their own disclosure controls processes, just as they do others. These processes would generally call for review of peer practices, as well as consideration of any consensus developing among regulators, investors and disclosure professionals regarding materiality and appropriate analysis of included topics. Because climate change is a topic that is often addressed in forums in addition to, or other than, formal SEC reports, disclosure committees would also do well to inform themselves about statements the company is making about climate change outside the context of formal disclosure in order to be sure that the company’s statements are consistent regarding these topics.

Knowing the intense interest in the topic, and to assist our clients and others with understanding the environment in which their climate change disclosures are being made, McGuireWoods LLP determined that it would be useful to conduct a broad-based review of such disclosures during 2008. The results of our Form 10-K reviews and related website checks are presented in this article.

The clear picture that emerges from our review is that through 2008, and notwithstanding highly publicized calls for additional disclosures in the fall of 2007, very few companies outside the energy and utility industries were making any type of climate change or greenhouse gas emissions-related disclosures in their SEC reports. However, unless the need to deal with the current and pressing issues presented by the economy completely overshadows the topic, we believe that the increased pressure for voluntary, and sometimes not-so-voluntary, disclosures is likely to change this state of affairs in 2009.

It now seems clear that the economy and the change in administration in Washington will delay substantive change in the regulatory environment as it relates to climate change beyond the Form 10-K filing season for calendar year companies. Consequently, most 2009 disclosures will be drafted in the context of uncertainties similar to those existing a year ago. This means that apart from what our 2008 review reveals about current practice, it may serve as a helpful baseline against which to measure changes driven by developing disclosure practices in this area as opposed to changes driven by greater certainty regarding climate change or greenhouse gas emissions-related regulation. We look forward to engaging in that analysis later in the year.

Constructing the Review

We constructed our review after considering both:

- The SEC disclosure requirements applicable to public companies that are the most likely to evoke climate change-related disclosures

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Page 2

- The Petition for Interpretative Guidance on Climate Risk Disclosure filed with the SEC on September 18, 2007, by the Coalition for Environmentally Responsible Economies (CERES) and others (CERES Petition).³

Based on this analysis, we looked at whether each company made disclosure in its 2008 10-K addressing one or more of the following issues, which roughly correspond to the types of disclosure requested in the CERES Petition:

- Amount of greenhouse gas (GHG) emissions (that is, has the company performed some type of GHG emissions assessment and reported the results in its 10-K).
- Impacts/risks related to current or proposed GHG regulations.
- Impacts/risks related to the physical effects of climate change.
- Legal proceedings regarding GHG emissions or climate change.
- Efforts related to reducing GHG emissions or climate change.

If a company made one or more of these types of disclosures in its 10-K, we also noted where in the 10-K the disclosures were made, including:

- Item 101 – Business
- Item 103 – Legal Proceedings
- Item 303 – Management’s Discussion and Analysis (MD&A)
- Risk Factors
- Cautionary Statements Regarding Forward-Looking Statements
- Elsewhere in the 10-K (for example, in the notes to the financial statements)

Finally, we also looked at whether each company’s website had significant and prominent, company-specific information regarding GHG emissions or climate change.

Companies Reviewed

We reviewed the 2008 10-K filings of approximately 350 companies included in the S&P 500, S&P MidCap 400 and S&P SmallCap 600 indices. The S&P indices assign companies to one of 10 industry sectors:³consumer discretionary, consumer staples, energy, financial, healthcare, industrials, information technology, materials, telecommunication services and utilities. S&P 500 companies have a market capitalization in excess of $5.0 billion (and cover approximately 75% of the U.S. equities market); S&P MidCap 400 companies, $1.5 billion to $5.5 billion (covering over 7% of the U.S. equities market); and S&P SmallCap 600 companies, $300 million to $2 billion (covering 3%-4% of the U.S. equities market).⁴

While the limited number of companies reviewed, particularly in certain industry segments, may not always allow us to make statistically precise statements about disclosure patterns, we think the results of this review are, in most cases, indicative of the current state of SEC disclosure practices among public companies across industry sectors and by market capitalization.

Recent developments that may affect public companies, indirectly, as they prepare their 2009 filings, are the settlements that Xcel Energy⁵ and Dynegy, Inc.⁶ have reached with the New York State Attorney General regarding the climate risk disclosure subpoena. Certain of the requirements of those settlement agreements are discussed further below.

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³ Standard & Poor's uses the Global Industry Classification Standard (GICS®) which establishes a common, global standard of industry classifications for companies worldwide.
⁴ Four hundred companies were selected for review, with roughly one-third coming from each of the S&P 500, S&P MidCap 400 and S&P SmallCap 600. The number of companies selected from each GICS Industry Sector was weighted to reflect the sector balance in each index. Out of these 400 companies, only companies that had filed a Form 10-K after December 31, 2007 were reviewed (this eliminated approximately 50 of the companies originally selected).
General Observations
The most striking result of our review is that in 2008, very few companies made any type of 10-K disclosure regarding GHG emissions or climate change. Out of the approximately 350 companies reviewed, only 42, or 12.2%, made any disclosure whatsoever regarding GHG emissions or climate change. Of the companies making disclosures:

- 34 addressed impacts/risks related to current or proposed regulation of GHG emissions.
- 20 discussed efforts related to reducing GHG emissions.
- 8 provided disclosure regarding the amount of their GHG emissions.
- 6 discussed physical impacts/risks related to climate change.
- 2 disclosed legal proceedings related to GHG emissions or climate change.

Perhaps less surprising is where these disclosures appear in the 10-Ks. Most can be found in Item 101 – Business and Risk Factors (with 30 each), followed by MD&A (13), Forward-Looking Statement Safe Harbor disclosures (8) and Item 103 – Legal Proceedings (2). Eleven companies made disclosures in other portions of the 10-K, typically in the notes to the financial statements.

Disclosure Practices by Company Size
In most cases there is some correlation between whether disclosure is made and the size of the company. In general, larger companies were more likely to provide disclosure than smaller companies. S&P 500 companies were most likely (as a percentage of companies in the same market capitalization category) to provide disclosure, followed by S&P MidCap 400 companies and then S&P SmallCap 600 companies. However, in most cases the companies making GHG emissions and climate change disclosures were spread, albeit unevenly, across each of the S&P market capitalization categories. The notable exceptions were disclosures regarding:

- The amount of a company’s GHG emissions, which were limited to a handful (8) of S&P 500 companies (six utilities, one energy company and one materials company).
- Legal proceedings related to GHG emissions or climate change, which were made by only two S&P 500 utility companies.

While larger companies were, in most cases, more likely to provide disclosure, the differences were not dramatic. It appears that company size may not be a significant factor as to whether a company will make climate change or GHG-related disclosures in its 10-K. Since size has less obvious correlation to climate change risk than the nature and location of the business, this conclusion seems logical. One exception, disclosure regarding the amount of a company’s GHG emissions, likely reflects the cost and effort involved in performing such an assessment.7

Outside the 10-K setting, there is a significant departure from the general pattern. S&P 500 companies are much more likely to provide company-specific climate change or GHG disclosure on their websites (27.6%), compared to S&P Midcap 400 (11.3%) and S&P SmallCap (2.8%) companies. This may be due, in part, to the larger companies’ larger investor following (and greater resources for preparing website content), which likely means more numerous and strident calls for disclosure of this information. For example, larger companies are more likely to be recipients of shareholder proposals requesting that the boards conduct such assessments and make them publicly available. Negotiating withdrawal of such proposals often involves voluntary disclosures of such information, with websites being the preferred vehicle. Even when the proposal will be presented to shareholders, companies may make voluntary disclosures, which may then be favorably cited, even when the proposal is opposed by the board of directors.

Disclosure Practices by Industry Sector
Utilities
As indicated above, out of the approximately 350 companies reviewed, only 42 provided any type of disclosure regarding GHG emissions or climate change. It will come as no surprise that the largest concentration of these companies was utility companies, particularly large utilities. In four out of the five disclosure topics, utilities represent a majority (or just under a majority) of all companies making these kinds of disclosures. The curious exception to this pattern is disclosure regarding physical impacts/risks related to climate change. One explanation may be that utilities

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7 As noted below, disclosure of data regarding GHG emissions is clearly related to the type of company involved, with utilities representing 75% of the companies that provided this type of information in their 10-Ks.
have long discussed weather-related risks that affect their business, and simply do not identify whether part of its weather-related risk is or may be attributable to climate change. In other words, a utility company may decide to be agnostic as to the causes of changes in weather patterns and, instead, focus on historical data and forecasts regarding weather patterns in its disclosures.

Twenty-one utility companies were reviewed, and 16, or 76.2%, of them provided some type of 10-K disclosure regarding GHG emissions or climate change.8 Of these 16 utility companies, all of them disclosed risks or impacts related to the regulation of GHG emissions. The next most common disclosure for utility companies was discussion of efforts to reduce GHG emissions (11), followed by information regarding the amount of the company's GHG emissions (6). The only two companies that disclosed legal proceedings related to GHG emissions or climate change were two S&P 500 utility companies.9

Most utility companies that made some type of 10-K disclosure also provide company-specific GHG emissions or climate change information on their websites; however, a sizable minority (43.8%) do not. Only one of the 21 utility companies reviewed provides information on its website, but did not make any type of 10-K disclosure.

It is somewhat surprising that five of the utility companies did not provide any type of climate change or GHG disclosures in their 10-Ks (four were S&P MidCap companies and one was an S&P SmallCap company). One company was one of the five companies that received a subpoena from the Office of the New York Attorney General on September 17, 2007. The other company, along with numerous other companies with coal-fired generation facilities and companies in other industries, was named as a defendant in a class action lawsuit filed on April 9, 2006, in the United States District Court for the Southern District of Mississippi. This suit, which was filed on behalf of residents and property owners in Mississippi who were harmed by hurricane Katrina, alleges that the emission of greenhouse gases by the defendants contributed to global warming, thereby causing hurricane Katrina and plaintiffs' damages. Other defendants in this suit, while not included in our review, are known to have made no disclosures regarding it, presumably judging it not to be material.

Non-Utility Companies

Out of the 42 companies that made some type of disclosure, 26 were non-utility companies: energy (9), industrials (4), materials (4), financials (3), information technology (3), consumer discretionary (2), healthcare (1). Out of the 12 consumer staples and three telecommunications services companies reviewed, none made disclosure of any type. However, three of the consumer staples companies did provide company-specific information on their websites.

Energy. Nine, or 42.9%, of the 21 energy companies reviewed provided disclosure in their 10-Ks. All but one of these companies disclosed risks/impacts related to regulation of GHG emissions. However, unlike the utility companies, energy companies made almost no other type of climate change or GHG-related disclosure. Only one of these companies (an S&P 500 company) provided information regarding the amount of its GHG emissions. The only energy company that did not discuss regulatory risks (an S&P MidCap 400 company) was the only energy company that discussed its efforts to reduce GHG emissions or climate change. Only five of the energy companies reviewed have website disclosure, which is fewer than the number of energy companies providing some type of 10-K disclosure, and all of these were S&P 500 companies.

Industrials. Only four, or 8.3%, of the 48 industrials companies reviewed made climate change or GHG disclosures in their 10-Ks. Two discussed risks related to current or proposed regulation of GHG emissions, and three talked about efforts to reduce GHG emissions or climate change. Two of these companies are S&P MidCap 400 companies, and two are S&P SmallCap 600 companies. Curiously, of the 15 S&P 500 companies in the industrials Industry Sector that were reviewed, none provided any disclosure.

Materials. Eighteen materials companies were reviewed, and four, or 22.2 %, provided some type of disclosure. Three of the four companies are S&P 500 companies, and each discussed regulation-related risks. In addition, two of these

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companies discussed efforts to reduce GHG emissions, one discussed risks related to the physical effects of climate change, and one disclosed information about its GHG emissions. The sole S&P MidCap 400 industrials company that made any disclosure talked about its efforts to reduce GHG emissions.

**Financials.** Three, or 4.5% of the 66 financials companies reviewed provided disclosure. Two are insurance companies, and one is a real estate management firm. All three companies discussed risks related to the physical effects of climate change, and one also addressed current or proposed regulation of GHG emissions.

**Information Technology.** Fifty-two information technology companies were reviewed, and three (one from each market capitalization category) provided disclosure regarding the regulation of GHG emissions. The information technology companies made no other type of disclosure (although 10 of the 52 information technology companies do include company-specific GHG emissions or climate change information on their websites).

**Consumer Discretionary.** Two out of 63 consumer discretionary companies reviewed provided disclosure. One, an S&P SmallCap 600 company, discussed risks related to GHG regulations and the other, an S&P 500 company, provided information regarding its efforts to reduce GHG emissions.

**Healthcare.** The lone healthcare company, out of 41 reviewed, that made any type of climate change or GHG related disclosure is an S&P 500 company that discussed its efforts to reduce its GHG emissions (and only two healthcare companies provide information on their websites).

As noted above, the most common type of disclosure made by the non-utility companies addresses risks/impacts related to the regulation of GHG emissions. Since the nature of that regulation remains largely undefined, the disclosures are necessarily general. Out of the 42 companies that made any type of disclosure whatsoever, 34 addressed this issue. Of the eight companies that did not provide disclosure regarding current or proposed regulation of GHG emissions:

- Six are non-utility companies that discussed their efforts in reducing GHG emissions or climate change.
- Two are insurance companies that discussed impacts/risks related to the physical effects of climate change.

In each case, these were the only climate change or GHG-related disclosures made by these companies (and only two of these companies provide any GHG emissions or climate change information on their websites).

**Website and Other Voluntary Disclosures**

The limited number of companies that provided some type of climate change or GHG disclosure in their 10-Ks may seem somewhat surprising given the number of companies that have elected to provide sometimes extensive disclosure in other, voluntary venues. While not widespread, significantly more of the companies reviewed provide company-specific information regarding climate change or GHG matters on their websites (51) than in their 10-Ks (42). There is less overlap than one might expect between the companies that provided 10-K disclosure and those that provide information on their websites. Out of the 42 companies that provided 10-K disclosure, only 19, or 45.2%, also provide information on their websites, while the majority (54.8%) do not. On the other hand, out of the 50 companies that provide information on their websites, 31, or 62.0%, provided no disclosure in their 10-Ks. Out of the 50 companies that provide company-specific information related to GHG emissions or climate change on their websites, only 19, or 38%, have apparently concluded that disclosure regarding these matters is material to their investors. Out of the 19 companies that provide both 10-K disclosure and website information, almost half (9, or 47.3) are utilities.

The contrast between the number of S&P 500 companies that made disclosures regarding GHG emissions or climate change in their 10-Ks and that make voluntary disclosures regarding these matters in other forums is striking. Voluntary GHG and climate change disclosure is occurring in a number of places, most notably the Carbon Disclosure Project (CDP), the Global Reporting Initiative, The Climate Registry, the World Economic Forum Global GHG Register, and the Global Framework for Climate Risk Disclosure. Of these, the Carbon Disclosure Project appears to be the largest repository of corporate greenhouse gas emissions data, serving as a secretariat for 385 institutional investors with over $57 trillion of assets under management.\(^{10}\)

The information provided in these voluntary forums is interesting, to say the least, when compared to SEC reporting on similar topics. For example, the Carbon Disclosure Project (CDP) in September 2008 released the results of its annual questionnaire.\(^{11}\) According to the CDP, 321, or 64% of the S&P 500 companies responded to the questionnaire.\(^{12}\)


\(^{11}\) Id.

\(^{12}\) Id.
contrast, only 19, or 15.4% of the 123 S&P 500 companies whose 10-Ks we reviewed provided any type of disclosure in their 10-Ks. In fact, at least one of the U.S. companies graded as a “top scorer” in the CDP’s U.S. Carbon Disclosure Leadership Index provided no climate change or GHG disclosure whatsoever in its 2008 10-K. There may be reasonable explanations for this disparity. However, the fact remains that many S&P 500 companies make extensive disclosures regarding these matters in the CDP and in many cases these companies identify climate change as posing “commercial risk,” having a likelihood of “significant impact” or as a “potential material risk.” and yet they do not reflect those risks in what is arguably their most important SEC report for the year.

On its website, the CDP states that the data it collects “provides investors with a better understanding of risks and opportunities from climate change in their portfolios.” Several scenarios suggest themselves:

- A risk related to GHG emissions and/or climate change discussed in a voluntary forum, but not in the company’s SEC reports. That risk manifests itself and has a material impact on the results of operations or financial condition of the company. It will be evident that management was aware of the risk, but arguably did not disclose that risk to its investors or make them aware that the company’s forward looking statements could be affected by such a risk.

- A risk related to GHG emissions and/or climate change is discussed in a voluntary forum, but not in the company’s SEC reports. Even if the risk does not manifest itself, this inconsistency may raise questions about the adequacy of the company’s disclosure controls, which must be certified in SEC filings quarterly by the company’s senior executive officers.

- Information/data that is provided in a voluntary forum such as the CDP turns out to be inaccurate or misleading in some material respect. An investor, for whose benefit the CDP exists, makes a 10b-5 type claim against the company arguing that the company provided the information in a forum where it knew investors would rely on the accuracy and completeness of the information in making investment decisions.

At a minimum, companies need to examine the implications for making these types of voluntary disclosures, determine what disclosure controls and procedures should apply to them and evaluate whether similar disclosures should be made in their SEC filings. In cases where a voluntary disclosure forum exists, at least in part, for the benefit of investors, a company must evaluate the potential liability that may attach to that disclosure.

**Conclusion: “In with the New” – 2009 will be the year for public companies to reevaluate their disclosure practices, policies and procedures regarding GHG and climate change issues.**

The clear picture that emerges from a review of 10-Ks filed in 2008 is that very few companies outside the energy and utility industries made any type of GHG emissions or climate change-related disclosures. Given the increased pressure for voluntary, and sometimes not-so-voluntary, GHG and climate change disclosures, this state of affairs is likely to change in 2009. Even in the absence of interpretive guidance from the SEC, public companies must reevaluate in 2009 whether, and to what extent, current rules and regulations require them to make company-specific disclosures regarding the risks and opportunities related to GHG and climate change matters.

In 2008, the pressure to provide GHG and climate change disclosures increased dramatically. While the implementation of a national cap-and-trade or carbon tax system may be uncertain in the current economic environment, it is unlikely that calls for more disclosure will abate. The conclusion for all public companies is that they must look closely at their disclosures, and disclosure policies and procedures, regarding GHG and climate change matters.

For the vast majority of public companies that provided no GHG or climate change-related disclosure in their 2008 10-Ks, 2009 will be an important opportunity to reevaluate this situation. Each company that does not currently provide GHG or climate change disclosure will need to carefully evaluate whether that is a reasonable approach given the kinds of risks, and opportunities, that GHG and climate change issues present. In particular, companies that make GHG or climate change disclosures in other forums, such as the Carbon Disclosure Project, must carefully evaluate the decision not to make similar disclosures in their SEC filings.

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For the minority of companies that did include GHG and climate change disclosures in their 2008 10-Ks, 2009 will be an important year to reexamine those disclosures. While the SEC has not responded to calls for interpretive guidance in this area, a clearer picture is emerging regarding the types of disclosures various investors (for example, the CDP) and governmental parties (for example, the New York Attorney General) are requesting/requiring. For example, public companies should consider their GHG and climate change disclosures for 2009, in light of the recent settlement agreements entered into by the New York Attorney General. Another helpful guidepost would be the request for interpretive guidance filed with the SEC by CERES and other investors. Neither of these sources is binding on public companies, but they do provide helpful information regarding the types of disclosures that may be appropriate in this area.

Recognizing that pressure is increasing for public companies to make GHG and climate change disclosures in their SEC reports does not make preparing those disclosures any easier. Many difficult issues arise when evaluating potential disclosure in these areas. For example, when considering risks related to the physical effects of climate change, difficult questions arise regarding the likelihood of the risk and the relevant time frame over which the risk may manifest itself. Until tangible effects begin to manifest themselves with respect to particular companies or geographic locations, or are far more imminent than they appear to be in much of the world today, the initial test for materiality (that is, whether the contingency is reasonably likely to occur) may not be met, leading to the conclusion that no disclosures are required. On the other hand, if potential physical effects of climate changes are influencing management's decisions in any material respect, for example, regarding material capital expenditures or plant locations, that information should be disclosed to investors.

Apart from disclosures that should be considered for formal SEC reports, there are other securities laws issues to take into account when informal GHG or climate change disclosures are made. All public companies that provide GHG or climate change information to specific investors or groups of investors should examine whether the information being provided is subject to the same disclosure controls and procedures that apply to information in their SEC filings. A company's message regarding GHG and climate change matters should be consistent across all disclosure channels, and discussions of the related risks and opportunities should be subject to consistent disclosure controls and procedures. Sending different messages to different audiences regarding the risks, or opportunities, presented by GHG and climate change issues can at a minimum create an inconsistent and confusing mix of information for Rule 10b-5 purposes, and, depending on the circumstances of the disclosure, may result in violations of the prohibition of selective disclosure under Regulation FD.

Another challenge posed by GHG and climate change matters is the substantive agenda motivating the calls for disclosure. It is clear that in many cases demands for “disclosure” in this arena are in reality attempts to affect corporate conduct and governance. For example, the governance and compensation-related disclosures mandated by the New York Attorney General will almost certainly cause the companies that have entered into settlement agreements, and may cause other public companies, to consider, and perhaps implement, changes in the role of the board of directors in GHG and climate change matters. Those “disclosure” requirements also are likely to prompt consideration of whether environmental performance factors, including meeting climate change objectives, should be a factor in setting executive compensation.

Despite the difficulties inherent in providing meaningful, company-specific GHG and climate change disclosures, we expect that the number of public companies that make GHG and climate change disclosures in their SEC reports will increase in 2009. The fact that many public companies are already making some type of voluntary GHG or climate change disclosure lends some urgency to this issue. It will become more difficult for companies to maintain disparity going forward regarding the information they provide to various audiences. This issue will be particularly acute for companies that access the capital markets in 2009, since underwriters and their counsel are increasingly likely to address these issues during due diligence. If the decision is made to make these types of disclosures in connection with capital raising activities, it will become even more difficult to justify omitting similar disclosures in a company's periodic reports filed with the SEC.