BNA's

Environmental Due Diligence Guide

REPORT

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An Insider's Perspective

Investment Community Driving Climate Risk Disclosure, Attorney Says

With ever-growing attention on the impact of climate change, the prospect of government regulation of greenhouse gas emissions, and lawsuits alleging damages from carbon emissions, investors increasingly are pressuring public companies to disclose information on climate-related risks in their SEC filings, a Dallas attorney told BNA Dec. 12.

Institutional investors want to ensure the companies in which they invest are aware of the risks they face and are taking steps to address them. ''If investors don't see meaningful disclosure on climate risk, they may assume that companies are blind to the risk or at least ill-prepared to deal with it,'' Greg Rogers, counsel with the Dallas environmental law firm Guida, Slavich & Flores, told BNA. Rogers also is president of Advanced Environmental Dimensions, located in Dallas.

A Corporate Governance Issue

Institutional investors, such as state pension funds, see climate risk as a corporate governance issue, Rogers explained. These are long-term investors. ''They are broadly invested in the market and cannot simply pull their money out. They learned from their huge losses with Enron that they can no longer be passive as companies fail to address significant risks, such as climate change,'' Rogers said.

Essentially, institutional investors are saying to companies, ''We need you to be successful over the long term, and we are going to put pressure on you to do a better job of managing these emerging risks.'' Smaller investors would not do this, Rogers explained. They simply would sell the stock.

Initially, companies must determine whether climate-related risks are material, that is, are they important investment factors for current and prospective investors in their business, said Rogers. If climate issues potentially are material, companies need to thoroughly assess these risks and provide appropriate disclosure under Securities and Exchange Commission Regulation S-K.

Three Categories of Risk

Investors are pressing companies to evaluate three categories of risk related to climate change. The first is regulatory risk, or the financial impact of existing and future government regulations on carbon emissions, Rogers said.

There also is physical risk associated with foreseeable changes in the climate, such as drought, increased storm intensity, and rising seawater levels. ''Once you consider physical risk, the number of companies and industries impacted is much larger,'' Rogers said.

Finally, there is litigation risk, or the risk that companies could be held liable for harm associated with their carbon emissions. For now, Rogers thinks litigation risk is a limited concern. Although lawsuits asserting liability for carbon emissions have been filed against a few companies, ''the legal theories are tenuous and there have been no successful cases,'' Rogers said. ''Litigation over carbon emissions is isolated and does not present the same challenges for disclosure as regulatory and physical risk,'' Rogers said. ''You have either been sued or you haven't. It's not hard to determine.'' Future litigation alleging failure to appropriately manage or disclose regulatory and physical risk may be a bigger concern, he added.

Determining what information is important and the extent to which it should be disclosed and why is a complex and strategic task, Rogers explained. ''It is not just a legal issue. If investors are undervaluing your stock because they wrongly believe you are ignoring a material risk, disclosure is a means of increasing corporate value.''

''There is a spectrum of disclosure that applies here,'' Rogers said. ''A company might acknowledge that a risk exists, describe the potential impacts either qualitatively or quantitatively, or go one step further and describe the strategies in place to address the risk,'' he said. Investors are asking for all of this information, but few companies are providing it.

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Regarding how these risks are communicated to investors, Rogers explained that disclosure is happening through both voluntary and mandatory media.

Inconsistency in Disclosure

Initially, investors pressured companies to participate in voluntary disclosure programs like the Carbon Disclosure Project (CDP). More recently, they are focusing on mandatory disclosure obligations under SEC regulations.

What is happening, Rogers said, is that companies are providing investors with more detailed and meaningful information in their voluntary disclosures than in their SEC filings. ''The inconsistency raises a legal issue. If companies are intending to gain favor with investors through voluntary disclosure, then presumably they believe the information is material to investment decisions. If so, the same information should be in their SEC filings,'' Rogers added.

The use of dual reporting tracks, voluntary (CDP) versus mandatory (SEC), is emerging as an important issue. ''Especially given the legal risk, do we really need two disclosure channels or just better SEC disclosure?'' Rogers believes the quantity and quality of climate disclosure in SEC filings will increase over time. ''It is just a natural response as companies adapt to a changing physical, regulatory, and business climate.''

More information about environmental disclosure and climate risk is available on Rogers's Web site at http://www.fin47.com. Rogers also is the chairman of the American Bar Association's Environmental Disclosure Committee. He can be reached via e-mail at rogers@gsfpc.com.

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EDDG ISSN 1931-6615