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Climate's Impact on Securities Disclosures

Editors' Summary: On September 27, 2007, the Environmental Law Institute and Sidley Austin LLP cosponsored a seminar to discuss drafting climate change securities disclosures. The panelists examined SEC requirements applying to climate change, examples of climate change disclosures, and what investors want to know about climate change and what they are doing to get that information. The seminar concluded with a question-and-answer period. Below is a transcript of the event.

[Transcribed by ACE Transcription Service, Washington, D.C. The transcript has been lightly edited, and citations have been added, for ease of reading.]

Moderator:
Maureen Crough, Partner, Sidley Austin LLP

Panelists:
Carol Lee Rawn, Senior Project Manager, Governance Program, Coalition for Environmentally Responsible Economies (CERES)
Jeffrey Smith, Partner, Cravath, Swaine & Moore LLP

Maureen Crough: I have the pleasure of introducing our two panelists. We have with us today Carol Lee Rawn, an environmental attorney with over 15 years of experience working with federal and state regulatory agencies, companies and not-for-profit organizations. She is currently the senior manager in the Governance Program at CERES, where her primary focus is the Sustainable Governance Forum on Climate Risks, a program that is designed to educate corporate directors and officers about the risks and opportunities presented by climate change. As many of you probably know, CERES was part of a group of organizations that filed a petition with the U.S. Securities and Exchange Commission (SEC) last week seeking interpretive guidance on existing climate change disclosure obligations, and we will spend a fair amount of time talking about that today.

Our other panelist is Jeff Smith. He is the partner in charge of the environmental practice at Cravath, Swaine & Moore, where he works on financings, underwritings, and mergers and acquisitions both nationally and internationally and across all industries. He recently completed a three-year term as chairman of the American Bar Association Special Committee on Environmental Disclosure, and frequently speaks, lectures, and writes on environmental disclosure and corporate governance issues.

I want to talk a bit about what today's agenda is going to be. When we were putting together today's seminar, we decided to focus on what the people who are actually helping corporations draft their climate change disclosure should be thinking about and doing. To do that, I will first analyze how existing SEC requirements apply to climate change.

Then Jeff is going to discuss examples of climate change disclosure and the themes that run through them. He will give us the good, the bad, and the ugly that is out there.

Carol Lee, then, is going to give us an assessment of what CERES thinks investors want to know about climate change, and what, at least, some of those investors are doing to get that information. Finally, we will ponder what the future may bring.

We all know the general concept behind SEC requirements for disclosure of material information and how that gets filtered through the lens of items 101, 103, and MD&A [Management Discussion and Analysis] for environmental purposes.

On September 18th, a group of institutional investors, environmental advocates, and state pension fund managers petitioned the SEC to issue interpretive guidance about how existing SEC requirements apply to climate change. The petition does not ask the SEC to start rulemaking or to issue any kind of new laws. But, the petition goes into great detail interpreting the existing requirements and how the petitioners believe those requirements currently apply to climate change disclosure obligations.

The first item of environmental SEC disclosure is item 101, the description of business. The black-letter interpretation is that it requires disclosure of material effects that compliance with environmental law has on the registrant's capital expenditures, earnings, and competitive position. So if a registrant is operating in a jurisdiction, e.g., EU, in which it is already subject to climate change regulation, it should consider whether it has a disclosure obligation under item 101.

The climate change petition—that is how I am going to refer to the petition that was filed last week—does something interesting when we look at item 101. Petitioners point out the obvious, which is that there are already companies that may well have disclosure obligations under item 101 because of existing environmental laws impacting climate change. But then petitioners point out a part of 101 that,

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frankly, I had not looked at in a very long time: an item called the general development of business.

The petition interprets the requirement broadly and says, under the part of item 101 dealing with the general development of business, that registrants need to think about whether they should be disclosing challenges that climate change presents to their business. Examples of such challenges might be changes to the cost of energy and contingency planning for extreme weather.

I read the regulation and spent time talking to one of my securities colleagues. We think the provision is narrowly written on its face. There can be differences of interpretation, but some commentators may say this part of the petition is incorrect when it asserts that it is simply interpreting existing law.

I will paraphrase this provision of item 101: "Describe the general development of the business of the registrant during the past five years. Information shall be disclosed for earlier periods of material." So right away, we are looking backwards. People think about climate change as forward-looking and being MD&A, but in the petition there is an interpretation of item 101 that is broader than that. This section of 101 also says, "In describing these developments, information should be given as to matters such as the following: the year in which the registrant was organized and its form of organization; the nature and results of certain transactions including certain acquisitions, divestitures, consolidations, and even bankruptcy filing." When you look at the language, it is on the narrow side. It will be interesting to see if this provision is interpreted broadly in the context of climate change or whether people stick to more literal interpretations.

I think we are all familiar with the basics of item 103 in the context of environmental litigation. If you have a registrant who is subject to an environmental legal proceeding, two key circumstances need to be considered for disclosure. In general terms, is the proceeding likely to be material? On a more micro level, if a government agency is a party, and monetary sanctions of $100,000 or more may be imposed, then there may be a disclosure obligation. In the context of climate change, one obvious example is if a company is already subject to climate change litigation, it should consider whether it has a disclosure obligation under item 103.

There are some commentators, though, that have gone farther in interpreting item 103. They say, "Well, even if a registrant is not actually a party to a climate change lawsuit, if the litigation could have significant impacts on its industry or lead to a change in regulation, perhaps the registrant should disclose it under item 103." It is interesting that the climate change petition filed last week does not make that interpretation. I think it is an expansive point. Item 103 talks about what parties in litigation need to disclose, such as, "What court are you in? How much is being sought in damages?" I think it is an extrapolation to say the provision requires disclosure of broader kinds of climate change litigation to which the registrant is not a party.

We will move on now to the MD&A, which is where most commentators focus when talking about making disclosure of climate change impacts. The climate change petitioners wrote extensively about MD&A type requirements.

The traditional formulation of MD&A includes disclosing known trends, events, or uncertainties that may have material effects on a company's financial condition. The climate change petition focuses on the phrase about a known trend and says, "both the physical and legal consequences of climate change have undoubtedly become known trends within the meaning of the commission's regulatory standards." This petition is making it very clear that it thinks MD&A is applicable to climate change disclosure.

I found it interesting that the petition focuses on legal consequences, which, obviously, lawyers are familiar with. What are proposed regulations? Where are the cases going? Those are the kinds of issue that lawyers can analyze. But a broader concept running through the climate change petition focuses on the physical consequences of climate change. I think the petition is asking, "When you look at a company's business from all angles and how climate change may impact the world, what is that going to mean in a big picture sense for the company?"

An example would be if you have a company that manages a series of resorts along the coast and you think about potential rising water levels—what kind of impact is that going to have and should it be disclosed in the MD&A? The other side is, "What if there are opportunities?" The petition points out the opportunities for some companies of climate change. What if a business generates equipment for wind farms? Maybe that is something that should be disclosed. It may not be anything that has a legal impact on the company, but there are physical consequences for that kind of a company. I think the petition supports those kinds of disclosures.

The traditional formulation of when a company needs to disclose material and environmental problems in the MD&A is the old standard from the 1989 MD&A interpretive release. Most people interpreted the standard to mean that if management knows of a potentially material environmental problem, disclosure is required unless management can determine that the problem is not reasonably likely to cause a material effect either because the event is not likely to happen, or if it does happen, the effect is not likely to be material. And then the MD&A interpretive release from 1989 goes on to give an example of that, which is really relevant when we talk about climate change.

The SEC 1989 interpretive release gave a good example of MD&A disclosure. It is not environmental per se, but it concerns what happens to a company that is facing potential regulations that, if promulgated, would require expenditures of approximately $30 million over a three-year period. The assumption is that the expenditure would be material for the company. The SEC is basically saying that legislation on the books that requires the regulations and the regulations have been proposed. In this circumstance, the company cannot make the determinations needed under the two-pronged, prove-the-negative test in order to get it out of the disclosure category, so it is in a circumstance where it is making MD&A disclosure.

If you parse this example of disclosure, you see the situation where the company has a fair amount of certainty that regulations are going to be passed because the law has already been passed requiring the regulations. I know some commentators point to this example and say, "Well, this example strongly indicates you should use the same kind of analysis if you are talking about proposed legislation."

There is a difference between proposed legislation and proposed regulation. With proposed regulation, you know that eventually something is going to happen because there is already a law on the books. The likelihood of proposed

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legislation being enacted is more speculative. But, I think it is hard for some businesses, especially ones in energy-intensive areas, to say that federal climate change legislation is not reasonably likely to happen, given the number of climate change proposals at the federal level.

One other point I would like to make about the 1989 MD&A release is that the release said that "each determination that is made must be objectively reasonable when viewed as of the time made." That statement was made at a point when there was a lot of uncertainty about what kind of disclosures a company needed to make about their Superfund liability. One thing that would happen is the company would have a paragraph about their potential responsibility at a site and give some details. Sometimes they would give potential dollars—the total amount of cleanup cost—and then conclude by saying, "But management does not believe that this will have a material impact on us." Then the SEC started saying, "Okay, why do you think it will not be material? There is always uncertainty. How did you get to that conclusion?" Some companies could give a good response because they knew the analysis of how they got there, and other companies were a little bit looser about what their basis was for the conclusion.

This is one of the issues that prompted people to start talking about the fact that statements in the environmental disclosures need to be objectively reasonable. When you start thinking about what can happen in the future in terms of climate change legislation, you come to this broader concept of what the physical consequences of climate change are for a company. I think in some areas it can be hard to reach this objectively reasonable standard.

The final point I want to mention regarding the climate change petition has to do with FASB [Financial Accounting Standards Board] 5. I have not seen the accountants say a lot about climate change. The climate change petition says that there are circumstances in which companies should already be accruing for climate change liability or at least should be disclosing the risk in footnotes on their balance sheets. The petition gives three examples of circumstances where the petitioners think companies may have already crossed the line.

First, where the companies are sources of significant levels of greenhouse gases, they are already subject to regulation and are obligated to disclose. Second, when the companies are considering major capital investments that are impacted by emerging regulation of greenhouse gas emissions, they are obligated to disclose. Third, if the corporations have physical operations at risk due to developments such as melting permafrost or storm damage, they may be obligated to disclose. The third point is what I referred to as this more amorphous concept of the physical risk to corporations resulting from climate change.

Now let us say a company is working on climate change disclosure for the MD&A. How does it figure out what it is going to say, especially because there is so much uncertainty in this area? I think a guiding principle has got to be how the company itself looks at climate change risk and analyzes it. And what is management already anticipating?

I was speaking to one of my securities colleagues the other day and I asked him, "How do you think companies should draft climate change disclosure for the MD&A? What framework would they use?" He pointed to this concept: "They should disclose whatever is material that the company itself has already thought about it and is already working through."

What does the climate change petition say about what companies should disclose? The petition lists three different things. One is physical risks that are material to the company's operations or financial condition; two is financial risks and opportunities concerning existing or probable regulations; three is legal proceedings.

So how do you gather this information? There was a lot of focus a few years ago about Sarbanes-Oxley and its requirements to be sure companies have adequate disclosure controls and procedures. I think most, if not all, large corporations now have mechanisms in place to gather environmental information, and to weave it into their financial statements and their SEC disclosure. These mechanisms focus on Superfund, though, and compliance with traditional regulatory programs.

When you think about trying to gather information about climate change, the issues are easier if there is a central coordinator for climate change analysis within a corporation. Different corporations, obviously, are going to be setup differently. Some of them may be more diffuse in terms of who has responsibility. You may have folks in the government relations department who are working on lobbying initiatives and analyzing potential legislative and regulatory impacts. You may have other folks who are working on impacts of climate change on the cost of raw materials, and other people may be working on where the business opportunities lie. I think the most important people to be speaking to when compiling information for disclosures are people who are crunching numbers.

Back in the late 1970s, U.S. Steel had estimated on how much it was going to cost the company to comply with new regulations under the Clean Air Act (CAA) and the Clean Water Act (CWA). The difficulty the company had during enforcement proceedings was those people generating the estimates had not been in a position to share that information with the people that had to make the financial disclosures and were preparing the 10-Ks.

Today, most corporations have good procedures for getting information about Superfund cost estimates to the people who make the financial disclosures. If there are people in companies now who are working on various estimates of climate change impact, is that information getting funneled to the people who are making the disclosure decisions?

We all know Superfund cost estimates are generated for different purposes. For example, some Superfund cleanup cost estimates are generated for insurance settlement purposes, while other estimates may be prepared for purposes of repairing balance sheets. Some companies are very careful about the caveats they put on documents when they are generating response cost estimates for different purposes; I wonder whether companies are thinking about those same kinds of caveats and internal calculations as they are running climate change costs.

Think for a minute about voluntary climate change disclosure. A lot of companies are making their own voluntary disclosure. Issues are being raised, though, about how that voluntary disclosure comports with the disclosure being made to shareholders. There could be a problem if a corporation is disclosing material information about climate change impacts in a voluntary report like a sustainability re-

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port or perhaps in response to a survey from the Carbon Disclosure Project, yet omits that material information from their SEC filings.

The climate change petition discussed this issue of internal controls and procedures, and wants part of the SEC interpretive release to make it clear that companies need to take into account climate change when preparing their financial statements. One of the specific points is for the SEC to state in the interpretive release that companies really should calculate their current and projected greenhouse gas emissions as a starting point for them to figure out what kind of disclosure needs to be made.

As a lawyer, to wrap up any discussion of existing requirements, I have to talk about what is happening on the enforcement front. There has not been a lot of SEC environmental enforcement over the years. Most recently, there were enforcement actions during the last 12 months involving allegations or even findings of improper action about environmental reserves.

When the climate change petition was filed, petitioners were requesting two things of the SEC. One was for the SEC to issue the interpretive release I have been talking about. The other was for the SEC to take a hard look at what corporations are already saying in their SEC filings. Petitioners included what they thought was required in terms of SEC climate change disclosure and asked the SEC to take action if those requirements were not met. I wonder what that action would be: Is that an inquiry letter, a comment letter? Is it an enforcement proceeding?

On September 14th, the New York Attorney General (AG) issued subpoenas to five utilities seeking information about their internal analyses of climate change risks and their disclosure of such risks to investors. This event was widely reported in the press and raised a red flag about corporate internal controls and procedures.

In the letters, the AG asserts that the companies did not even attempt to evaluate or quantify the possible effects of future greenhouse gas emissions, and that the emissions make it difficult for investors to make informed decisions. The letters reminded the companies that states as well as the federal government have their own SEC laws and their own enforcement powers.

One of the questions we just received from the audience has to do with companies that respond to a request for information for the Carbon Disclosure Project (CDP). "If the company is already providing information to the public in areas that the SEC petitioners are interested in, what are the risks to a corporation of referring to its CDP response in its 10-K?" Specifically, CDP responses are not necessarily subject to the same level of rigor as is required for SEC filings, and may offer more qualitative or speculative statements beyond what a corporation typically would include in SEC filing.

Jeffrey Smith: I would say that reflexive incorporation by reference is clearly a tactical error, if for no other reason than the people who are doing your CDP numbers-crunching are typically very different people from the people who are vetting your 10-Ks and your 10-Qs. So if that is being proposed or thought of as a quick answer to what is really a very vexing question, I think it is the wrong answer at the wrong time. That is not to say that it is impossible for all time.

One of the things about environmental management that has been true for a long time is the frustration with the columnar nature of environment, health, and safety data and how it gets broadcast out into the world, how it gets appreciated throughout the corporation, and how, ultimately, for purposes of this conversation, it gets disclosed to the investing public.

One of the things that the climate change series of controversies has done is to put a real turbo charge into that discussion. Coincidentally, it comes at the same time as Sarbanes-Oxley, which has focused management in a way that has never historically been true on data reporting and gathering protocols and real responsibility for that data. Those of you who have been doing environmental management systems for what seems like an eternity are probably much more familiar than you know with the rigors of Sarbanes-Oxley.

If the information can be redistributed in a way that is SEC-friendly, it is clearly very valuable. It may be premature, it may not be material, but a reflexive incorporation by reference is not the way to go—not now.

Audience Member: When the subpoenas were issued by the New York AG, there was not a statement accompanying them saying there would be an enforcement action. The letters seemed to be an information-gathering activity under the investigative authority of the Martin Act. Do you know of other subpoenas that have been issued beyond the five that have been reported, and have you heard any information reported publicly about the AG actually being in enforcement mode as opposed to just gathering information? Also, have you seen any other developments on the SEC front or with other states?

Maureen Crough: I would answer no to all of that. I have not heard of the SEC or any other states at this point issuing subpoenas or anything different than what has been reported in the press.

Jeffrey Smith: No, technically. But I will venture a guess politically that, without making any commentary on this AG's agenda, it would be very surprising if he took this bold move under the Martin Act and extended both the Martin Act and extended himself into this arena, with one of his principal assistants as a signatory to the subpoenas, without having both a second and a third act of the play very firmly in mind. Those second and third acts would not only be, "What is it that you have to say to me in response to the subpoena," but expansion of this process along the lines that your question implies. In English, the other shoe has yet to drop.

Audience Member: Do you have any insight into whether New York will be looking for legislation along the lines of the federal legislation?

Maureen Crough: No.

Jeffrey Smith: I am not a Beltway guy, and I am not an Albany guy. I think the real answers to the question are Beltway answers and Albany answers. But I do think that part of what is going on in the CERES petition and part of the extraordinary aspect of climate change regulation to date has been the primacy that the states and localities have played in

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the federal vacuum, and how far they have gotten with what they have done.

I do not know if you practice environmental law or you are on the securities side, but the phenomena of the state as legislative laboratory is one that we are very well familiar with. There was a Spill Act before there was Superfund. So we know how that story plays out. I am actually stunned at how far the states have gotten. I think it is clear that has emboldened not only Governor [Arnold] Schwarzenegger in his arena, but it has also emboldened others similarly situated to make extraordinary moves. Long answer short, it ups the ante and raises the chances that something is going to happen on the federal level.

In a moment, I will show you some examples of what I have assembled from my files and from other sources of how this story is actually playing out in real language and for real people. Most of it is public disclosure. There is a little bit of voluntary disclosure in here. I have deleted the names to give me a latitude to make comments that are maybe snide and maybe even self-critical, since I actually helped draft some of this language.

I do not intend to bash anybody or to suggest that somebody is in the wrong place at the wrong time but, first, what I think you are going to take away from this is the incredible variability in the underlying issues—scientific, legal, regulatory, etc. And that alone, before you get into company culture, politics and all the rest, has led to incredible variability in actual disclosure practices.

Second, I think there are a number of companies who are doing the best that they can with the cards that have been dealt thus far, and that to do more or to do it faster would be inappropriate. There is a lot of focus today for stakeholders to look up the ladder and say, "Why is your page blank? Why are you only saying two lines? This is the major defining issue of our time." But when you actually filter most climate change disclosure through the working realities of what is actually known and what is on the table, most companies end up in a place that is at least marginally defensible.

Third, I think that there are a lot of different things in play, and that companies have different approaches to each of those things. Technical regulatory compliance is very important. But there is more art than science to disclosure, even in the best of times. So you see the results of a lot of art here. This is sort of like 1920s in Paris: people were doing a lot of crazy things on a canvas. Climate change disclosure today is very interesting in that respect. You want to comply, and you do the best that you can that you comply.

There is also an element of market management. A lot of companies learned the hard way through the asbestos trials and tribulations that if you surprise the market, you are going to get crushed. You may not get crushed rationally, but you are going to get crushed. The market is going to react adversely. Your shareholders are going to react adversely. You want to warm the market up to the fact that things may not be looking so good. That is just good management, good strategy, and it happens all the time, so you are seeing this a little bit.

Finally, we are still in a time on climate change that is unripe enough from a political perspective that we are seeing SEC disclosure being used as a political template or an advocacy template by some companies, particularly those companies who are forward-looking and who have done their homework. They are using the opportunity to take a stand on particular issues one way or the other.

An example from the not-so-murky past is the Houston ship channel litigation that was filed a few years back. It was a putative class action in which everybody who did business up and down the Houston ship channel was a defendant. The ad damnum clause in the case called for $1 trillion in damages. The response to that varied; this was before the advent of tort reform. The spectrum of responses in the securities disclosure on that case mirrors the spectrum of responses to the potential cataclysms of climate change.

What do you do? Do you conclude the suit is frivolous on its face and not disclose it? Or do you treat it as a legitimate piece of litigation and do the stylized analysis and disclosure that we will go through in a minute or two? Or do you do what some companies did and say, "We have been sued for $1 trillion for doing legal business in the Houston ship channel. And by the way, we stopped doing it in 1985." You saw that spectrum of disclosure, and you are seeing now the spectrum of that disclosure relating to climate change.

I have an aggressive view of the second part of Item 103 which reads in part, "to which your property is subject." The regulations talk about the subject in the context of litigation in which you were a defendant. But if there is a loose end here, which is interesting in the climate change arena, it is "to which your property is subject," meaning the pending case that could have an effect on something that is important to you, such as one of your assets.

Let's turn now to some specific examples. In response to the mandate under Item 103 to talk about *Massachusetts v. U.S. Environmental Protection Agency (Massachusetts v. EPA)*[1] before it was decided, one coal company offered the following disclosure:

> In November 2006, the United States Supreme Court heard oral argument in *Massachusetts v. EPA* on whether EPA has improperly failed to list carbon dioxide as a criteria pollutant. If this litigation results in a court order directing EPA to promulgate a new NAAQS for carbon dioxide, then the market demand for coal could decline.

I think this disclosure is very stark, abrupt, not necessarily correct, and an example of how you can really get ahead of the curve too far too fast. The first sentence of the disclosure talks about *Massachusetts v. EPA* and what was at issue in the case. I am not sure it is, in fact, a correct characterization of what was at issue in the case, although it is arguably true and arguably sufficient for the purposes of a coal company at that particular time.

The second sentence strikes me as blunt and unnecessarily negative as a market signal: If this litigation results in a court order directing EPA to promulgate a new national ambient air quality standard for carbon dioxide, then the market demand for coal could decline. There are a lot of dots that are missing between the premise and the consequence. That may be true, but it is also true to say if we land on Mars, then we could all be wiped out by foreign viruses. There are many, many letters missing in that sequence. In an attempt to illuminate for the marketplace what the problems might be for the coal industry as a result of an adverse decision and following adverse regulations for *Massachusetts v. EPA*, you have made a disclosure that, unless they are deeply informed about this issue, stockholders will not understand.

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1. 127 S. Ct. 1438, 37 ELR 20075 (2007).

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Another example, this one related to climate change litigation:

> In July 2004 attorneys general of eight states and others sued [various] utilities alleging that carbon dioxide emissions from power generating facilities constitute a public nuisance under federal common law. The suits were dismissed by the trial court, and plaintiffs have appealed the dismissal. While we believe the claims are without merit, the costs associated with reducing carbon dioxide emissions could harm our business and our results of operations and financial position.

The essence of this disclosure is simple. In 2004, in *Connecticut v. American Electric Power Co. (Connecticut v. AEP)*,[2] the Attorney General sued some utilities. There was a public nuisance alleged; the suit was dismissed. We believe the claims are without merit. The costs associated with reducing carbon dioxide emissions could harm our business and our operations and financial positions.

The tag line, however, is a non sequitur, because there is no predicate in this disclosure for understanding how the outcome of that suit could result in what is being disclosed as the risk. The suit sought equitable relief, Kyoto-like remedies, and reductions in emissions. That is the missing piece in this disclosure but, again, the actual causative effect of that piece of litigation was not disclosed in a way helpful to investors. It was a good try, but a swing and a miss on a difficult issue.

Here is another specific example, much more detailed, involving the same litigation.

> In July 2004, attorneys general from eight states, each outside of [our] service territory, and the corporation counsel for New York City filed a complaint in the U.S. District Court for the Southern District of New York. A nearly identical complaint was filed by three environmental groups in the same court. The complaints allege that the companies' emissions of carbon dioxide, a greenhouse gas, contribute to global warming, which the plaintiffs assert is a public nuisance. Under common law public and private nuisance theories, the plaintiffs seek a judicial order: (1) holding each defendant jointly and severally liable for creating, contributing to, and/or maintaining global warming and (2) requiring each of the defendants to cap its emissions of carbon dioxide and then reduce those emissions by a specified percentage each year for at least a decade. Plaintiffs have not, however, requested that damages be awarded in connection with their claims. [We] believe these claims are without merit and note that the complaint cites no statutory or regulatory basis for the claims. In September 2005, the U.S. District Court for the Southern District of New York granted . . . the defendants' motion to dismiss these cases. The plaintiffs filed an appeal to the U.S. Court of Appeals for the Second Circuit on October 19, 2005. The ultimate outcome of these matters cannot be determined at this time.

Note the nuances. I want to focus in particular on a couple of points that did not appear in the previous disclosure. What this issuer is doing is not uncommon and is perfectly permissible, but has the risk of being overly aggressive. "In July 2004, attorneys general from eight states, each outside our service territory"—there is a nice little dig; they do not have the nerve to sue anybody who they actually have to do business with—"filed a complaint alleging that utilities' carbon dioxide emissions contribute to global warming, which plaintiffs assert is a public nuisance. A nearly identical complaint was filed by three environmental groups in the same court." And then, another little swipe. "Plaintiff has not requested damages be awarded." True. It is important to tell the market that there is no monetary payment that is going to be made. Then as the previous registrant said, "We believe these claims are without merit, and note that the complaint cites no statutory or regulatory basis for the claims;" also true but sort of beside the point.

So here you see an example of a company that was seriously ticked off by the fact that it has been sued, completely skeptical as to the merits of the case, and is doing the best it can not to litigate the matter. But—since this probably went up to the General Counsel's office—they were unable to resist the opportunity to take a couple of good shots at plaintiffs' case.

These shots are interesting windows into the culture of addressing these types of issues. Although sometimes the functions are blended—that is, the General Counsel's office may have easier access to the people who are putting the Ks and Qs on the street than anybody else—as the general counsel or the assistant general counsel in charge of litigation, it is important that you do not confuse your disclosure hat with your litigation hat and you do not try the case in your SEC filing, unless you are being very, very careful about what words you are using. But this is a full, thorough, robust disclosure of what was, at the time it was filed, one of the most significant pieces of climate change litigation on the horizon.

At this point, we move from litigation risk to regulatory risk and take a step back in time to illustrate a point. This is a Fortune 50 company's disclosure circa 1983 about Superfund:

> Superfund also requires disclosure of certain other releases into the environment and creates potential liability for clean-up costs and for injury to the environment resulting from a release. [We have] received notices under Superfund or applicable state law that, along with others, [we] may be a potentially responsible party under such legislation for the cost of cleaning up a number of hazardous waste disposal sites in California, Illinois, Indiana, Michigan, Minnesota, New Jersey and Ohio. [We] may have been a generator of hazardous wastes at a number of other sites. [We are] unable to determine the costs which [we] may incur under such legislation; however, such costs could be substantial.

You can read this all you want, but you would have no idea whether or not you wanted to invest in this company, how many Superfund sites are involved, or what the likely outcome of any of the Superfund investigations were or what their shares were.

This is to remind everybody that those of us that have been in the business for a while have seen this arc from confused but seemingly specific responses; to a dramatic reversal of statutory events; to complaints about getting words but not getting data or information; to clarification from the SEC about what you really need to say; to further clarification from the accounting community about how the numbers play out; to, finally, a world aware.

Today, if you look at a responsible company's Superfund disclosure, you are going to get a disaggregated, financially driven disclosure with reserves, stated outcomes, etc., be-

2. No. 04-CV-05669 (S.D.N.Y. July 21, 2004).

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cause the field has matured and because the response from the disclosing community has matured. That is what makes me optimistic about the future evolution of climate change disclosure, although I am probably somewhat more patient, given my position in life.

Carol Lee may be focused on how much and how fast, but it is clear that the arc of what is happening is going to bend in this direction, because we are almost at exactly the same starting point. You do not even have to make the argument that the perils of climate change are far more exigent and far-reaching than the perils of Superfund.

Maureen Crough: I think you are suggesting that the corporation that made that Superfund disclosure did itself a disservice because it disclosed a lot of information, but there is no sense of how significant the exposure will be other than it could be substantial.

Would companies making similar climate change disclosures with a couple of paragraphs saying that all these various things could happen be doing themselves a disservice if they don't try to quantify the exposure?

Jeffrey Smith: No. What I am trying to suggest is that what you see above is basically a toddler's disclosure. This is what you did in 1983 before you could walk or run. It is primitive; it looks naïve, and it is clearly uninformative by today's standards. Then what I am going to flash on the screen are variations on that theme. Some of them I would argue are actually much more sophisticated than this was in its time.

This disclosure is a reasonable starting point. It was fine for its time, but both internal and external forces made this company mature to a point where its current disclosure on Superfund is four pages long, far more robust, and completely financially driven. It needed 20 years to get there. It needed a maturation of the statutory scheme, and it needed four or five different prods and kicks from various regulatory sources in order to push it there. It also needed development in management systems and other ways to get the data from column A to column B.

What I am also suggesting, sub rosa, is that having seen this movie before, I think we are going to get to the comparable place in climate change disclosure in comparatively lightning speed. But there are inherent complications in climate change disclosure.

Some things are quantifiable right now. When that is the case, responsible companies are disclosing them. Other things are just dartboard and no better, and in some places you do not even know what wall the dartboard is on, and that is where we happen to be. Where companies need to build their muscle and focus their attention is to distinguish between those things that they know, those things that they can know, those things that they think that they know, and what to tell the market about where the company is going or where they want the regulatory scheme to go, and to set a predicate for maturation of their own approach to climate change.

I am a huge fan of "warm-up" disclosure. Joba Chamberlain does not come in, as wonderful as he has been, without warming up in the bull pen. This is the bull pen.

I have a couple of additions to what Maureen said about Item 101 requirements to disclose capital expenditure.

Two of the things that are deeply embedded in the regulation are the following: (a) it is clear and beyond dispute that you need to tell the marketplace what the assumptions are that you have used in order to get to what it is that you said; that is the black letter; and (b) when you have a futuristic development not only scientifically, but also in a regulatory way—you need to disclose for a time period so as not to make what you say misleading. If what you are trying to say is a movie, you cannot disclose a still photograph; you have got to show the movie. Here is where things are going in five years—IGCC, or whatever your huge capital expenditures are going to be.

Probably the closest corollaries are in the Cluster Rules for the pulp and paper industry in the late 1990s. If you are really a student of this stuff, go back and look at the way that various large integrated pulp and paper mills handled the advent of that regulatory development. There were multimedia regulations under the joint authority of the CAA and CWA, and what were going to be substantial capital expenditure requirements for some mills and negligible ones for others. Companies were all over the map on it. There was a huge differentiation in actual performance, and disclosure on this issue went through the same changes; it went through the same arc. First, there were not going to be Cluster Rules. Then the Cluster Rules were in draft. Then, the drafts rules were subject to comments, etc. At each point, if you track major pulp and paper companies through those developments, from the very beginning as with the Superfund disclosure, responsible companies were wrestling with the issue the best that they could.

Let's move onto another example, this time of disclosure relating to legislative risk.

> There have been a variety of unsuccessful legislative efforts to force mandatory control of utility emissions that allegedly contribute to climate change. If legislation is passed in the future requiring mandatory carbon dioxide emission reductions to address climate change, this could have a tremendous impact on all coal-fired electric utilities, including the company's operations, by requiring the company to significantly reduce the use of coal as a fuel source.

So here is a coal-fired company, what I'll call Generic Disclosure Co.; stating that there have been "a variety of unsuccessful legislative efforts to force mandatory control of utility emissions. If legislation is passed in the future requiring mandatory carbon dioxide emission reductions, this could have a tremendous impact on all coal-fired electric utilities."

Is it totally clear, just as with the first disclosure I described, that the impact of a legislative effort to control utility emissions would be the reduction of use of coal as a fuel source? Or would it be syn gas or whatever else? There are a lot of possible technical solutions. This is a company overwarning the market by sending out the right warning signals but ahead of itself and ahead of what the reality is from a regulatory standpoint.

Maureen Crough: When I look at that example, it strikes me as the kind of thing that a lot of companies would disclose in their MD&A rather than under the description of business.

Jeffrey Smith: I think when in doubt, get it in. As a practical matter, the thinking that goes into MD&A needs to be more strategic and is better suited for climate change risks. Mean-

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while, the thinking that goes into typical calculations about Item 101 is more like Cluster Rule thinking; you should treat the cards that you have been dealt as inevitable and the consequences of having certain costs, and then the rest is engineering and math.

So if you got the group of people who typically cluster around—no pun intended—an Item 101 issue, they are probably very different people than those who are looking forward to where we are headed in this industry given our current posture. What do we need to tell the marketplace right now, and what does Item 303 require us to tell the marketplace now?

Let's now look at sweeping disclosure about market-wide regulatory risk.

> If significant increases in [Corporate Average Fuel Economy (CAFE)] standards are imposed beyond those presently in effect or proposed, or if state greenhouse gas regulations are not overturned, we may be forced to take various costly actions that could have substantial adverse effects on our sales volume and profits. For example, we may have to curtail production of certain vehicles such as family-size, luxury, and high-performance cars and full-size light-trucks; restrict offerings of selected engines and popular options; and/or increase market support programs for our most fuel-efficient cars and light-trucks in order to maintain compliance.

Here is Generic Automobile Company using basically the same "Chicken Little" disclosure; all accurate, not histrionic. It is basically a recital of a series of worst-case results from increases in the CAFE standards. We are not going to sell SUVs anymore. All of our popular options have gone away. We have to support the marketplace for our less popular but more fuel-efficient vehicles. This is not bad; it is probably a triumph to some people who want to see a big automobile company acknowledge that these are market-moving forces.

It is not wrong strategically to go this way, but I would submit to you that from an investor's perspective this is not all that much better than the early Superfund disclosure that I showed you. It is self-protective, but it is not informative. Self-protective is good when in doubt. Cynics say that is the name of the security disclosure game. But it is not informative if what you are really looking to do, as the CERES petition in many respects is looking to do, is to drive and elevate the dialogue in the public arena about the data that is behind the effects of climate change on business.

Here is some more regulatory risk disclosure on an industry-wide basis:

> Until an implementation plan is developed [for Kyoto] it is impossible to assess the impact on specific industries and individual businesses within an industry. It is generally believed that the oil and gas industry, as a major producer of carbon dioxide, will bear a disproportionately large share of the anticipated cost of implementation. Any required reductions in the greenhouse gases emitted from our operations could result in increases in our capital expenditures and operating expenses, which could have an adverse effect on our results of operations and financial condition.

Let's focus on a sentence that jumps out at me: "It is generally believed that the oil and gas industry as a major producer of carbon dioxide will bear a disproportionately large share of the anticipated cost of implementation." That is an interesting disclosure, and I would question the basis: (a) on which a company could assert that it is generally believed, and (b) the propriety of disclosing in your own 10-K or Q a general belief.

It would be one thing if it were a legislative probability as the result of that but, again, this is a flag thrown up in the middle of the battlefield, probably for other purposes. As a disclosure matter, this company's first shot out of the box is not necessarily grounded in anything that gives me comfort. It doesn't shout out that there has been internal analysis of the issue with a degree of robustness that is going to serve as a good indication of how this disclosure is going to work its way through this company in the future.

The 800-pound gorilla in the room is once an issue is in your K, then your next K has to look a little bit like your previous K; otherwise, you are going to surprise the market. If you take a left turn in your 2007 K, and there have been no changes in external developments, you just had a change in feeling or thought, you really have to explain yourself pretty thoroughly because people look thoroughly at those sorts of reversals.

Here is an example of legislative risk disclosure, to demonstrate how quickly the climate change world is evolving. The first sentence was true when it appeared, and may still be true, but is not longer pertinent after *Massachusetts v. EPA*. Let's focus on the second sentence.

> The Federal EPA has stated that it does not have authority under the CAA to regulate greenhouse gas emissions that may effect global climate trends. While mandatory requirements to reduce [carbon dioxide] emissions at our power plants do not appear to be imminent, we participate in a number of voluntary programs to monitor, mitigate, and reduce greenhouse gas emissions.

"While mandatory requirements to reduce [carbon dioxide] emissions of our power plants do not appear to be imminent, we participate in a number of voluntary programs to monitor, mitigate, and reduce greenhouse gas emissions." This is a watered-down, nice guy disclosure basically saying to the marketplace, "We do not think there is a legislative or regulatory crisis pending, but we are positioning ourselves as being good guys generally." No numbers, no specificity, but a market signal about company mood.

One of the interesting elements of the disclosure debate is that amidst all of the rest of the uncertainty, there are markets that have already developed in the carbon arena that put a price on emissions. You may have your views, cynical or not, about how viable or valuable those markets are and how long-term they are, what happens in a second Kyoto, what the result of the EU/ETS crash and burn is, and what price means. The point is there is a unit of cost that at least exists in non-U.S. markets for carbon-related emissions.

As the old environmental saw goes, what you can measure, you can manage. Once you start getting numbers then you are really in a statistical world. What is going to happen? Is it probable, estimable? If it is estimable and there are numbers to it, then it is material, and you need to find a way to get it down there.

With that in mind, here is disclosure that talks in a general sense about carbon credits and what the effect of buying and selling of emission allowances might be on a company.

While it is unknown at this time what the final outcome of these regulations will entail or whether federal or state carbon dioxide laws or regulations will be enacted, any capital

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and operating costs of additional pollution control equipment or carbon dioxide emission reduction measures, such as the cost of sequestration or purchasing allowances, or offset credits, that may be required could materially adversely affect future results of operations, cash flows, and possibly financial condition, unless such costs could be recovered through regulated rates and/or future market prices for energy.

A corollary obviously is the acid rain program. Go back to early 1988 disclosure for Midwest coal-burning utilities about what the consequences of acid rain legislation were going to be, and then look at the emissions trading system that developed, and the disclosure that evolved about that trading system. You will get roughly the same cycle and the same arc that I think we are bound to follow in climate change.

Here is a company that has sharpened its pencil, and you actually see a decimal point:

> We currently estimate that in 2010 the impact of the Kyoto Protocol on [our] cash operating costs would be an increase of about $0.20 to $0.27 per barrel. This estimate assumes a reduction obligation of 15% from 2010 business-as-usual energy intensity (5) and that the maximum price for carbon credits would be capped at $15 per ton of carbon dioxide equivalent until 2012. Based on these assumptions, we do not currently anticipate that the cost implications of federal and provincial climate change plans will have a material impact on our business or future growth plans.

This is not in the presentation by accident. It stands out like a sore thumb. It is the first time we have seen a number. This company, in response to Canada's adoption of the Kyoto Protocol, actually charged its people to go do math. And what do you think? A price for carbon credits at $15 per ton equivalent until 2012 based on these assumptions —good. These are assumptions; tell your investing public these are assumptions. "We do not currently anticipate the cost implications of federal and provincial climate change plans will have material impact on our business or future growth plans."

As it turns out, this math, only two years old, is completely useless. It is not pertinent anymore. But it was an interesting strategic decision. Once you start down the math road: (a) you have educated your investing public that you are doing the math; and (b) you may have condemned yourself to a mathematical future and therefore, every subsequent disclosure is going to have to retreat from this math, develop this math, or explain why this math is no longer pertinent.

The existence of a price point, or data of any kind in this murk, is actually a fairly substantial development. To finish this point, let's look at the next disclosure slide.

> The countries within which we operate in Europe are all signatories of the Kyoto Protocol, and we have developed a [greenhouse gas] strategy in line with this protocol. Our European mills have been set [carbon dioxide] emissions limits of the allocation period 2005 to 2007. Based upon in-depth analysis of our mill production, it is unlikely that [we] will exceed [our carbon dioxide] emission limits. Consequently, in July 2005 [we] sold 90,000 surplus [carbon dioxide] credits [with a] value of $2.5 million (euro 2.0 million) on the European Climate Exchange.

These are European-based assets of a multinational company with several billion dollars in annual revenues. So these numbers are not material to this company and, therefore, could properly have been excluded, but this is nice disclosure for a couple of soft reasons. "Based on an in-depth analysis of mill production, it is unlikely we will exceed our [carbon dioxide] emission limits. Consequently, in July 2005 we sold 90,000 surplus [carbon dioxide] credits with a value of $2.5 million on the European Climate Exchange."

They probably also sold $10 million worth of fine paper, but they did not report that. This disclosure is an interesting market signal that says, "We are on it and we are telling you that we have analyzed whether we are going to be a buyer or a seller. And we are telling you now that we are a seller. It is not that we are proud that we made $2.5 million for some of these credits. It is that we have done a substantial operational analysis of our facilities, and we have rendered math out of that analysis."

I have an example of disclosure on climate change opportunities. This is an interesting one, because this takes us to MD&A:

> Revenues from materials used to build the blades of wind turbine applications again showed strong growth, up over 17% compared to 2005. The outlook for wind energy remains robust with growing global demand for renewable energy, and we anticipate another year of mid-to-high teens revenue growth. Sales of composite materials used to manufacture wind turbine blades now represent the largest contributor within our Industrial market segment. These results reflect the underlying growth in global wind turbine installations.

This is a composite maker seeking to use this time in the marketplace to tell its investors that it is in a good place. They make high-tensile strength composite materials, used to build the blades of wind turbine applications. So under Item 303 MD&A—known trends, events or uncertainties reasonably expected to have a material effect—they make this disclosure.

It again "showed strong growth up over 17%"; the outlook for wind energy range is robust; high revenue growth, "sale of composite materials is now the largest contributor within our industrial market segment." This reflects the underlying growth in global wind turbine installations. None of these sentences is false. What is not disclosed is that wind power still represents less than one percent of the total energy generation portfolio worldwide.

The disclosure omits the market context in which it appears. As companies have gotten their hands around their own management of these issues better, one of the greatest errors that I see, especially when I am representing underwriters, and that I take my proverbial red pencil to, is the overabundant use of phrases like "environmentally friendly" and all sorts of other touting-type disclosure, which is really unnecessarily risky and probably not factually accurate.

I am not accusing this registrant of having falsely disclosed or wrongly disclosed; I am questioning whether, tactically, it would not have been sounder to include a sentence or at least an introductory clause to say, "Although the wind market is still only a minute fraction of worldwide power source—dot, dot, dot—we are well positioned" because that is the real message.

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So, on the opportunity side of climate change, if you are overly robust in what it is you have to say, you can set the table for a future problem based on a lot of different variables that may not break the way you want them to.

Maureen Crough: Would you think that is a bit risky, too, to put yourself out there in terms of what you are voluntarily doing in the climate change world?

Jeffrey Smith: I think if you are taking voluntary actions and that is factual, I think it is fair to disclose those things. You disclose them in a way that is in context. The net effect of the disclosure is to give your investors a sense that: (a) there is nothing to worry about; and (b) you got it all handled because you are being a good guy in this voluntary way.

Meanwhile, the guys who are really analyzing this question have come to the conclusion, or are about to come to the conclusion, that you are dead in the water on a couple of particular issues. If a regulatory scenario plays out the way that it might, then your disclosure is unnecessarily risky because you have given the impression that you are (a) a good actor; and (b) well-situated. While (a) may be true, it is irrelevant if (b) is not fundamentally true.

You want to look at the totality of the words and also of how you get to those words. What pain have you gone through to get to what you are telling the marketplace in these documents? What muscle do you have if you are called down to Washington to justify an MD&A analysis? What do you have in your back pocket that you are going to be able to say to the regulators, "Here it is. This is where we went through. Here are our controls. Here are our systems. Here is our analysis and it stacks up this high. And here is our conclusion and here is our paragraph." It is a distillation of that process.

Audience Member: Given all the mushiness and the uncertainty in the climate change area, what is the real risk that someone is going to have liability for failing to make appropriate disclosure in MD&A at this point, failing to lay out or at least flag that they might have some climate change exposure?

Jeffrey Smith: I guess if you were a betting guy based on enforcement history, you would say it is a negligible risk at the moment in the current climate—no pun intended. My view of the real risk, where the rubber really meets the road is the short- to medium-term future. It is not that different from reputational risk in life. When you go on record, you take your first steps in this area; you have set yourself on a disclosure journey. And if you deviate from that, you run the risk both of surprising the market and losing credibility. Then if you develop that journey in the same direction, as the old saying goes, what a tangled web you weave when first we practice to disclose. And then, you find yourself building on something that you really wish you had not started.

I advised a company years ago that did this in its disclosure, and I will tell you that by the time they finished, the five-page, single-spaced environmental disclosure was probably the most turgid narrative that had ever been offered up in the history of the SEC. But it was all the product of good intentions.

The real risk is not so much the immediate "snap-gotcha-prove-it" risk, but the "where you are going in two years with this?" And also, realistically and organizationally, what is this the product of? Are you just saying it? What is in it and what is behind it that ultimately is going to have to be demonstrable, whether it is on an analyst's call or an enforcement action?

The other lurking risk is the strike suit risk, which is not an inconsiderable risk. It happened to a number of companies in the asbestos arena who first came to the disclosure market with portfolios of 20,000 cases or 30,000 cases, betting you never heard that they had any cases. Maybe these cases were all small, but nobody wants to read for the first time in 2001 that you have been handling 30,000 claims for asbestos exposure; overnight, 25%, 30%, 40% reductions in the stock price. That is not a rational reaction, but it is true.

Carol Lee Rawn: I am going to move to the macro level and talk about investors' increasing appetite for more disclosure and action on climate risk. I will also briefly address how companies can be responsive to those concerns.

For those of you who are not familiar with CERES, it is a network of investors and companies and environmental groups that are working together to promote sustainability in corporations. CERES coordinates an investor network on climate risk, which has over 50 investors with over $4 trillion in assets, that has been increasingly active in recent years. CERES has also convened a series of institutional investor summits on climate risk with Wall Street leaders and companies and investors.

There is a clear trend toward a greater diversity and number of investors seeking climate risk disclosure. Public pension funds are big players, particularly CalPERS [California Public Employees' Retirement System] and CalSTRS [California State Teachers' Retirement System], the two largest public pension funds in the country; as well as a variety of state and city finance officials and labor pension funds. In addition, religious investors are an increasingly vocal and active sector, as are foundations, various asset managers, global banks, and university endowments.

Why do investors care about this issue? Because a company's response to risk will have a direct impact on its bottom line. A broad spectrum of sectors will be affected by climate change; both by facing increased risk, be it regulatory, physical, competitive, or reputational, and by seizing various opportunities associated with climate change.

In the category of risk, there is a great deal of regulatory activity at the state level, and federal regulation is certainly on the horizon. Physical risks include sea level rise as well as increased intensity and frequency of prolonged drought, heat waves, floods, storms, and wild fires. These kinds of physical changes will affect a broad range of sectors, including real estate, agriculture, tourism, health care, insurance, fisheries, and forestry, as well as any company with offshore or coastal facilities. And similarly, the increasing problem of water scarcity, which will be exacerbated by climate change, will affect the agriculture, hydroelectric, industrial, beverage, and food sectors as well. Oil and gas companies are especially vulnerable to climate risk, since their production and consumption account for more than half of the greenhouse gas emissions in the United States. Citigroup recently downgraded coal stocks in part due to reputational and potential regulatory risks associated with climate change.

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There are also many examples of companies seizing competitive opportunities associated with climate change. For example, DuPont started acting relatively early and has developed carbon-free refrigerants, more energy-efficient home insulation products, and bio-based fuels. They expect to realize additional revenues of $6 billion or more by 2015 from such products. Over the past 15 years, they have also reduced their own greenhouse gas emissions by more than 70%, saving $3 billion on energy bills in the process.

Wall Street is taking an increasingly greater interest in this area. For example, Citigroup, JPMorgan, Lehman Brothers, and Standard & Poor's have all recently issued reports on climate risks and opportunities. Similarly, climate risk advisory services, such as those offered by Price Waterhouse and JP Morgan, are increasingly common. Interestingly, one of the rationales for the SEC petition was that material information regarding climate risk should be widely disclosed to the entire market and not just for those who may be able to pay for it.

So what are investors doing? They are engaging with companies, they are investing in clean technology, and they are vigorously advocating for public policy.

First, there has been a sharp increase in the number of shareholder resolutions filed in the past decade. In 1995, two resolutions were filed; this past year there have been 43 shareholder resolutions filed seeking disclosure as well as action and leading to positive action on the part of 15 companies. The 2007 proxy season was marked by the first filing of resolutions requesting that companies set specific greenhouse gas reduction targets. These also received strong support—31% at Exxon Mobil and 29% at General Motors. It is also interesting that those resolutions that went to a vote received a record-high average of voting support of 21.6%. In many cases, once management understands what the shareholders are seeking, they are willing to sit down and negotiate with them. For example, ConocoPhillips committed to spend $300 million on low-carbon research and to set greenhouse gas reduction goals in addition to other measures as a result of negotiations resulting from the filing of a shareholder resolution which was later withdrawn.

Second, the trend toward investment in clean technology is clearly accelerating. In the third quarter of 2006, clean technology investments attracted the third highest amount of all venture capital funding in North America. The world's biggest climate change index was launched this week by HSBC. According to HSBC, since January 2004, companies in that index have produced nearly twice the returns of other stocks as measured by the MSCI World Index. In Europe, in the first seven months of this year alone, $6.4 billion has been invested in environmental funds.

Finally, on the policy front, last spring, there was a Call to Action by 65 investors and businesses worth more than $4 trillion asking for national climate policy, for reductions of greenhouse gas emissions as well as SEC guidance on climate disclosure. The businesses included companies like Alcoa, ConEd, DuPont, and PG&E.

Maureen has already provided a thorough analysis of the petition that was filed September 18th by leading institutional investors (managing more than $1.5 trillion in assets), as well as various states, CERES and Environmental Defense. For a detailed discussion of the provisions Maureen referenced, I would refer you to the petition itself, which can be found on the CERES website at http://www.ceres.org/NETCOMMUNITY/Page.aspx?pid=445&srcid=430. This petition builds on earlier efforts that CERES began about five years ago.

Maureen Crough: This petition was the third time in the last couple of years that a group went to the SEC and said, "Issue some guidance about climate change disclosure." Do you think this one has a better chance because of everything that has happened in the scientific world since the last two went in?

Carol Lee Rawn: Yes, I do. I should clarify the first two efforts were letters, and that each time more investors participated. In light of the latest report of the International Panel on Climate Change confirming the reality of climate change, in addition to increased investor awareness and interest in this issue, the SEC has every reason to take action in this area at this point.

To continue, at the international level, investors have also been active. In 2006, the Global Framework for Climate Risk Disclosure was issued. This was the result of a collaboration between U.S. investors and climate groups which resulted in a framework consisting of emissions disclosure, strategic analysis of climate risk, and emissions management. The Framework recommends an explanation of the governance structures in place to address climate change issues in the company, as well as physical risks and regulatory risks. The authors suggest disclosure through existing vehicles such as the Global Reporting Initiative (GRI), the CDP, or SEC filings.

In sum, it is becoming increasingly clear that climate change is no longer considered solely an environmental issue, but recognized as a business issue as well. This was recognized by the *McKinsey Quarterly* back in 2004, when it stated that "over the next 10 to 15 years the way a company manages its carbon disclosure could create or destroy shareholder value."[3] Today, an increasing number of investors are recognizing that carbon risk management has a direct effect on the long-term viability of a company.

Maureen Crough: Let's assume that the SEC does virtually everything that is in the petition. It comes forth with the type of interpretive release that the petitioners have requested. If that happens, do you think there still would be a role for companies to do voluntary disclosure of their climate change risks?

Carol Lee Rawn: I think there still would be a role for voluntary disclosure simply because such meachanisms are more comprehensive and provide a great deal of additional useful information. For example, the GRI goes well beyond climate risk to address a broad range of sustainability issues, and the Global Framework for Carbon Risk Disclosure would provide more information than what would be provided were the SEC to explicitly require disclosure. Thus, both GRI and the Global Framework provide information that is critical to investors, and should continue to be used.

3. Christoph Grobbel et al., *Preparing for a Low-Carbon Future*, McKinsey Q. (2004), http://www.mckinseyquarterly.com/article_page.aspx?ar=1506&12=3&13=50&srid=85&gp=1#sidebar1up.

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But that does not negate the fact that it is very important for the SEC to send a strong signal here.

Jeffrey Smith: I think voluntary disclosure definitely has a future, no matter what. I think that for a couple of reasons. First of all, one of the things that has happened in the vacuum of SEC guidance is that there has been an extraordinarily robust development of the way that companies have reported voluntarily on this issue.

Companies have found it very useful to talk to their shareholders on this issue in that way. I do not know how many people have seen the Cinergy report from 2004, a very sophisticated third-party verified and detailed analysis, containing details which are not appropriate in any existing K or Q, and for which an independent marketplace should exist.

One of the things that is important now is that the SEC needs to reassert its role as the gatekeeper of information in this arena, because it was established to control the marketplace. We need a universal benchmark. With all due respect to CDP and GRI and all the rest of the templates that have proliferated, ultimately for those who are seriously interested, those venues will be great places for continuing the debate in great detail.

But at some point in the future, there needs to be clarity about what the marketplace and the SEC needs and wants to see in this arena. Whether the CERES petition works or not, I am going to suggest to those of us who are in the room who are old enough to remember a parallel with the catastrophe that never happened: the SEC's response to Y2K. In response to the then-coming cataclysm of the Y2K bug, which was going to eliminate all computer functions across the world and send off nuclear missiles and, much more importantly, stop all elevators in Manhattan, the SEC said this: "If you have not figured out what you are doing about it, disclose it. If you have not done your homework, tell the investing public. If you are going to make a disclosure, do not pre-mitigate and then net out and disclose what you think the net is." The same thing happened in Superfund as well, and this is part of the 1989 guidance and then SAB 92. If you think you are going to get insurance money, you may want to keep insurance books as well as your ordinary ROD books. But do not tell investors that your net negative is one when what your negative is 500 and you are hoping you are getting 499 from the insurance carriers. Tell them both of those things; disaggregate and tell them both.

Do not remain silent because you think that there is something that is going to make it better. The same principle works for climate change. Then address in "meaningful and specific language"—these are the words of a staff legal bulletin that covered Y2K—your general plans to address the issue. Include how it is going to affect customers, suppliers, and other constituents, and your timetable and your budgetary impact. It sounds like good strategic planning to me; not unprecedented, not earth shattering, but in a few basic sentences give some clarity that will provide an overarching benchmark under which the world of voluntary disclosure can continue to flourish for those who are really interested in 3P versus 4P or the comparative benefits of IGCC technology or any of the other minutiae that are fascinating strategically but not material to the investing public. We are at a very critical point in time.

Audience Member: Given the current makeup of the SEC, what do the panelists think the likelihood is of what kind of response there will be to the petition?

Jeffrey Smith: I would hope that the SEC would be responsive to some aspects of what the CERES petition seeks. We should not really care in the SEC context about all carbon emissions, and the petition seeks disclosure of all such emission. That is not for this arena, it may be for other arenas, maybe the voluntary arena.

But if you are in the heart of darkness, if you are in the insurance sector, if you are in the coal-fired utility sector, if you are really in the crossfires here, if you are Exxon Mobil, there is stuff that we care about. And the "ask" in the petition is not all that great. In fact, you could make the argument that the "ask" in the CERES petition when you really boil it down is less than the ask for Y2K. So I would hope that the SEC would seize the day.

If the staff gives the issue its due, irrespective of political climate, which may or may not control, the task is not so great. The need is tremendous, because the imbalance between voluntary and mandatory disclosure—the "mush," as Maureen so eloquently called it earlier—is very dangerous for the marketplace. The imbalance between what is being said voluntarily in non-SEC arenas and what is being compelled in the SEC arena has reached a very dangerous place. It is really time for the SEC to reassert its role as the market gatekeeper on this point.

As Carol Lee said, the things that were being debated three years ago are not being debated. So we have got to move down the road. I think that there will be a fair amount of sympathy for that general sense of the world at the SEC. I hope, but I do not know.

Carol Lee Rawn: I completely agree with Jeff's statement that it is time for the SEC to act, but would take issue with his comment about the irrelevance of carbon emission disclosure. We feel that one cannot realistically assess a company's exposure to climate risk in the absence of emission measurement and disclosure.

Maureen Crough: I do not have any prediction myself, either, about what the SEC will do. Let me just underscore something that Jeff was saying and, also, I think, that came through with part of Carol's presentation. The wide array and diversity of the kind of disclosure you get does make it hard for some investors to compare apples to apples.

Also, I think frustration exists for some corporations about what should they really do. They go out to survey what their peer companies are doing, but I think right now, given the amount of voluntary disclosure that is out there and a great diversity even between the voluntary disclosure and the mandated disclosures, it is tough for a lot of companies to feel comfortable with what they are doing.