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Climate Change: Disclosure Regulation

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Proposed Mandatory Greenhouse Gas Reporting Rule

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Background

- The FY08 Consolidated Appropriations Act, signed in December 2007, directed EPA to issue within 18 months a final rule requiring mandatory greenhouse gas (GHG) reporting “in all sectors of the economy”
- According to an accompanying explanatory statement, the Agency is to include, as appropriate, upstream production, downstream sources, and thresholds
- EPA Administrator Lisa Jackson signed a 1400+ page proposed rule on March 10, 2009

What gases are covered?

- The proposed rule would cover the following GHGs
  - Carbon dioxide (CO_2)
  - Methane (CH_4)
  - Nitrous oxide (N_2O)
  - Hydrofluorocarbons (HFCs)
  - Perfluorocarbons (PFCs)
  - Sulfur hexafluoride (SF_6)
  - “Other fluorinated greenhouse gases” (e.g., Nitrogen trifluoride and Hydrofluorinated ethers)

Who Reports?

- Suppliers of fossil fuels and industrial greenhouse gases
- Manufacturers of vehicles and engines
- Facilities that emit 25,000 metric tons or more of carbon dioxide equivalent (CO_2e) per year

“All In” Direct Sources*

- A facility containing any of the source categories listed below would be required to report emissions from all source categories at the facility for which calculation methodologies are provided in any subpart of the proposed rule

Adipic Acid Production

Aluminum Production

Ammonia Manufacturing

Cement Production

Electric Power Systems that include electrical equipment with a total nameplate capacity exceeding 17,820 pounds (7,838 kilograms) of SF_6 or PFCs

Electricity–Generating Facilities subject to the Acid Rain Program, or that emit 25,000 metric tons of CO_2e or more per calendar year beginning in 2010

Electronics Manufacturing Facilities with an annual production capacity that exceeds: (A) semiconductors, 1,080 square meters (sq m) silicon; (B) microelectrico-mechanical system, 1,020 sq m; (C) liquid crystal display (LCD), 235,700 sq m LCD

HCFC-22 Production

HFC-23 Destruction Processes that are not located at an HCFC-22 production facility and that destroy more than 2.14 metric tons of HFC-23 per year

Landfills *that generate* CH_4 in amounts equivalent to 25,000 metric tons of CO_2e per year or more

Lime Manufacturing

Manure Management Systems that emit, in aggregate, CH_4 and N_2O in amounts equivalent to 25,000 metric tons of CO_2e per year or more

Nitric Acid Production

Petrochemical Production

Petroleum Refineries

Phosphoric Acid Production

Silicon Carbide Production

Soda Ash Production

Titanium Dioxide Production

Underground Coal Mines that are subject to quarterly or more frequent sampling of ventilation systems by the Mine Safety & Health Administration (MSHA)

*Source: www.epa.gov/climatechange/emissions/downloads/GeneralProvisions.pdf

Emission Threshold Sources*

- If a facility does not contain any of the source categories listed in Slide 6, then the facility would be required to determine whether it emits 25,000 metric tons of CO_2e or more in combined emissions from stationary fuel combustion, miscellaneous carbonate use, and the source categories listed in this table in any calendar year starting in 2010
- If so, the facility would be required to report emissions from all source categories at the facility for which calculation methodologies are provided in any subpart of the proposed rule

Electricity Generation

Electronics–Photovoltaic Manufacturing

Ethanol Production

Ferroalloy Production

Fluorinated Greenhouse Gas Production

Food Processing

Glass Production

Hydrogen Production

Industrial Landfills

Industrial Wastewater

Iron and Steel Production

Lead Production

Magnesium Production

Oil and Natural Gas Systems

Pulp and Paper Manufacturing

Zinc Production

*Source: www.epa.gov/climatechange/emissions/downloads/GeneralProvisions.pdf

Combustion Sources*

- If a facility does not contain any of the source categories in Slides 6 and 7, then it would be required to determine whether it emits 25,000 metric tons of CO_2e from stationary combustion in any calendar year starting in 2010. If so, the facility would report only emissions from stationary fuel combustion devices such as
  - Boilers
  - Stationary engines
  - Process heaters
  - Combustion turbines
  - Others
- Note: If the maximum rated heat input capacity for all stationary fuel combustion equipment is less than 30 million British thermal units (Btu)/hour, then the facility is presumed to emit less than 25,000 metric tons of CO_2e and the facility does not have to calculate or report emissions

* Source: www.epa.gov/climatechange/emissions/downloads/GeneralProvisions.pdf

How Would You Report?

- Data primarily would be reported at the *facility* level
- Reporting would be at the corporate level for vehicle and engine manufacturers, fossil fuel importers and exporters, and local gas distribution companies
- Depending on the source, the report would contain a variety of facility, unit, process, and production data
- Where measurement data are currently collected (e.g., electric utilities), they would be utilized in the reports. Otherwise, the Agency would define facility-specific calculation methods
- Reports would be submitted at least annually

Next Steps

- Two public hearings are scheduled
  - April 6-7, 2009 in Arlington, Virginia
  - April 16, 2009 in Sacramento, California
- Written comments will be due within 60 days of the proposal's publication in the Federal Register
- The proposal would require the first reports to be submitted in 2011 for 2010 emissions

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Climate Change Disclosures

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Activist Efforts

- Carbon Disclosure Project
  - Questionnaire to companies requesting data re emissions, risks and opportunities, accounting, governance actions
- October 2006 group of institutional investors and public interest groups issue “Global Framework for Climate Risk Disclosure”
  - CalPERS, Ceres, et al.
  - Calls for disclosure of
    - Emissions (past, present and projected)
    - Corporate policy, strategy to reduce, governance actions
    - Physical risks
    - Financial risks, including from potential regulation

Activist Efforts

- September 2007 petition to the SEC by coalition of institutional investors, environmental advocates and others
  - CalPERS, CalSTRS, Ceres, Friends of the Earth, NY AG Andrew Cuomo, et al.
  - Requests interpretive guidance by SEC re how existing disclosure requirements apply to asserted climate change matters
  - Requests review of filings and follow up by the SEC as to companies not making such disclosures
- 2008 ASTM draft voluntary guidelines for climate change related disclosures

Government Action

- December 2007 letter from Senators Dodd, Reed to Cox requesting that the SEC issue guidance re existing disclosure requirements with respect to climate change matters

Government Action

- NY Attorney General Andrew Cuomo
  - September 2007 subpoenas to utilities re internal risk analyses and external risk disclosures
    - Xcel, AES, Dominion, Dynegy, Peabody
  - 2008 agreement by Xcel and Dynegy to provide greater climate change disclosures in Forms 10-K
    - Financial risks, including effect of legislation or regulations, expected trends and potential impact of legislation or regulations
    - Litigation, e.g. asserting nuisance
    - Physical impacts
    - Company's current position on climate change
    - Corporate governance actions, e.g. role of board, whether executive compensation is tied to achieving environmental goals
    - Current and projected greenhouse gas emissions, and strategies for reducing such

Government Action

- Potential for federal legislation
  - 2007 Lieberman-Warner cap-and-trade bill
    - Would have required SEC to state as to Reg S-K Items 101 and 103 that (i) country's commitment to reduce GHG will have "material effect" and (ii) global warming constitutes a "known trend"
    - Would have required SEC to promulgate regulations re risks of emissions by issuer, impact of warming on the issuer
  - Other potential bills would have required similar action by SEC
    - Greenhouse Gas Accountability Act of 2007, Global Warming Reduction Act of 2007, Global Warming Pollution Reduction Act

Government Action

- New federal cap-and-trade program under Obama administration?
- Regional cap-and-trade program in Northeast, potentially others in Midwest and West
- California
- EPA “endangerment” finding under the Clean Air Act
  - Permitting burden, emission fees, potential requirement to install best available control technology (“BACT”) for new sources and facilities

Current SEC Rules

- General materiality
  - Rule 10b-5
  - Rule 12b-20
- Regulation S-K
  - Item 101 (Description of Business)
    - "General development of the business"
    - In IPO by company without revenue from operations, anticipated material acquisitions of plant and equipment, and other material areas which may be peculiar to the business
    - "Competitive conditions"
    - Item 101(c)(1)(xii): "Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material."

Current SEC Rules

- Item 103 (Legal Proceedings)
  - "Material pending legal proceedings, other than ordinary routine litigation incidental to the business"
  - Instruction 5: "Notwithstanding the foregoing, an administrative or judicial proceeding … arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary [primarily] for the purpose of protecting the environment shall not be deemed 'ordinary routine litigation incidental to the business' and shall be described if: A. Such proceeding is material to the business or financial condition of the registrant; B. Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or C. A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000…."

Current SEC Rules

- Item 303 (MD&A)
  - "Known trends or uncertainties … that the registrant reasonably expects will have a material … impact on net sales or revenues or income from continuing operations"
  - "The discussion shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past…."
- Item 503(c) (Risk Factors)

Accounting

- FAS 5 (Accounting for Contingencies)
  - Must take charge to earnings if (i) future event confirming the fact of a loss is probable and (ii) the amount of loss can be reasonably estimated
  - No charge, but disclosure required in notes to financials, if there is at least a reasonable possibility that a loss may have been incurred
    - "The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made."
    - "Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable."

Accounting

- Trend toward fair value accounting
  - 2001 FAS 143 re asset retirement
  - 2002 FIN 45 re guarantees and indemnities
  - 2006 FAS 157 framework for fair value accounting
  - 2007 FAS 141(R) re liabilities acquired in business combination
    - 2008 proposed FASB staff position 141(R)-a re same

Accounting

- 2008 proposed amendment to FAS 5 and 141(R)
  - Significant expansion of footnote disclosures

Enforcement

- Failure to disclose potential exposure
  - 1977 Allied Chemical (toxic chemicals)
  - 1979 US Steel (resistance to regulations, delay of cap ex for environmental control)
  - 1980 Occidental Petroleum (Love Canal)
  - 1998 Lee Pharmaceuticals (refused to remediate, designated as PRP under Superfund)
- Manipulation of reserves
  - 2002 Waste Management
  - 2002 Safety-Kleen
  - 2006 Ashland
  - 2007 ConAgra

Watch Out For…

- Consistency of disclosures in SEC filings as compared to other public statements, e.g. analyst calls, and other documents, e.g. sustainability reports

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Truth in Green Advertising:
US Regulation of Environmental Marketing

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Sources of Regulation

- FTC Act and FTC enforcement policy
- Lanham Act
- State consumer protection laws
- National Advertising Division
  - Industry self-regulation by Council of Better Business Bureaus
- International law

FTC Act and FTC Enforcement Policy

- FTC Act prohibits “unfair and deceptive acts or practices in commerce”
- FTC environmental marketing guidelines (“Green Guides”)
  - State the FTC’s interpretation of Section 5 as applied to environmental claims
  - Discuss examples of environmental claims that were common in 1992
  - FTC is now updating the Guides to address new issues

Core FTC Enforcement Policies

- All claims must be substantiated in advance
  - All claims imply that the speaker has “a reasonable basis” for the claim
  - “A reasonable basis means “competent and reliable scientific evidence”
  - A claim made without a “reasonable basis” is deceptive even if it can later be proved true

Core FTC Enforcement Policies

- General claims of “environmental virtue” are deceptive because they cannot be substantiated
  - FTC interprets these claims broadly, and requires substantiation of their broadest possible meaning – which normally is impossible
  - Examples: “eco-safe,” “environmentally friendly,” “environmentally safe,” “environmentally preferable,” and “Earth Smart.” 16 CFR § 260.7(a)

Core FTC Enforcement Policies

- Vague claims are misleading
  - Comparisons (‘better’ or ‘safer’) without saying what is being compared
  - Claims of irrelevant or insignificant benefits
  - Claims using undefined terms that consumers don’t generally understand

FTC is updating the Green Guides

- FTC is examining new environmental claims that were unknown in 1992, e.g.
  - "Sustainability"
  - "Green building"
  - "Carbon neutrality" and other carbon claims
- FTC may define these terms or otherwise regulate their use

Lanham Act § 43(a)

- Prohibits false advertising, including
  - False or misleading statements about your own product
  - False or misleading comparisons with another's product
- Enforced by civil litigation

State Consumer Protection Laws

- "Baby FTC acts" and other consumer protection laws prohibit false advertising
- Enforced by state Attorneys General
- Civil litigation

National Advertising Division

- Industry self-regulation by Council of Better Business Bureaus
- Arbitration system hears and decides claims of false advertising
  - Claims may be brought by competitors, consumers, public interest groups, or the NAD itself
  - NAD staff attorneys review evidence and issue findings and recommendations
- Recommendations followed in 95% of cases
- NAD refers cases to FTC

International Law

- International Organization for Standardization's ISO 14021: *Environmental Labels and Declarations*
- The Canadian Standards Association ("CSA"), in partnership with the Canadian Competition Bureau, report entitled "*Plus 14021, Environmental Claims: A Guide for Industry and Advertisers*"

The “Six Sins of Greenwashing”

- Sin of the Hidden Trade Off
- Sin of No Proof
- Sin of Vagueness
- Sin of Irrelevance
- Sin of Fibbing
- Sin of Lesser of Two Evils

Hot Button Issues: Claims of "Sustainability"

- ISO 14021 prohibits all claims of sustainability
  - "There are no definitive methods for measuring sustainability . . . Therefore, no claim of achieving sustainability shall be made."
- The Canadian Competition Bureau prohibits general claims of sustainability, but permits claims that a seller conforms to a specific environmental certification standard
  - Canada prohibits a claim that "This wood is sustainable," but permits a claim that "This wood comes from a forest that was certified to a [specific] sustainable forest management standard."
- FTC is investigating the issue; it held hearings in 2008

Hot Button Issues: Carbon Claims

- Carbon offsets, renewable energy certificates, and claims of carbon neutrality
- January 2008 FTC Hearing
  - The FTC requested commenters to “identify third-party and self-regulatory programs that address consumer protection issues in the carbon offset and REC markets”
  - This suggests that the FTC may choose to defer to private self-regulatory programs for both definitions and substantiation of carbon-related claims
  - Or the FTC may choose to define terms and regulate their use

Hot Button Issues: Third-Party Certification

- Green Guides caution against the use of symbols or seals of approval that the public doesn't understand
- But Canada has embraced third-party certification of forest products
- Legal and market acceptance of third-party certification is growing
- At FTC hearings, commenters urged greater acceptance of third-party certification

Conclusion

- US and international law regulating environmental marketing is in flux
- FTC is attempting to keep up with changes in the science and policy that drive companies' environmental practices
- Expect further developments this year

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