September 26, 2007

ENVIRONMENTAL ALERT

CLIMATE CHANGE DISCLOSURE OBLIGATIONS HEATING UP

Publicly-traded companies faced with potential climate change obligations, a set that includes nearly every company, are facing rapidly increasing scrutiny of their securities disclosures. New York Attorney General Andrew Cuomo subpoenaed five major energy companies last week to determine whether the companies adequately disclosed the financial risks likely to arise from climate change regulations. On the heels of that action, a group of state officials and environmental organizations jointly petitioned the Securities and Exchange Commission (SEC) for clarification that companies are obligated to disclose the financial risks posed by impending climate change regulations.

Attorney General Cuomo is investigating whether the five corporations targeted by his initiative provided investors with sufficient information regarding the financial risk posed by likely future climate change regulations in connection with the companies' plans to build new coal-fired power plants. Cuomo issued the subpoenas under New York's Martin Act, which grants the attorney general broad powers to investigate and prosecute any "fraudulent practices" in connection with securities trading. N.Y. Gen. Bus. Law, Art. 23-A § 352.

The standards for liability under the fraud provisions of the Martin Act are exceptionally broad, with many of the traditional elements of fraud such as intent and reliance nonapplicable. The attorney general must only show a material misrepresentation or material omission and may seek injunctive relief and restitution of any money or property obtained. The only traditional elements of a fraud claim required under the Martin Act appear to be a material misrepresentation or omission. The New York Court of Appeals has held that "an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . It does not require proof of a *substantial likelihood* that disclosure of the omitted fact would have caused the reasonable investor to change his vote." *State v. Rachmani Corp*., 71 N.Y.2d 718, 726-27 (N.Y. 1988) (citations omitted) (emphasis in original).

On September 18, 2007, a consortium of state treasurers and comptrollers, municipal treasurers, environmental groups and large institutional investors petitioned the SEC to issue guidance requiring greater public disclosure of risks associated with climate change. Petitioners simultaneously sent a letter calling for the SEC's Division of Corporate Finance to examine the adequacy of climate change related disclosures when reviewing 10-K and 10-Q filings to ensure the filings meet existing requirements.

Publicly-held corporations are required to disclose facts about their performance and operations that would be material to a reasonable shareholder's investment decisions. The petition argues that concerns about climate risk are now highly relevant to a reasonable investor, and generally are not sufficiently disclosed in corporate filings. The petition identifies three specific areas of risks related to climate change:

- physical risks associated with climate change that are material to the company's operations or financial condition
- financial risks and opportunities associated with present or probable greenhouse gas regulation
- legal proceedings relating to climate change.

Physical risks include risks to personnel, physical assets and supply and distribution chains; they can be the result of – among other things – changes in weather patterns, rising sea levels, loss of permafrost or the lack of available clean water. Financial risks associated with regulation are most obvious when dealing with direct emitters of greenhouse gases. Corporations owning these facilities will likely face new laws and regulations and will be faced with determining costs of compliance and penalties for non-compliance. Financial risks can also arise indirectly, such as when regulation increases the costs or decreases the supply of a good or service on which a business depends, or decreases the demand for a business' own products or services. Finally, numerous lawsuits have already been filed against emitters of greenhouse gases, and this trend is likely to increase as state and local governments seek to recover costs they will incur in adapting to climate change regulation.

The petition seeks only "interpretive guidance," not the enactment of new regulations. The petition asserts that disclosure requirements already in force, primarily Statement of Financial Accounting Standards No. 5 (FAS 5) and SEC Regulation S-K, already require greater disclosure than is typically being made. Accordingly, the petition requests that the SEC "issue an interpretive release clarifying that registrants, in preparing their periodic mandatory public disclosures, must carefully review the implications of climate change for their financial condition and operations, and must disclose climate risks that are material." Corporations subject to SEC regulation should review their internal procedures for gathering information about and assessing climate risk and ensure that they have established mechanisms necessary to ensure careful review and appropriate disclosure of potential climate risks.

Publicly-traded companies must be prepared to protect themselves and their investors against the threat of possible Martin Act enforcement actions by the state of New York and enforcement actions brought by the SEC. Lawyers at Akin Gump have developed strategies to keep companies out of the line of fire. Akin Gump's deep and expansive knowledge of climate change issues, and disclosure requirements and "political knowledge" of SEC activities can shield clients from the threat of similar enforcement actions.

Attorney General Cuomo's letters to the energy companies may be found at:
www.oag.state.ny.us/press/2007/sep/sep17a_07.html

The joint petition to the SEC may be found at: www.ceres.org/pub/docs/Full%20Petition.pdf

CONTACT INFORMATION

For more information on climate change disclosure obligations, please contact:

Paul E. Gutermann................. 202.887.4088 .... pgutermann@akingump.com.................. Washington, D.C.
Kenneth B. Mehlman............. 202.887.4049 .... kmehlman@akingump.com.................... Washington, D.C.
Robert H. Pees....................... 212.872.1072 .... rpees@akingump.com .... New York
Robert A. Johnson .... 212.872.1077 .... rajohnson@akingump.com .... New York

Austin Beijing Dallas Dubai Houston London Los Angeles Moscow
New York Philadelphia San Antonio San Francisco Silicon Valley Taipei Washington, D.C.