Changing Standards For Environmental Disclosures

September 7, 2011

Elaine Wolff, Partner, Jenner & Block

Jim Coburn, Senior Manager, Investor Programs, Ceres

Katie Pavlovsky, Principal, Deloitte Financial Advisory Services

C. Gregory Rogers, President, Advanced Environmental Dimensions, LLC

E. Lynn Grayson, Partner, Jenner & Block, ***Moderator***

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Elaine Wolff

JENNER & BLOCK

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Reference

SEC Interpretive Release

Title: Commission Guidance Regarding Disclosure Related to Climate Change

Effective Date: February 8, 2010

Citation Information: Exchange Act Release Nos. 33-9016, 34-61469 (Feb. 2, 2010), *available at* http://www.sec.gov/rules/interp.shtml.

Changing Standards for Environmental Disclosures

Overview of SEC Climate Change Interpretive Release

Two-pronged analysis to determine whether disclosure of known trend is required:

•Is the known trend, event or uncertainty likely to come to fruition? If management determines that the contingency is **not reasonably likely to occur-no disclosure is required**.

- If management **cannot** make the determination that it is not reasonably likely to occur, **it must assume** that it will come to fruition. In this case, **disclosure is required, unless** management decides **that a material effect** on the company's financial condition or results of operations **is not reasonably likely to occur**.

Four areas of climate change matters that companies should consider for disclosure:

- The impact of legislation and regulation
- Effects of international accords
- Indirect consequences of regulation and business trends
- Physical impacts of climate change on the environment

Regulation S-K requires climate change discussion in the following sections of Form 10-K:

- **Business description**
- **Risk factors**
- **Legal Proceedings**
- **Managements Discussion and Analysis**

SEC comments on climate change disclosures

Since the Release, we have identified only about 14 climate change disclosure comments issued by the SEC. The comments were issued to:

- two manufacturing companies,
- five energy companies
- two companies focusing on coal bed methane gas,
- two insurance companies,
- one company that provides water and sewage systems, and
- one beauty salon.

SEC comments on climate change disclosure include:

- Questions regarding consideration given to the Release in preparing the disclosure on climate change matters.
- Request for a stand-alone climate risk factor rather than inclusion in a general environmental risk factor.
- Request for greater clarification of climate change risk factors and deletion of mitigating risk factor disclosure from the presentation of the risk.

- Request for clarification of amounts spent and anticipated spending in furtherance of the company’s enumerated targets with “a view toward providing a more complete description of the material effects of government regulations on the company’s business.”
- With respect to the insurance companies, the comments requested disclosure of the material risks related to climate change.

- Request for disclosure about the expected effect of two federal climate change bills that were discussed elsewhere in the filing.
- Question regarding the need for disclosure on the UN Framework Convention on Climate Change and the Kyoto Protocol in light of a statement that climate change would “not have any specific effect” on its operations.

Climate change disclosure in light of new SEC trends in examining filings.

FASB's old FAS No. 5 (now Topic 450)

- Requires companies to **accrue** an estimated loss for a loss contingency if the information that is available before the financial statements are issued indicates that it is both ***probable*** and ***can be reasonably estimated.***

- Even where the company determines that no **accrual** is necessary because a loss is not considered "probable" and/or cannot be reasonably estimated, a company must nevertheless **disclose** the loss contingency in the footnotes to the financial statements if there is at least a **reasonable possibility** that a loss may have been incurred.

Review of public statements

The Staff of the Division of Corporation Finance are listening to earnings calls and reviewing companies websites to ensure that disclosure that the company has made public in other forums and have couched as material to the company appear in their SEC filings.

Companies should review statements about climate change that have been considered material enough to have been discussed in earnings calls, earnings releases and on a website to determine whether they ought to be considered for inclusion in the company's filings.

Investor Network on CLIMATE RISK a project of Ceres

Investor Perspectives:
Disclosure of Climate Risks and Opportunities

September 7, 2011

Jim Coburn, Senior Manager, Investor Programs

Ceres

Investor Network on
CLIMATE RISK

a project of Ceres

Ceres is a national network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges, such as climate change.

Company Network

More than 80 members in more than 20 sectors

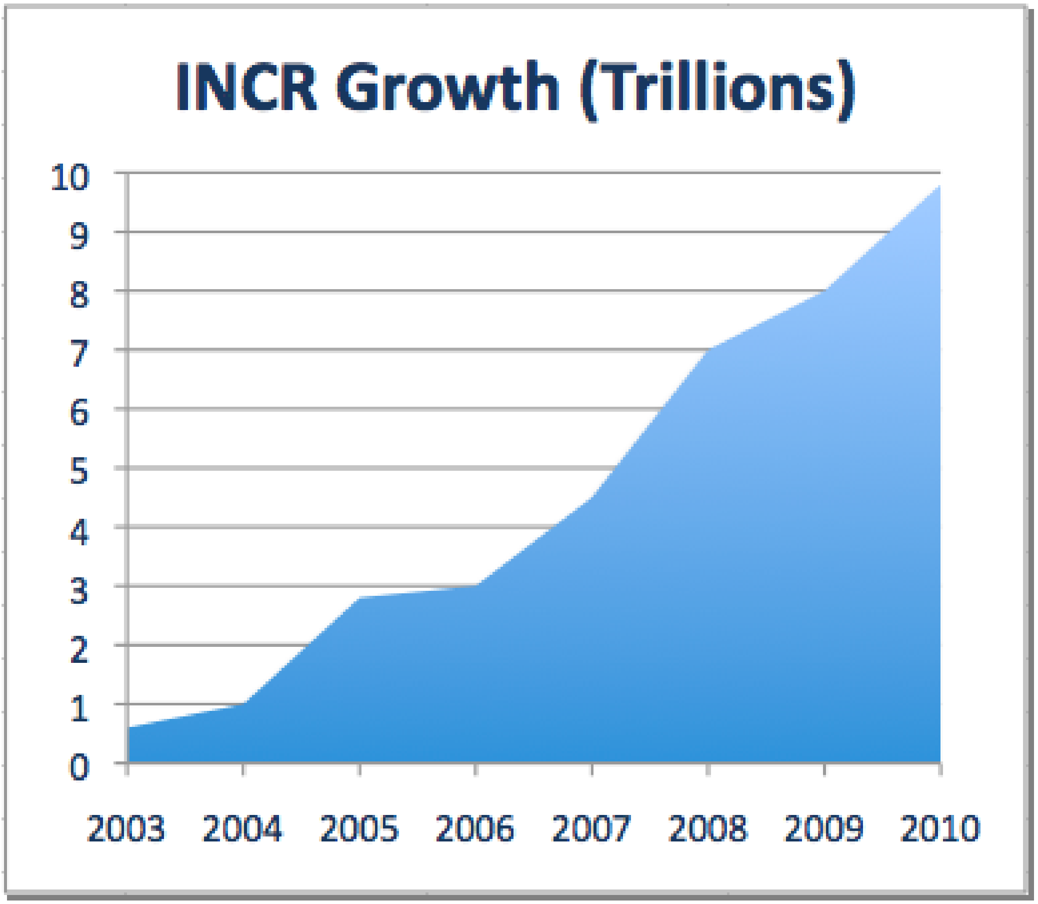
Investor Network

More than 90 members currently representing $9.8 trillion

The Ceres Coalition

More than 130 organizations including environmental experts, public interest groups, and investors

Investor Network on Climate Risk



Key members include

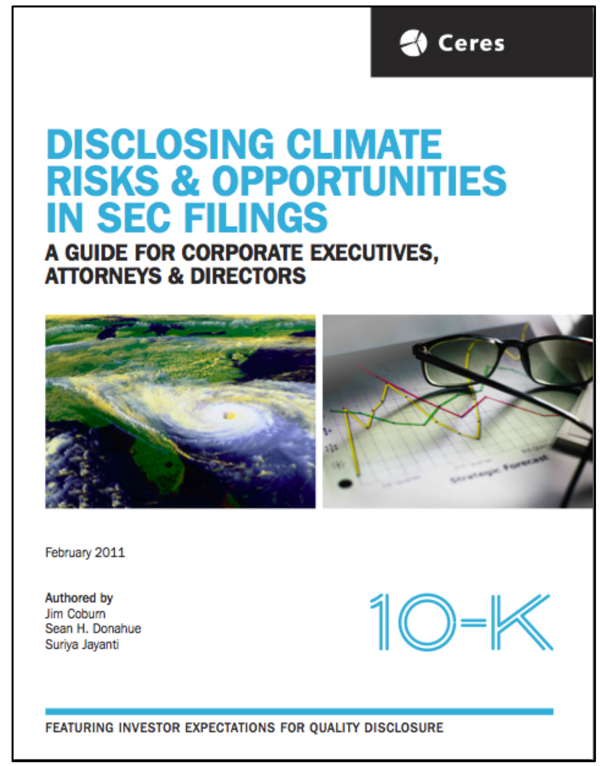
- CalPERS
- CalSTRS
- Deutsche Asset Management
- Florida State Board
- Illinois State Treasurer
- North Carolina Treasurer
- NYC Comptroller
- NY STRS
- Blackrock Financial
- TIAA-CREF
- State Street Global Advisors

Overview

- SEC and investor expectations for reporting, including disclosure examples from SEC filings
- Emerging standards for climate disclosure

New guide to disclosing climate risks/opportunities

- Overall quality of disclosure, while improving, does not meet investors’ needs
- Companies provide most disclosure about regulatory risks, although financial impacts rarely discussed
- Physical risks usually not discussed in detail, nor are impacts quantified
- Indirect risks or opportunities rarely discussed



Impact of legislation and regulation

- SEC examples of possible consequences of pending legislation and regulation include:
  - "Costs to purchase, or profits from sales of, allowances or credits under a 'cap and trade' system"
  - "Costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a 'cap and trade' regime"

AES

AES Corp. 2010 10-K filing disclosed:

- Description of Regional Greenhouse Gas Initiative (RGGI), a currently operating cap-and-trade regime in Northeast U.S.
- Discussion of AES facilities in 4 states affected by RGGI (CT, MD, NY, NJ)
- *Financial impact of an existing regulation*: estimated RGGI compliance costs of $15 million for 2011, and modeling used to arrive at this estimate.

Physical impacts

SEC examples include:

- "For registrants with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products"

- "Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods"

- "Decreased agricultural production capacity in areas affected by drought or other weather-related changes"

Chiquita

Chiquita Brands International Inc. 2010 10-K filing:

- Disclosed information on physical risk to supply chain, and potential increased risk from climate change
- Disclosed lower productivity from cooler temperatures across Latin American growing regions in fourth quarter 2010
- Quantified costs from "weather-related disruptions" at approximately $33 million as a result of flooding in Costa Rica and Panama in 2008 and 2009

Chiquita Brands International

Indirect consequences of regulation or business trends

SEC examples include:

- "Decreased demand for goods that produce significant greenhouse gas emissions"
- "Increased demand for goods that result in lower emissions than competing products"
- "Increased demand for generation and transmission of energy from alternative energy sources"

Siemens 2010 20-F

- Included information on indirect consequences of *business trends*
- "Environmental Portfolio" is products/services with "direct and verifiable contribution" to environmental and climate protection. Rationale for Portfolio:

> "Global megatrends are long-term processes that will drive global demand in coming decades. We at Siemens view demographic change, urbanization, **climate change** and globalization as megatrends that will have an impact on all humanity and leave their mark on global developments. **We therefore have aligned our strategy and business activities with these trends**."

- Disclosed €27.6 billion in revenues from Environmental Portfolio in 2010, accounting for about **36% of total revenues**

SIEMENS

GHG emissions

Investors ask for disclosure of:

- Past emissions
- Current direct and indirect emissions; and
- Estimated future direct and indirect emissions of greenhouse gases from operations, purchased electricity, and products/services

Rio Tinto 2010 20-F

- Disclosed greenhouse gas emissions, each group's contribution to company's total emissions, and emissions calculation process
- "Our total GHG emissions were 43.4 million tonnes of carbon dioxide equivalent (CO_2e) in 2010, 2.3 million tonnes higher than in 2009."
- Tracked emissions "associated with our products along the value chain." Three largest sources of indirect emissions: transport, coal for electricity generation and steel production, and iron ore for steel production.

RIO TINTO

Investor Network on CLIMATE RISK a project of Ceres

Climate Disclosure Standards Board (CDSB) framework

- **Strategic analysis:** Disclosure should connect information used for internal management decisions to information provided to investors.

- **Management actions:** Disclosure should include long- and short-term strategies to address climate risks and opportunities and reduce GHG emissions, including reduction targets and an analysis of performance against those targets.

- **Future outlook:** Disclosure should include timeframe for strategies, and factors that would change the timeframe.

ASTM standard for climate disclosure in financial filings

- Disclosures should be made when a company's financial impacts "**in the aggregate**" are material

- Disclosure should include a company's:
  - Position
  - Strategic activities
  - Corporate governance information

- If **financial impacts can't be quantified,** "A written statement should describe the conditions or problems associated with estimation."

Thank You

Jim Coburn
Senior Manager, Investor Programs
Ceres

617-247-0700 ext. 119
coburn@ceres.org

www.ceres.org
www.incr.com

Ceres

Changing Standards for Environmental Disclosures

Kathryn Pavlovsky, Deloitte Financial Advisory Services LLP

September 7, 2011

Agenda

Overview of SEC guidance on disclosure

Marketplace activity influencing disclosure

Governance structure

Business implications

Overview of SEC's Guidance on Disclosure

Item 101 of Regulation S-K, *Description of Business*. Item 101 requires a registrant to describe its business and that of its subsidiaries. Also, among other things,Item 101 expressly requires disclosure regarding certain costs of complying with environmental laws.

Item 103 of Regulation S-K,*Legal Proceedings*. Item 103 requires a registrant to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party. Instruction 5 to Item 103 provides some specific requirements that apply to disclosure of certain environmental litigation.

Item 303 of Regulation S-K, *Management's Discussion and Analysis of Financial Condition and Results of Operations*. Item 303 includes a broad range of disclosure items that address the registrant's liquidity, capital resources and results of operations. For example, registrants must identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance.

Item 503 of Regulation S-K, *Prospectus Summary, Risk Factors, and Ratio of Earnings to FixedCharges*.Item 503(c) requires a registrant to provide where appropriate,under the heading "Risk Factors,"a discussion of the most significant factors that make an investment in the registrant speculative or risky.

In addition to the disclosure requirements of Regulation S-K and Regulation S-X, the Securities Act Rule 408 and Exchange Act Rule 12b-20 require a registrant to disclose "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."

Marketplace forces influencing disclosure

- Accounting standards trend towards transparency
  - Lower thresholds for probability
  - Fair value measurement
  - Enhanced provisions for estimating
  - Prescriptive disclosure requirements
- Alignment of regulatory bodies
  - Congress and the SEC (Dodd-Frank Act)
  - Environmental, Safety & Enforcement regulators
  - SEC (Climate Change Disclosure)
- Subpoenas
- Shareholder resolutions
- Catastrophic events

Governance considerations

Does the Company have adequate Governance structures?

- Accountability supported by appropriate competencies
- Policies, procedures and controls
- Data collection systems

Has the risk been appropriately assessed? How reliable is the supporting data and information?

- Uncertainty regarding legislation/regulation
- Materiality / likelihood threshold and analysis
- Application of relevant frameworks (e.g. regulatory, ISO, ASTM, etc)

Are the Company's disclosures consistent across communication channels?

Potential business implications

Enterprise-wide understanding of sustainability-related risks and opportunities including but not limited to:

- **Regulatory**
  - Enacted and proposed regulation and corresponding enforcement provisions
  - Current emissions and potential for reduction
- **Operational**
  - Physical risks
  - Business partner/supply and value chain implications
- **Reputational**
  - Consistency with previous representations in Voluntary disclosures and across communication channels
- **Financial**
  - Financial and accounting implications including whether the Company has corresponding asset or liability positions
  - Adequacy of internal processes, procedures, controls and systems for information gathering and reporting

Context-based performance management and review of management’s approach to address climate change and sustainability-related growth and innovation opportunities

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Changing Standards for Environmental Disclosures

A Legal & Market Perspective

C. Gregory Rogers, JD, CPA

Agenda

- Disclosure objectives: What are you trying to accomplish?
- Legal and liability considerations: Has the legal calculus changed?
- Investors and the market: Is disclosure relevant to valuation?

Disclosure Objectives

- Compliance with Regulation S-K
- Compliance with GAAP
- Compliance with anti-fraud provisions of securities laws: avoidance of future shareholder class action claims
- Increasing corporate value by —
  - Reducing inaccurate market perceptions of risk?
  - Increasing market perception of competency in governance and risk management?
- Other?

Legal and Liability Considerations

- Has the law changed?
- Have accounting standards changed?
- What does the law minimally require?
- Is SEC enforcement reasonably foreseeable?
- What are the benefits and risks of disclosing more than the law mandates?

Disclosure Risks

- Getting too far ahead of possible changes in climate change legislation and physical climate change
- If the risk is perceived to be reasonably likely and material: disclosure of confidential/strategic business information
- If the risk is not perceived to be reasonably likely and material: high cost of investigation to estimate potential financial impact and potential inappropriate use of corporate resources to do so

Disclosure Risks (cont.)

- Just don’t know: attracting undue negative attention by stepping out from the pack without good reason to do so
- Prospective information: risks of disclosing positive forecasts
- 20/20 hindsight bias: whatever you say can and will be used against you

Market Considerations

- Beginning with the end in mind: Imagining a loss scenario
  - Differentiated impact of climate change / environmental risk on a particular company versus an entire industry
  - High-risk scenarios –
    - Changing your current position (e.g., large new cap-ex in coal-fired power plants) without due regard for possible changes in climate regulations or market forces.
    - Operating in the zone of insolvency due to undisclosed environmental liability (e.g., Tronox).

Market Considerations (cont.)

- Market efficiency: self-disclosure vs. independent research?
- Disclosure laws not designed to ensure sound risk management: market is free to infer poor risk management from lack of disclosure but is there evidence that the market is doing so?

Changing Standards for Environmental Disclosures

QUESTIONS?

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Other Environmental Disclosure Resources

"SEC Disclosure Obligations: Increasing Scrutiny on Environmental Liabilities and Climate Change Impacts," *Environmental Issues in Business Transactions*, American Bar Association, 2011

By: E. Lynn Grayson and Patricia L. Boye-Williams

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Other Environmental Disclosure Resources

"Disclosing Climate Risks & Opportunities in SEC Filings – A Guide for Corporate Executives, Attorneys and Directors," a Ceres report featuring investor expectations for quality disclosures (February 2011)

By: Jim Coburn, Sean H. Donahue and Suriya Jayanti

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