

# **CORPORATE ENVIRONMENTAL REPORTING AND CLIMATE CHANGE RISK: THE NEED FOR REFORM OF SECURITIES AND EXCHANGE COMMISSION DISCLOSURE RULES**

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This article will focus on the need for reform of Securities and Exchange Commission (“SEC”) disclosure rules relating to corporate environmental reporting, especially with respect to climate change risk. In recent years, investors and other corporate stakeholders have placed increased emphasis on the environmental track record of businesses, and some U.S. companies have risen to the challenge. Many major U.S. companies now publicly tout their efforts to go green, or at least not to engage in egregious acts of pollution, on their websites and in newspaper and magazine ads. Some critics view these efforts as attempts by businesses to “greenwash” their environmental records and to hide the truth. These critics are calling for better environmental reporting by businesses. In fact, it is not easy for investors and other stakeholders to obtain accurate information on the environmental impact of companies’ operations due to deficient disclosure by U.S. companies.

It can be argued that environmental reporting is mandated by current SEC disclosure rules, as supplemented by guidance issued by the SEC and the Financial Standards Accounting Board. SEC Regulation S-K requires reporting companies to disclose certain categories of information if it is deemed material: for example, Item 101 mandates disclosure of the general development of the business during the preceding five-year period;<sup>1</sup> Item 103 requires disclosure of material pending legal proceedings other than ordinary routine litigation incidental to the business;<sup>2</sup> and Item 303 directs management to disclose its analysis of the financial condition and results of operations of the company.<sup>3</sup> A discussion of material impacts of environmental matters, including risks associated with climate change, would seem to fall within these requirements, but few reporting companies interpret these requirements to mandate the type of disclosure that many investors now seek.

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<sup>1</sup> SEC Standard Instructions for Filing Forms, 17 C.F.R. § 229.101 (2008).

<sup>2</sup> *Id.* at § 229.103.

<sup>3</sup> *Id.* at § 229.303.

The U.S. General Accountability Office (“GAO”) issued a report in 2004 on environmental reporting by U.S. companies under SEC disclosure rules (“GAO Report”).<sup>4</sup> In attempting to assess the extent of such reporting, the GAO surveyed the results of 15 studies conducted on the adequacy of environmental disclosure, both of existing liabilities and future risks, between 1995 and 2003.<sup>5</sup> More than half of these studies concluded that environmental disclosures were inadequate.<sup>6</sup> The GAO also surveyed key stakeholders about whether current SEC rules adequately defined the requirements for environmental disclosure, concluding there was a difference of opinion among stakeholders on that point.<sup>7</sup> Environmental groups and those interested in socially responsible investing believed that companies may not be reporting their environmental liabilities because the SEC rules were not specific enough in the following areas: “(1) disclosing liabilities when their occurrence or amount is uncertain; (2) assessing the materiality of liabilities and potential risks; and (3) disclosing potentially significant environmental problems or regulatory initiatives that could pose future financial risks.”<sup>8</sup>

On the other hand, many reporting companies and investors with general investing interests believe that the flexibility built into the SEC disclosure rules is necessary to accommodate the varying circumstances of companies and thus more specific guidance would not be feasible.<sup>9</sup> In short, some investors would prefer to receive more information, but reporting companies would prefer not to provide it.

This lack of transparency is especially troubling when it comes to the business risks associated with climate change. It is now widely acknowledged by scientists that climate change is occurring.<sup>10</sup> It seems clear to some institutional investors and environmental groups that climate change will have a significant financial impact on

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<sup>4</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT TO CONGRESSIONAL REQUESTERS: ENVIRONMENTAL DISCLOSURE: SEC SHOULD EXPLORE WAYS TO IMPROVE TRACKING AND TRANSPARENCY OF INFORMATION (2004) [hereinafter *GAO Report*], available at [http://www.gao.gov/new\\_items/d04804.pdf](http://www.gao.gov/new_items/d04804.pdf).

<sup>5</sup> *Id.* at Appendix III.

<sup>6</sup> The GAO was hesitant to validate those conclusions, noting limitations in the methodology used in such studies. *Id.* at 20.

<sup>7</sup> *Id.* at 3.

<sup>8</sup> *Id.* at 3, 12-13.

<sup>9</sup> *Id.* at 3, 14-16.

<sup>10</sup> The Intergovernmental Panel on Climate Change, a group of climate experts charged by the United Nations Environment Program with providing information on global warming, noted that “[w]arming of the climate system is unequivocal, as is now evident from observations of increases in global average air and ocean temperatures, widespread melting of snow and ice and rising global average sea level.” INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, CLIMATE CHANGE 2007: SYNTHESIS REPORT, SUMMARY FOR POLICYMAKERS 2 (Nov. 17, 2007), available at [http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4\\_syr\\_spm.pdf](http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr_spm.pdf).

many types of businesses. For example, the Investor Network on Climate Risk (“INCR”), a network of institutional investors and financial institutions organized to promote awareness of the financial risks associated with climate change, identifies four types of risk: (1) regulatory risk of compliance with new state, federal, and international regulations limiting carbon emissions and imposing a cost on carbon; (2) risk of physical impacts of climate change due to severe weather events such as droughts, floods, storms, and sea level rise; (3) risk of loss of reputation and competitive position due to lack of climate change preparedness, such as failure to produce automobiles that comply with new emissions standards; and (4) litigation risk associated with lawsuits charging corporate responsibility for global climate change.<sup>11</sup> INCR advocates for companies to take steps to mitigate such risks and fashion strategies to position themselves in the emerging low-carbon global economy, as well as disclosing such risks and strategies to investors.<sup>12</sup>

Currently, few U.S. companies are disclosing these risks in their SEC filings. This conclusion has been corroborated by a number of studies conducted by non-governmental organizations (“NGOs”) dedicated to environmental sustainability, such as Ceres, and by academic researchers.<sup>13</sup> The most recent study, published in June 2009 by Ceres and the Environmental Defense Fund, examined annual reports filed with the SEC by 100 companies in five sectors determined to be subject to climate change impacts in the future, namely electric utilities, coal, oil and gas, transportation, and insurance (“2009 Ceres Study”).<sup>14</sup> The 2009 Ceres Study concluded that U.S. companies were deficient in reporting their greenhouse gas emissions, their positions on climate change, the climate risks they face, and actions to address climate change.<sup>15</sup> While many companies neglected to address these issues altogether, even those that did made

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<sup>11</sup> Investor Network on Climate Risk, *Why Climate Change is a Business Issue*, <http://www.incr.com/Page.aspx?pid=253> (last visited Sept. 25, 2009).

<sup>12</sup> *Id.*

<sup>13</sup> See Kevin L. Doran & Elias L. Quinn, *Climate Change Risk Disclosure: A Sector by Sector Analysis of SEC 10-K Filings from 1995-2008*, 34 N.C. J. INT’L L. & COM. REG. 721 (2009) (studying climate change risk disclosure in SEC-10K filings between 1995-2008, and concluding that the vast majority of reporting companies do not discuss climate change and the informational value of disclosures made by companies is low from the point of view of investors); see also CERES ET AL., CLIMATE RISK DISCLOSURE BY THE S&P 500 7 (Jan. 2007), available at <http://www.ceres.org/Document.Doc?id=146> (surveying U.S. S&P 500 companies, of whom only half responded to the survey, and concluding that current disclosure by U.S. companies was inadequate and lagged well behind their foreign competitors).

<sup>14</sup> BETH YOUNG, CELINE SUAREZ & KIMBERLY GLADMAN, CLIMATE RISK DISCLOSURE IN SEC FILINGS: AN ANALYSIS OF 10-K REPORTING BY OIL AND GAS, INSURANCE, COAL, TRANSPORTATION AND ELECTRIC POWER COMPANIES (Ceres and the Environmental Defense Fund eds., 2009), available at <http://www.ceres.org/Document.Doc?id=473>.

<sup>15</sup> *Id.* at iv.

only a mediocre effort.<sup>16</sup>

In order to facilitate more disclosure, a number of reporting frameworks for disclosure of the financial risks associated with climate change have been proposed. The 2006 Global Framework for Climate Risk Disclosure (“Global Framework”) is perhaps the most widely known framework.<sup>17</sup> In the forefront of this effort are Ceres and the Carbon Disclosure Project, an NGO dedicated to climate change issues. These entities, along with investor groups focused on climate change, such as INCR, and institutional investors, including California Public Employees’ Retirement System (“Calpers”), and with some input from the United Nations Environment Program, developed the Global Framework to clarify investor expectations on climate change risk disclosure.<sup>18</sup>

The Global Framework consists of four points: companies should disclose their total greenhouse gas emissions, perform a strategic analysis of climate risk and emissions management, assess the physical risks of climate change, and analyze the risks of regulation at the state, local, and national level.<sup>19</sup> The Global Framework is intended to be applicable in a wide variety of disclosure contexts, including mandatory financial reports filed with the SEC, reports filed with the Carbon Disclosure Project’s database on corporate greenhouse gas emissions, and voluntary reports on the economic, environmental, and social aspects of corporate activities under guidelines issued by the Global Reporting Initiative (“GRI”).<sup>20</sup>

In 2007, Ceres, along with several other NGOs, some large institutional investors, and a number of state government officials, petitioned the SEC to issue interpretive guidance clarifying that material climate change risk information should be included in SEC filings under existing law (“SEC Petition”).<sup>21</sup> The SEC Petition noted that climate change risk is not being adequately disclosed and requested the SEC to issue an interpretive release setting forth the elements of climate change risk disclosure recommended by Ceres, essentially mirroring the requirements of the Global

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<sup>16</sup> *Id.*

<sup>17</sup> CERES, GLOBAL FRAMEWORK FOR CLIMATE RISK DISCLOSURE (2006), *available at* [http://www.calstrs.com/Investments/GlobalFramework\\_Climate.pdf](http://www.calstrs.com/Investments/GlobalFramework_Climate.pdf).

<sup>18</sup> *See id.*

<sup>19</sup> *Id.* at 5-8.

<sup>20</sup> *Id.* at 1.

<sup>21</sup> Petition for Interpretive Guidance on Climate Risk Disclosure, SEC File No. 4-547 (Sept. 18, 2007), *available at* <http://www.sec.gov/rules/petitions/2007/petn4-547.pdf>; *see also* Letter from California Public Employees’ Retirement System et al. to Florence E. Harmon, Acting Secretary, United States Securities and Exchange Commission (June 12, 2008), *available at* <http://www.sec.gov/rules/petitions/2008/petn4-547-supp.pdf> (supplementing the petition with relevant developments that had occurred since its filing).

Framework.<sup>22</sup>

The SEC has not yet responded to the SEC Petition. However, with the change in administration in Washington, D.C. and the appointment of a new SEC chairwoman, Mary Schapiro, the SEC may take steps to respond. The SEC has met in recent months with institutional investors and state government officials interested in the topic of climate change risk disclosure. Reportedly, the SEC is assessing whether public companies should be disclosing such information.<sup>23</sup>

The insurance industry has already taken steps to require climate change risk disclosure by its largest members. In March 2009, the National Association of Insurance Commissioners, a voluntary association of the chief insurance regulatory officials of all 50 states, promulgated a requirement of mandatory disclosure by insurance companies with premiums over \$500 million of the financial risks they face from climate change.<sup>24</sup> Information that must be disclosed focuses on issues related to insurer solvency, insurance availability, and insurance affordability. This information includes the insurer's plans to reduce emissions in its operations, risk management and investment management policies linked to climate change, identification of current or future risks posed by climate change, and alteration of its investment portfolio to take account of the impacts of climate change.<sup>25</sup> This development signals that financial regulators are beginning to recognize the importance of climate change risk disclosure.

Given the current state of corporate environmental reporting, especially climate change risk disclosure, it makes sense to look for avenues for reform of the SEC disclosure system or for alternative approaches. It is apparent that the poor state of such disclosure may be attributable to one of two phenomena: either companies are not aware of the significant impact that climate change risk may have on their operations, or they are simply reluctant to disclose it. Mandatory climate change risk disclosure under SEC rules, the approach proposed in the SEC Petition, is the most important avenue of reform because it may result in the sort of uniform and consistent reporting that allows investors to compare similarly situated companies based on the same reporting criteria.

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<sup>22</sup> SEC File No. 4-547, at 51-53.

<sup>23</sup> See Evan Lehmann, *SEC Turnaround Sparks Sudden Look at Climate Disclosure*, N.Y. TIMES, July 13, 2009; Letter from Members of the Investor Network on Climate Risk to Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm'n (June 12, 2009) [hereinafter *INCR Letter*], available at <http://www.ceres.org/Page.aspx?pid=1106> (requesting a meeting with SEC Chairman Schapiro to discuss climate change risk disclosure).

<sup>24</sup> News Release, NAIC, Insurance Regulators Adopt Climate Change Risk Disclosure (Mar. 17, 2009), available at [http://www.naic.org/Releases/2009\\_docs/climate\\_change\\_risk\\_disclosure\\_adopted.htm](http://www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm). (companies with premiums over \$300 million will be subject to mandatory disclosure starting in 2010, while smaller companies are encouraged to voluntarily disclose such information).

<sup>25</sup> NAIC, Insurer Climate Risk Disclosure Survey, available at [http://www.naic.org/documents/committees\\_ex\\_climate\\_climate\\_risk\\_disclosure\\_survey.pdf](http://www.naic.org/documents/committees_ex_climate_climate_risk_disclosure_survey.pdf).

However, some additional approaches to filling the environmental risk disclosure gap should be mentioned at this point, namely (1) enhanced SEC monitoring and enforcement of existing disclosure requirements; (2) use of shareholder proposals under Securities and Exchange Act Rule 14a-8 (“SEC Rule 14a-8”) to require such disclosure by reporting companies;<sup>26</sup> (3) use of state law enforcement mechanisms to force disclosure by individual companies; and (4) voluntary reporting by companies under global frameworks for economic, social and environmental disclosure, such as GRI’s Sustainability Reporting Framework (“GRI Framework”).<sup>27</sup> While none of these proposals provides a viable alternative to mandatory climate change risk disclosure, these approaches may be used successfully as complementary tools for providing more information to the public on this important issue.<sup>28</sup>

The first such complementary approach is better monitoring and targeted enforcement actions by the SEC. This approach was one of the proposals discussed in the GAO Report, and was based upon the opinion of experts interviewed by the GAO.<sup>29</sup> Specifically, the proposal was to increase the number of filings reviewed by the SEC in industries more likely to experience a large number of environmental issues, such as manufacturing and oil and gas, to issue more comment letters on such filings, and to initiate targeted enforcement actions in high-profile cases in order to deter non-disclosure.<sup>30</sup> The GAO Report also acknowledged that such an approach would require coordination among the SEC, the Environmental Protection Agency (“EPA”), and state environmental agencies to obtain information useful for evaluating companies’ environmental disclosures.<sup>31</sup> While this approach may lead to increased environmental disclosure by some companies, it does not guarantee consistent and uniform reporting by all companies.

A second complementary approach is the use of shareholder proposals under SEC Rule 14a-8. In recent years, climate change has dominated shareholder resolutions under this rule relating to environmental matters, with companies in the automobile, utility, oil and gas, and manufacturing sectors being the primary recipients of such proposals.<sup>32</sup> Global warming shareholder proposals have risen steadily in number over

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<sup>26</sup> Securities Exchange Act of 1934 General Rules and Regulations, 17 C.F.R. § 240.14a-8 (2008).

<sup>27</sup> Global Reporting Initiative, G3Guidelines, <http://www.globalreporting.org/ReportingFramework/G3Guidelines> (last visited Sept. 25, 2009).

<sup>28</sup> See INCR Letter, *supra* note 23 (calling for improved disclosure under SEC rules but recognizing the importance of the shareholder resolution process for forcing disclosure of climate change and other environmental risks).

<sup>29</sup> GAO Report, *supra* note 4, at 4-5, 33-34.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 35.

<sup>32</sup> INCR, Climate Resolutions Toolkit-2008, <http://www.incr.com/Page.aspx?pid=1061> (last visited Dec. 15, 2009); INCR, Climate Resolutions Toolkit-2009, <http://www.incr.com/resolutions> (last visited Dec.

the past five years and have garnered a relatively high level of support compared to shareholder proposals generally, receiving on average the support of one-quarter, and in some cases, up to one-third of voting shareholders.<sup>33</sup> In a few cases, companies have either voluntarily agreed to the disclosure requested in the proposal, even though the proposal itself was not accepted by the shareholders, or have voluntarily agreed to the requested disclosure in advance of the shareholder meeting, and the proposal request was withdrawn and never presented to the shareholders.<sup>34</sup> The disadvantage to this approach is that it does not target all similarly situated companies equally, and does not result in uniform and consistent disclosures across companies.

A third complementary approach is the use of state law enforcement mechanisms to force disclosure by individual companies. An example of this approach is the use of the Martin Act by New York State Attorney General Andrew Cuomo to force disclosure of climate change risk and its financial consequences by five major energy companies, including Xcel Energy, Dynegy Inc., AES Corporation, Dominion Resources, and Peabody Energy.<sup>35</sup>

In September 2007, Attorney General Cuomo subpoenaed the executives of these energy companies for information on whether disclosures to investors in filings with the SEC adequately described the companies' financial risks related to their emissions of global warming pollution, using his authority under New York State's Martin Act, a 1921 state securities law granting the Attorney General broad powers to access the financial records of businesses.<sup>36</sup> Xcel Energy entered into an agreement with the Attorney General in exchange for terminating the investigation, and agreed to provide detailed disclosure of climate change and associated risks in its 10K filings with the SEC, including an analysis of present and probable future climate change regulation and legislation, climate change related litigation, physical impacts of climate change, current carbon emissions and projected increases from planned coal-fired power plants,

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15, 2009).

<sup>33</sup> *Id.*

<sup>34</sup> Elise N. Rindfleisch, *Shareholder Proposals: A Catalyst for Climate Change-Related Disclosure, Analysis, and Action?*, 5 BERKELEY BUS. L.J. 45, 62-70 (2008) (describing actions taken by Andarko, ConocoPhillips, and ExxonMobil in response to the filing of shareholder proposal requests).

<sup>35</sup> Posting of John Horan to Global Climate Law Blog, <http://www.globalclimatelaw.com/articles/securities-disclosure> (Aug. 27, 2008). See, e.g., Assurance of Discontinuance Pursuant to Exec. Law § 63(15), *In re* Xcel Energy Inc., AOD No. 08-012 (Aug. 26, 2008), available at [http://www.oag.state.ny.us/media\\_center/2008/aug/xcel\\_aod.pdf](http://www.oag.state.ny.us/media_center/2008/aug/xcel_aod.pdf); Assurance of Discontinuance Pursuant to Exec. Law § 63(15), *In re* Dynegy Inc., AOD No. 08-132 (Oct. 23, 2008), available at [http://www.oag.state.ny.us/media\\_center/2008/oct/dynegy\\_aod.pdf](http://www.oag.state.ny.us/media_center/2008/oct/dynegy_aod.pdf).

<sup>36</sup> Press Release, New York Attorney General, Cuomo Reaches Landmark Agreement With Major Energy Company, Xcel Energy, to Require Disclosure of Financial Risks of Climate Change to Investors (Aug. 27, 2008), available at [http://www.oag.state.ny.us/media\\_center/2008/aug/aug27a\\_08.html](http://www.oag.state.ny.us/media_center/2008/aug/aug27a_08.html).

and strategies for reducing such emissions, among other things.<sup>37</sup> While this approach has worked successfully on one occasion and may well serve as a model for other states' top law enforcement officials, it is a piecemeal approach which will not achieve the broad-based and uniform disclosure that investors seek.

A fourth complementary approach is the use of voluntary sustainability reporting by companies. There are a number of global frameworks that have been developed for voluntary corporate reporting on economic, environmental and social performance, with the most widely accepted being the GRI Framework.<sup>38</sup> The GRI Framework is designed to provide investors with complete, transparent, and consistent reporting from companies on a broad range of social and environmental issues. Some U.S. reporting companies, who disclose little on this topic in their 10K filings, have provided fuller disclosure on a voluntary basis in the form of sustainability reporting.<sup>39</sup> More than 1,000 companies are currently issuing GRI-based sustainability reports. However, only 103 U.S. companies are among that group. Among these, 66 S&P 500 companies use the GRI Framework.<sup>40</sup> As the INCR Letter noted, this type of ad hoc, voluntary approach to climate change risk disclosure does not serve investors well, as it does not provide investors with "the ability to compare company policies and performance to their peers, which requires reporting by all companies, using well-understood protocols for such reporting."<sup>41</sup> The INCR Letter once again called on the SEC to integrate reporting of material factors into its disclosure system, using the GRI Framework as guidance in order to provide uniform and comparable information.<sup>42</sup>

The need for reform of the SEC disclosure standards is apparent. Recently, additional standards for climate change risk reporting have been proposed by the Climate Disclosure Standards Board in its Reporting Framework and by ASTM International in its Draft Guide for Financial Disclosures Attributed to Climate Change.<sup>43</sup> While publication of such standards will assist companies in determining how to assess and report climate change risk, it is imperative that the SEC adopt a uniform standard in its clarification of the reporting requirements for public companies.

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<sup>37</sup> Assurance of Discontinuance, *In re* Xcel Energy Inc., *supra* note 35.

<sup>38</sup> *Supra* note 27.

<sup>39</sup> INCR Letter, *supra* note 23, at 2.

<sup>40</sup> *Investors Press S&P 500 Companies for Better Disclosure on Social and Environmental Challenges*, CERES, Oct. 4, 2006, <http://www.ceres.org/Page.aspx?pid=520>.

<sup>41</sup> INCR Letter, *supra* note 23, at 2.

<sup>42</sup> *Id.* at 2-3.

<sup>43</sup> Climate Disclosure Standards Board Reporting Framework: Exposure Draft (2009), *available at* [http://www.cdsb-global.org/uploads/pdf/CDSB\\_Reporting\\_Framework.pdf](http://www.cdsb-global.org/uploads/pdf/CDSB_Reporting_Framework.pdf); ASTM International, Draft Guide for Financial Disclosures Attributed to Climate Change (2009) (on file with author).



Governmental authorities and accounting bodies in other countries have issued specific guidance on climate change risk disclosure. For example, the Canadian Institute of Chartered Accountants issued the first climate change risk disclosure guidance by an accounting body in 2005 in its MD&A Disclosure about the Financial Impact of Climate Change and Other Environmental Issues, which provides best practices for such disclosure and clarifies existing regulatory requirements on climate change and other environmental risk disclosure.<sup>44</sup> The European Union in its Accounts Modernization Directive discussed the needs for companies to disclose environmental Key Performance Indicators (“KPIs”) and the United Kingdom Department for Environment, Food and Rural Affairs has issued guidance that outlines best practices for companies using these KPIs.<sup>45</sup> The proliferation of standards at the national and regional level raises the specter that U.S. companies, many of which operate across national borders, may be subject to multiple reporting standards. It would be useful for the SEC and other financial regulators to cooperate on an international level to ensure that such standards are uniform and consistent across national borders. This effort might be coordinated through a multilateral organization, and then subsequently implemented on the national level by cooperating countries. It should be recognized that climate change is a global problem, not just a national problem, and that international coordination on climate change risk disclosure is necessary.

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<sup>44</sup> CANADIAN PERFORMANCE REPORTING BOARD, MD&A DISCLOSURE ABOUT THE FINANCIAL IMPACT OF CLIMATE CHANGE AND OTHER ENVIRONMENTAL ISSUES (Oct. 2005).

<sup>45</sup> Council Directive 2004/109/EC, 2004 O.J. (L 390) 38; ENVIRONMENTAL KEY PERFORMANCE INDICATORS, DEPT. FOR ENV’T, FOOD & RURAL AFFAIRS (2006), *available at* <http://www.defra.gov.uk/environment/business/reporting/pdf/envkpi-guidelines.pdf>.