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104 An Update on Environmental Disclosures

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Faculty Biographies

Kathleen Brennan de Jesus

Kathleen Brennan de Jesus is part of the corporate governance and finance section of the Southern California Edison Company's Law Department. Her primary responsibilities include securities law compliance and reporting, escheat (unclaimed property), and director and officer liability insurance.

Prior to joining the department, Ms. Brennan de Jesus advised clients and trained lawyers on federal securities laws while working at Jones, Day, Reavis & Pogue in Chicago, and at Brown & Wood LLP and Herbert Smith LLP, both in London, England.

Ms. Brennan de Jesus received her JD, magna cum laude, from the University of San Diego School of Law, and received her undergraduate degree from UCLA.

Harrison Clay

Harrison Clay is vice president and general counsel at Clean Energy Fuels Corp. Clean Energy is the largest provider of vehicular natural gas in North America with a broad customer base in the refuse, transit, shuttle, ports, taxi, trucking, airport, and municipal fleet markets with more than 14,000 vehicles fueling daily at strategic locations in the United States and Canada.

Prior to joining Clean Energy, Mr. Clay served as director of corporate development and general counsel at the San Francisco investment bank WR Hambrecht + Co. Mr. Clay has extensive experience in securities offerings, corporate development, venture capital, and the investment banking and energy industries.

Mr. Clay has a JD from the University of Virginia.

Bonni Kaufman

Bonni F. Kaufman is partner in the public policy and regulation group of Holland & Knight LLP, where she focuses on the practice of environmental law. Ms. Kaufman represents clients in a wide variety of matters relating to regulatory enforcement and compliance, environmental aspects of corporate and real estate transactions, and litigation. She has counseled clients with respect to compliance with requirements under FIFRA, the Clean Air Act, RCRA, CERCLA, TSCA, and state environmental laws and has successfully resolved many substantial enforcement actions and litigation related to violations of environmental regulations and migration of contamination.

Ms. Kaufman is a frequent speaker and writer on environmental issues, including lender liability law, transactional issues, and green buildings.

Preliminary Considerations

"It isn't pollution that's harming the environment. It's the impurities in our air and water that are doing it."

Dan Quayle

2

CAVEAT

- Environmental disclosure and reporting requirements are complex areas of the law. This presentation is not intended to provide legal advice, but highlight issues and questions that arise when disclosing and reporting environmental liabilities and making "green claims."

6

Disclosures are less there to inform investors and more there to ward off litigation. They are something a company can point to and say "Well, we told you there was a risk of that happening. You were informed."

Tom Kostigen, Market Watch

7

OUTLINE OF PRESENTATION

- -- SEC DISCLOSURE STANDARDS – A BRIEF PRIMER ON S-K REGULATIONS AND ENVIRONMENTAL CONTINGENCY REPORTING
- -- CURRENT PETITIONS AND PRESSURE ON SEC REGARDING THE IMPACT OF GLOBAL WARMING ON COMPANY PROFITS AND OPERATIONS
- -- FASB PROPOSAL TO OVERHAUL FAS 5, ACCOUNTING FOR LOSS CONTINGENCIES
- -- FTC GREEN MARKETING GUIDES
- -- RENEWABLE ENERGY CERTIFICATES AND CARBON OFFSETS

8

SEC S-K Regulations are primary source for environmental disclosure requirements, including climate change reporting

Item 101 – Description of Business

Requires companies to disclose material effects of compliance with federal and local environmental laws

- * This includes future or anticipated new regulations and Superfund liabilities
- * Also includes contingent remediation liabilities

SAB 92 – report range of reasonably estimable contingent liabilities

FIN 47 – Asset retirement obligations, i.e. asbestos disposal, remediation upon closing of facility

9

- -- Companies required to evaluate future consequences of regulations
- -- Duty to disclose pertains to costs and liabilities that are material

Test is "would information alter a reasonable investor's view of the company."

10

Item 103 – Legal Proceedings

- Requires disclosure of material pending legal proceedings other than ordinary routine litigation incidental to Company's business
- Requires disclosure of any enforcement proceedings where the government is a party, that could reasonably result in sanctions of $100,000 or more
- Not just known proceedings, <u>but those a company knows are contemplated by governmental authorities</u>

11

Item 303 – Management's Discussion and Analysis (MD&A) of Financial Conditions and Results of Operations

- Requires analysis and disclosure of material effects of known trends or uncertainties on company operation and financial conditions
- SEC has said there is no quantitative threshold for materiality
- Many companies include global warming discussion in MD&A

12

"Climate change has broad implications for the marketplace that could significantly impact companies' future earnings, and, if not accurately disclosed, could impair investors' ability to make sound decisions…"

Senator Jack Reed, D. R.I.
Chairman, Senate Banking Subcommittee

13

Climate Change Disclosure Issues

-- Companies in electric power, oil, and automotive sectors face financial risks from regulatory efforts to reduce carbon emissions.

-- Insurance companies and other companies with facilities in certain geographic areas could also face exposures

-- Regulatory efforts to reduce or cap carbon emissions may have to be disclosed

-- Global warming may affect almost all sectors of the economy: travel, electronics, plastics, consumer goods, financial services

14

SAMPLE DISCLOSURES FROM 2007 YEAR-END FILINGS

- The Environmental Protection Agency ("EPA") has announced its intention to issue an Advance Notice of Proposed Rulemaking on the subject of regulating greenhouse gases as "pollutants" subject to regulation under the CAA. There are, however, a number of potential problems associated with trying to regulate greenhouse gases under the CAA. EPA will seek public comment on these issues before determining how to proceed.

Automotive Company 10Q, Item 5 in MD&A.

15

SAMPLE DISCLOSURES (cont'd)

- Setting the Foundations for a Sustainable Energy Future

  The immediacy and the enormity of the challenge we face in global warming became even more stark in 2007. Multiple new studies showed that warming is changing the planet more rapidly and severely than previously forecast

  We believe the imminent and urgently needed reckoning with greenhouse gas emissions is likely to significantly and permanently change the utility business. A carbon-constrained future is no longer a question of it, but rather when and how. X company is urging policy makers to act now, with a focus on creating national laws that limit greenhouse gases and impose a market price on carbon emissions

  Utility Company 10k

16

SAMPLE DISCLOSURES (cont'd)

- The liability for environmental remediation and other environmental costs is accrued when it is considered probable and the costs can be reasonably estimated. We have accrued amounts in conjunction with the foregoing environmental issues that we believe was adequate as of October 31 2007. These accruals were not material to our operations or financial position and we do not currently anticipate material capital expenditures for environmental control facilities.

  From computer company 10k, MD&A

17

SAMPLE DISCLOSURES (cont'd)

- The airline industry is subject to increasingly stringent federal, state, local, and foreign environmental laws and regulations concerning emissions to the air, discharges to surface and subsurface waters, safe drinking water, and the management of hazardous substances, oils, and waste materials. New regulations surrounding the emission of greenhouse gases (such as carbon dioxide) are being considered for promulgation both internationally and within the United States. The company is carefully evaluating the potential impact of such proposed regulations. Other areas of developing regulations include the State of California rule-makings regarding air emissions from ground support equipment and a federal rule-making concerning the discharge of deicing fluid

SAMPLE DISCLOSURES (cont'd)

The airline industry is also subject to other environmental laws and regulations, including those that require the Company to remediate soil or ground water to meet certain objectives. Compliance with all environmental laws and regulations can require significant expenditures. Under the federal Comprehensive Environmental Response, Compensation and Liability Act, commonly known as "Superfund," and similar environmental cleanup laws, generators of waste materials, and owners or operators of facilities, can be subject to liability for investigation and remediation costs at locations that have been identified as requiring response actions.

From Airline Company 10k, MD&A Section

HEIGHTENED INTEREST IN ENVIRONMENTAL DISCLOSURE

For many years, studies and articles in the Press have indicated that disclosures of environmental issues by public companies are inadequate

- Friends of the Earth "Third Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies" July 2004
- 1998 USEPA OECA study allegedly showed that 74 percent of publicly traded companies failed to adequately disclose environmental legal proceedings

20

- SEC Division of Corporate Finance Study of Fortune 500 disclosures, including environmental disclosures, indicated poor environmental disclosure
- CERES (Coalition for Environmentally Responsible Economies) studies show that emitting companies do not properly report impact of climate change and greenhouse emission gases on their future operations
- Overall reporting rate is 39%, fact that some companies are already reporting climate risks to their shareholders suggests that climate change is a material business risk

21

Current Action

1. CERES and Investor Network On Climate Risk have issued a Call to Action
2. Several states and regions have implemented carbon reduction regulations and initiatives.
3. CERES believes that climate risk disclosure is required in MD&A, but some companies do not report

22

Pressure on the SEC for Rulemaking on Climate Change

- CERES Petition to the SEC (September 2007)
- Dodd/Reed Letter to the SEC (December 2007)
- CERES Supplemental Letter to the SEC (June 2008)
- Free Enterprise Action Fund Petition to the SEC (October 2007)
  - Disclose business risks of global warming laws and regulations
- Free Enterprise Action Fund Letter to the SEC (July 2008)
  - Asks SEC to issue guidance to warn issuers against making potentially false and misleading statements about global warming and other environmental issues

23

Investor Efforts to Require Disclosure Rulemaking/Guidance on Climate Change -

Reporting Frameworks

- Global Reporting Initiative (CERES)
- Carbon Disclosure Project
- CA and Other Climate Registries
- WRI/World Business Council for Sustainable Development GHG Protocol

24

VOLUNTARY CLIMATE CHANGE REPORTING

- Corporate Responsibility Statements
- Consistency with SEC reports is vital

25

Pressure on Companies by Shareholders/ Investor Groups

- Shareholder Proposals on environmental issues
  - Exxon Mobil resolutions (May 2008)
  - ConocoPhilips
- CERES/ACCA Sustainability Reporting Awards

26

FAS 5 Proposal to Revise Disclosure of Loss Contingencies – Pressure from the Accountants

- Goal: achieve disclosures of loss contingencies that provide adequate information to assess likelihood, timing and amount of future cash flows associated with loss contingencies
- Standard: disclose all loss contingencies except where likelihood of a loss is remote (although if a loss contingency is expected to be resolved in the near term and there is a potentially severe impact on the entity's financial position, cash flow or results of operations, such loss contingency must be disclosed regardless of the likelihood of loss)
- Comment letters available on http://www.fasb.org/ocl/fasb-getletters.php?project=1600-100
- Impact on environmental (climate change) disclosure in financial statements and MD&A

27

Environmental Marketing Claims

- How FTC Green Guide Revisions Might Affect Your Business and Marketing Claims

What are the Green Guides?

- Section 5 of the FTC Act authorizes FTC to regulate and enforce "deceptive" and "unfair" acts or practices.
- FTC's Green Guides create "safe harbors" for green marketing claims if the guidelines are followed.
- FTC considering revising Green Guides, currently reviewing public comment and holding workshops

28

What is An Environmental Claim?

Any statement, symbol or graphic that:

- Refers to an environmental aspect of a product
- Is made on products, on product packaging, in product literature or in advertisements

29

Overview of Green Guides Scheme

- Environmental Marketing claims must be supported by competent and reliable evidence
- FTC can take enforcement action against deceptive acts and practices
- Last FTC environmental marketing enforcement case was in 2000, but this is an increasing area of focus: huge increase in number of green claims being made and concern about "greenwashing"

FTC Perspective

- Advertiser must have substantiation for all claims that a reasonable consumer might take away from an ad or claim;
- If a claim is only truthful under certain circumstances, then claim must be qualified; and
- Disclosure to ensure a claim is not deceptive must be clear and conspicuous

Five Critical Issues to Consider Before Making a Green Claim

- Is the claim substantiated?
- Is the claim open-ended or vague?
- Are claims on comparisons qualified?
- Are features exaggerated?
- Are there claims which consumers won't understand?

32

Substantiation of Claim

- Is there standard scientific evidence such as tests, analyses or research conducted and evaluated in an objective manner that supports your claim?
  - -- Ex: "all energy used in producing this product was supplied by renewable sources" is verifiable, and thus needs to be verified before made
- Consider making proof available at product purchase point or website

33

Open-Ended or Vague Claims

- “Made from Recycled Material”: Need to qualify – is it the whole product, or the package, 100% or less, post-consumer or post-industrial waste, is it recyclable in the area sold?
- Other examples:
  - “chemical free” – nothing is
  - “all natural” – arsenic is natural
  - “green” or “environmentally friendly” – meaningless without elaboration

34

Qualified Comparisons

- Carbon Reduction: as compared to what? If a fuel lowers carbon by [x]%, which fuel are you comparing it to? Diesel and different grades of fuel, refined from different petroleum sources, may have very different carbon profile.
- Wells to wheels analysis: must factor in carbon output of production and transportation.

35

Exaggerated Claims

- Hidden trade offs
  - Paper products that promote "green" origin due to recycled content or harvesting without attention to manufacturing impacts
- Avoiding pseudo-science and promoting attributes which are actually irrelevant: -
  - Scientific names for products that are "made-up"

36

Claims must be understandable by reasonable consumer

- Avoid certifications or symbols that consumer will not understand
- Example: saying "food energy" instead of calories

37

FTC Enforcement Powers

Lanham Act

Section 43(a) of the Trademark Act of 1946 (Lanham Act)

- Provides a federal civil cause of action for false and misleading representation of fact made in connection with the advertising and promotion of goods and services
- Standing: any person who believes that they may be damaged by the act excluding consumers but including competitors
- Injunctive relief and money damages available

- Companies advertising or promoting products as GREEN must be careful not to violation 43(a) of the Lanham Act

38

Emerging Issues

- Green Guide revision hearing held January 8, 2008 to focus on Renewable Energy Certificates and Carbon Offsets. Additional workshop held in April on green packaging claims.
- Workshop Highlights
  - Focus on need to regulate growing use of vague claims
  - Need for specific guidance, clearer definitions and standards supported by transparent methodologies
  - Greater enforcement of Green Guides a possibility
  - Complexity of claims like "sustainability"

39

- Proponents of increased activism by FTC have expressed interest in developing methods for substantiating claims about
  - Renewable Energy Certificates (RECs)
  - Carbon Offsets

40

Carbon Offsets and Renewable Energy Certificates (RECs): Background

- Carbon Offsets
  - Compliance Markets: Regional cap and trade programs in development (RGGI, Western States), International: Kyoto CERs under Clean Development Mechanism
  - Voluntary Markets: can not be business as usual (additionality)
- Renewable Energy Credits
  - Renewable Portfolio Standards in 21 States and D.C.
  - Different states: different standards. Not all RECs are the same

41

Emerging Issues

- Renewable Energy Certificates (RECs): measured in Megawatts?
- Carbon offsets: permanent reductions? What is verifiable?
- What scientific standards must be applied to measure MW or GHG reductions and must the people applying them have minimum technical skills?
- House Committee on Energy letter to GAO: concerns about carbon offsets becoming "21st century version of snake oil"

42

Carbon Offsets and RECs: Certification and Verification

- Markets for RECs and Carbon Offsets rely heavily on private registration and certification agencies – some are for-profit. Potential issues include:
  - Independence
  - Audit
  - Record keeping requirements
  - Identification of certifying agency, financial sponsor any fees charged

43

Carbon Offsets and RECs: Literal Truth vs. Potential Deception

- Renewable power generated to make product but REC sold to another firm: claim is "We generated renewable power to make this product"
- Carbon offsets: would the project have been pursued without the offset market? Does lack of additionality make premium paid for "carbon neutral" product meaningless?
- If a firm uses traditional power sources but purchases RECs, can they market "100% renewable powered"

44

Carbon Offsets and RECs: Literal Truth vs. Potential Deception

- RECs = Offsets? (Are we "carbon neutral")
  - REC is a production subsidy, not offset
  - No means to quantify carbon reduction from a REC
  - Additionality: carbon reduction typically only if project would not have taken place without offset value. Can't be "business as usual"

45

Green Claims Conclusions

- FTC looks at claims from the point of view of reasonable consumers: even literal truth can be deceptive
- Substantiate all claims – express or implied – that could be taken from the advertising
- Qualify carefully if claim is only true under certain circumstances
- Disclosure required to prevent deceptive advertising must be clean and conspicuous
- Growth in complexity and analysis of environmental claims growing, but as markets for RECs and Carbon offsets grow clear standards should emerge

46

- "[A]ny senior corporate official who considers his or her personal involvement in determining the disclosure to be presented in quarterly or annual reports to be a 'administrative burden,' rather than an important and paramount duty, seriously misapprehends his or her responsibility to security holders."

SEC Announcement Regarding Sarbanes-Oxley Requirements

47

Hypothetical – To Be Discussed

Company GreenX manufactures tennis shoes in a historic factory building on the banks of the Hudson River, in Hattersville, New York. The building was originally built and occupied in the early 20th century by a hat manufacturer.

GreenX manufactures and distributes tennis shoes made out of synthetic rubber, foam rubber and plastic. The shoes also contain a very small percentage of natural rubber produced from trees in Southeast Asia. The rubber trees are planted and harvested using sustainable agricultural practices. As a result, GreenX makes several "green" claims in its advertising, including claims that its shoes are made from sustainable, natural materials.

48

Hypothetical (cont'd)

GreenX's manufacturing process involves heating foam rubber in high temperature ovens, applying adhesives and shaping the shoes. The ovens are fueled by electricity supplied by the electric grid operated by the local electric utility. The facility also has an emergency back-up generator fueled with diesel fuel. Prices for electricity and diesel have been steadily increasing in 2008, and are a material cost of production.

49

Hypothetical (cont'd)

Formaldehyde is released during the foam molding process and the adhesive process. The formaldehyde is captured by vapor recovery units that discharge through smoke stacks into the atmosphere. The heating ovens operate 24 hours a day.

Prior uses of the factory included the manufacture of felt hats in the early 20th century. Arsenic and mercury were commonly used in the process of "felting hats" during that time period. The hats were boiled in large vats located adjacent to the Hudson River.

50

Hypothetical Environmental Issues:

1. USEPA has recently issued an advanced Notice of Proposed Rulemaking indicating that it is considering proposing lower emissions limits for formaldehyde used in manufacturing processes. The shoe and furniture industry trade associations intend to submit comments opposing the regulation and have conducted their own studies that contradict the results of the studies EPA has published. New pollution control equipment to achieve lower emissions limits for formaldehyde is approximately $850,000 per formaldehyde unit. The company is currently investigating alternatives to the formaldehyde used in its production and is currently experimenting with new types of foam and a natural adhesive that do not contain formaldehyde.

51

Hypothetical Environmental Issues: (cont'd)

2. New York has enacted legislation implementing a cap and trade program for carbon emissions. The cap on carbon emissions from the Company's facilities has not been promulgated, nor does the Company have any sense of what that cap might be and whether the Company can meet or purchase credits for emissions that exceed the cap.

3. The Company has received a Notice of Potential Responsibility from USEPA that it is potentially responsible for arsenic and mercury in unacceptable levels in the soils on its property. The property is adjacent to several other properties that were also used for hat making and it is not clear whether the contamination is from operations on the Company's property.

52

Take-Aways

- SEC Disclosure Rules may require companies to disclose impact of global warming on business operations
- New accounting rule proposals require earlier reporting of contingent liabilities
- Practitioners should keep abreast of regulations, laws and public interest initiatives on carbon reductions for reporting purposes
- Green Marketing Claims can be suspect – follow FTC guides carefully

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53

Federal Trade Commission

RESPONSIBLE GREEN MARKETING

J. Thomas Rosch[1]
Commissioner, Federal Trade Commission

at the

American Conference Institute's
Regulatory Summit for Advertisers and Marketers
Washington, DC
June 18, 2008

I. Introduction

I am pleased to be here today to discuss the Commission's recent activities regarding the Guides for the Use of Environmental Marketing Claims, more commonly known as the "Green Guides."[2] As all of you have probably noticed, "green" marketing claims seem to have recently become ubiquitous – running the gamut from "luxury vodka that's good for the environment"[3] to

[1] The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Beth Delaney, for her invaluable assistance in preparing these remarks.

[2] 16 C.F.R. § 260 (2008). Industry guides, such as the Green Guides, are administrative interpretations of the law. As such, they do not have the force and effect of law and are not independently enforceable. The Commission can take action under the FTC Act, however, if a business makes environmental marketing claims inconsistent with the Guides. In such an enforcement action, the Commission has to prove that the challenged act or practice at issue was unfair or deceptive.

[3] Stuart Elliott, *"Green Grows the Vodka,"* The New York Times, Mar. 17, 2008, *available at* www.nytimes.com/2008/03/17/business/media/17adnewsletter1.html?.

the purported ability to offset greenhouse gas emissions from hotel stays[4] to "carbon-neutral" Super Bowl games[5] and "green" Academy Awards ceremonies.[6] One news organization reported that by one count, manufacturers launched 328 "environmentally friendly" products last year, up from only 5 such products in 2002.[7] Activity at the U.S. Patent and Trademark Office reflects this trend as well – applications with the word "green" more than doubled from 2006 to 2007, while applications with the words "clean," "eco," "environment," "earth," "planet," and "organic" also jumped.[8]

In light of this scale of activity, it comes as no surprise that the FTC decided to accelerate its periodic regulatory review of the Green Guides. This past November, the Commission published a Federal Register notice soliciting comments on the Green Guides.[9] Part of the review focuses on general issues: the continuing need for the Guides; their effect on the accuracy of various environmental claims; and their interaction with other environmental

[4] Michael S. Rosenwald, *"A Tactical Turn to Green for Marriott,"* The Washington Post, Apr. 8, 2008, at D1, *available at* www.washingtonpost.com/wp-dyn/content/article/2008/04/07/AR2008040702630.html.

[5] Scott Edward Anderson, *"Greening the Gridiron: Environmental Responsibility at the Superbowl and Beyond,"* Feb. 6, 2006, *available at* www.climatebiz.com/feature/2006/02/06/greening-gridiron-environmental-responsibility-super-bowl-and-beyond.

[6] Press Release, *"Natural Resources Defense Council 'Greens' the Academy Awards,"* Feb. 25, 2007, *available at* www.nrdc.org/media/2007/070225.asp.

[7] CBS Evening News, *"A Closer Look at 'Green' Products,"* May 18, 2008, *available at* www.cbsnews.com/stories/2008/05/18/eveningnews/main4105507.shtml.

[8] GreenBiz Staff, *"Eco Trademarks Made Big Gains in 2007,"* Apr. 28, 2008, *available at* www.greenbiz.com/news/2008/04/28/eco-trademarks-made-big-gains-2007.

[9] Guides for the Use of Environmental Marketing Claims, 72 Fed. Reg. 66,091 (Nov. 27, 2007).

marketing regulations. At the same time, the Commission recognizes that science and technology in the environmental area is constantly changing. As a result, consumer perception of environmental claims may have evolved since the inital issuance of the Guides in 1992,[10] and the subsequent reviews of the Guides.[11] Accordingly, the Commission also asked for submission of any relevant consumer survey evidence and consumer perception data that addresses environmental claims – including claims not currently covered by the Guides.

In addition to seeking information through the questions published in the Federal Register, the FTC also is holding a series of public workshops to explore developments in environmental and "green-energy related" marketing.[12] Topics for these workshops include carbon offsets, "green" packaging claims, and "green" claims in the building and textiles markets. In a few minutes, I will discuss some of the issues raised by those participating in the comment process and the workshops, but first, I would like to begin by talking a little bit about the history of the FTC's involvement in the oversight of environmental marketing claims.

[10] Guides for the Use of Environmental Marketing Claims, 57 Fed. Reg. 36363 (Aug. 13, 1992) (publication of final guides).

[11] Guides for the Use of Environmental Marketing Claims, 61 Fed. Reg. 53311 (Oct. 11, 1996)(publication of revised guides); Guides for the Use of Environmental Marketing Claims, 63 Fed. Reg. 24240 (May 1, 1998)(final revised guides).

[12] *See* Guides for the Use of Environmental Marketing Claims; Carbon Offsets and Renewable Energy Certificates; Public Workshop, 72 Fed. Reg. 66,094 (Nov. 27, 2007)(workshop held on January 8, 2008); Guides for the Use of Environmental Marketing Claims; The Green Guides and Packaging; Public Workshop, 73 Fed. Reg. 11371 (Mar. 3, 2008)(workshop held on April 30, 2008); and Press Release, "*FTC Announces Workshop on 'Green Guides' and Environmental Claims for Buildings and Textiles*," June 3, 2008, *available at* www.ftc.gov/opa/2008/06/greenguides.shtm.

II. Environmental Marketing Claims Before the Green Guides

As many of you know, the Green Guides were initially issued in 1992, in response to a similiar proliferation of environmental marketing claims during the late 1980s and early 90s. However, as a veteran of the Bureau of Consumer Protection, it behooves me to mention that the FTC had begun addressing environmental claims and concerns even earlier. In 1971, for example, the Commission proposed a trade regulation rule to address the environmental effect of detergents.[13] Among other things, that proposed rule would have deemed it an unfair or deceptive act or practice to sell or distribute any detergent containing phosphorous without incorporating in all labeling and advertising, a "warning" that the product contains phosphorous and that phosphorous contributes to water pollution.[14] Ultimately, rather than promulgating a rule, the Commission negotiated an industry-wide agreement on phosphate and degradability claims for detergents.[15]

Around the same time, the Commission adopted a trade regulation rule relating to incandescent light bulbs, after finding that, contrary to what most consumers thought, light bulbs of the ***same*** wattage level could have different rated lives as well as varying amounts of actual light output. In order to give consumers the opportunity to weigh greater light output versus

[13] *See, e.g.*, Annual Report of the Federal Trade Commission for the Fiscal Year Ended June 30, 1971, *available at* www.ftc.gov/os/annualreports/ar1971.pdf ("Because of recent, widespread concern with the effect of commercial products on the environment, advertising based on claims of beneficial environmental effects were subjected to intensive scrutiny").

[14] Notice of Public Hearing and Opportunity to Submit Data, Views or Arguments Regarding a Proposed Trade Regulation Rule, 36 Fed. Reg. 1012 (1971).

[15] FTC News Release, "*Detergent Manufacturers to Adopt Uniform Labeling for Phosphorous Content and Biodegradable Statements*," (Aug. 6, 1973).

longer life, the Rule required the disclosure of certain information on the bulbs or their packages.[16]

Another example of our early intervention with respect to environmental claims were our challenges and subsequent Commission orders regarding anti-pollution claims made for gasoline additives.[17] In those cases, manufacturers had claimed that gasoline additives would dramatically reduce exhaust emissions and thereby reduce air pollution.

By the early 1990s, it became clear that there was broad-based support for the view that truthful and reliable advertising had an important role to play in encouraging the development of more environmentally sound products and packages.[18] At the same time, there was concern about the potential for the development of differing or inconsistent standards on a state-by-state basis.[19] Ultimately, the issuance of national industry-wide guidance for environmental marketing claims was recognized as a way to promote truthful and substantiated advertising while providing certainty in the marketplace for both advertisers and consumers.[20]

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[16] Final Rule and Statement of Basis and Purpose, 35 Fed. Reg. 11784 (July 23, 1970). The Commission later repealed the "Light Bulb Rule," determining that the Rule was no longer necessary in light of the more comprehensive lamp labeling rules adopted in 1994 under the Energy Policy and Conservation Act, and current industry light bulb marking practices. *See* "*FTC Turns Out the Light on 1970 Light Bulb Rule,*" July 1, 1996, *available at* www.ftc.gov/opa/1996/07/bulbs4.shtm.

[17] *In the Matter of Crown Central Petroleum Corporation*, 84 F.T.C. 1493 (Nov. 26, 1974); *In the Matter of Standard Oil Company of California*, 84 F.T.C. 1401 (Nov. 26, 1974).

[18] Roscoe B. Starek, III, "*The Federal Trade Commission's Green Guides: A Success Story,*" Speech Before the Alliance for Beverage Cartons and the Environment Symposium, Dec. 4, 1996, *available at* www.ftc.gov/speeches/starek/egstarek.htm.

[19] *Id.*

[20] Keith Schneider, "*Guides on Environmental Ad Claims,*" The New York Times, July 29, 1992, *available at* (noting that manufacturers praised the agency's work, and that

In 1991, the FTC held public hearings and initiated a 90-day comment period on issues concerning environmental marketing and advertising claims, and in 1992, issued the Green Guides.[21] In fact, one of the Commission attorneys primarily responsible for this commendable work is here today – Mary Engle – you will see her on the children's advertising panel later today.

III. The Green Guides Now

Now I would like to make a couple of general observations about the Green Guides themselves. I was long gone from the agency when the Green Guides were issued, but in preparing my remarks to you I went back and reviewed some of the speeches I gave to the advertising community in 1974 about the basic legal principles applicable to advertising and I was struck by how firmly rooted the Guides are in those basic principles. The Guides do nothing more than reflect, with respect to particular types of claims – whether it be recyclability, biodegradability or compostability – the basic requirements that have been spelled out over the years in FTC statements and cases for ***all*** advertising claims.

Those principles are fivefold. First, advertising claims should be substantiated before the claims are made. The Commission has said that since the *Pfizer*[22] and *Firestone*[23] cases more

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consumers get accurate information about the environmental advantages of packaging and products, while the manufacturer gets clear guidance for claiming certain attributes).

[21] Guides for the Use of Environmental Marketing Claims, 57 Fed. Reg. 36363 (Aug. 13, 1992).

[22] *Pfizer Inc.*, 81 F.T.C. 23 (1972).

[23] *Firestone Tire & Rubber Co.*, 81 F.T.C. 398 (1972), *aff'd* 481 F.2d 246 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973).

than 30 years ago. This principle is reflected in the Green Guides' prohibition against unsubstantiated environmental claims.[24]

Second, do not make "open-ended" claims – broad, unqualified claims that are applicable only in quite limited circumstances. This kind of claim is no newcomer to the Commission. Way back in 1944, the Vacu-Matic Carburetor Company made an unqualified claim that its device to be used on car engines would reduce gasoline consumption.[25] In fact, the device wasn't useful except where "the fuel mixture, due to improper adjustment of the carburetor, is excessively rich." The Commission said no. Just as it says in the Green Guides for example, that claims about recyclability must correspond to the availability of recycling facilities in the area where the claim is made.[26]

Third, do not make "dangling comparative" claims – claims that something is "better" or "safer" without saying what it is being compared with. The landmark decision in this area is the Commission's decision in *Liggett & Myers*.[27] There, the company claimed that "Chesterfields are milder," then argued that this just meant "milder than *some* other cigarettes," not milder than cigarettes generally. The Commission found the claim deceptive. Thus, the Green Guides warn against making comparative environmental claims without identifying the basis of comparison.[28]

Fourth, do not make "exaggerated feature" claims – claims that dwell on a product

[24] 16 C.F.R. § 206.5 (2008).

[25] *Vacu-Matic Carburetor Co. v. F.T.C.*, 38 F.T.C. 704 (1944), *aff'd*,157 F.2d 711 (7th Cir. 1946). *See also In the Matter of Octa-Gane, Inc., et al.*, 53 F.T.C. 195 (1956).

[26] 16 C.F.R. § 260.7(d)(2008).

[27] *In the Matter of Liggett & Myers Tobacco Co.*, 55 F.T.C. 354 (1958).

[28] 16 C.F.R. § 260.6(d)(2008).

feature which may have no significance or benefit for consumers. The leading case here is the Commission's 1966 decision in *American Home Products*.[29] There *AHP* highlighted the ingredient "Bio-Dyne" in ads for Preparation H. The Commission found the claim deceptive because the ingredient had little or no therapeutic value. This conclusion is reflected in the Green Guides' admonition that environmental claims should not exaggerate or overstate attributes or benefits.[30]

Fifth, do not make claims using terms that consumers don't generally understand. The prime example I used in 1974-75 was use of the term "food energy" which simply meant calories, though most consumers did not realize that. This principle is reflected in the Green Guides' caution against the use of symbols or seals of approval whose significance the public doesn't understand, and therefore could be deceptive.[31]

IV. <u>Where To Next?</u>

So, where are we now? As I mentioned earlier, this past November, the Commission put the Guides out for review.[32] The Commission also requested comments in conjunction with the workshops it is conducting on various "green" topics. To date, the Commission has received

[29] *In the Matter of American Home Products Corp.*, 70 F.T.C. 1524 (1966).

[30] 16 C.F.R. § 260.6(c)(2008).

[31] 16 C.F.R. § 260.7(a), Example 5 (2008).

[32] Guides for the Use of Environmental Marketing Claims, 72 Fed. Reg. 66,091 (Nov. 27, 2007).

over 150 comments from interested parties.[33] There is an enthusiastic consensus among commenters that the Guides are important to both consumers and industry. Commenters have many thoughtful ideas about how we can improve the Guides and how the Guides might need to be supplemented to address new issues in environmental marketing. As you can imagine, staff is still in the process of reviewing and synthesizing all of these ideas and suggestions. Speaking entirely on my own behalf, however, there are a few major themes that are apparent and that I would like to highlight for you today.

I think one of the most interesting challenges is raised by the concept called "life cycle analysis." Life cycle analysis involves looking at the entire lifespan of a product – beginning with how the product is manufactured and what types of materials and equipment are used, to how the product is transported for distribution, to how the consumer uses the product and ultimately, disposes of it. Life cycle analysis is a "big picture" concept, and is a new way of looking at the impact of consumer products on the environment. Instead of focusing merely on the disposal of a product, this analysis takes into consideration all of the components involved in the manufacture, distribution, use and disposal of the product. Some commenters call this a cradle-to-grave analysis, while others have coined the term "cradle to cradle."

As the focus of environmental marketing turns more in this direction, product manufacturers will face challenges on how to truthfully and accurately inform consumers about

[33] Seventy-two responses were submitted in response to the request for comments for the review of the Green Guides. The comment period closed in mid-February and the comments can be found at www.ftc.gov/os/comments/greengudesregreview/index.shtm. The Commission received 56 comments regarding issues raised by the Carbon Offsets and Renewable Energy Certificates workshop held on January 8, 2008 (comments available at www.ftc.gov/os/comments/carbonworkshop/index.shtm); and received 30 comments for the Green Packaging Claims workshop held on April 30, 2008 (comments available at www.ftc.gov/os/comments/greenpkgworkshop/index.shtm).

their practices. Likewise, this is an area that we will need to consider as we review the Guides. Does current guidance provide enough assistance? What do consumers understand about the claims made about one part of the manufacturing, distribution or disposal process, when actual practices in other parts of the process may "undo" the good accomplished by that part of the process? One environmental marketing agency identifies this as the "Sin of the Hidden Trade-Off" – and gives the following example: a product may come from a sustainably harvested forest, but what are the impacts of the milling and transportation practices?[34] In terms of advertising practices, what is important is the net impression taken away by the consumer about the claims made.

Participants in the comment process and the workshops have also highlighted the fact that the Guides could be fine tuned to address the use of terms like "biodegradability" and "recyclability" in light of consumer perception about what these words mean. For example, the Guides point out that an unqualified biodegradability claim should be substantiated by competent and reliable scientific evidence that the entire product or package will break down and return to nature "**within a reasonably short period of time after customary disposal**."[35] One issue raised concerns the meaning of the term "reasonably short period of time." Consumers may have a very different perception of how long it takes for something to degrade. More information about consumers' understanding of this will help the FTC provide guidance on

[34] TerraChoice Environmental Marketing, Inc., "*The Six Sins of Greenwashing – A Study of Environmental Claims in North American Consumer Markets*," Nov. 2007, *available at* www.terrachoice.com/files/6_sins.pdf. *See also* Christopher A. Cole & Carly Van Orman, "*Green Marketing: Avoiding Unwanted Attention from Regulators and Marketers*," Legal Backgrounder, May 19, 2008, *available at* www.wlf.org/upload/05-16-08vanorman.pdf.

[35] 16 C.F.R. § 260.7(b)(2008).

making truthful and accurate claims. How consumers actually dispose of biodegradeable products is another issue. The Guides talk about "**customary disposal**" with respect to claims of biodegradability. However, disposal for many consumers means a landfill, and landfills today are often constructed in a manner that specifically thwarts biodegradability. Do claims need to be clarified so that consumers have this information?

Recyclability claims raises similar issues – the Guides point out that such claims "should be qualified to the extent necessary to avoid consumer deception **about any limited availability of recycling programs and collection sites**."[36] As newer products develop that have the capability to be recycled, producers must keep in mind the fact that facilities may not be yet be widely available for the recycling of such products. As a policy matter, it is tempting to label as "recyclable" anything that is even remotely so. However, it is my view that the goal of the Green Guides should be focused on promoting accurate and truthful advertising. While I believe that motivating socially responsible behavior is very useful, I personally think that motivating socially responsible behavior, as such, is not the FTC's mission as its mission is defined by Section 5 of the FTC Act. However, I do think that consumer education as a byproduct of accurate and truthful advertising, ultimately, can lead to more responsible behavior.

Another issue is the growing use of words like "sustainable" and "renewable" in environmental marketing. As many of you know, the basic framework of the Guides, for the most part, anticipates claims about specific attributes of a product. Some commenters have suggested that these terms are too vague and that the FTC should not try to define them for purposes of the Guides. Others have opined that these terms are comparable to phrases such as

[36] 16 C.F.R. § 260.7(d)(2008).

"eco-friendly" and other general "green" claims and should be prohibited as a "general environmental benefit" claim unless the marketing claim is limited to a particular attribute of a product and it could then be substantiated.[37] Still other commenters have noted that their industries can and have defined terms such as "sustainable," and accordingly, they should be allowed to use them in their marketing and self-regulatory efforts. These are some of the issues that staff is in the process of sorting out.

V. First Amendment/Free Speech/Image Advertising – Then and Now

Even when our mission is defined in narrow terms, we must be mindful of the First Amendment. I say this for five reasons.

First, image advertising can be a very effective tool, especially for an advertiser whose products are more or less fungible. As the public becomes increasingly aware of the fungibility, the advertiser may try to differentiate itself on some basis and image is one way to do it. A company that is viewed by consumers (and/or shareholders) as a "good" company, as compared to its rivals may do better in the competitive and capital markets than those rivals.

Second, image advertising is not a new phenomenon. When I was at the Commission in the mid-1970s, we saw a lot of it, as you can imagine, by petroleum companies. After I left, the Commission brought a case against R.J. Reynolds based on a paid advertisement it placed in major magazines regarding its "Of Cigarettes and Science" message – basically an advertorial looking at medical studies and questioning the link between smoking and heart disease. The

[37] 16 C.F.R. § 260.7(a)(2008)("Unqualified claims of environmental benefit are difficult to interpret, and depending on their context, may convey a wide range of meanings to consumers").

ALJ dismissed the case on the basis that the message was fully protected speech, but then the Commission reversed that order, remanding the matter back to the ALJ.[38] Ultimately, the parties settled, avoiding further exploration of these difficult issues.

Third, I am well aware that "image" and "message" advertising continues to pose difficult constitutional issues. For example, the Supreme Court recently avoided tough issues in the *Nike v. Kasky* case by ruling that certiorari was improperly granted.[39] More specifically, I understand that the First Amendment shields non-commercial advertising from challenges except in very unusual circumstances, and I think that shield is available to many, if not, most pure image and message advertisements -- including ads relating to reforesting and environmental issues, for example -- regardless of whether the "message" is true or false.

Fourth, however, that said, I am not convinced that all image ads are shielded. Some such ads may be predominantly commercial in their purpose and effect. As I've said, there are commercial reasons for engaging in this kind of advertising. The closer the image claims are associated with specific branded products, I think the less likely it is that the First Amendment provides absolute protection. Or conversely, the more likely it is that the ad will only be afforded the protection given to commercial speech.

Fifth, it's strongly arguable that the Commission should challenge ads that don't enjoy absolute First Amendment immunity when the claims made are false. It's a form of unfair competition when the bad guys are able to tune the public off on the good guys by making deceptive claims.

[38] *In the Matter of R.J. Reynolds Tobacco Co., Inc.*, 111. F.T.C. 539 (1998).

[39] *Nike, Inc., et al. v. Kasky*, 539 U.S. 654 (2003).

Finally, I don't suggest for a moment that the Commission should go after all unprotected ads. There may well be sound policy reasons – internal policy reasons – for not going after some ads insofar as that would conflict with other law enforcement activities. There may also be some valid law enforcement strategic reasons for not challenging some ads; in particular, if the invalidity or protectability of the claim made turns on facts that are hard to prove, the game may not be worth the candle. Or, some matters may be better resolved in actions by competitors, either through Lanham Act cases or the self-regulatory process. But I would not want to leave you with the impression that image ads are entirely off limits. At least in my own mind.

VI. Conclusion

The thought I would like to conclude with today is that I think the Green Guides are alive and well, and I am optimistic about their utility in the future. I make this point for two reasons.

First, because the Commission has not brought any environmental marketing cases that relate to conduct described in the Guides since 2000,[40] and one may legitimately ask why that is

[40] *Dura Lube Corporation, et al.*, D-9292 (May 3, 2000) (challenging claims that the companies' motor oil additive, among other things, reduces emissions). From 1990 to 2000, the FTC brought 37 cases involving environmental marketing claims. *See* Energy & Environment microsite *available at* www.ftc.gov/energy/ (cases listed under the Enforcement tab of the Environment portion of the microsite).

Since 2000, the Commission has brought other cases, however, that relate to energy efficiency. *See, e.g., U.S. v. Northwestern Ohio Foam Packaging, Inc.*, Civil Action No. 3:06-cv-02407 (filed Oct. 5, 2006)(alleging that an insulation made exaggerated R-value claims for its insulation product); *F.T.C. v. Intl. Research and Dev. Corp. of Nevada, et al.*, Case No.: 04C 6901 (filed Oct. 7, 2004)(alleging deceptive claims about an "automatic fuel saver" device); *In the Matter of Kryton Coatings Intl., Inc.*, Docket No. C-4052, File No. 012 3060 (decision issued June 14, 2002)(alleging unsubstantiated performance and R-value claims for building coatings).

so. I think the answer relates to the Commission's views as to whether and to what extent the Green Guides' teaching has been absorbed by the firms making environmental claims and whether and to what extent alternatives to Commission law enforcement exist. I think the Guides have been very successful as guides. That doesn't surprise me. I was skeptical when the FTC issued the Fuel Economy Guides[41] in 1975, that guides, as opposed to rules, would be obeyed. But they were obeyed by the automobile industry, and I think the same thing is true of environmental claims. Additionally, the extent to which there is self-regulation and private enforcement – through the Lanham Act – in the advertising world far surpasses anything we saw in the early 70s.

Second, my own view is that if the incidence of objectionable claims increases or the alternatives dissipate, the FTC cop can and should get on the beat vigorously – because these are very important claims in today's world (and they will increasingly be important, I think in our grandchildrens' world). Indeed, staff is currently investigating a variety of environmental product claims. Although some of these products may be new innovations – for example, "green" building materials and "environmentally friendly" textiles – and their advertising may use creative terminology, I believe that the current Green Guides, and any revisions to them, will continue to offer an extremely helpful framework to enforce truthful and accurate advertising.

Thank you for your time and attention.

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[41] Guide Concerning Fuel Economy Advertising for New Automobiles, 40 Fed. Reg. 42003 (Sept. 10, 1975); *see also* Guide Concerning Fuel Economy Advertising for New Autmobiles, 16 C.F.R. § 259 (2008).

NO. 1600-100 | JUNE 5, 2008

Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Disclosure of Certain Loss Contingencies

an amendment of FASB Statements No. 5 and 141(R)

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. 1600-100

Comment Deadline: August 8, 2008

Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be **received** in writing by August 8, 2008. Interested parties should submit their comments by email to director@fasb.org, File Reference No. 1600-100. Those without email may send their comments to the "Technical Director—File Reference No. 1600-100" at the address at the bottom of this page. Responses should **not** be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB's website and will be included in the project's public record.

Any individual or organization may obtain one copy of this Exposure Draft without charge until August 8, 2008, on written request only. **Please ask for our Product Code No. E195.** For information on applicable prices for additional copies and copies requested after August 8, 2008, contact:

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Financial Accounting Standards Board
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Notice for Recipients of This Proposed FASB Statement

This proposed Statement would replace and enhance the disclosure requirements in FASB Statement No. 5, *Accounting for Contingencies,* for loss contingencies that are recognized as liabilities in a statement of financial position and for unrecognized loss contingencies that would be recognized as liabilities if the criteria for recognition in paragraph 8 of Statement 5 were met. It would not change the disclosure requirements for loss contingencies that are (or would be) recognized as asset impairments. This proposed Statement also would apply to loss contingencies recognized in a business combination accounted for under FASB Statement No. 141 (revised 2007), *Business Combinations.*

Effective Date and Transition

The disclosures about loss contingencies required by this proposed Statement would be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

Request for Comments

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement, particularly on the questions listed below. Respondents need not comment on each issue and are encouraged to comment on additional matters they believe should be brought to the Board's attention. Comments are requested from those who agree with the provisions of this proposed Statement as well as from those who do not. Comments are most helpful if they identify the issues to which they relate and clearly explain the reasons for the positions taken. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning. Respondents must submit comments in writing by August 8, 2008.

The Board requests that constituents provide comments on the following questions:

1. Will the proposed Statement meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?
2. Do you agree with the Board's decision to include within the scope of this proposed Statement obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations, which are currently subject to the provisions of Statement 5? Why or why not?
3. Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is

expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

4. Paragraph 10 of Statement 5 requires entities to "give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." One of financial statement users' most significant concerns about disclosures under Statement 5's requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity's best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity's actual exposure.
   a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?
   b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity's actual exposure? Why or why not?
   c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute?
5. If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?
6. Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?
7. Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?
8. This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?
9. If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

10. The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be *extremely rare*. This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be *rare* (instead of *extremely rare*). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?
11. Do you agree with the description of *prejudicial information* as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define *prejudicial information* and why?
12. Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should the tabular reconciliation be required only annually? Why or why not?
13. Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?
14. Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

Public Roundtable Meeting

The Board plans to hold one or more public roundtable meetings on this Exposure Draft. The purpose of roundtable meetings is to listen to the views of, and obtain information from, interested constituents about the Exposure Draft. The Board plans to seek participants for the meetings that represent a wide variety of constituents, including investors, preparers of financial statements, auditors, and others to ensure that it receives broad input. Any individual or organization desiring to participate must notify the FASB by sending an email to director@fasb.org by July 25, 2008, and submit their comments on the Exposure Draft in writing by August 8, 2008. Roundtable meetings can accommodate a limited number of participants. Depending on the number of responses received, the Board may not be able to accommodate all requests to participate.

Field Testing Volunteers

The Board also is soliciting entities that would be willing to participate with the staff, on a confidential basis, in field testing the provisions of this proposed Statement. The purpose of the field tests is to assess the workability of the proposed guidance and evaluate the cost and benefits of the proposed change. Those interested parties can contact David B. Elsbree, Jr., practice fellow, at 203-956-3453 or dbelsbree@fasb.org.

Summary

Why Is the FASB Issuing This Proposed Statement and When Is It Effective?

Investors and other users of financial information have expressed concerns that disclosures about loss contingencies under the existing guidance in FASB Statement No. 5, *Accounting for Contingencies*, do not provide adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies. This proposed Statement would expand disclosures about certain loss contingencies in the scope of Statement 5 or FASB Statement No. 141 (revised 2007), *Business Combinations*. This proposed Statement would require expanded disclosures for those loss contingencies unless certain criteria are met. This proposed Statement would be effective for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

What Is the Scope of This Proposed Statement?

This proposed Statement would apply to all loss contingencies that are within the scope of either Statement 5 or Statement 141(R) except for the following:

a. Loss contingencies that are (or would be) recognized as asset impairments in a statement of financial position. Such loss contingencies would continue to be disclosed in accordance with Statement 5. Creditors would continue to disclose information about impaired loans in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*.
b. Guarantees within the scope of the disclosure requirements in FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, including guarantees that are recognized either initially or subsequently based on the Statement 5 accounting guidance.
c. Liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a reinsurance entity within the scope of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, or No. 163, *Accounting for Financial Guarantee Insurance Contracts*.
d. Liabilities for insurance-related assessments within the scope of AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*.
e. Liabilities for employment-related costs, including pensions and other postemployment benefits. However, obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations would be disclosed in accordance with this Statement.

How Will This Proposed Statement Improve Current Accounting Practice?

This proposed Statement would enhance disclosures about loss contingencies that are (or would be) recognized as liabilities in a statement of financial position. Specifically, this proposed Statement would (a) expand the population of loss contingencies that are required to be disclosed, (b) require disclosure of specific quantitative and qualitative information about those loss contingencies, (c) require a tabular reconciliation of recognized loss contingencies to enhance financial statement transparency, and (d) provide an exemption from disclosing certain required information if disclosing that information would be prejudicial to an entity's position in a dispute. The Board believes that these enhanced disclosure requirements will significantly improve the overall quality of disclosures about loss contingencies by providing financial statement users with important information.

How Does This Proposed Statement Relate to International Convergence?

The disclosures that would be required by this proposed Statement are similar, but not identical, to those required by IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. This proposed Statement would require disclosures about a broader population of contingencies than required by IAS 37. Specifically, this proposed Statement would require disclosures about loss contingencies, regardless of the likelihood of loss, if the contingencies are expected to be resolved in the near term and if the contingencies could have a severe impact on the entity's financial position, cash flows, or results of operations. IAS 37 does not require disclosures for remote loss contingencies regardless of the expected timing of resolution or potential severity of the contingency. The IASB currently is deliberating changes to IAS 37 but has not yet considered its disclosure requirements. The IASB is expected to evaluate the disclosure requirements in this proposed Statement when it reconsiders the IAS 37 disclosure requirements, which will provide a potential convergence opportunity.

Proposed Statement of Financial Accounting Standards

Disclosure of Certain Loss Contingencies

an amendment of FASB Statements No. 5 and 141(R)

June 5, 2008

CONTENTS

	Paragraph Numbers
Objective	1–2
Standards of Financial Accounting and Reporting:	
Scope	3
Disclosures	4–11
Tabular Reconciliation of Recognized Loss Contingencies	8–9
Subsequent Events	10
Exemption from Disclosing Prejudicial Information	11
Effective Date and Transition	12
Appendix A: Background Information and Basis for Conclusions	A1–A37
Appendix B: Amendments to FASB Pronouncements and Other Authoritative Literature	B1–B15

Proposed Statement of Financial Accounting Standards

Disclosure of Certain Loss Contingencies

an amendment of FASB Statements No. 5 and 141(R)

June 5, 2008

OBJECTIVE

1. FASB Statement No. 141 (revised 2007), *Business Combinations*, establishes the accounting and reporting for gain and loss contingencies recognized in a business combination. FASB Statement No. 5, *Accounting for Contingencies*, establishes the accounting and reporting for all other gain and loss contingencies. The objective of this Statement is to improve the disclosures about certain loss contingencies by amending Statements 5 and 141(R). This Statement does not change the recognition and measurement guidance for loss contingencies contained in those Statements.

2. The term *loss contingency*, as defined in Statement 5, includes losses that may result from the loss or impairment of an asset or the incurrence of a liability. This Statement replaces the disclosure requirements in Statement 5 for loss contingencies that are recognized as liabilities in a statement of financial position and for unrecognized loss contingencies that would be recognized as liabilities if the criteria for recognition in paragraph 8 of Statement 5 were met. Loss contingencies that are (or would be) recognized as asset impairments should continue to be disclosed in accordance with Statement 5. This Statement also amends Statement 141(R) to require the disclosures included in this Statement for loss contingencies recognized in a business combination.

All paragraphs in this Statement have equal authority.
Paragraphs in **bold** set out the main principles.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

3. This Statement applies to all loss contingencies that are within the scope of either Statement 5 or Statement 141(R), except for the following:

a. **Loss contingencies that are (or would be) recognized as asset impairments in a statement of financial position. Such loss contingencies shall continue to be disclosed in accordance with Statement 5. Creditors shall continue to disclose information about impaired loans in accordance with FASB Statement No. 114,** ***Accounting by Creditors for Impairment of a Loan.***

b. **Guarantees within the scope of the disclosure requirements of FASB Interpretation No. 45,** ***Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,*** **including guarantees that are recognized either initially or subsequently based on the Statement 5 accounting guidance.**

c. **Liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a reinsurance entity within the scope of FASB Statement No. 60,** ***Accounting and Reporting by Insurance Enterprises,*** **No. 97,** ***Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,*** **No. 113,** ***Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts,*** **No. 120,** ***Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts,*** **or No. 163,** ***Accounting for Financial Guarantee Insurance Contracts.***

d. **Liabilities for insurance-related assessments within the scope of AICPA Statement of Position 97-3,** ***Accounting by Insurance and Other Enterprises for Insurance-Related Assessments.***

e. **Liabilities for employment-related costs, including pensions and other postemployment benefits. However, obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations shall be disclosed in accordance with this Statement.**

Disclosures

4. An entity shall provide disclosures to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies that are (or would be) recognized as liabilities in a statement of financial position. Those disclosures shall include information about the risks those loss contingencies pose to the entity and their potential and actual effects on the entity's financial position, cash flows, and results of operations.

2

5. An entity shall disclose all loss contingencies within the scope of this Statement, except as follows (or as required by paragraph 6):

a. Disclosure is not required for a loss contingency for which the entity has made an assessment and determined that the likelihood of a loss is remote.

b. Disclosure is not required for a loss contingency involving an unasserted claim or assessment in which there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, unless:
   (1) It is probable that a claim will be asserted; and
   (2) The likelihood of a loss, if the claim or assessment were to be asserted, is more than remote.

6. Notwithstanding the guidance in paragraph 5, an entity shall disclose a loss contingency, or a combination of loss contingencies, regardless of the likelihood of loss, if both:

a. The contingency or contingencies are expected to be resolved in the near term;[1] and

b. The contingency or contingencies could have a severe impact[2] on the entity's financial position, cash flows, or results of operations.

7. An entity shall disclose the following information about loss contingencies required to be disclosed under paragraph 5 or 6:

a. Quantitative information about the entity's exposure to loss from the contingency (including any amounts already recognized in the financial statements but excluding potential recoveries disclosed under paragraph 7(c)), as follows:
   (1) The amount of the claim or assessment against the entity (including damages, such as treble or punitive damages), if applicable
   (2) If there is no claim or assessment amount, the entity's best estimate of the maximum exposure to loss.

   An entity also may disclose its best estimate of the possible loss or range of loss if it believes that the amount of the claim or assessment or the maximum exposure to loss is not representative of the entity's actual exposure.

b. Qualitative information about the contingency sufficient to enable users to understand the risks posed to the entity. This information shall include, at a minimum, a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution;

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[1] The term *near term* means a period of time not to exceed one year from the date of the financial statements. [AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*]

[2] The term *severe impact* means a significant financially disruptive effect on the normal functioning of an entity. Severe impact is a higher threshold than material. Matters that are important enough to influence a user's decisions are deemed to be material, yet they may not be so significant as to disrupt the normal functioning of the entity. Some events are material to an investor because they might affect the price of an entity's capital stock or its debt securities, but they would not necessarily have a severe effect on (disrupt) the entity itself. The concept of severe impact, however, includes matters that are less than catastrophic. Matters that are catastrophic include, for example, those that would result in bankruptcy. [SOP 94-6]

3

a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome; the entity's qualitative assessment of the most likely outcome of the contingency; and significant assumptions made by the entity in estimating the amounts disclosed in paragraph 7(a) and in assessing the most likely outcome.

c. A qualitative and quantitative description of the terms of relevant insurance or indemnification arrangements that could lead to a recovery of some or all of the possible loss, including any caps, limitations, or deductibles that could affect the amount of recovery.

The disclosures required by this paragraph may be aggregated by the nature of the loss contingency (for example, product liability or antitrust matters).

Tabular Reconciliation of Recognized Loss Contingencies

8. For each period for which a statement of income is presented, an entity shall provide a reconciliation, in tabular format, of the total amount recognized in the aggregate for loss contingencies in its statement of financial position at the beginning and end of the period. Amounts recognized for loss contingencies that are accounted for in accordance with Statement 141(R) shall be shown separately from amounts for loss contingencies that are accounted for in accordance with Statement 5. The reconciliation shall include at a minimum:

a. Increases for loss contingencies recognized during the period
b. Increases resulting from changes in estimates of the amounts of loss contingencies previously recognized
c. Decreases resulting from changes in estimates or derecognition of loss contingencies previously recognized
d. Decreases resulting from cash payments (or other forms of settlement) for loss contingencies.

An entity shall provide a qualitative description of the significant activity in the reconciliation and shall disclose the line items in the statement of financial position in which recognized loss contingencies are included. All loss contingencies recognized in a business combination shall be included in the reconciliation. However, other loss contingencies whose underlying cause and ultimate settlement occur in the same period shall be excluded from the reconciliation.

9. An entity also shall disclose the total amount of recoveries from insurance or indemnification arrangements recognized in each statement of financial position and statement of income presented that are related to the loss contingencies included in the tabular reconciliation required by paragraph 8.

Subsequent Events

10. After the date of an entity's financial statements but before those financial statements are issued, information may become available indicating that a liability was

4

incurred after the date of the financial statements or that it is more than remote that a liability was incurred after that date. In those situations, an entity shall provide the disclosures required in paragraph 7. In the case of a loss arising after the date of the financial statements in which the amount of the liability incurred can be reasonably estimated, an entity may supplement the historical financial statements by disclosing pro forma financial data giving effect to the loss as if it had occurred at the date of the financial statements. It may be desirable to present pro forma statements, usually a statement of financial position only, in columnar form on the face of the historical financial statements.

Exemption from Disclosing Prejudicial Information

11. For certain contingencies, such as pending or threatened litigation, disclosure of certain information about the contingency may be prejudicial to an entity's position (that is, disclosure of the information could affect, to the entity's detriment, the outcome of the contingency itself). In those circumstances, an entity may aggregate the disclosures required by paragraph 7 at a level higher than by the nature of the contingency such that disclosure of the information is not prejudicial. In those rare[3] instances in which the disclosure of the information required by paragraph 7, when aggregated at a level higher than by the nature of the contingency, or of the tabular reconciliation would be prejudicial (for example, if an entity is involved in only one legal dispute), the entity may forgo disclosing only the information that would be prejudicial to the entity's position. In those circumstances, an entity shall disclose the fact that, and the reason why, the information has not been disclosed. In no circumstance may an entity forgo disclosing the amount of the claim or assessment against the entity (or, if there is no claim amount, an estimate of the entity's maximum exposure to loss); providing a description of the loss contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution; and providing a description of the factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome.

EFFECTIVE DATE AND TRANSITION

12. This Statement shall be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years. A tabular reconciliation of recognized loss contingencies is not required for earlier periods that are provided for comparative purposes.

The provisions of this Statement need not be applied to immaterial items.

[3]The term *rare* is not intended to mean *never*. The example provided is not intended to represent the only circumstance in which a disclosure might be sufficiently prejudicial as to warrant omission of that disclosure. All of the facts and circumstances must be considered and significant judgment must be applied to determine in what circumstances disclosures might be prejudicial.

5

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

	Paragraph Numbers
Introduction	A1
Background Information	A2–A4
Scope	A5–A10
Business Combinations	A6
Guarantees	A7
Insurance	A8–A9
Multiemployer Plans	A10
Disclosure Principle	A11
Disclosure Threshold	A12–A14
Unasserted Claims and Assessments	A14
Disclosure of the Claim Amount or the Maximum Exposure to Loss	A15–A16
Qualitative Nature of Loss Contingencies	A17–A18
Recoveries	A19
Aggregation of Disclosures about Loss Contingencies	A20
Tabular Reconciliation	A21–A24
Prejudicial Exemption	A25–A29
Effective Date and Transition	A30
Similarities and Differences with International Accounting Standards	A31–A33
Benefits and Costs	A34–A37

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this proposed Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

A2. In September 2007, the Board added a project to its agenda on the accounting for certain nonfinancial liabilities and contingencies, including contingencies under FASB Statement No. 5, *Accounting for Contingencies*. The Board decided to conduct this project in two phases: a short-term phase to amend and enhance the disclosure requirements for Statement 5 loss contingencies and a long-term phase to comprehensively reconsider the recognition and measurement guidance for certain nonfinancial liabilities.

A3. The short-term phase of the project was undertaken to address constituents' concerns that the disclosures about certain loss contingencies under existing guidance do not provide sufficient information in a timely manner to assist users in assessing the likelihood, timing, and amounts of cash flows associated with loss contingencies. The loss contingencies affected are those that are (or would be, if the criteria in paragraph 8 of Statement 5 were met) recognized as liabilities in a statement of financial position that do not have other applicable disclosure guidance, such as liabilities arising from litigation. The following are the primary criticisms of disclosures about such loss contingencies that are addressed in this project:

a. The initial disclosure of specific information about a loss contingency often does not occur until a material accrual is recognized for that loss contingency.
b. The *at least reasonably possible* threshold for disclosing loss contingencies has not resulted in the disclosure of the full population of an entity's existing loss contingencies that would be of interest to financial statement users.
c. The option to state that "an estimate of the possible loss or range of loss cannot be made" is exercised with such frequency by financial statement preparers that users often have no basis for assessing an entity's possible future cash flows associated with loss contingencies.
d. The amounts recognized in the financial statements related to loss contingencies are not transparent to users.

A4. To address these concerns, this proposed Statement expands the disclosures about certain loss contingencies by replacing the disclosure requirements of Statement 5 for

those loss contingencies with the new, enhanced disclosure requirements in this proposed Statement.

Scope

A5. Loss contingencies that are recognized as asset impairments in a statement of financial position, such as allowances for uncollectible accounts receivable and impairments of loans, are outside the scope of this proposed Statement and, therefore, would continue to be subject to the existing disclosure requirements of Statement 5. The Board has a separate project on its agenda to consider disclosures related to allowances for credit losses associated with finance receivables.

Business Combinations

A6. Loss contingencies assumed in a business combination in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations*, are within the scope of this proposed Statement. The Board reasoned that those loss contingencies have a similar economic nature to loss contingencies arising from the normal operations of the entity and, thus, also should be subject to the disclosure requirements of this proposed Statement. However, because loss contingencies recognized under Statement 141(R) have a different measurement attribute than those recognized under Statement 5, the Board decided that these amounts would be shown separately in the tabular reconciliation required by paragraph 8 of this proposed Statement.

Guarantees

A7. The Board considered whether guarantees within the scope of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, should be included in the scope of this proposed Statement. The Board determined that because of the nature of guarantees, separate disclosure requirements were needed that reflect the specific recognition and measurement guidance to which they are subject in Interpretation 45. The Board also noted that including guarantees in the tabular reconciliation required by this proposed Statement would result in additional complexity because of the various subsequent measurement methods used for guarantees. As a result, the Board decided to exclude all guarantees within the scope of Interpretation 45 from the scope of this proposed Statement. This exclusion would include guarantees for which the subsequent recognition and measurement of a guarantee within the scope of Interpretation 45 are based on the Statement 5 criteria. For those guarantees, the Board concluded that the associated liability is still within the scope of Interpretation 45 and should follow the disclosure requirements of that Interpretation.

Insurance

A8. The Board does not intend to change the accounting and disclosure requirements for insurance and reinsurance entities in this project. Accordingly, liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a

reinsurance entity are outside the scope of this proposed Statement. However, the existing disclosure requirements of Statement 5 apply in certain circumstances, as required by AICPA Statement of Position 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*. This Statement amends that SOP to include within its body the existing Statement 5 disclosure requirements. Similarly, liabilities for insurance-related assessments also are outside the project's scope; thus, AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*, also is being amended to reflect the existing Statement 5 disclosure requirements, rather than the requirements in this proposed Statement.

A9. Loss contingencies of insurance and reinsurance entities that are unrelated to insurance or reinsurance contracts are within the scope of Statement 5; therefore, the disclosure requirements of this proposed Statement would apply to those contingencies. Additionally, loss contingencies that are self-insured are in the scope of Statement 5 and, therefore, also would be in the scope of this proposed Statement.

Multiemployer Plans

A10. The Board noted that under the existing accounting model for multiemployer plans, obligations that may result from withdrawal from a multiemployer plan represent loss contingencies that are within the scope of Statement 5. The Board decided that those loss contingencies also are in the scope of this proposed Statement.

Disclosure Principle

A11. The Board agreed to include a disclosure principle to communicate the objective of the disclosure requirements. By including an objective, an entity could better understand what information about loss contingencies should be included in the notes to the financial statements. The disclosure principle is based on paragraph 37 of FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, which states that "financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise" (footnote reference omitted). To meet this objective, the principle requires that an entity also provide a discussion of the risks associated with loss contingencies and their actual and potential effects on the entity's financial position, cash flows, and results of operations.

Disclosure Threshold

A12. Financial statement users have stated that, on balance, the *at least reasonably possible* threshold in Statement 5 results in delayed disclosure of relevant information about loss contingencies. The disclosure threshold in this proposed Statement would expand the population of loss contingencies that are required to be disclosed, resulting in more timely disclosure of loss contingencies for financial statement users. The Board decided that this proposed Statement should require disclosures of the entire population of loss contingencies except those contingencies that meet certain narrow criteria. Disclosure would not be required for a loss contingency for which the entity has made an

assessment and determined that the likelihood of a loss is remote, except as discussed in paragraph A13. The Board wanted this proposed Statement to emphasize that an entity should make an assessment of the likelihood of loss for its population of loss contingencies each reporting period. Additionally, the Board believes that if an entity is unable to assert that the likelihood of loss is remote, it should disclose the contingency.

A13. The Board also decided to require disclosure of loss contingencies if the contingencies are expected to be resolved in the *near term* and if the contingencies could have a *severe impact* on the entity (as those terms are defined in AICPA Statement of Position 94-6, *Disclosures of Certain Significant Risks and Uncertainties*), without regard to the likelihood of loss. The Board agreed that users should be aware of all loss contingencies with the potential to have a significantly disruptive effect on the financial health or operations of an entity within one year. Initially, the Board considered requiring disclosure of all loss contingencies that could have a severe impact on the entity, without regard to the expected timing of resolution. However, the Board decided to narrow this requirement because it believes that disclosure of all contingencies that could severely affect the entity would result in disclosure of a significant amount of information that would not be cost-beneficial.

Unasserted Claims and Assessments

A14. The Board decided to substantially retain existing language from Statement 5 about unasserted claims or assessments against an entity. This language states that disclosure of a loss contingency related to an unasserted claim or assessment is not necessary unless it is probable that a claim or assessment will be asserted and the likelihood of loss, if the claim or assessment were to be asserted, is more than remote. The Board believes that unasserted claims and assessments represent a unique set of loss contingencies for which specific guidance is necessary.

Disclosure of the Claim Amount or the Maximum Exposure to Loss

A15. To enhance the quantitative disclosure requirements, the Board decided to require disclosure of the amount of the claim or assessment against an entity, or an entity's best estimate of the maximum exposure to loss if there is no claim or assessment amount. The Board decided that disclosing the claim or assessment amount would provide relevant information about the maximum potential for loss, even if it is unlikely that a loss would ever be realized in this amount. The amount of the claim is an objective amount that often can be determined by reference to court documents, which are publicly available. Therefore, it is not prejudicial to disclose this amount. Furthermore, if the entity believes that the amount of the claim or maximum exposure is not representative of the entity's actual exposure to loss, it may explain why it is unlikely that the amount would ever be incurred and what a more reasonable range of the possible loss would be. Therefore, additional disclosure of the entity's best estimate of the possible loss, or range of loss, is permitted, but not required, by this proposed Statement.

A16. The Board decided not to retain the disclosure exemption that if an amount cannot be reasonably estimated, an entity would not have to provide an amount in the disclosure

but, instead, would provide the reasons why an estimate cannot be made. Financial statement users indicated that this exemption in Statement 5 is used with such regularity that rarely does any quantitative information accompany loss contingency disclosures. They prefer to have a highly uncertain estimate supplemented with a qualitative description than no quantification of a potential loss as commonly occurs in existing practice.

Qualitative Nature of Loss Contingencies

A17. Under this proposed Statement, the required disclosures include a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution. The Board believes that an entity generally includes much of this information when describing the nature of the contingency under the existing Statement 5 requirements.

A18. This proposed Statement also requires disclosure of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome, a qualitative assessment of the most likely outcome of the contingency, and any assumptions made in estimating the amounts in the quantitative disclosures and in assessing the most likely outcome. The Board decided that this information would provide users with data to perform analysis and better understand the potential future cash flows of the entity. In particular, disclosure of the factors that are likely to affect the ultimate outcome and their potential effects will assist users in making their own assessments about the likelihood of future events related to the loss contingency as well as the potential cash flows related to those future events.

Recoveries

A19. FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, specifies the criteria that must be met in order to offset an asset and a liability in a statement of financial position. The Board believes it would be unusual for those criteria to be met in the case of a possible recovery from an insurance, indemnification, or other similar arrangement related to a loss contingency primarily because there is usually more than one counterparty involved. Accordingly, loss contingencies and their related recoveries usually must be presented separately in a statement of financial position at their gross amounts. Consistent with this presentation, the Board decided that the quantitative disclosures required by paragraph 7 and the amounts in the tabular reconciliation required by paragraph 8 of this proposed Statement should exclude the effect of possible recoveries from insurance, indemnifications, or other similar arrangements. The Board decided that information about these arrangements and any amounts recognized in the statement of position should be disclosed separately.

Aggregation of Disclosures about Loss Contingencies

A20. To simplify the disclosure presentation and reduce the possibility of disclosing prejudicial information, the Board decided that the qualitative and quantitative disclosures required by paragraph 7 may be aggregated by the nature of the contingency. The Board

believes that many financial statement preparers already aggregate their disclosures about loss contingencies in a meaningful way. Therefore, this option is not likely to result in a significant change to current practice.

Tabular Reconciliation

A21. To provide more transparency about the effects of loss contingencies on the financial statements, the Board decided to include a requirement for a tabular reconciliation for recognized loss contingencies in this proposed Statement. The Board believes that a tabular reconciliation will provide users with valuable information about significant and sensitive estimates and changes in those estimates that are subject to significant measurement judgment.

A22. The Board is aware of the concerns of financial statement preparers that information about recognized loss contingencies could be used against them in legal disputes. To address those concerns, the Board decided to allow amounts recognized for all loss contingencies to be aggregated. The Board believes that disaggregating the information in the tabular reconciliation would not incrementally improve a user's ability to predict future cash flows and may provide excess information that is not cost-beneficial. Additionally, the Board decided that the tabular reconciliation would be subject to the exemption from disclosing prejudicial information.

A23. The Board considered whether the tabular reconciliation should be required for annual periods only or for both interim and annual periods. Some Board members expressed concerns about the amount of effort required for preparers to collect and auditors to review this information in the short time available for performing these activities between the end of an interim period and the quarterly filing deadline for SEC registrants. However, a majority of Board members supported requiring the tabular reconciliation in both interim and annual financial statements because financial statement users generally consider interim information to be as important as annual information. Therefore, it is important to provide information about the effect of recognized loss contingencies on the financial statements on an interim and annual basis.

A24. The Board decided that loss contingencies whose underlying cause and ultimate settlement occur in the same period should be excluded from the tabular reconciliation. The Board reasoned that the short period of time involved in those circumstances raises questions about whether the item meets the definition of a contingency. Additionally, the Board noted that for those items, the loss is recognized in the same period as cash is paid or other assets transferred. Therefore, there is no effect on the financial statements across reporting periods, and including those items would not fulfill the purpose of the tabular reconciliation. The Board noted that, in contrast, loss contingencies initially recognized in a business combination are not recognized in earnings. The Board concluded that it was important to include those loss contingencies in the tabular reconciliation because they result in payments of cash, transfers of assets, or recognition of income for which no corresponding loss was recognized at the time of initial recognition.

Prejudicial Exemption

A25. This proposed Statement provides a limited disclosure exemption for instances in which an entity concludes that disclosing quantitative or qualitative information about a loss contingency as required by this proposed Statement, either separately or aggregated by the nature of the contingency, would be prejudicial to its position in a dispute (that is, disclosure of the information could affect, to the entity's detriment, the outcome of the contingency itself).

A26. Financial statement users generally opposed providing any exemption from disclosing prejudicial information. They stated their concern that preparers would use such an exemption excessively, resulting in no significant improvement in the quality of disclosures about loss contingencies. Financial statement preparers, on the other hand, raised concerns about being required to disclose information that would be harmful to the entity and its shareholders, who represent a significant financial statement user constituency.

A27. The Board considered those concerns and decided to include an exemption from the disclosure requirements that would strike a balance between the interest of both users and preparers. Specifically, the Board considered under what conditions such an exemption would be allowed and also considered the information that an entity would still be required to disclose if the criteria for the exemption were met. The Board decided on a two-step approach for entities to follow. In the first step, entities would be allowed to aggregate information about loss contingencies at a higher level than by the nature of the contingency. The Board believes that this step will enable preparers to disclose information that is valuable to users without enabling the counterparty in a dispute to take advantage of the information to the detriment of the entity, because the information could not be linked to its specific case. In the second step, if disclosure of the information would still be prejudicial even when aggregated at this higher level, an entity would be allowed to forgo disclosing only the information that would be prejudicial.

A28. The Board noted that a prejudicial exemption already exists under International Financial Reporting Standards. The Board considered whether to include language from paragraph 92 of IAS 37 indicating that the circumstances under which that exemption may be exercised are expected to be *extremely rare*. Some Board members felt that including this language was appropriate, as they expect the ability to first aggregate disclosures at a higher level will reduce the frequency with which a prejudicial exemption would need to be utilized. Those Board members also were sensitive to the broad concern of financial statement users that providing the exemption would result in a lack of transparency about loss contingencies (a situation that users assert exists currently).

A29. A majority of Board members, however, expressed concern about how the words *extremely rare* may be interpreted in practice. Consequently, the Board agreed that the circumstances under which a prejudicial exemption would be exercisable should be characterized as *rare* rather than *extremely rare*. The Board decided to include language clarifying that *rare* is not intended to mean *never* and that the determination of when it is

appropriate to exercise this exemption is a matter of significant judgment that depends on the facts and circumstances.

Effective Date and Transition

A30. The Board decided that this proposed Statement should be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and for interim and annual financial statements thereafter. The Board believes it is important that enhanced disclosures be available to financial statement users as soon as practicable. The Board also believes that most of the information required by this proposed Statement is already available and that collecting those data from various locations in year-end reporting packages should be feasible for entities whose fiscal year ends on December 31, 2008. The Board also decided that the tabular reconciliation should not be required for earlier periods that are presented for comparative purposes, because of concerns that it may be impracticable for entities to gather the necessary information.

Similarities and Differences with International Accounting Standards

A31. Deliberations continue in the International Accounting Standards Board's (IASB's) project to reconsider IAS 37; however, those deliberations have not progressed to the point of reconsidering the disclosure requirements of IAS 37. The Exposure Draft issued by the IASB in June 2005 included disclosure requirements that are largely consistent with the existing disclosure requirements of IAS 37. Those requirements are similar to the disclosures included in this proposed Statement. The IASB is expected to evaluate the disclosure requirements in this proposed Statement when it reconsiders the IAS 37 disclosure requirements, which will provide a potential convergence opportunity. Similarly, the FASB expects to consider the IASB's decisions on recognition and measurement when it deliberates those issues in the long-term phase of this project.

A32. IAS 37 requires disclosure of the carrying amount of provisions at the beginning and end of the period as well as changes during the period. This requirement is largely consistent with the tabular reconciliation of recognized loss contingencies in this proposed Statement. Under IAS 37, separate disclosure is required for additional provisions, amounts incurred against provisions, and unused amounts reversed during the period. Increases during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate also are required to be disclosed. This proposed Statement does not require that last disclosure because contingencies usually are not measured at a discounted amount under Statement 5.

A33. This proposed Statement would require disclosures about a broader population of contingencies than required by IAS 37. Specifically, this proposed Statement would require disclosures about loss contingencies, regardless of the likelihood of loss, if the contingencies are expected to be resolved in the near term and if the contingencies could have a severe impact on the entity's financial position, cash flows, or results of operations. IAS 37 does not require disclosures for remote loss contingencies regardless of the expected timing of resolution or potential severity of the contingency.

Benefits and Costs

A34. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Current and potential investors, creditors, donors, and other users of financial information benefit from the improvements in financial reporting, while the costs to implement a new standard are borne primarily by current investors. The Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an accounting standard or to quantify the value of improved information in financial statements.

A35. The Board's assessment of this proposed Statement's benefits and costs is based on discussions with preparers, auditors, regulators, and users of financial statements. The Board considered the incremental costs of providing the additional disclosure requirements, particularly the tabular reconciliation of recognized loss contingencies, and concluded that those costs do not outweigh the benefits of improved information about loss contingencies.

A36. The Board recognizes that the effort for gathering the necessary data to provide the disclosures required in this proposed Statement may be significant for some entities and that the review and audit procedures of such disclosures may require additional effort. Notwithstanding the above additional costs, these disclosures were developed with the goal of providing users of financial statements with pertinent information about potential cash flow requirements of an entity. Furthermore, the Board believes that many entities already have the information necessary to fulfill these disclosure requirements and that including the information should not require substantial additional cost or effort. The Board plans to conduct field testing of these disclosure requirements before issuing a final Statement to better assess the relative costs and benefits of the disclosures that would be required.

A37. The Board believes that this proposed Statement requires disclosures that provide more specific information about loss contingencies. This will enable users to make a more informed assessment of the likelihood, timing, and amount of future cash flows. Discussions with users and regulators, as well as the Board's research, indicated that the recognition or derecognition of a loss contingency, or a change in the estimate of a loss contingency, can have a significant impact on an entity's financial statements. Therefore, the Board concluded that the benefits of the disclosures in this proposed Statement outweigh the costs.

Appendix B

AMENDMENTS TO FASB PRONOUNCEMENTS AND OTHER AUTHORITATIVE LITERATURE

B1. FASB Statement No. 5, *Accounting for Contingencies,* is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraph 7A, as added:

> The accounting requirements in t~~T~~his Statement do~~does~~ not apply to contingent gains or losses that are recognized at the acquisition date in a business combination. FASB Statement No. 141 (revised 2007), *Business Combinations,* provides the subsequent accounting ~~and disclosure~~ requirements for both contingent gains ~~or~~ and contingent losses recognized as part of a business combination. The accounting requirements in t~~T~~his Statement do~~es~~, however, apply to contingent gains or losses that were acquired or assumed in a business combination but that were not recognized at the acquisition date because they did not meet the recognition threshold in Statement 141(R) at that date.

b. Paragraphs 7B and 7C are added as follows:

> 7B. The disclosure requirements in paragraphs 9–11 of this Statement apply to loss contingencies that are (or would be, if the recognition criteria in paragraph 8 of this Statement were met) recognized as asset impairments in a statement of financial position. Loss contingencies that are (or would be) recognized as liabilities shall be disclosed in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies.*

> 7C. Gain contingencies accounted for in accordance with this Statement shall be disclosed in accordance with paragraph 17 of this Statement. Gain contingencies accounted for in accordance with Statement 141(R) shall be disclosed in accordance with that Statement.

c. Paragraphs 9–11 and the related heading and footnotes 5 and 6:

> **Disclosure of Loss Contingencies That Are (or Would Be) Recognized as Asset Impairments**

> 9. Disclosure of the nature of an asset impairment recognized ~~accrual~~[5] ~~made~~ pursuant to the provisions of paragraph 8, and in some circumstances the amount of that impairment~~accrued~~, may be necessary for the financial statements not to be misleading.

> 10. If no asset impairment ~~accrual~~ is recognized ~~made~~ for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount recognized ~~accrued~~ pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.[6] 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.

> 11. After the date of an enterprise's financial statements but before those financial statements are issued, information may become available indicating that an asset was impaired ~~or a liability was incurred~~ after the date of the financial statements or that there is at least a reasonable possibility that an asset was impaired ~~or a liability was incurred~~ after that date. The information may relate to a loss contingency that existed at the date of the financial statements, e.g., an asset that was not insured at the date of the financial statements. On the other hand, the information may relate to a loss contingency that did not exist at the date of the financial statements, e.g., threat of expropriation of assets after the date of the financial statements ~~or the filing for bankruptcy by an enterprise whose debt was guaranteed after the date of the financial statements~~. In none of the cases cited in this paragraph was an asset impaired ~~or a liability incurred~~ at the date of the financial statements, and the condition for recognition ~~accrual~~ in paragraph 8(a) is, therefore, not met. Disclosure of those kinds of losses or loss contingencies may be necessary, however, to keep the financial statements from being misleading. If disclosure is deemed necessary, the financial statements shall indicate the nature of the loss or loss contingency and give an estimate of the amount or range of loss or possible loss or state that such an estimate cannot be made. Occasionally, in the case of a loss arising after the date of the financial statements where the amount of the asset impairment ~~or liability incurrence~~ can be reasonably estimated, disclosure may best be made by supplementing the historical financial statements with pro forma financial data giving effect to the loss as if it had occurred at the date of the financial statements. It may be desirable to present pro forma statements, usually a statement of financial position ~~balance sheet~~ only, in columnar form on the face of the historical financial statements.

[5] ~~Terminology used shall be descriptive of the nature of the accrual (see paragraphs 57-64 of *Accounting Terminology Bulletin No. 1,* "Review and Resume").~~

[6] For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 8(a) but that is not accrued because the amount of loss cannot be reasonably estimated (paragraph 8(b)). Disclosure is also required of some loss contingencies that do not meet the condition in paragraph 8(a)—namely, those contingencies for which there is a *reasonable possibility* that a loss may have been incurred even though information may not

indicate that it is *probable* that an asset had been impaired ~~or a liability had been incurred~~ at the date of the financial statements.

d. Paragraph 12:

~~Certain loss contingencies are presently being disclosed in financial statements even though the possibility of loss may be remote. The common characteristic of those contingencies is a guarantee, normally with a right to proceed against an outside party in the event that the guarantor is called upon to satisfy the guarantee. Examples include (a) guarantees of indebtedness of others, (b) obligations of commercial banks under "standby letters of credit," and (c) guarantees to repurchase receivables (or, in some cases, to repurchase the related property) that have been sold or otherwise assigned. The Board concludes that disclosure of those loss contingencies, and others that in substance have the same characteristic, shall be continued. The disclosure shall include the nature and amount of the guarantee. Consideration should be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor's right to proceed against an outside party.~~

e. Paragraph 25:

If, based on available information, it is probable that customers will make claims under warranties relating to goods or services that have been sold, the condition in paragraph 8(a) is met at the date of an enterprise's financial statements because it is probable that a liability has been incurred. Satisfaction of the condition in paragraph 8(b) will normally depend on the experience of an enterprise or other information. In the case of an enterprise that has no experience of its own, reference to the experience of other enterprises in the same business may be appropriate. Inability to make a reasonable estimate of the amount of a warranty obligation at the time of sale because of significant uncertainty about possible claims (i.e., failure to satisfy the condition in paragraph 8(b)) precludes accrual and, if the range of possible loss is wide, may raise a question about whether a sale should be recorded prior to expiration of the warranty period or until sufficient experience has been gained to permit a reasonable estimate of the obligation; in addition, the disclosures called for by paragraphs 13–16 ~~10~~ of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, ~~this Statement~~ should be made.

f. Paragraph 34:

As a condition for accrual of a loss contingency, paragraph 8(a) requires that information available prior to the issuance of financial statements indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Accordingly, accrual would clearly be inappropriate for litigation, claims, or assessments whose underlying cause is an event or condition occurring after the date of financial statements but before those financial statements are issued, for example, a suit for damages alleged to have been suffered as a result of an accident that occurred after the date of the financial statements. Disclosure may be required, however, by Statement 16x~~paragraph 11~~.

g. Paragraphs 37 and 38 and 39, as amended:

37. The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition for accrual in paragraph 8(a) would be met if an unfavorable outcome is determined to be probable. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, accrual would be inappropriate, but disclosure would be required by Statement 16x~~paragraph 10 of this Statement~~.

38. With respect to unasserted claims and assessments, an enterprise must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. For example, a catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case. By way of further example, an enterprise may believe there is a possibility that it has infringed on another enterprise's patent rights, but the enterprise owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable. If the judgment is that assertion is not probable, no accrual ~~or disclosure~~ would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 8. If an unfavorable outcome is probable but the amount of loss cannot be reasonably estimated, accrual would not be appropriate~~, but disclosure would be required by paragraph 10. If an unfavorable outcome is reasonably possible but not probable, disclosure would be required by paragraph 10~~. Disclosures shall be made in accordance with Statement 16x.

39. As a condition for accrual of a loss contingency, paragraph 8(b) requires that the amount of loss can be reasonably estimated. In some cases, it may be determined that a loss was incurred because an unfavorable outcome of the litigation, claim, or assessment is probable (thus satisfying

the condition in paragraph 8(a)), but the range of possible loss is wide. For example, an enterprise may be litigating a dispute with another party. In preparation for the trial, it may determine that, based on recent developments involving one aspect of the litigation, it is probable that it will have to pay $2 million to settle the litigation. Another aspect of the litigation may, however, be open to considerable interpretation, and depending on the interpretation by the court the enterprise may have to pay an additional $8 million over and above the $2 million. In that case, paragraph 8 requires accrual of the $2 million if that is considered a reasonable estimate of the loss. Additionally, disclosures shall be made in accordance with Statement 16xParagraph 10 requires disclosure of the additional exposure to loss if there is a reasonable possibility that the additional amounts will be paid. Depending on the circumstances, paragraph 9 may require disclosure of the $2 million that was accrued.

B2. FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, is amended as follows:

a. Paragraph 26:

A debtor shall disclose in financial statements for periods after a troubled debt restructuring the extent to which amounts contingently payable are included in the carrying amount of restructured payables pursuant to the provisions of paragraph 18. If required by paragraphs 9-13 of *FASB Statement No. 5*, aA debtor shall also disclose in those financial statements total amounts that are contingently payable on restructured payables and the conditions under which those amounts would become payable or would be forgiven.

B3. FASB Statement No. 87, *Employers' Accounting for Pensions*, is amended as follows:

a. Paragraph 70:

In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of its unfunded benefit obligations. If wWithdrawal under circumstances that would give rise to an obligation shall be accounted for in accordance with is either probable or reasonably possible, the provisions of FASB Statement No. 5, *Accounting for Contingencies*, and shall be disclosed in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies* shall apply. Paragraph 7 of Statement 5 is amended to delete the references to accounting for pension cost and Opinion 8.

B4. FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, is amended as follows:

a. Footnote 13 to paragraph C26:

Paragraph 70 of Statement 87 states, in part: "In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of its unfunded benefit obligations. If wWithdrawal under circumstances that would give rise to an obligation shall be accounted for in accordance with is either probable or reasonably possible, the provisions of FASB Statement No. 5, *Accounting for Contingencies*, and shall be disclosed in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies* shall apply."

B5. FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, is amended as follows:

a. Paragraph 83:

In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of the plan's unfunded accumulated postretirement benefit obligation. If it is either probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the accounting guidance in provisions of FASB Statement No. 5, *Accounting for Contingencies*. Disclosure shall be made in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*.

B6. FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, is amended as follows:

a. Paragraph 13:

In some situations, withdrawal from a multiemployer plan may result in an employer having an obligation to the plan for a portion of the unfunded benefit obligation of the pension plans and other postretirement benefit plans. If wWithdrawal under circumstances that would give rise to an obligation shall be accounted for in accordance with is either probable or reasonably possible, the provisions of FASB Statement No. 5, *Accounting for Contingencies*, and shall be disclosed in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies* shall apply (Statement 87, paragraph 70). If it is more than remoteeither probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds

necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the accounting guidance in~~provisions of~~ Statement 5 and the disclosure guidance in Statement 16x (Statement 106, paragraph 83).

B7. FASB Statement No. 141 (revised 2007), *Business Combinations*, is amended as follows:

a. Paragraph 68(j):

For assets ~~and liabilities~~ arising from gain contingencies:

(1) The amounts recognized at the acquisition date or an explanation of why no amount was recognized (paragraph 24)

(2) The nature of recognized and unrecognized gain contingencies

(3) An estimate of the range of outcomes (undiscounted) for gain contingencies (recognized and unrecognized) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated.

An acquirer may aggregate disclosures for assets ~~and liabilities~~ arising from gain contingencies that are similar in nature.

b. Paragraph 68(jj) is added as follows:

For liabilities arising from loss contingencies:

(1) The amounts recognized at the acquisition date or an explanation of why no amount was recognized (paragraph 24)

(2) The disclosures required by FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*.

c. Paragraph 72(c):

For each reporting period after the acquisition date until the acquirer collects, sells, or otherwise loses the right to recognized assets arising from gain contingencies~~, or the acquirer settles recognized liabilities or its obligation to settle them is cancelled or expires~~:

(1) Any changes in the recognized amounts of assets ~~and liabilities~~ arising from gain contingencies and the reasons for those changes

(2) Any changes in the range of outcomes (undiscounted) for both recognized and unrecognized assets ~~and liabilities~~ arising from gain contingencies and the reasons for those changes.

d. Paragraph 72(cc) is added as follows:

For each reporting period after the acquisition date until the acquirer settles recognized liabilities or its obligation to settle them is cancelled or expires, the disclosures required by Statement 16x.

B8. FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, is amended as follows:

a. Paragraphs 3–7:

3. When condition (a) in paragraph 8 is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, condition (b) in paragraph 8 is met and an amount shall be accrued for the loss. When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.[1] If the loss is recognized as an asset impairment in the statement of financial position, the disclosures in paragraphs 9 and 10 of Statement 5 are required. If the loss is recognized as a liability in the statement of financial position, disclosure should be made in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*.~~In addition, paragraph 9 of the Statement may require disclosure of the nature and, in some circumstances, the amount accrued, and paragraph 10 requires disclosure of the nature of the contingency and the additional exposure to loss if there is at least a reasonable possibility of loss in excess of the amount accrued.~~

4. As an example, assume that an enterprise is involved in litigation at the close of its fiscal year ending December 31, 1976, and information available indicates that an unfavorable outcome is probable. Subsequently, after a trial on the issues, a verdict unfavorable to the enterprise is handed down, but the amount of damages remains unresolved at the time the financial statements are issued. Although the enterprise is unable to estimate the exact amount of loss, its reasonable estimate at the time is that the judgment will be for not less than $3 million or more than $9 million. No amount in that range appears at the time to be a better estimate than any other amount. *FASB Statement No. 5* requires accrual of the $3 million at December 31, 1976, and the disclosures in Statement 16x are required~~disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to $6 million, and possibly disclosure of the amount of the accrual~~.

5. The same answer would result under the example in paragraph 4 above if it is probable that a verdict will be unfavorable even though the trial has not been completed before the financial statements are issued. In that situation, condition (a) in paragraph 8 would be met because information available to the enterprise indicates that an unfavorable verdict is probable. An assessment that the range of loss is between $3 million and $9 million would meet condition (b) in paragraph 8. If no single amount in that range is a better estimate than any other amount, *FASB Statement No. 5* requires an accrual of $3 million at December 31, 1976, and the disclosures in Statement 16x are required~~disclosure of the nature of the contingency and~~

~~the exposure to an additional amount of loss of up to $6 million, and possibly disclosure of the amount of the accrual~~. Note, however, that if the enterprise had assessed the verdict differently (e.g., that an unfavorable verdict was *not* probable but was only reasonably possible), condition (a) in paragraph 8 would not have been met and no amount of loss would be accrued but the disclosures in Statement 16x would still be required~~nature of the contingency and any amount of loss that is reasonably possible would be disclosed~~.

6. Assume that in the examples given in paragraphs 4 and 5 above condition (a) in paragraph 8 has been met and a reasonable estimate of loss is a range between $3 million and $9 million but a loss of $4 million is a better estimate than any other amount in that range. In that situation, *FASB Statement No. 5* requires accrual of $4 million, and the disclosures in Statement 16x are required~~disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to $5 million, and possibly disclosure of the amount of the accrual~~.

~~7. As a further example, assume that at December 31, 1976 an enterprise has an investment of $1,000,000 in the securities of another enterprise that has declared bankruptcy, and there is no quoted market price for the securities. Condition (a) in paragraph 8 has been met because information available indicates that the value of the investment has been impaired, and a reasonable estimate of loss is a range between $300,000 and $600,000. No amount of loss in that range appears at the time to be a better estimate of loss than any other amount. *FASB Statement No. 5* requires accrual of the $300,000 loss at December 31, 1976, disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to $300,000, and possibly disclosure of the amount of the accrual.~~

B9. EITF Issue No. 03-8, "Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity," is amended as follows:

a. Paragraph 26:

> The Task Force discussed what disclosures would be appropriate when an enterprise changes from occurrence-based insurance to claims-made insurance or elects to significantly reduce or eliminate its insurance coverage. Members of the Task Force noted that paragraph 10 of Statement 5 requires disclosure if it is at least reasonably possible that a loss has been incurred. That paragraph also discusses disclosure with respect to unasserted claims. Statement 16x, which is effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years, replaces the disclosure requirements in Statement 5 for loss contingencies that are (or would be, if the recognition criteria were met) recognized as liabilities in a statement of financial position. Upon adoption of Statement 16x, an entity should disclose loss contingencies, whether insured or uninsured, in accordance with that Statement, rather than in accordance with Statement 5. [Note: See STATUS section.]

b. Paragraph 30:

> ~~No further EITF discussion is planned.~~ Statement 16x, which is effective for annual financial statements issued for fiscal years ending after December 15, 200x, and interim and annual periods in subsequent fiscal years, replaces the disclosure requirements in Statement 5 for loss contingencies that are (or would be, if the recognition criteria were met) recognized as liabilities in a statement of financial position. Issue 5 addresses the disclosures that should be made by an entity that changes from occurrence-based to claims-made insurance or that elects to significantly reduce or eliminate its insurance coverage. Upon adoption of Statement 16x, an entity should disclose loss contingencies, whether insured or uninsured, in accordance with that Statement, rather than in accordance with Statement 5.

c. Paragraph 31 is added as follows:

> No further EITF discussion is planned.

B10. AICPA Audit and Accounting Guide, *Federal Government Contractors*, is amended as follows:

a. Paragraph 3.43:

> The rights of the contracting parties in a default termination of a fixed-price contract differ significantly from those in a convenience termination; consequently, the accounting must reflect these differences. Accordingly, contractors should record, in addition to normal contract liabilities, those liabilities arising from a default termination (for example, damages, excess reprocurement costs, and progress payments to be repaid). Termination for default may result in a reduction of previously recorded earnings. In such cases, adjustments of prior-period amounts are not appropriate. Instead, the resulting income effect should be included in the loss on termination of the contract in the current period as a change in an accounting estimate in conformity with FASB Statement No. 154. If material in amount, such loss should be reported as a separate item in the income statement or otherwise disclosed in the notes to the financial statements in conformity with FASB Statement No. ~~5~~16x, *Disclosure of Certain Loss Contingencies*.

b. Paragraph 3.44:

> Generally, the effect of a contract termination should be reflected in the financial statements of the contractor in the period in which the termination occurs, or earlier if the termination is a subsequent event occurring prior to issuance of the financial statements and attributable to conditions that

existed at the date of the balance sheet. However, if sufficient information is not available to predict the effect of a very recent termination, then the best information available should be disclosed in the notes to financial statements in conformity with FASB Statement No. ~~5~~16x.

c. Paragraph 3.46:

Significant uncertainties may exist about the recoverability of costs in a termination claim, particularly in cases of termination for default. Such termination may create additional uncertainties regarding possible liabilities for damages or excess reprocurement costs. ~~As required by paragraphs 8 through 10 of FASB Statement No. 5, a~~A determination should be made about the probability that a loss has been incurred and whether an amount can be estimated. Based on this determination, such liabilities should be recorded as required by paragraph 8 of FASB Statement No. 5 and ~~or~~ disclosed in accordance with FASB Statement 16x.

d. Paragraph 3.87:

Defective pricing. As discussed in Chapter 2, the Truth in Negotiations Act permits the government to make contract price reductions if a contractor fails to submit certified accurate, current, and complete cost or pricing data before award of certain negotiated contracts or contract amendments. When defective pricing exists, contract prices, including profit or fee, may be adjusted, and disclosure should be made if the amounts are material. Instances may occur when defective pricing may be alleged by the government but disputed by the contractor. In these cases, consideration of the circumstances (including consultation with legal counsel) and judgment is required. If the potential amounts involved are material, disclosure in the notes to financial statements should be made in accordance with FASB Statement No. ~~5~~16x.

B11. AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code,* is amended as follows:

a. Paragraph .24:

Prepetition liabilities, including claims that become known after a petition is filed, should be reported on the basis of the expected amount of the allowed claims in accordance with FASB Statement No. 5, *Accounting for Contingencies,* as opposed to the amounts for which those allowed claims may be settled. Claims not subject to reasonable estimation should be disclosed in the notes to the financial statements based on the provisions of FASB Statement No. ~~5~~16x, *Disclosure of Certain Loss Contingencies*. Once these claims satisfy the accrual provisions of FASB Statement No. 5, they should be recorded in the accounts in accordance with the first sentence of this paragraph.

B12. AICPA Statement of Position 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises,* is amended as follows:

a. Paragraph .12:

If an insurance enterprise has recognized a liability for unpaid claims and claim adjustment expenses for difficult-to-estimate liabilities (such as for claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures), disclosure of the nature of the liability recognized, and in some circumstances the amount recognized, may be necessary so the financial statements are not misleading. If no liability has been recognized, or if an exposure to loss exists in excess of the amount recognized, disclosure of the contingent unpaid claims and claim adjustments shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingent unpaid claims or claim adjustments 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 an unasserted claim when there has been no manifestation by a potential claimant of an awareness of a possible claim unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. In addition to ~~the~~ these disclosures and those required by ~~FASB Statement No. 5 and~~ other accounting pronouncements, insurance enterprises should disclose management's policies and methodologies for estimating the liability for unpaid claims and claim adjustment expenses for difficult-to-estimate liabilities~~, such as for claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures~~.

b. Paragraph .15, subparagraph A-4:

The following is an illustration of an insurance enterprise disclosure designed to meet the requirements of paragraph .12 of this SOP to disclose management's policies and methodologies for estimating the liability for unpaid claims and claim adjustment expenses for difficult-to-estimate liabilities. (Additional disclosures about the liabilities for unpaid claims and claim adjustment expenses may be required under paragraph .12 of this SOP, ~~FASB Statement No. 5, FASB Interpretation 14, *Reasonable Estimation of the Amount of a Loss,*~~ AICPA SOP 94-6, and SEC requirements.)

[For ease of use, the note, which is unaffected by this Statement, has been omitted.]

B13. AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, is amended as follows:

a. Paragraph .05:

The disclosure requirements of this SOP in many circumstances are similar to or overlap the disclosure requirements in certain pronouncements of the Financial Accounting Standards Board (FASB), such as FASB Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*, and, for public business enterprises, FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*.* The disclosure requirements of this SOP in many circumstances also are similar to or overlap the disclosure requirements in certain pronouncements of the Securities and Exchange Commission (SEC). This SOP does not alter the requirements of any FASB or SEC pronouncement.

b. Paragraph .12:

Various accounting pronouncements require disclosures about uncertainties addressed by those pronouncements. In particular, paragraphs 9 through 11~~12~~, and 17b, and footnote 6 of FASB Statement No. 5, and paragraphs 4 through 11 of FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*, specify disclosures to be made about contingencies[6] that exist at the date of the financial statements. The disclosure requirements ~~of paragraphs 9 through 12~~ of Statement No. 5 and Statement No. 16x are further clarified in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*. In addition to disclosures required by FASB Statement No. 5, FASB Statement No. 16x, and other accounting pronouncements, this SOP requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or in disclosure of gain or loss contingencies, as described below.

c. Paragraph .14:

The disclosure should indicate the nature of the uncertainty and include an indication that it is at least reasonably possible[8] that a change in the estimate will occur in the near term.[9] ~~If the estimate involves a loss contingency covered by FASB Statement No. 5, the disclosure also should include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.~~ Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required.

d. Paragraph .16:

This SOP's disclosure requirements are separate from and do not change in any way the disclosure requirements or criteria of FASB Statement No. 5 or FASB Statement No. 16x; rather, the disclosures required under this SOP supplement the disclosures required under those Statements~~Statement No. 5~~ as follows:

- If an estimate (including estimates that involve contingencies recognized in accordance with ~~covered by~~ FASB Statement No. 5 or disclosed in accordance with either FASB Statement No. 5 or FASB Statement No. 16x) meets the criteria for disclosure under paragraph .13 of this SOP, this SOP requires disclosure of an indication that it is at least reasonably possible that a change in the estimate will occur in the near term; FASB Statement No. 5 does not distinguish between near-term and long-term contingencies.
- An estimate that does not involve a contingency covered by Statement No. 5 or Statement No. 16x, such as estimates associated with long-term operating assets and amounts reported under profitable long-term contracts, may meet the criteria in paragraph .13. This SOP requires disclosure of the nature of the estimate and an indication that it is at least reasonably possible that a change in the estimate will occur in the near term.

e. The note under the heading "Certain Significant Estimates" in paragraph .27 (between subparagraphs A-10 and A-11) of Appendix A:

Note: Some of the following disclosures contain certain information that is already required to be disclosed under FASB Statement No. 5 and FASB Statement No. 16x; in those cases, the following disclosures illustrate that the FASB Statement No. 5 and FASB Statement No. 16x disclosure requirements are supplemented by an indication that it is at least reasonably possible that a change in an estimate will occur in the near term. They are not intended to illustrate all of the disclosure requirements of FASB Statement No. 5 and FASB Statement No. 16x. Others may not be covered by FASB Statement No. 5 or FASB Statement No. 16x.

f. Paragraph .28, subparagraph B-23:

FASB Statement No. 5 requires reporting entities to disclose certain loss contingencies, as follows:

~~If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or *if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.*[6] 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. [Emphasis added.] [FASB Statement No. 5, paragraph 10]~~

~~Footnote 6 to Statement No. 5 states:~~

> ~~For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 8(a) but that is not accrued because the amount of loss cannot be reasonably estimated (paragraph 8(b)). Disclosure is also required of some loss contingencies that do not meet the condition in paragraph 8(a)—namely, those contingencies for which there is a *reasonable possibility* that a loss may have been incurred even though information may not indicate that it is *probable* that an asset has been impaired or a liability had been incurred at the date of the financial statements. [Emphasis in original.]~~

~~FASB Statement No. 5 defines loss contingencies as:~~

> ~~an existing condition, situation, or set of circumstances involving uncertainty as to possible . . . loss . . . to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability. [paragraph 1]~~

~~The recognition and disclosure requirements of Statement No. 5 are further clarified in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*. This SOP does not change the requirements of FASB Statement No. 5 or FASB Interpretation No. 14; the requirements of this SOP supplement those requirements. For example, i~~If a loss contingency meets the criteria for disclosure under ~~both~~ either Statement No. 5 or Statement No. 16x and paragraph .13 of this SOP, this SOP requires disclosure that it is at least reasonably possible that future events confirming the fact of the loss or the change in the estimated amount of the loss will occur in the near term.

B14. AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*, is amended as follows:

a. Paragraph .123:

> Two kinds of costs that may be involved in environmental remediation situations are not discussed in this chapter. These costs—natural resource damages and toxic torts—are identified in paragraphs .21 and .48 through .50 in chapter 2 of this SOP. Concepts and practices with respect to natural resource damages are still evolving, and third-party suits are too case-specific for general guidance. The accounting guidance with respect to litigation [FASB Statement No. 5, especially paragraphs 33 through 39, and FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*] should be considered in accounting for and the disclosure of such costs.

b. Paragraphs .155 and .156:

> .155 FASB Statement No. ~~5~~16x provides the primary guidance applicable to disclosures of environmental remediation loss contingencies. ~~Paragraphs 9 and 10 of FASB Statement No. 5 state:~~
>
> > ~~9. Disclosure of the nature of an accrual made pursuant to the provisions of paragraph 8 [of Statement No. 5], and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading.~~
> >
> > ~~10. If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional 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. [footnotes omitted]~~
>
> .156 The disclosure requirements of SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, also apply to environmental remediation liabilities. SOP 94-6, paragraphs 12 through 14 state in part:
>
> > 12. In addition to disclosures required by FASB Statement No. 5, FASB Statement No. 16x, and other accounting pronouncements, this SOP requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or disclosure of gain or loss contingencies, as described below.
> >
> > 13. Disclosure regarding an estimate should be made when known information available prior to issuance of the financial statements indicates that *both* of the following criteria are met:
> >
> > - It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
> > - The effect of the change would be material to the financial statements.

14. The disclosure should indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. ~~If the estimate involves a loss contingency covered by FASB Statement No. 5, the disclosure also should include an estimate of the possible loss or range of loss or state that such an estimate cannot be made.~~ Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required.

c. Footnote 15 to paragraph .158:

Nothing in this SOP eliminates disclosures that are required by FASB Statement No. ~~5~~16x or SOP 94-6.

d. Paragraph .159:

~~Paragraphs 9 and 10 of FASB Statement No. 5 provide for disclosures related to three different aspects of loss contingencies: (*a*) recognized losses and reasonably possible (additional) loss exposures, (*b*) probable but not reasonably estimable losses, and (*c*) unasserted claims. Following are the disclosures that are required or encouraged by Statement No. 5, SOP 94-6, and this SOP for each aspect.~~

e. Paragraph .160 and its related footnote 16:

~~If the FASB Statement No. 5 criteria of remote, reasonably possible, and probable were mapped onto a range of likelihood of the existence of a loss spanning from zero to 100 percent, the reasonably possible portion would span a significant breadth of the range starting from remote and ending with probable. The potential outcomes of environmental remediation loss contingencies often span a range of possibilities. If a loss is deemed probable and it is reasonably estimable, it is recognized; however, beyond the recognized losses, there may be additional exposure to loss that is reasonably possible. This often happens in situations in which a range of possible outcomes is identified and, in accordance with FASB Interpretation No. 14, the entity records either a best estimate within the range or the minimum amount in the range, thus leaving unrecorded amounts of additional possible loss for the higher cost outcomes.[16] In other situations, no loss may be probable, but a loss is reasonably possible. There may also be situations where a loss is probable, but no amount that would be material to the entity is reasonably estimable (see the subsequent section entitled "Probable But Not Reasonably Estimable Losses" in paragraphs .165 through .167).~~

[16] ~~When an overall liability is estimated by combining estimates of various components of the liability, additional possible losses present in the component estimates must be considered in determining an overall additional possible loss.~~

f. Paragraphs .161–.164:

.161 With respect to recorded accruals for environmental remediation loss contingencies and assets for third-party recoveries related to environmental remediation obligations, in addition to the disclosures required by FASB Statement No. 16x, financial statements should disclose ~~the following:~~

~~*a.* The nature of the accruals, if such disclosure is necessary for the financial statements not to be misleading, and, in situations where disclosure of the nature of the accruals is necessary, the total amount accrued for the remediation obligation, if such disclosure is also necessary for the financial statements not to be misleading~~

~~*b.* If any portion of the accrued obligation is discounted,~~ the undiscounted amount of the obligation and the discount rate used in the present-value determinations, if any portion of the accrued obligation is discounted

~~*c.* If the criteria of SOP 94-6 are met with respect to the accrued obligation or to any recognized asset for third-party recoveries, an indication that it is at least reasonably possible that a change in the estimate of the obligation or of the asset will occur in the near term~~

~~.162 With respect to reasonably possible loss contingencies, including reasonably possible loss exposures in excess of the amount accrued, financial statements should disclose the following:~~

~~*a.* The nature of the reasonably possible loss contingency, that is, a description of the reasonably possible remediation obligation, and an estimate of the possible loss exposure or the fact that such an estimate cannot be made~~[1]

~~*b.* If the criteria of SOP 94-6 are met with respect to estimated loss (or gain) contingencies, an indication that it is at least reasonably possible that a change in the estimate will occur in the near term~~

.163 Entities also are encouraged, but not required, to disclose the following:

a. The estimated time frame of disbursements for recorded amounts if expenditures are expected to continue over the long term

b. The estimated time frame for realization of recognized probable recoveries, if realization is not expected in the near term

~~*c.* If the criteria of SOP 94-6 are met with respect to the accrued obligation, to any recognized asset for third-party recoveries, or to reasonably possible loss exposures or disclosed gain contingencies, the factors that cause the estimate to be sensitive to change~~

~~*d.* If an estimate of the probable or reasonably possible loss or range of loss cannot be made, the reasons why it cannot be made~~

e. If information about the ~~reasonably~~ possible loss or the recognized and additional unrecognized ~~reasonably~~ possible loss for an environmental remediation obligation related to an individual site is relevant to an understanding of the financial position, cash flows, or results of operations of the entity, the following with respect to the site:

- The total amount accrued for the site
- ~~The nature of any reasonably possible loss contingency or additional loss, and an estimate of the possible loss or the fact that an estimate cannot be made and the reasons why it cannot be made~~
- Whether other PRPs are involved and the entity's estimated share of the obligation
- ~~The status of regulatory proceedings~~
- ~~The estimated time frame for resolution of the contingency~~

~~.164 The following is an illustration of disclosure for a situation in which—~~

~~*a.* An entity is involved in a single environmental site at which a number of potential outcomes may occur.~~
~~*b.* There is a probable, reasonably estimable recovery from a third party.~~
~~*c.* The entity has accrued for the most likely outcome within a range of possible outcomes for each component.~~
~~*d.* The nature of the amounts accrued for remediation and the related probable recovery are necessary to be disclosed in order for the financial statements not to be misleading.~~
~~*e.* There is a reasonably possible loss exposure in excess of the amount accrued that is material and it is reasonably possible that a change in estimate that would be material to the financial statements will occur in the near term.~~

~~Information that is not required is italicized and enclosed in brackets.~~

~~Enterprise A has been notified by the United States Environmental Protection Agency (EPA) that it is a potentially responsible party (PRP) under Superfund legislation [*with respect to XYZ site in Sometown, USA, a disposal site previously used in its chemical-fertilizer business. The EPA has also identified ten other PRPs for XYZ. A remedial investigation and feasibility study has been completed, and the results of that study have been forwarded to the EPA. The study indicates a range of viable remedial approaches, but agreement has not yet been reached with the EPA on the final remediation approach. The PRP group has preliminarily agreed to an allocation that sets Enterprise A's share of the cost of remediating XYZ site at 6 percent.*] Enterprise A has accrued its best estimate of its obligation with respect to the site at December 31, 199X, [*which is $10 million and which is included in long-term liabilities and is expected to be disbursed over the next ten years. If certain of the PRPs are ultimately not able to fund their allocated shares or the EPA insists on a more expensive remediation approach,*] Enterprise A could incur additional obligations of up to $7 million. It is reasonably possible that Enterprise A's recorded estimate of its obligation may change in the near term.~~

~~With respect to the environmental obligation discussed above, the site was acquired in 1982, and, in connection with that acquisition, the former owner partially indemnified Enterprise A for environmental impacts occurring prior to the acquisition. [*Based on existing documentation indicating the years in which the business shipped wastes to XYZ and the terms of the indemnification in the acquisition agreement,*] Enterprise A [*believes it is probable that it will recover from the prior owners 50 percent of its allocated remediation costs for XYZ and, accordingly,*] has recorded a receivable of $5 million at December 31, 199X.~~

g. Paragraphs .166–.168:

.166 Even though an entity may not be able to establish a reasonable estimate of a material loss or a range of reasonably estimable material loss exposure that must be recorded, in many cases it can determine early in the investigation whether the costs of environmental remediation, in fact, may be material (that is, the upper end of the range of the reasonable estimate of the loss is material). If an entity's probable but not reasonably estimable environmental remediation obligations may be material, the financial statements should disclose ~~the nature of the probable contingency~~information about the loss contingency in accordance with FASB Statement No. 16x~~, that is, a description of the remediation obligation, and the fact that a reasonable estimate cannot currently be made. Entities also are encouraged, but not required, to disclose the estimated time frame for resolution of the uncertainty as to the amount of the loss~~.

~~.167 An illustration of disclosure of a probable but not-yet reasonably estimable environmental remediation loss contingency follows (information that is italicized and enclosed in brackets is not required):~~

~~Enterprise A has been notified by the U.S. Environmental Protection Agency (EPA) that it is a potentially responsible party (PRP) with respect to environmental impacts [*identified at the XYZ site in Sometown, USA. Several meetings have been held with the EPA and the other identified PRPs, and a remedial investigation has recently commenced.*] Although a loss is probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation [*of XYZ site*] that would be material to Enterprise A's financial statements [*because the extent of environmental impact, allocation among the PRPs, remediation*~~

~~*alternatives (which could involve no or minimal efforts), and concurrence of the regulatory authorities have not yet advanced to the stage where a reasonable estimate of any loss that would be material to the enterprise can be made*]. [*A reasonable estimate of a material obligation, if any, is expected to be possible in 199X.*]~~

Unasserted Claims

.168 Whether notification by regulatory authorities in relation to particular environmental laws and regulations constitutes the assertion of a claim is a matter of legal determination. If an entity concludes that it has no current legal obligation to remediate a situation of probable or possible environmental impact, then in accordance with ~~paragraph 10 of~~ FASB Statement No. ~~5~~16x, no disclosure is required. Similarly, future actions of an entity, when they occur, may create a legal obligation to perform environmental remediation; however, no obligation exists currently (for example, if the obligation arises only when and if an entity ceases to operate a facility).[17] However, if an entity is required by existing laws and regulations to report the release of hazardous substances and to begin a remediation study or if assertion of a claim is deemed probable, the matter would represent a loss contingency subject to the disclosure provisions of Statement No. ~~5, paragraph 10~~16x, regardless of a lack of involvement by a regulatory agency.

h. Paragraph .171:

Financial statements may include a *contingency conclusion* that addresses the estimated total unrecognized exposure to environmental remediation and other loss contingencies. Such contingency conclusions may state, for example, that "management believes that the outcome of these uncertainties should not have (or "may have") a material adverse effect on the financial condition, cash flows, or operating results of the enterprise." Alternatively, the disclosure may indicate that the adverse effect could be material to a particular financial statement or to results and cash flows of a quarterly or annual reporting period. Although potentially useful information, these conclusions are not a substitute for the required disclosures of this SOP and of FASB Statement No. ~~5~~16x~~, such as their requirement to disclose the amounts of material reasonably possible additional losses or to state that such an estimate cannot be made~~. Also, the assertion that the outcome should not have a material adverse effect must be supportable. If the entity is unable to estimate the maximum end of the range of possible outcomes, it may be difficult to support an assertion that the outcome should not have a material adverse effect.

i. Paragraph .173, subparagraph A-5:

~~Paragraphs 9 and 10 of FASB Statement No. 5 state the following.~~

~~9. Disclosure of the nature of an accrual [*footnote omitted*] made pursuant to the provisions of paragraph 8, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading.~~

~~10. If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.[6] 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.~~

~~The disclosure requirements of FASB Statement No. 5 are emphasized in FASB Interpretation No. 14.~~

~~[6]For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 8(*a*) but that is not accrued because the amount of loss cannot be reasonably estimated (paragraph 8(*b*)). Disclosure is also required of some loss contingencies that do not meet the condition in paragraph 8(*a*)—namely, those contingencies for which there is a *reasonable possibility* that a loss may have been incurred even though information may not indicate that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements.~~

j. In paragraph .174, subparagraph B-1 of Appendix B, the following footnote is added to the end of the second paragraph after the heading ***Discussion of Case:***

[18]"The disclosure requirements of FASB Statement No. 16x apply to loss contingencies that are (or would be, if the recognition criteria were met) recognized as liabilities in a statement of financial position for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

B15. AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*, is amended as follows:

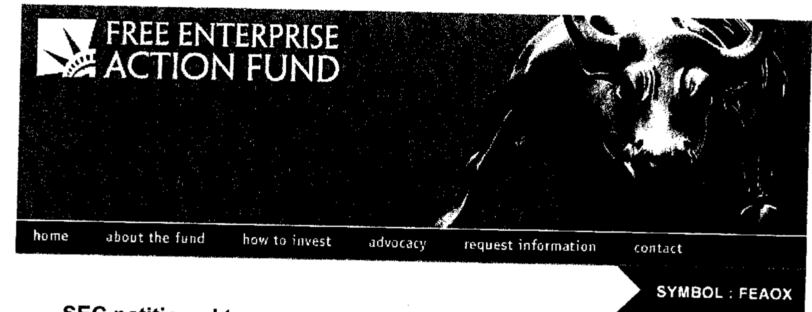
a. Paragraph .27:

If an entity has recognized a liability for assessments covered by this SOP, disclosure of the nature of the liability recognized, and in some circumstances the amount recognized, may be necessary for the financial statements not to be misleading. If no liability has been recognized, or if an exposure to loss exists in excess of the amount recognized, disclosure of the contingent assessment shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingent assessment 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 an unasserted assessment when there has been no manifestation by a potential claimant of an awareness of a possible assessment unless it is considered probable that an assessment will be asserted and there is a reasonable possibility that the outcome will be unfavorable. ~~FASB Statement No. 5, FASB Interpretation No. 14, and SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, address disclosures related to loss contingencies. That guidance~~The guidance in SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, also is applicable to assessments covered by this SOP. Additionally, if amounts have been discounted, the entity should disclose in the financial statements the undiscounted amounts of the liability and any related asset for premium tax offsets or policy surcharges as well as the discount rate used. If amounts have not been discounted, the entity should disclose in the financial statements the amounts of the liability, any related asset for premium tax offsets or policy surcharges, the periods over which the assessments are expected to be paid, and the period over which the recorded premium tax offsets or policy surcharges are expected to be realized.

38

Advocacy | Free Enterprise Action Fund

Page 1 of 4



Portfolio
Pricing/Performance
In the Media
News Releases
Annual Report
Proxy Voting

SEC petitioned to warn companies against making false and misleading claims on global warming; Misinformation puts investors at risk, says Free Enterprise Action Fund (Ticker: FEAOX)

For more info contact: Steve Milloy, 301-258-2852, steve@feafund.com

Washington DC, July 23, 2008 - The Free Enterprise Action Fund (Ticker: FEAOX) submitted the following letter to the U.S. Securities and Exchange Commission (SEC) requesting the SEC to warn publicly-owned companies against making false and misleading statements concerning global warming:

Ms. Florence E. Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Petition for Interpretive Guidance on Public Statements Concerning Global Warming and Other Environmental Issues

Dear Ms. Harmon,

We are writing on behalf of the Free Enterprise Action Fund ("FEAOX"), a publicly-traded mutual fund, to petition the U.S. Securities and Exchange Commission ("SEC" or "Commission") to issue interpretive guidance pursuant to the Securities and Exchange Act of 1934 ("the Act") that would warn registrants against making potentially false and misleading statements pertaining to global warming and other environmental issues.

We believe the Commission should take action immediately to protect investors.

I. Examples of potentially false and misleading

statements made by registrants.

Below are but a few examples of the sort of potentially false and misleading statements being made by registrants. The problematic nature of these statements is discussed in Section II.

- **Exelon Corp.** issued a media release and placed full-page advertisements in major newspapers on July 15, 2008 stating, "The science is overwhelming -- climate change is happening now and human activity is the primary cause."
- **Lehman Brothers** issued a report on climate change featuring the so-called "hockey stick" graph to support the notion that humans are causing global warming.
- The **General Electric Company** issued a "Call for Action" to "slow, stop and even reverse the damage of greenhouse gasses."
- **Toyota Motor Corp.** states in a report, "When we drive a vehicle, it consumes fossil fuels and emits CO2, a major contributor to climate change."
- **Goldman Sachs** states in a 2007 report, "By now, the dynamics of global warming are widely known, and we find no reason to dispute the scientific assumptions."
- **Caterpillar** said in a public statement that, "We must take action now [to reduce carbon dioxide emissions] or risk serious harm to our planet."

All these statements are potentially false and/or misleading as recent events show.

II. Recent events that put registrants at risk of making false and misleading statements.

A number of recent developments have tended to expose the above-mentioned registrant statements (and probably many others) as false and/or misleading, including:

- The American Physical Society, the leading professional society for American physicists announced in July 2008 on one of its websites that, "There is a considerable presence within the scientific community of people who do not agree with the IPCC conclusion that anthropogenic CO2 emissions are very probably likely to be primarily responsible for the global warming that has occurred since the Industrial Revolution."
- In May 2008, the Oregon Institute of Science and Medicine released a petition signed by more than 31,000 U.S. scientists stating, "There is no convincing scientific evidence that human release of carbon dioxide, methane or other greenhouse gases is causing, or will cause in the future, catastrophic heating of the Earth's atmosphere and disruption of the Earth's climate..." India's National Action Plan on Climate Change issued in June

2008 states, "No firm link between the documented [climate] changes described below and warming due to anthropogenic climate change has yet been established."

- Researchers belonging to the UN Intergovernmental Panel on Climate Change (IPCC) reported in the science journal Nature (May 1) that, after adjusting their climate model to reflect actual sea surface temperatures of the last 50 years, "global surface temperature may not increase over the next decade," since natural climate variation will drive global climate.
- Climate scientists reported in the December issue of the International Journal of Climatology, published by Britain's Royal Meteorological Society, that observed temperature changes measured over the last 30 years don't match well with temperatures predicted by the mathematical climate models relied on by the IPCC.
- A British judge ruled in October 2007 that Al Gore's film, "An Inconvenient Truth," contained so many factual errors that a disclaimer was required to be shown to students before they viewed the film.
- A panel of the National Academy of Sciences concluded in 2006 that the "hockey stick" graph is not proof that human activity is linked to global warming.

III. Conclusion

Based on the foregoing, we request that the Commission immediately inform and remind registrants that:

1. False and/or misleading statements on material matters may violate the anti-fraud provision of the federal securities laws.
2. Statements by registrants on global warming and other environmental issues could be considered material.
3. There is considerable ongoing debate about the science of global warming and its impacts and;
4. Statements to the effect that "the science is conclusive," "the debate is over," and that "human activities are definitely causing harmful global warming" should be avoided.

If you have any questions, please contact the undersigned at 301-258-2852.

Sincerely,

/s/

Steven J. Milloy, MHS, JD, LLM
Thomas J. Borelli, PhD
Managing Partners
Portfolio Managers, Free Enterprise Action Fund

FEAOX is a shareholder in Exelon (605 shares), Lehman Brothers (487 shares), General Electric (9606 shares), Goldman Sachs (402 shares) and Caterpillar (887 shares). FEAOX does not own shares in Toyota Motor Corp.

By investing in the FEAOX (http://www.FEAOX.com), individuals can participate in the global warming debate while having an opportunity to earn a financial return through ownership of a large-cap mutual fund. With a minimum investment of $2,500, individuals can join FEAOX□fs effort to make CEOs justify their positions on global warming. FEAOX is available exclusively through Northern Lights Distributors LLC, (applications may be obtained at http://www.FEAOX.com/how.html), and through E*Trade Financial, Scottrade, TD Ameritrade and HSBC.

An investor should consider the Free Enterprise Action Fund's investment objective, risks, charges, and expenses carefully before investing. This and other information about the Funds is contained in the fund's prospectus, which can be obtained by calling 1-800-766-3960). Please read the prospectus carefully before investing. Distributed by Northern Lights Distributors, LLC, member FINRA/SIPC.

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BEFORE THE UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

California Public Employees' Retirement System

California State Controller,
John Chiang

California State Teachers' Retirement System

California State Treasurer,
Bill Lockyer

Ceres

Environmental Defense

F&C Management

Florida Chief Financial Officer,
Alex Sink

Friends of the Earth

Kentucky State Treasurer,
Jonathan Miller

Maine State Treasurer,
David G. Lemoine

Maryland State Treasurer,
Nancy K. Kopp

The Nathan Cummings Foundation

New Jersey State Investment Council,
Orin Kramer, Chair

New York City Comptroller,
William C. Thompson, Jr.

New York State Attorney General,
Andrew M. Cuomo

File No.

New York State Comptroller,
Thomas P. DiNapoli

North Carolina State Treasurer,
Richard Moore

Oregon State Treasurer,
Randall Edwards

Pax World Management Corporation

Rhode Island General Treasurer,
Frank T. Caprio

Vermont State Treasurer,
Jeb Spaulding

PETITION FOR INTERPRETIVE GUIDANCE ON CLIMATE RISK DISCLOSURE

The fundamental principle underlying the Commission's disclosure requirements is that a public corporation must fully and fairly disclose all facts about its performance and operations that would be material to a reasonable shareholder's investment decision. Efficient markets depend on the availability of information on corporate strategy, performance, and policies to give investors the insights they need to make investment decisions.

Recent scientific, legal, and regulatory developments make it unavoidably clear that the risks and opportunities many corporations face in connection with climate change fall squarely within the category of material information that is required to be analyzed and disclosed in many corporate filings. Yet corporate disclosures of the risks and opportunities created by climate change lag behind these developments, and investors are left with little or in some cases no useful information about corporate exposure to these risks. Investors are responding to this information gap with increasing demand for more and better disclosure on climate risk that will allow them to make informed investment decisions.

This petition respectfully requests that the Commission issue an interpretive release clarifying that material climate-related information must be included in corporate disclosures under existing law. The petitioners include a broad coalition of state officials with regulatory, law enforcement, and fiscal management responsibilities; some of the nation's largest

institutional investors; asset management firms; organizations dedicated to fair and effective climate risk disclosure; and conservation organizations dedicated to climate stabilization with hundreds of thousands of members nationwide. A description of each petition signatory is included in Appendix A.

TABLE OF CONTENTS

Introduction: Climate Change Now Has Material Financial Consequences for Many Corporations.

1. What Is Climate Change?

2. Current Law Requires Corporations to Disclose Material Information About Climate Risk.
   a. Climate Risk Is Material to Investors' Decisions.
   b. FAS 5 and Regulation S-K Require Registrants to Disclose Climate Risk.
      FAS 5
      Regulation S-K
         Item 101: Description of Business
         Item 103: Legal Proceedings
         Item 303: Management's Discussion and Analysis of Financial Condition and Results of Operations
   c. Interpretive Guidance Is Needed to Clarify the Application of These Disclosure Requirements to Corporate Climate Risk.

3. What Are the Climate-Related Risks to Publicly Traded Corporations?
   a. The Changed Regulatory Environment for Greenhouse Gas Emissions.
   b. The Changing Physical Environment.
   c. The Impact of Climate Change on Businesses.

4. Climate Risk Is Increasingly Important to Investors.
   a. Climate-Related Advisory Services, Investment Research, Funds, and Indices.
   b. Investor Initiatives to Improve Corporate Climate Risk Disclosure.
   c. International Efforts to Improve Climate Risk Disclosure.
   d. Climate Risk Disclosure Is Needed to Allow Investors to Fulfill Their Fiduciary Duties.

5. Climate Risk Is Not Being Adequately Disclosed.
   a. SEC Filings.
   b. Voluntary Climate Disclosures.

6. The Commission Should Clarify Corporate Obligations to Disclose Climate Risk.
   a. The Commission Should Issue an Interpretive Release Clarifying the Application of Existing Law to Climate Risks and Setting Forth the Elements of Climate Risk Disclosure.
   b. Complying with Climate Risk Disclosure Requirements Will Not Be Unduly Burdensome.
   c. The Commission Should Provide the Requested Guidance Promptly.

Appendix A: Petition Signatories

Appendix B: The Science of Climate Change

Appendix C: Regional and State Regulatory Actions Concerning Greenhouse Gas Emissions

Appendix D: Nationwide and International Regulation of Greenhouse Gas Emissions

Appendix E: Federal Legislation Related to Climate Change Pending in the 110th Congress

Appendix F: Business Leaders' Comments on Climate Change Regulation and Disclosure

Appendix G: Key Elements of Proposed SEC Guidance on Climate Disclosure

Introduction: Climate Change Now Has Material Financial Consequences for Many Corporations.

The empirical evidence that human activities are changing the global climate in significant ways, and at an accelerating pace, is now overwhelming. The Fourth Assessment Report released earlier this year by the Intergovernmental Panel on Climate Change (IPCC) reviewed and synthesized the state of knowledge in climate change science. The IPCC concluded that evidence of the warming of the climate system is now "unequivocal" and that "numerous long-term changes in climate have been observed."[1] The IPCC's research also shows how climate change is affecting societies, economies and natural systems in the United States and throughout the world. The findings of the Fourth Assessment Report are described briefly below, and are further discussed in Appendix B to this petition.

A growing recognition that effective measures to reduce greenhouse gas emissions must happen very soon, if the most severe harms associated with climate change are to be averted, has prompted the adoption of comprehensive and mandatory programs to limit greenhouse gas emissions in many other countries. Such policies apply in large and populous regions and states in this country as well as in most of Europe. This enormous body of new law has important implications, even for companies not directly subject to regulation, because these initiatives govern sectors like electric power and transportation, on which entire economies depend. New legal obligations relating to greenhouse gas emissions are described in Part 3a, below, and in Appendices C (state regulation) and D (international regulation). In just the last few months, all three branches of the federal government have taken actions that emphasized the urgency of climate change and its newly central place in public policymaking. *See infra* Part 3.a (discussing federal administrative policies and *Massachusetts v. EPA*, 127 S. Ct. 1438 (2007)); Appendix E (enumerating climate legislation pending in Congress).

In response to these developments, many business leaders now recognize the economic and financial risks associated with climate change, the enormous opportunities presented by the shift to a carbon-constrained economy, and the pressing need for a comprehensive national climate change policy. Appendix F compiles a small sampling of the many recent statements

[1] *See* INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, *Summary for Policymakers*, *in* CLIMATE CHANGE 2007: THE PHYSICAL SCIENCE BASIS 5, 7 (2007) [hereinafter IPCC, SPM-1], *available at* http://ipcc-wg1.ucar.edu/wg1/Report/AR4WG1_Print_SPM.pdf.

from corporate leaders on the importance of climate change as a market force and the inevitability and need for national greenhouse gas controls.

Climate change has far-reaching implications for business. The term "climate risk" includes effects on a company's performance and operations that range from physical damage to facilities, to new regulatory costs and incentives, to shifts in the market for products or services. The influence of climate change and greenhouse gas regulation on particular companies varies, but it is increasingly clear these developments have already had material effects on many companies' performance and operations, and that those impacts will increase as the climate continues to change. The days are long past when climate risk can be treated as a peripheral or hypothetical concern. Companies' financial condition increasingly depends upon their ability to avoid climate risk and to capitalize on new business opportunities by responding to the changing physical and regulatory environment.

Climate change has now become a significant factor bearing on companies' financial condition. For many companies, climate risk is material and subject to mandatory disclosure under traditional principles of the securities laws and the Commission's regulations. To date, however, disclosure of climate risk has been scant and inconsistent. In periodic reports filed pursuant to the Commission's disclosure regulations, many corporations have taken the position that any risks associated with climate change are too uncertain and remote in time to be material to their performance. The rapidly changing regulatory environment makes clear that this position is no longer sound. Moreover, companies whose assets are expected to last for decades must deal with changes—such as sea-level rise, increasingly severe weather, greater incidence of floods, fires, and droughts, and expanded ranges of disease and pest vectors—that will very likely continue to intensify. The growing body of data about the physical changes associated with climate change similarly shows that significant physical changes, and resulting risks, are no longer remote possibilities, but present realities that are only going to become more consequential.

Investors are looking for the companies best positioned to avoid the financial risks associated with climate change and to capitalize on the new opportunities that greenhouse gas regulation will provide. Interest in climate risk is not limited to investors with a specific moral or policy interest in climate change; it now covers an enormous range of investors whose interest is purely financial—from ordinary individuals whose appreciation for the business significance

of climate change has been quickened by recent scientific and legal developments, to large institutional investors looking for companies best positioned to respond to the very significant long-term financial hazards and opportunities. Investors of all types are aware that climate change, and greenhouse gas regulation, will have enormous implications for long-term capital investments that are being made right now by corporations. They want to know how fully (if at all) companies are taking climate change into account in making those decisions. They want to identify, and invest in, companies that are "out front" in responding to climate risks and opportunities, and to avoid firms that are behind the curve.

Investors' ability to evaluate climate risk and opportunity, however, depends upon access to the necessary information. To obtain the critical information on companies' ability to respond to the risks and opportunities of climate change, the investment community is increasingly demanding detailed disclosures about the risks companies face in connection with climate change. *See infra* Part 4.b. The market's judgment that climate risk has become a key indicator of corporate performance is further reflected in the briskly growing field of investment products and indices that attempt to capture data about climate risk. *See infra* Part 4.a.

Climate risk has simply become too important to corporate performance to be left out of mandatory disclosures under the securities laws and the Commission's rules. The expansive language of the Commission's existing regulations requires corporations to disclose to investors information that the reasonable investor would find significant to his or her assessment of the corporation's value. The magnitude of the regulatory consequences and physical changes associated with climate change for many companies brings climate risk within these requirements. In light of the current state of the scientific information on climate change, and the rapid growth of greenhouse gas regulation at all levels from international to municipal, both the physical and legal consequences of climate change have undoubtedly become "known trends" within the meaning of the Commission's regulatory standards. Particularly for small and individual investors who lack the resources to obtain restricted or for-hire products concerning firms' climate risks and opportunities, the necessary information will be obtained only through mandatory disclosures to the public at large under the Commission's rules.

We respectfully urge the Commission to clarify that corporations should assess their climate risk, analyze whether that risk is likely to have a material impact on them, and if so, disclose it to the public as required under the Commission's rules.

Specifically, we seek a statement from the Commission that companies must consider climate risk in their review of information that may be material and subject to disclosure. As the Commission has explained, registrants' judgments about what information is material and subject to disclosure obligations depend upon a careful review of all available information. The first step in providing adequate disclosure is ensuring that the company has the base of information necessary to make sound judgments about materiality. Companies' review of the significance of climate change for their operations and financial condition should include careful attention to the adequacy of their internal procedures for gathering and assessing climate-related information and of any corporate structures relating to climate risk, such as Board committees. Moreover, in order to assess whether they are subject to material risks associated with greenhouse gas regulation, companies will need to calculate their current and projected greenhouse gas emissions.

In addition to explaining that climate risk merits careful scrutiny in companies' assessment of their financial condition, the Commission should clarify that, under existing law, registrants must disclose any and all material information related to climate change. Depending on the particular corporation's circumstances, this obligation may require disclosure of information on:

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

Part 6, below, and Appendix G set forth and discuss these elements in greater detail.

Because of the unevenness and inconsistency of current corporate disclosure of climate risks, investors will benefit from Commission guidance clarifying the application of existing law to the new business realities associated with climate change. However, considering the urgency of the need for improved disclosure, and because we are not proposing a change in substantive

legal standards, we also respectfully ask the Commission to take action now, while it develops such guidance. In a separate letter submitted today, we urge the Commission, through its Division of Corporation Finance, to devote close attention to the adequacy of disclosures concerning climate risk, particularly by registrants in industry sectors that emit high levels of greenhouse gases and those that are subject to regulation of greenhouse gas emissions. When it determines that registrants may not have disclosed material information on climate risk, the Commission should take action to ensure that they meet their obligations under the securities laws and regulations.

1. What Is Climate Change?

An overwhelming body of scientific evidence demonstrates that emissions of greenhouse gases, including carbon dioxide, are changing the world's climate with already extensive, and potentially catastrophic, effects. The scientific consensus on climate change was reiterated by the recent release of the IPCC's Fourth Assessment Report. This comprehensive survey, prepared by the international body charged with assessing the scientific, technical, and socio-economic information relevant to climate change, synthesized the massive body of scientific literature on climate change, its already observed and potential future impacts, and options for adaptation and mitigation. Appendix B contains a summary of the primary conclusions in the IPCC's 2007 Assessment, and a list of other widely respected information sources on various aspects of climate change. Petitioners are submitting to the Commission copies of the Fourth Assessment Report's three Summaries for Policymakers.

The IPCC's 2007 Assessment concludes that evidence of climate change "is unequivocal, as is now evident from observations of increases in global average air and ocean temperatures, widespread melting of snow and ice, and rising global average sea level."[2] These conclusions, which are consistent with those of the U.S National Academy of Sciences and many other scientific bodies, are that human-induced increases in greenhouse gases have already caused the Earth's atmosphere to warm, with very rapid warming occurring over the last three decades.[3]

[2] *See id.* at 5.
[3] *See id; see also* Joint Science Academies' Statement: Global Response to Climate Change (June 2005), *available at* http://www.royalsoc.ac.uk/displaypagedoc.asp?id=20742; *see also* Naomi Oreskes, *The Scientific Consensus on Climate Change*, 306 SCIENCE 1686 (2004) (studying 928 scientific studies on

Climate change has already caused a wide range of impacts. As the IPCC confirmed, "numerous long-term changes in climate have been observed," including "changes in arctic temperatures and ice, widespread changes in precipitation amounts, ocean salinity, wind patterns and aspects of extreme weather including droughts, heavy precipitation, heat waves and the intensity of tropical cyclones."[4] Some of the observed evidence and impacts of climate change include:

- Eleven of the last twelve years (1995-2006) rank among the twelve warmest years on record;
- Mountain glaciers and snow cover have declined on average in both hemispheres, and widespread decreases in glaciers and ice caps have contributed to sea level rise;
- Losses from the ice sheets of Greenland and Antarctica have very likely contributed to recent sea level rise;
- The rate of observed global sea level rise has accelerated;
- More intense and longer droughts have been observed since the 1970s;
- Widespread changes in extreme temperatures have been observed over the last 50 years;
- There is observational evidence for an increase in intense tropical cyclone activity in the North Atlantic since 1970, correlated with increases in tropical sea surface temperatures.[5]

In the short term, further warming is predicted regardless of whether greenhouse gas emissions are reduced. But the *amount* of further warming later in the century is contingent upon future human actions which will, in part, determine how high concentrations of greenhouse gases climb. While even the amount of warming at the lower end of projections will have significant adverse impacts, the possibility of warming at the higher end would involve very grave risks for human health and safety, for the world economy, and for natural systems.[6]

climate change and finding that none of them disagreed with consensus view that the Earth's climate is being affected by human activities).
[4] *See* IPCC, SPM-1, *supra* note 1, at 7.
[5] *See id.* at 5-9.
[6] Indeed, the distinctive threat posed by climate change was described in a recent report based upon a study by ten retired admirals and generals of the United States Armed Forces. That report concluded that "[p]rojected climate change poses a serious threat to America's national security," explaining that:

Warming like that expected under "business as usual" scenarios would fundamentally alter the global environment, with sweeping negative effects for human society.[7]

To avoid severe and potentially catastrophic warming later in the 21st Century, there is a growing consensus that it will be necessary to reduce emissions very soon.[8] Even with immediate action, stabilizing and then reducing atmospheric greenhouse concentrations will take decades.

The science of climate change is complex. But the fact that technically complex matters affect climate risk does not distinguish climate change from the many other scientific or technical subjects that can affect corporate value, or from the many known trends and uncertainties that Commission regulations require corporations to analyze and disclose. For corporations operating in fields such as biotechnology and pharmaceuticals, or any other high-tech field or area in which research and development is evolving, assessment of value frequently requires assessment of scientific information. It is not the Commission's responsibility or obligation to provide independent scientific assessment of risks that are beyond its technical expertise. But it is the Commission's responsibility to make sure corporations disclose material information that will allow investors to make their own assessments. Indeed, the Commission commonly requires disclosure of material risks in areas of technical complexity. Moreover, many of the most important ways in which climate change affects companies' financial condition are entirely traditional and familiar, such as by changing a company's costs of regulatory compliance, energy, or insurance.

The Commission's historic emphasis upon equal public access to material market information serves investors' interests and supports a robust economy. In the coming years, the

> The predicted effects of climate change over the coming decades include extreme weather events, drought, flooding, sea level rise, retreating glaciers, habitat shifts, and the increasing spread of life-threatening diseases. These conditions have the potential to disrupt our way of life and to force changes in the way we keep ourselves safe and secure . . Unlike most conventional security threats that involve a single entity acting in specific ways and points of time, climate change has the potential to result in multiple chronic conditions, occurring globally within the same time frame.

CNA CORP., NATIONAL SECURITY AND THE THREAT OF CLIMATE CHANGE 6 (2007), *available at* http://securityandclimate.cna.org.

[7] *See, e.g.*, INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, *Summary for Policymakers*, *in* CLIMATE CHANGE 2007: IMPACTS, ADAPTATION AND VULNERABILITY 7 (2007) [hereinafter IPCC, SPM-2], *available at* http://www.ipcc-wg2.org/index.html; IPCC, SPM-1, *supra* note 1, at 13; CAL. CLIMATE CHANGE CTR., OUR CHANGING CLIMATE: ASSESSING THE RISKS TO CALIFORNIA 6-20 (2006), *available at* http://www.energy.ca.gov/2006publications/CEC-500-2006-077/CEC-500-2006-077.PDF.

[8] *See* IPCC, SPM-2, *supra* note 7, at 11, 22; CAL. CLIMATE CHANGE CTR., *supra* note 7, at 3-6.

economy will be called upon to deliver innovation to respond to climate change. No one yet knows exactly what combination of measures will prove necessary for society to avoid the hazardous effects of climate change, nor what new technologies will emerge as critical tools to produce energy with less climate impact. The enormous power of financial markets to deliver innovation will be critical to our ability to meet the challenge of climate change. Ensuring that corporations provide those markets with material climate information is vital, not only to providing investors the information they need, but also to society's ability to respond to climate change itself.

2. Current Law Requires Corporations to Disclose Material Information About Climate Risk.

The Commission's existing disclosure regulations speak in expansive and flexible terms that reflect the broad range of information investors consider when they assess corporate value. For many companies, climate risk clearly meets the standard of materiality established by the Commission and the courts, and falls directly within several of the specific disclosure requirements of Regulation S-K.

a. Climate Risk Is Material to Investors' Decisions.

The fundamental principle underlying the Commission's disclosure requirements is that a public corporation must fully and fairly disclose all facts about its performance and operations that would be material to a shareholder's investment decision. This disclosure obligation springs from the core requirement of the 1933 and 1934 Acts that investors receive financial and other significant information concerning securities offered for public sale. Under both Supreme Court and Commission precedent, the existence of significant investor demand for information helps to guide the determination of whether that information is material and hence required to be disclosed. "A fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[9]

The Supreme Court has made clear that the determination of whether a fact is material is a holistic inquiry that cannot be reduced to a simple numeric formula. Determinations of

[9] SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 12, 1999) (quoting TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976)).

materiality require "delicate assessments of the inferences that a 'reasonable investor' would draw from a given set of facts, and the significance of those inferences to him . . . ."[10] In Staff Accounting Bulletin No. 99, Commission Staff reiterated this principle and rejected the practice of using a simple numeric threshold for determining whether an omission or misstatement in a financial statement is material.[11] Instead, Staff have made clear that the question of what information is material must take into account both quantitative and qualitative factors. This interpretation of materiality is also supported by the Financial Accounting Standards Board, which has stated that:

> [M]ateriality judgments can properly be made only by those who have all the facts. The Board's present position is that no general standards of materiality could be formulated to take into account all the considerations that enter into experienced human judgment.[12]

The steadily growing demand from investors for information about climate risk, described below in Part 4, demonstrates that "reasonable investors" exercising human judgment increasingly consider climate risk part of the total mix of information they assess to make investment decisions. Investors representing $41 trillion in assets participate in the Carbon Disclosure Project and its annual requests for climate risk information from corporations.[13] Members of the Investor Network on Climate Risk, which represents more than $4 trillion in assets, have repeatedly requested SEC action to clarify the need for climate risk disclosure.[14] Further, financial markets are actively addressing the demand for climate risk information in the products and services described below in Part 4. Corporate leaders themselves, as exemplified in Appendix F, have also recognized the critical importance of climate risks, in the form of both regulatory developments and physical risks, to the global economy.

The financial markets have judged that climate risk is important to investors' ability to assess corporate operations and performance. This judgment, along with the importance of climate risk for many registrants' financial prospects, compels the conclusion that material climate risk must be disclosed under the Commission's regulations.

[10] *TSC Industries*, 426 U.S. at 450.
[11] *See* SEC Staff Accounting Bulletin No. 99, *supra* note 9.
[12] FINANCIAL ACCOUNTING STANDARDS BOARD, STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 2: QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION 45 (1980), *available at* http://www.fasb.org/st/.
[13] *See* Carbon Disclosure Project: About Us, http://www.cdproject.net/aboutus.asp.
[14] *See, e.g.*, Letter from Bradley Abelow et al. to Chairman Cox (June 14, 2006).

b. FAS 5 and Regulation S-K Require Registrants to Disclose Climate Risk.

Because climate change affects different corporations in different ways, there are several portions of a registrant's periodic reports in which it may be appropriate for a corporation to disclose climate risk.

FAS 5

Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (FAS 5), sets the standard for disclosure of material contingent liabilities that can be expressed on the balance sheet. FAS 5 requires a company to accrue a charge against current income for the entire amount of a material liability that is probable and reasonably estimable. It allows a contingent liability to be expressed as a range of estimable liabilities. If a material contingent liability is "reasonably possible" but cannot be estimated, FAS 5 requires that liability to be disclosed in the footnotes to the financial statements.

Examples of companies that have likely crossed the FAS 5 threshold for accruing actual dollar values for climate related contingent liabilities include companies that emit significant levels of greenhouse gases and are already subject to direct regulation of those emissions here or abroad, companies considering major capital investments that are affected by new and evolving regulatory treatment of greenhouse gas emissions, and companies whose physical operations are at hazard due to developments such as melting permafrost or storm damage. FAS 5 requires those companies to disclose material climate risks that can be reasonably estimated on their balance sheets now.

Regulation S-K

For many other companies, analysis of climate risks may not yet have reached the level of sophistication or certainty that would allow or require disclosure of climate risk as a specific amount or even a range of amounts on the balance sheet. For these companies, as well as for those who have crossed the FAS 5 threshold, the narrative disclosure provisions of Regulation S-K require that they disclose and discuss their material climate risks. Three specific provisions of Regulation S-K require narrative disclosures of climate risks:

Item 101: Description of Business

Item 101 requires a description of the "general development of business,"[15] including plan of operation, "any anticipated material acquisition of plant and equipment and the capacity

[15] 17 C.F.R. § 229.101(a) (2007).

thereof,"[16] and "other material areas which may be peculiar to the registrant's business."[17] Item 101(c) requires disclosure of "competitive condition in the business."[18] As described in Part 3, below, both regulatory developments relating to greenhouse gas emissions and the physical risks of climate change pose immediate challenges to the general development of many businesses. Some of these challenges include changes to the cost of energy and transportation, changes to and uncertainty about the cost of capital investments, and contingency planning for climate change-influenced events such as extreme weather or changes in water supply.

Item 101(c)(1)(xii) specifically requires disclosure of the cost of complying with environmental laws:

> 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.

For those companies operating in any of the United States or overseas jurisdictions that have enacted or adopted greenhouse gas emissions limits, the effects of those limits on capital expenditures, earnings and competitive position must be disclosed whenever they are material.

Item 103: Legal Proceedings

Climate change has already generated significant litigation, including suits against private companies that are major emitters of greenhouse gases.[19] Such climate litigation may trigger disclosure requirements under Item 103 of Regulation S-K, which provides in part:

[16] 17 C.F.R. § 229.101(a)(2)(B)(*3*) (2007).
[17] 17 C.F.R. § 229.101(a)(1)(B)(*5*) (2007).
[18] 17 C.F.R. § 229.101(c)(1)(x) (2007).
[19] *See, e.g.*, JUSTIN R. PIDOT, GLOBAL WARMING IN THE COURTS: AN OVERVIEW OF CURRENT LITIGATION AND COMMON LEGAL ISSUES (2006) (summarizing litigation in U.S. courts on climate issues), *available at* http://www.law.georgetown.edu/gelpi/current_research/documents/GWL_Report.pdf. In July 2004, New York, seven other states, and the City of New York filed a lawsuit grounded in the common law of public nuisance against the five power companies that were, at the time, the nation's largest emitters of carbon dioxide. Although these claims were initially dismissed in the lower court, the states continue to pursue

> Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject.[20]

In 1993, the Office of the Chief Accountant addressed the disclosure of environmental litigation liabilities in Staff Accounting Bulletin 92.[21] In an effort to "elicit more meaningful information concerning environmental matters in filings," SAB 92 made clear that a company must accrue a charge for environmental liabilities if it is probable that the liability has been incurred, and if it can be reasonably estimated. Recognizing the "significant uncertainties" inherent in determining many environmental liabilities before they are reduced to judgment, Commission Staff nonetheless directed that corporations disclose the reasonably probable results of legal proceedings, which in some cases would be a range of values supported by a narrative discussion of the uncertainties.

Item 303: Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 303 of Regulation S-K requires the preparation and disclosure of the Management's Discussion and Analysis of Financial Conditions and Results of Operations (MD&A). The importance of MD&A as a vehicle for disclosing the critical subjects facing corporate management is reflected by the frequency with which the Commission has addressed and clarified this requirement in studies, rulemakings, and releases. Commission Staff has summarized the MD&A requirement as follows:

> Item 303 of Regulation S-K requires a company to discuss its financial condition, changes in financial condition and results of operations. A company must include in this section a discussion of its liquidity, capital resources and results of operations. In particular, forward looking information is required where there are known trends, uncertainties or other factors enumerated in the rules that will result in, or that are reasonably likely to result in, a material impact on the company's liquidity, capital resources, revenues and results of operations, including income from continuing operations. A company must focus on known material events and uncertainties that would cause reported

the litigation on appeal. *See* Connecticut v. Am. Elec. Power Co., 406 F. Supp. 2d 265 (S.D.N.Y. 2005), *appeal docketed*, No. 05-5104 (2d Cir. Sept. 22, 2005).
[20] 17 C.F.R. § 229.103 (2007). Item 103 also requires disclosure of proceedings that are "known to be contemplated by government entities." *Id.* (Instruction No. 5).
[21] SEC Staff Accounting Bulletin No. 92, 56 Fed. Reg. 33,376 (June 14, 1993).

financial information not to be necessarily indicative of future operating results or of future financial condition.[22]

The Commission's December 2003 interpretive guidance makes clear that the discussion of the future challenges facing corporate management is central to MD&A: "A good introduction or overview would . . . provide insight into material opportunities, challenges and risks, such as those presented by known material trends and uncertainties, on which the company's executives are most focused for both the short and long term, as well as the actions they are taking to address these opportunities, challenges and risks." [23] As described in Part 4 below, information about the scope of the challenges climate change poses to a specific company, and whether its management is adequately prepared to face those challenges, is precisely the type of information that the market is now demanding about climate risk.

The requirement for companies to address "known trends and uncertainties" in their MD&A is particularly applicable to climate risk. Item 303 requires that publicly traded companies disclose:

> [A]ny known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.[24]

The Division of Corporation Finance Staff has described this obligation as follows:

> The requirement to discuss uncertainties in MD&A encompasses both financial and non-financial factors that may influence the business, either directly or indirectly. In many cases, there will be current or immediate accounting implications associated with an uncertainty, as occurs when the likelihood of a loss contingency becomes probable and the amount of loss is reasonably estimable. However, the need to discuss such matters in MD&A will often precede any accounting recognition when the registrant becomes aware of information that creates a reasonable likelihood of a material effect on its financial condition or results of operations, or when such information is otherwise subject to disclosure in the financial statements, as occurs when the effect of a material loss contingency becomes reasonably possible. If a registrant is unable to estimate the reasonably likely impact, but a range of amounts are determinable based on the facts and circumstances surrounding the contingency, it should disclose those amounts.[25]

[22] U.S. SEC. & EXCH. COMM'N, DIV. OF CORP. FIN., SIGNIFICANT ISSUES ADDRESSED IN THE REVIEW OF THE PERIODIC REPORTS OF THE FORTUNE 500 COMPANIES (Feb. 23, 2003), *available at* www.sec.gov/divisions/corpfin/fortune500rep.htm.

[23] Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056 (Dec. 29, 2003).

[24] 17 C.F.R. § 229.303(a)(3)(ii) (2007).

Item 303 specifically deals with the disclosure obligation when a known trend has an uncertain impact on a corporation. The mere fact of uncertainty is not an excuse against disclosure. Item 303 sets forth disclosure requirements for those situations in which a registrant's reported past and present financial records do not accurately indicate its long-term viability and profitability because of a known trend or change in the business environment. "Item 303(a)(3)(ii) essentially says to a registrant: If there has been an important change in your company's business or environment that significantly or materially decreases the predictive value of your reported results, explain this change in the prospectus."[26] When a company encounters "'matters that would have an impact on future operations and have not had an impact in the past'" and "'matters that have had an impact on reported operations and are not expected to have an impact on future operations,'"[27] Item 303 requires disclosure. Determinations of whether a future event requires disclosure are judged according to a negligence standard of objective reasonableness; the assessment is whether the "'known trend, demand, commitment, event or uncertainty [is] likely to come to fruition.'"[28]

Item 303 does not require unlimited speculation about future possibilities or "forward looking information."[29] Rather, "known trends and uncertainties" are "understood as referring to those trends discernable from hard information alone."[30] The critical distinction between optional disclosure of "forward looking" analysis and required disclosure of "the future impact of presently known trends" is based on "the nature of the prediction required."[31] If the future

[25] U.S. SEC. & EXCH. COMM'N, DIV. OF CORP. FIN., CURRENT ACCOUNTING AND DISCLOSURE ISSUES IN THE DIVISION OF CORPORATION FINANCE (Nov. 30, 2006), *available at* http://www.sec.gov/divisions/corpfin/cfacctdisclosureissues.pdf.

[26] Oxford Asset Management, Ltd. v. Jarvis, 297 F.3d 1182, 1192 (11th Cir. 2002).

[27] *Id.*

[28] *Id.*

[29] 17 C.F.R. § 229.303(a) (2007) (Instruction No. 7).

[30] Glassman v. Computervision Corp., 90 F.3d 617, 631 (1st Cir. 1996).

[31] Concept Release on Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 6711, 52 Fed. Reg. 13,715, 13,717 (Apr. 24, 1987); *see also id.* ("Required disclosure is based on currently known trends, events, and uncertainties that are reasonably expected to have material effects, such as: A reduction in the registrant's product prices; erosion in the

event is "based on *currently known trends, events, and uncertainties that are reasonably expected to have material effects,*"[32] then disclosure is required.

Further, Item 303 requires disclosure when a known trend reflects "persistent conditions of the particular registrant's business environment."[33] Thus, businesses are not obligated to disclose trends that they reasonably believe will have only a short-term impact on the market, but are obligated to report any changes that will have a long-term impact on their business environment.[34] Thus the fact that climate change carries significant to severe long-term risks for many companies places it squarely within Item 303's disclosure requirements.

For corporations operating in the many jurisdictions in which greenhouse gas-related emission limitations or regulations are now in effect, disclosure of the material effects of those programs on capital expenditures, earnings and competitive position is now required under both Item 101 and Item 303. The trend toward increased greenhouse gas regulation, and the associated uncertainty about the impact of this regulation, must be analyzed to determine if they are material and subject to disclosure under Item 303.

c. Interpretive Guidance Is Needed to Clarify the Application of These Disclosure Requirements to Corporate Climate Risk.

Notwithstanding the plain terms of Regulation S-K, corporate practice on climate risk disclosure is lagging behind the rapidly evolving economic, legal, and scientific developments related to climate change. The low rate of meaningful climate risk disclosure and the inconsistency in how companies are addressing this subject in their filings are denying investors the information they need and demand about climate risk. The Commission's mission "to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation"[35]

registrant's market share; changes in insurance coverage; or the likely non-renewal of a material contract. In contrast, optional forward-looking disclosure involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty.").

[32] *Id.* (emphasis in original); *see also* Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,428-29 (May 24, 1989).

[33] Oxford Asset Management, Ltd. v. Jarvis, 297 F.3d 1182, 1191 (11th Cir. 2002).

[34] *See* Kapps v. Torch Offshore, 379 F.3d 207, 218 (5th Cir. 2004) (holding that Torch Offshore was not obligated to disclose a 60% drop in the price of natural gas over a 5 ½ month period, because "at the time of the IPO, it was not unreasonable to consider the decline in natural gas prices as not yet constituting a trend").

[35] U.S. SEC. & EXCH. COMM'N, 2005 PERFORMANCE AND ACCOUNTABILITY REPORT (2005), *available at* http://www.sec.gov/about/secpar/secpar2005.pdf.

requires clarification of the application of existing disclosure standards to the critical issue of climate risk.

The remainder of this petition describes those risks in Part 3, the growing demand from investors for information about corporations' exposure to those risks in Part 4, and the current inconsistent and inadequate state of climate risk disclosure in Part 5. Part 6 sets forth the action we request from the Commission to clarify the application of existing law to the disclosure of climate risks.

3. What Are the Climate-Related Risks to Publicly Traded Corporations?

The far-reaching nature of the climate changes that are underway makes global warming and greenhouse gas regulations important considerations for corporations throughout the economy. For investors, these developments make climate risk a key area of interest concerning corporate performance. In a recent McKinsey survey of over 4,000 international executives, climate change was the third most commonly cited risk to shareholder value in the near term.[36] As explained in a recent report by Marsh, the world's largest insurance broker:

> Climate risk cuts across almost every industry in every corner of the world—energy producers and consumers; transportation providers and those reliant on it; forestry, agriculture, and food producers; construction; chemicals, pharmaceuticals, and the life sciences; real estate; communications and technology; tourism and hospitality; the retail industry, and more. The number of companies publicly addressing the risks and opportunities posed by climate change has increased dramatically over the past several years.[37]

A recent statement joined by 153 companies that are part of the U.N. Global Compact—including DuPont and Pfizer—declared that "[c]limate change poses both risks and opportunities to all parts of the business sector, everywhere."[38] Similarly, as explained in the disclosure framework adopted by the Investor Network on Climate Risk:

[36] McKinsey & Co., *The McKinsey Global Survey of Business Executives: Business and Society*, 2 MCKINSEY Q. 33 (2006).

[37] Tom Walsh, Marsh, *Climate Change: Business Risks and Solutions*, RISK ALERT, Apr. 2006, at 1; *see also* Jonathan Lash & Fred Wellington, *Competitive Advantage on a Warming Planet*, HARV. BUS. REV., Mar. 2007, at 95, 96 (quoting Wal-Mart CEO Lee Scott regarding his company's reasons for addressing the issue); CERES, GLOBAL FRAMEWORK FOR CLIMATE RISK DISCLOSURE 4 (Oct. 2006), *available at* http://www.ceres.org/pub/docs/Framework.pdf.

[38] *See* Statement of the Business Leaders of the U.N. Global Compact, Caring for Climate: The Business Leadership Platform (2007) (including list of signatories), *available at* http://www.unglobalcompact.org/Issues/Environment/Climate_Change/index.html.

> Given the sweeping global nature of climate change, climate risk and opportunity is embedded in the operations of all companies. Some companies with significant emissions of greenhouse gases or energy use face current or future regulatory risks, while climate change may pose a range of physical or financial risks to other firms . . . In some cases, the risks to companies may be indirect. For example, even if a company is not directly subject to regulations, significant emissions in its value chain may still result in increased costs (upstream) or reduced sales (downstream). Climate change also represents significant opportunities for many firms. Some companies will develop profitable new technologies or markets as governments pursue innovative strategies to address climate change and spur technology development.[39]

Climate change can pose challenges to businesses in numerous ways, but the most significant risks and opportunities tend to flow from two broad developments: (1) the changing regulatory environment for greenhouse gas emissions, and (2) the changing physical environment associated with global warming.

a. The Changed Regulatory Environment for Greenhouse Gas Emissions.

A growing appreciation of the serious consequences likely to occur if warming continues has created an urgency to reduce emissions as soon as possible. Governments at all levels are now undertaking policies to limit greenhouse gas emissions. Individual countries and multi-state coalitions around the globe have enacted binding greenhouse gas regulations (see Appendix D). In 2005, the Kyoto Protocol to the U.N. Framework Convention on Climate Change entered into force, committing the vast majority of industrial nations to reduce their greenhouse gas emissions.[40] Although the U.S. and Australia have not ratified the Kyoto Protocol, registrants with the Commission face regulation of their greenhouse gas emissions under the Protocol due to their operations in Europe and other industrialized nations. Almost half of aggregate sales by the Standard & Poor's 500 corporations were overseas in 2006, with much of those sales in countries that have also enacted laws and regulations limiting greenhouse gas emissions.[41] The European

[39] CERES, GLOBAL FRAMEWORK FOR CLIMATE RISK DISCLOSURE, *supra* note 37, at 4; *see also* Lash & Wellington, *supra* note 37, at 96 (noting "far-reaching effects of climate change on business" and that financial significance is not limited to "utilities and energy-intensive industries," but extends to "most industries").
[40] *See* U.N. Framework Convention on Climate Change (UNFCCC), Essential Background, http://unfccc.int/essential_background/items/2877.php. As of June 6, 2007, 174 countries and one regional economic integration organization (the EU) had ratified or accepted the Kyoto Protocol. The United States and Australia have not ratified the Protocol.
[41] *See* Press Release, Standard & Poor's, Foreign Sales by U.S. Companies on the Rise, Says S&P (July 9, 2007), *available at* http://www2.standardandpoors.com/spf/pdf/index/070907_SP500FOREIGN.pdf;

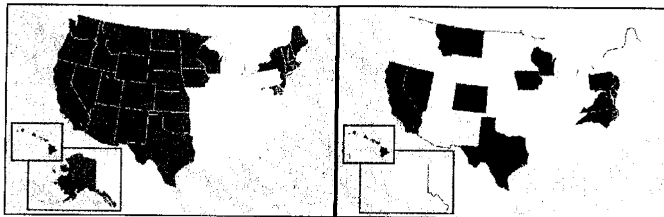
Union has established a cap and trade regime for greenhouse gas emissions, linked to the Kyoto Protocol, known as the European Union Greenhouse Gas Emissions Trading Scheme (EU-ETS).[42] The EU-ETS was launched in early 2005, and created an EU-wide market for trading in greenhouse gas emissions. Due to initiatives like the EU-ETS, the global greenhouse gas emissions trading market increased from involving negligible sums in 2003 to being valued at approximately 18 billion Euros (almost $25 billion at current exchange rates) in 2006.[43] Negotiations are underway to develop the next level of limits under the Kyoto agreement, which will go into effect after the first round of limits expires in 2012. The G-8 group of major industrial nations—including the United States and China—recently agreed in principle to a commitment to reduce greenhouse gas emissions by fifty percent by the year 2050.[44]

The United States has yet to adopt a federal program to control greenhouse gas emissions. However, in the absence of federal legislation, state and local regulation of greenhouse gas emissions has already become a significant force in the United States economy. Appendix C summarizes regional initiatives among states, mandatory state regulations on greenhouse gas emissions and emissions reporting requirements, state emissions goals and emissions reduction incentives, and other state actions regarding greenhouse gas emissions. Many of these programs are already in effect, and are affecting corporate performance by changing financial conditions and liabilities and creating new opportunities and markets for both alternative energy and carbon emission credits.[45]

Multi-state regional initiatives to reduce greenhouse gas emissions now apply in territory representing over 58% of the U.S. GDP[46] and 54% of the nation's population.[47] Renewable

Michael Tsang & Daniel Hauck, *Bulls See Wall Street Gains This Year as Key U.S. Firms Benefit from Growth Overseas*, INT'L HERALD TRIB. (Paris), May 7, 2007 (citing S&P's finding that S&P 500 firms' sales made 49 percent of their sales outside the United States, up from 30 percent in 2001).
[42] *See* European Commission, Emission Trading Scheme (EU ETS), http://ec.europa.eu/environment/climat/emission.htm.
[43] GLOBAL REPORTING INITIATIVE & KPMG GLOBAL SUSTAINABILITY SERVS., REPORTING THE BUSINESS IMPLICATIONS OF CLIMATE CHANGE IN SUSTAINABILITY REPORTS 8 (2007) [hereinafter GRI/KPMG STUDY].
[44] *See* Mark Landler & Judy Dempsey, *U.S. Compromise on Global Warming Plan Averts Impasse at Group of 8 Meeting*, N.Y. TIMES, June 7, 2007, at A10.
[45] GRI/KPMG STUDY, *supra* note 43, at 5 (in study of sustainability reports for 2005 submitted by major companies drawn from FT 500, "a surprising two thirds of companies reported new business opportunities from climate change").
[46] *See* News Release, Bureau of Economic Analysis, Gross Domestic Product (GDP) by State, 2006 (June 7, 2007), *available at* http://www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm.

portfolio standards (RPSs) that require a certain portion of electricity needs to be met by renewable energy sources have been adopted in 25 states which collectively represent over 65% of the nation's GDP and more than 60% of its population. Several states have further adopted greenhouse gas emissions reduction goals, and three—California, Hawaii and New Jersey—have set mandatory, economy-wide caps on greenhouse gas emissions. These three states together account for 17% of the U.S. GDP and 16% of the country's population. The geographic reach of these state actions to control greenhouse gas emissions indicates that they have significant economic and competitive consequences already.



Left: State participation in regional initiatives involving greenhouse gas emissions caps or standards, or development and coordination of policies to deploy cleaner lower carbon energy resources.
Right: Blue, green and yellow states collectively indicate those having adopted an RPS; yellow states have further set GHG emissions reduction goals, while green states have established mandatory caps on statewide GHG emissions.

Many states have joined together in regional agreements to reduce greenhouse gas emissions. New York has joined with nine other northeastern states (Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, Rhode Island, and Vermont) to form the Regional Greenhouse Gas Initiative (RGGI), which is a mandatory cap-and-trade program to reduce carbon dioxide emissions from power plants. Under the program, emissions will be capped starting in 2009 at then-current levels, and then reduced by 10 percent below 2009 levels by 2019. RGGI member states are now in the process of enacting implementing legislation or regulations.[48] In 2007, the Governors of Arizona, California, New Mexico,

[47] *See* U.S. CENSUS BUREAU, U.S. CENSUS 2000 tbl.2 (2000), *available at* http://www.census.gov/population/www/cen2000/respop.html.
[48] REGIONAL GREENHOUSE GAS INITIATIVE, FREQUENTLY ASKED QUESTIONS (Dec. 20, 2005), *available at* http://www.rggi.org/agreement.htm.

Oregon, Utah, and Washington, as well as several Canadian provinces and Indian tribes, entered into the Western Climate Initiative to establish a regional greenhouse gas reduction goal and develop market-based strategies to achieve emissions reductions.[49] In 2007, 34 states—representing over 70% of the population of the United States—joined the Climate Registry, a central repository of greenhouse gas emissions data gathered by states under mandatory and voluntary reporting programs.[50]

California also has enacted a suite of ambitious measures to limit greenhouse gas emissions that are setting the standard for further state action:

- The Global Warming Solutions Act (Assembly Bill 32) (2006) establishes a mandatory greenhouse gas emissions cap for the State, based on 1990 emissions, mandates the promulgation of regulations, by 2011, to achieve the maximum technologically feasible and cost-effective reductions in greenhouse gases, and requires reporting of greenhouse gas emissions by 2008.[51]

- Assembly Bill 1493 limits greenhouse gas emissions from new motor vehicles. Fourteen other states "have adopted or announced their intention to adopt California's greenhouse gas emission controls" and, "[i]ncluding California, these states account for 44% of the total U.S. population."[52]

- Greenhouse gas procurement standards for electricity providers entering long-term power procurement contracts mandate a performance level of no greater than 1,100 pounds of carbon dioxide per megawatt-hour.[53] This standard affects long-term contracts made with any electricity provider serving the California electricity market, whether in-state or

[49] *See* Western Climate Initiative (Feb. 26, 2007), *available at* http://www.governor.wa.gov/news/2007-02-26_WesternClimateAgreementFinal.pdf; Office of Energy Efficiency and Renewable Energy, U.S.Dep't of Energy, Utah Joins Western Climate Initiative (May 22, 2007), http://www.eere.energy.gov/states/news_detail.cfm/news_id=10987.
[50] *See* The Climate Registry, http://www.theclimateregistry.org.
[51] *See* California Air Resource Board, AB 32 Fact Sheet – California Global Warming Solutions Act of 2006 (Sept. 25, 2006), *available at* http://www.arb.ca.gov/cc/factsheets/ab32factsheet.pdf.
[52] *See* CONG. RESEARCH SERV., CALIFORNIA'S WAIVER REQUEST TO CONTROL GREENHOUSE GASES UNDER THE CLEAN AIR ACT 6 (Aug. 20, 2007). California's request for a waiver pursuant to Section 209 of the Clean Air Act is pending before the EPA. *See id.* at 15 (noting that California has a "strong case" for a waiver). Auto manufacturers and dealers have filed lawsuits challenging the state greenhouse gas emissions standards for automobiles adopted by California and other states. *See* Central Valley Chrysler-Jeep v. Witherspoon, No. CV-04-6663 (E.D. Cal. filed Dec. 7, 2004); Lincoln Dodge, Inc. v. Sullivan, No. 1:06-CV-0070 (D.R.I. filed Feb. 13, 2006). In one of those cases, on September 12, 2007, the United States District Court for the District of Vermont rejected all of the manufacturers' and dealers' challenges to the state greenhouse gas emissions standards. Green Mountain Chrysler Plymouth Dodge Jeep v. Crombie, No. 2:05-CV-302 (D.Vt. Sept. 12, 2007).
[53] *See* Press Release, Cal. Pub. Utilities Comm'n, PUC Sets GHG Emissions Performance Standard to Help Mitigate Climate Change (Jan. 25, 2007), *available at* www.cpuc.ca.gov; S.B. 1368 (Cal.) (signed into law on Sept. 29, 2006).

out-of-state. Washington and Montana also recently adopted requirements for electricity generation units to meet greenhouse gas emissions limitations.[54]

- Executive Order S-01-07 directs the California Air Resources Board to promulgate regulations to require the state's petroleum refiners and gasoline sellers to cut by 10 percent the emissions of greenhouse gases associated with the production and use of their products.[55]

Over 500 of the nation's Mayors, representing cities containing over 65 million Americans, have signed the U.S. Mayors' Climate Protection Agreement, under which they commit to greenhouse gas emission reductions that meet or exceed Kyoto agreement targets of seven percent below 1990 levels by 2012.[56] State and local governments have enacted hundreds of other measures to reduce emissions of greenhouse gases, and scores of further proposals are under consideration throughout the country (see Appendix C).

The various programs passed by state and local governments are already exerting their force in the economy and in many cases having material impact on corporate performance. In addition to these measures, federal action to reduce greenhouse gas emissions is widely considered to be inevitable. The Supreme Court's 2007 decision in *Massachusetts v. EPA* broadly confirmed EPA's authority to take regulatory action addressing global warming pollution under the existing terms of the Clean Air Act. In May, President Bush directed EPA and other federal agencies "to take the first steps toward regulations that would cut gasoline consumption and greenhouse gas emissions from motor vehicles" and to complete the regulatory process by the end of 2008.[57]

In addition, Congress is actively considering bills that would establish national systems of greenhouse gas regulation. Appendix E summarizes pending federal legislation relating to

[54] *See* S.B. 6001, 2007 Leg. (Wash. 2007); *see also* H.B. 25, 2007 Leg. (Mont. 2007) (codified in scattered sections); *see also* Pew Ctr. on Global Climate Change, What's Being Done: States Latest News, http://www.pewclimate.org/what_s_being_done/in_the_states/news.cfm.

[55] *See* Exec. Order No. S-01-07 (Cal. Jan. 18, 2007) (establishing Low Carbon Fuel Standards); *see also* A.B. 1007 (Cal.) (instituting state alternative fuels plan).

[56] *See* Office of the Mayor, Seattle, U.S. Mayors Climate Protection Agreement, http://www.seattle.gov/mayor/climate/; Anthony Faiola & Robin Shulman, *Cities Take Lead on Environment as Debate Drags at Federal Level: 522 Mayors Have Agreed to Meet Kyoto Standards*, WASH. POST, June 9, 2007, at A1.

[57] *See* Press Release, The White House, Rose Garden Statement: President Bush Discusses CAFE and Alternative Fuel Standards (May 14, 2007), http://www.whitehouse.gov/news/releases/2007/05/20070514-4.html.

climate change and greenhouse gas emissions.[58] Although debate continues about the precise mix of measures that should be adopted, enactment of a broad national program of mandatory controls on greenhouse gas emissions appears highly likely in the near term.[59]

According to the public statements of many business leaders, much of the corporate community has already largely incorporated the inevitability of federal greenhouse gas controls into plans for the future. Indeed, one of the most significant developments over the past five years has been a dramatic shift in the business community toward the recognition that climate change is a real and imminent problem for our economic security, and the increasing advocacy for an effective policy response. Appendix F contains a collection of statements that indicate the degree to which corporate leaders now view climate change as a critical market force, and greenhouse gas controls as both inevitable and necessary.

A long and growing list of corporate leaders has joined the call for mandatory federal limits on greenhouse gas emissions. More than thirty prominent corporations have joined with a coalition of environmental groups to form the United States Climate Action Partnership (USCAP), a group that calls for a strong national policy to reduce U.S. greenhouse gas emissions, including an economy-wide, mandatory cap and trade program limiting greenhouse gas emissions as part of an overall package of policies designed to limit "global atmospheric [greenhouse gas concentrations] to a level that minimizes large-scale adverse climate change impacts to human populations and the natural environment . . ."[60] USCAP members include Alcoa, Chrysler Group, ConocoPhillips, Duke Energy, DuPont, Ford Motor Company, General

[58] In addition to those bills already introduced for legislative consideration, Senators Joseph Lieberman and John Warner, both members of the Senate Environment and Public Works Committee, recently released a detailed proposal for a climate bill they will introduce later this Fall. This bipartisan effort will call for an economy-wide reduction in greenhouse gas emissions, to be achieved through the implementation of a cap and trade program coupled with various carbon market monitoring provisions. *See* Press Release, Office of Senator Joe Lieberman, Lieberman and Warner Unveil Bipartisan Climate Proposal (Aug. 2, 2007); The Lieberman-Warner America's Climate Security Act of 2007: An Annotated Table of Contents, *available at* http://lieberman.senate.gov/documents/acsa.pdf.

[59] Two Senate climate change bills, the Sanders-Boxer and Kerry-Snowe bills, would require the Commission to improve corporate disclosure of climate risk in securities filings. *See* S. 309, 110th Cong. § 9 (2007); S. 485, 110th Cong. § 302 (2007). The corporate disclosure provisions in these bills would require the SEC to (1) issue an interim interpretive release clarifying that climate change constitutes a known trend, and (2) within two years, direct public companies to inform investors of risks relating to their financial exposure due to their greenhouse gas emissions, and the potential economic impacts of global warming on the interests of each company.

[60] *See* U.S. CLIMATE ACTION P'SHIP, A CALL FOR ACTION 6 (2007), *available at* http://www.us-cap.org/USCAPCallForAction.pdf.

Electric, General Motors, PepsiCo, PG&E Corporation, Rio Tinto, and Shell, among many other prominent corporations.

The growing list of regulatory controls on greenhouse gas emissions at the local, state, regional and international levels constitutes a "known trend" whose affects should be analyzed and, if material, disclosed under Regulation S-K. Corporate participation in advocacy for federal climate change policy demonstrates the likelihood of federal greenhouse gas laws is "known" as well, and that the uncertainty about the scope and form of federal climate laws is a known uncertainty that has important implications for corporate financial prospects. In spite of this, analysis of and disclosure of the impact of greenhouse gas regulation on corporate performance remains inconsistent, and sometimes nonexistent, to the distinct detriment of investors and the market as a whole.

b. The Changing Physical Environment.

The alterations to the physical environment observed and expected from climate change already have implications for the operations and financial condition of many companies, and these physical changes will likely affect more companies as the climate continues to change. The physical changes described in Part 1 above and in Appendix B include both the obvious—changing temperatures, rising sea levels, more severe storms—and the more subtle, such as changes in the amount of local precipitation and accelerated snowmelt that will affect water supply, as well as warmer temperatures that may expand the ranges of disease vectors and pests that affect human health and food and fiber production.[61] All of these changes will have economic impacts on businesses, including the continued use of corporate facilities in vulnerable locations and the viability of the other businesses in their supply chain.[62]

Many of the potential impacts from physical risks resulting from climate change are known or predictable, and should be disclosed if material. The overwhelming consensus in the scientific literature establishes that the physical shifts brought by climate change are known

[61] *See, e.g.*, Matthew D. Zinn, *Adapting to Climate Change: Environmental Law in a Warmer World*, 34 ECOLOGY L.Q. 61, 68 (2007) (stating that "[i]t is hard to overstate the significance of climate change's implications for western water supply," and discussing studies).

[62] *See* CARBON DISCLOSURE PROJECT, CALVERT & CERES, CLIMATE RISK DISCLOSURE BY THE S&P 500 at 33 (2007), *available at* http://www.calvert.com/pdf/ceres_calvert_sandp_500.pdf (noting significance of "physical risks . . . from severe weather, sea level rise, ecosystem impairment, and shifting ranges of pests and diseases" and that "[c]ompanies that may believe they face little risk may find that their supply chain is more vulnerable than they expected, or that physical or regulatory factors combine to raise the price of essential factors of production (most notably, energy)").

trends and uncertainties which may have a profound effect on the profitability and performance of a broad range of corporations. Frank analysis of how these changes in the physical environment will affect a corporation will give investors critical information about whether corporate management is truly prepared for the future.

c. The Impact of Climate Change on Businesses.

Until recently, the risks and opportunities associated with climate change have often been viewed as potentially significant at some indefinite point in the future, but as too uncertain to bear on corporate planning and actions in the near term. The emergence of scientific consensus about the existence and seriousness of climate change, the presence of major international climate policies, and the arrival of significant state level greenhouse gas regulation in the United States, have made climate change an immediate economic concern to corporations. Moreover, because of the long-term capital investments required to retool and reinvest for a carbon-constrained regulatory environment, decisions companies make now will determine their financial prospects as existing controls on emissions take effect and new carbon regulations are adopted. As one recent study put it: "[M]anagements and investors cannot assume that there will be time to react to policy when it is approaching implementation, because there are strategic structural factors such as access to resources and technology, or consumer mix, which take longer to shift."[63]

The costs and opportunities associated with the changing regulatory and physical environments bear directly on the financial condition and operations of many companies.[64] Regulation of greenhouse gas emissions imposes direct costs on major sources of greenhouse gas emissions and indirect costs on the companies that use their products and services. At the same time, these new regulatory developments will offer major opportunities for firms that can reduce emissions, thereby garnering marketable emissions credits or cost advantages over their competition, and for firms offering technologies and services needed to reduce emissions.[65]

[63] ALLIANZ GROUP & WORLD WIDE FUND FOR NATURE, CLIMATE CHANGE & THE FINANCIAL SECTOR: AN AGENDA FOR ACTION 18 (2005), *available at* http://www.wwf.org.uk/filelibrary/pdf/allianz_rep_0605.pdf.

[64] *See id.* (discussing studies of impacts of the European Union's Emission Trading Scheme on different business sectors).

[65] *See* CERES, GLOBAL FRAMEWORK FOR CLIMATE RISK DISCLOSURE, *supra* note 37, at 8; *see also*, ASPEN INSTITUTE & CERES, THE WIRTH CHAIR 2004 LEADERSHIP FORUM: CLIMATE CHANGE RISKS AND THE SEC (Oct. 18, 2004); Lash & Wellington, *supra* note 37, at 100 (discussing supply chain risk); ALLIANZ GROUP & WORLD WIDE FUND FOR NATURE, *supra* note 63, at 17-20, 26, 32 (stating that

In addition, firms that are major greenhouse gas emitters and that do not have in place policies for reducing emissions face serious reputational risks.[66] On June 19, 2007, Climate Counts, an environmental non-profit group, released a scorecard detailing the climate related practices of major retail organizations, with the goal of influencing consumer purchasing habits against low scorers like Apple and Sara Lee.[67] The website release was covered in over 100 news articles worldwide in such prominent venues as CNNMoney and Forbes. Conversely, companies with large exposure to the retail market have the potential to build positive images with consumers and gain a competitive edge in their sector if they enact climate friendly policies.[68]

The dramatic hurricane season of 2005 demonstrated the potential physical risk to businesses from the increase in severe weather expected as part of climate change. Forty-three of the 100 largest members of the S&P 500, from a wide range of sectors including infrastructure, financial services, insurance, oil and gas, reported significant impacts from the 2005 hurricane season in their 10-K reports.[69] The insurance industry suffered $80 billion of insured weather-related losses in 2005, and many insurance consumers in at-risk regions have subsequently lost coverage or seen premiums rise as much as 500%.[70] In particular, Hurricanes Katrina and Rita caused damage of unprecedented cost across the Gulf Coast region. The hurricanes destroyed thousands of homes and businesses and damaged 113 offshore oil rigs, which sent shocks though the gasoline markets.[71] Allstate's 2005 10-Q report stated, "[l]osses in the third quarter of 2005 include estimates of $3.68 billion related to Hurricane Katrina and $850 million, net of reinsurance recoverable of $205 million, related to Hurricane Rita."[72]

"[c]arbon constraints will have different effects on the earnings of companies, both from sector to sector and within sectors," and enumerating climate-related risks and opportunities for insurers and the banking industry).

66 *See* CARBON DISCLOSURE PROJECT, *supra* note 62; Lash & Wellington, *supra* note 37, at 100.

67 Climate Counts, Scorecard Overview, http://climatecounts.org/scorecard.php.

68 *See* John Llewellyn, *The Business of Climate Change*, LEHMAN BROTHERS, Feb. 2007.

69 *See* CARBON DISCLOSURE PROJECT, *supra* note 62, at 24, 33-36, 72.

70 *See* EVAN MILLS & EUGENE LECOMTE, CERES, FROM RISK TO OPPORTUNITY: HOW INSURERS CAN PROACTIVELY AND PROFITABLY MANAGE CLIMATE CHANGE (2006), *available at* http://www.ceres.org/pub/docs/Ceres_Insurance_Climate_%20Report_082206.pdf.

71 *See id.*

72 *See* Allstate Corp., Quarterly Report (Form 10-Q), at 7 (Nov. 1, 2005), *available at* http://ccbn.10kwizard.com/xml/download.php?repo=tenk&ipage=3757279&format=PDF.

Insurer AXA Group recently stated that, for insurance companies, climate change "is more important than interest rate risk or the foreign exchange risk."[73] Insurance industry catastrophe modelers forecast that significantly more costly storms than Katrina are possible and, indeed, inevitable. One analysis by A.M. Best Co. estimated that such storms, with $100 billion in losses, would bankrupt as many as 40 insurers.[74] Losses from the 2005 hurricane season already amounted to 50 to 100 times the insurers' typical yearly profit in the affected states. As noted in a 2007 report by the Government Accountability Office, "both major private and federal insurers are exposed to increases in the frequency or severity of weather-related events associated with climate change," and "many large private insurers are incorporating both near and longer-term elements of climate change into their risk management practices."[75]

A recent study of the oil and gas industry illustrates the multiple risks associated with climate change.[76] Because oil and gas production and consumption accounts for more than half of carbon dioxide emissions in the United States, and because the industry is characterized by long-term capital investment horizons, the industry faces substantial financial risks from regulatory developments including limits on greenhouse gas emissions. These limits pose competitive risks for oil and gas by driving the market toward low-carbon alternatives such as solar and wind power and biofuels. Purveyors of these alternative energy sources, in turn, enjoy opportunities that are the converse of the risks posed to the oil and gas sector.

The physical changes from climate change carry risks for the oil and gas industry as well. The damage to critical infrastructure from the 2005 hurricanes caused "nationwide petroleum shortages," a surge in gas prices, and supported the consumer trend toward hybrid and fuel efficient vehicles.[77] Climate change has placed at risk billions of dollars of long-term investments in pipelines and other infrastructure that depends on permafrost in Alaska, Canada, and elsewhere; the rapid thawing of frozen ground due to climate change leaves "[l]ong-term

73 CARBON DISCLOSURE PROJECT, CLIMATE CHANGE AND SHAREHOLDER VALUE IN 2004 8 (2004), *available at* http://www.cdproject.net/download.asp?file=cdp_report2.pdf.

74 *See* MILLS & LECOMTE, *supra* note 70, at 4.

75 GOV'T ACCOUNTABILITY OFFICE, CLIMATE CHANGE: FINANCIAL RISKS TO FEDERAL AND PRIVATE INSURERS IN COMING DECADES ARE POTENTIALLY SIGNIFICANT, 5, 14, (2004), *available at* http://www.gao.gov/new.items/d07820t.pdf; *see also* EVAN MILLS & EUGENE LECOMTE, *supra* note 70, at 4.

76 MIRANDA ANDERSON, CIVIL SOCIETY INSTITUTE & CERES THE FUTURE OF OIL: ENERGY SECURITY, CLIMATE RISKS, AND MARKET OPPORTUNITIES 7 (2007), *available at* http://www.ceres.org/pub/docs/Future_of_Oil.pdf.

77 *Id.* at 9.

capital investment . . . at risk of literally sinking away."[78] The CEO of Chesapeake Energy, a major natural gas producer, "declared that global warming is the 'single largest threat to the natural gas industry' because of its potential to decimate winter heating demand."[79]

The coal industry similarly demonstrates the risks companies can face from emerging and expected climate regulations. A July 25, 2007, front page *Wall Street Journal* article highlighted the increasing difficulty of building coal-fired generation, pointing to proposals for new coal-fired power plants in Texas, Florida, North Carolina, Oregon, and Minnesota that have been cancelled because "states [have concluded] that conventional coal plants are too dirty to build." The article reported that "[t]he rapid shift away from coal shows how quickly and powerfully environmental concerns, and the costs associated with eradicating them, have changed matters for the power industry."[80] At the same time, a wide range of policies, discussed above in Part 3.a, are designed to create incentives for cleaner power generation, including the statewide caps on greenhouse gas emissions adopted by California, Hawaii and New Jersey; the Regional Greenhouse Gas Initiative; California, Montana and Washington's emission performance standards for electricity providers; Renewable Portfolio Standards; and emerging Western regional and national cap and trade emission policies. As part of Citigroup's research services for its investors, Citigroup recently downgraded coal stocks "across the board" and recommended investors switch into other energy markets, in part due to increasing regulatory and reputational risk related to climate change.[81]

In response to present and probable state regulations, and in anticipation of comprehensive federal climate policy, many utilities and electric generation companies now incorporate a carbon price in planning decisions. These utilities have pointed to the increasing scientific certainty of climate change and the financial risk from current and future carbon regulations as justification for incorporating cost estimates for carbon abatement into long-term planning. Pacific Gas and Electric, Avista, Portland General Electric, Xcel-PSCCo, Idaho Power, and Pacificorp all now include a range of carbon costs into their long-term planning

[78] *Id.* at 9.
[79] *Id.* at 9 (citing *Chesapeake CEO Says Low Gas Prices Will Eventually Rise*, CBSMARKETWATCH.COM (Oct. 3, 2006) (quoting Aubrey McClendon, CEO of Chesapeake Energy)).
[80] Rebecca Smith, *Coal's Doubters Block New Wave of Power Plants*, WALL ST. J., July 25, 2007, at A1.
[81] *See* JOHN H. HILL & GRAHAM WARK, CITIGROUP GLOBAL MARKETS, COAL: MISSING THE WINDOW (2007).

calculations.[82] In California, the Public Utility Commission requires the use of carbon risk values for long-term planning or procurement decisions.[83] The failure to adequately address carbon dioxide regulatory risks was part of the reason a proposed new Florida coal plant was recently rejected by the Florida utility commission: many of the cost scenarios that incorporated carbon abatement values showed that the proposed plant was not a cost-effective choice.[84] Electricity generation companies already hedge their decisions in the face of numerous uncertainties, including future fossil fuel prices, construction expenses and consumer demand, among many others; expenses related to carbon abatement have now become another key variable in corporate strategy and planning.

Though they present significant financial risks for many companies, existing and future greenhouse gas regulations can also present significant opportunities for companies to prosper. Companies that capitalize on new opportunities or technologies that will benefit from climate change have the potential to earn substantial income and large returns for investors. For example, companies positioned to take advantage of carbon trading opportunities have the potential to profit enormously. Global carbon trading markets were worth $30 billion in 2006, and some have estimated that the value of a future carbon market could reach as high as $15 trillion.[85] In addition, recent policy efforts to support renewable energy and increasing consumer interest have led to tremendous growth in wind, solar, and biofuel energy markets. Between 1997 and 2005, globally installed wind turbine capacity experienced a compound annual growth rate of 29%, in part due to the implementation of Renewable Portfolio Standards or Renewable

[82] *See* SYNAPSE ENERGY ECON., INC, CLIMATE CHANGE AND POWER: CARBON DIOXIDE EMISSIONS COSTS AND ELECTRICITY RESOURCE PLANNING (2006).
[83] California Climate Change Portal, State of California Agencies' Roles in Climate Change Activities, http://www.climatechange.ca.gov/policies/state_roles.html.
[84] Smith, *supra* note 80, at A1.
[85] Even in the absence of a national emissions trading program in the United States, many U.S.-based multinational corporations are involved in GHG emissions trading overseas. *See, e.g.*, GRI/KPMG STUDY, *supra* note 43, at 17 (noting that nearly half of the companies studied who were based in the United States and Australia—nations that have not ratified the Kyoto Protocol—"still reported on emissions trading" in their sustainability reports, likely because "multinational companies based in USA and Australia often have overseas operations in regions that are involved in emissions trading"). Because of the high likelihood that a program limiting greenhouse emissions will involve emissions trading—as do all the many climate bills currently before Congress—opportunities for American companies are likely to increase.

Energy Targets in at least 18 countries, 25 states, and the District of Columbia.[86] Emerging state and federal legislation will further support the expansion of these and other low polluting industries.

Even in sectors that are likely to be heavily affected by climate regulations, climate change can present an opportunity to capitalize on changing consumption patterns and new regulatory incentives. Within particular industries, firms' ability to adjust to the challenges posed by the rapidly changing legal and regulatory environment will provide an important source of competitive advantage; firms that are slower to adapt will face corresponding disadvantages. In particular, the automobile industry demonstrates how companies' responses to climate change can determine whether global warming will present a risk or an opportunity. Over a decade ago, many automakers began developing hybrid car product lines to prepare for a carbon-constrained economy. Now existing international regulations, rising gas prices, and public concern over greenhouse emissions are leading to strong sales of hybrid and fuel efficient vehicle lines and positive public reputations for corporations that produce fuel efficient vehicles. Low carbon and energy efficiency product lines are proving a significant advantage for forward-thinking firms.

4. Climate Risk Is Increasingly Important to Investors.

The standard by which information's materiality is judged is whether a reasonable investor would consider the information an important part of his or her assessment of a corporation's value.[87] As shown above, climate change can present a wide range of risks and opportunities for a wide range of sectors, leading McKinsey, Marsh, and others to identify climate risk as a major factor in determining shareholder value. As a result, the market is answering the increasingly loud call for climate risk information that enables investors to determine whether and how corporations are prepared to deal with the many regulatory and physical challenges of climate change. The growing availability of these climate risk information services demonstrates investors' critical need for this type of analysis. However, the private services currently available fail to meet investors' need for consistent, widely available disclosure of climate risk.

[86] *See* EDWARD M. KERSCHNER & MICHAEL GERAGHTY, CITIGROUP GLOBAL MARKETS, CLIMATIC CONSEQUENCES 68 (2007).
[87] *See* Basic Inc. v. Levinson, 485 U.S. 225, 240 (1988); TSC Industries v. Northway, Inc., 426 U.S. 438, 440 (1976).

a. Climate-Related Advisory Services, Investment Research, Funds, and Indices.

Investment firms and consulting agencies have responded to this significant and growing demand for information on climate risk by creating advisory services, investment research, funds and indices that analyze the business implications of climate change. New climate risk advisory services include:

- PriceWaterhouseCoopers' Climate Change Services Group, which "offers a broad range of advisory, assurance and specialist services that collectively guide clients through the complexities of climate change."[88]
- Innovest's Carbon Finance Practice, including their proprietary Carbon Beta™ analytics platform that analyzes "1. Absolute and relative risk exposures for individual companies. 2. Their capacity to manage these risks. 3. Their ability to identify and capture the upside commercial opportunities being created."[89]
- JP Morgan's Climate Change Investment Research practice, which provides investment research on business risks and opportunities related to climate change.[90]

Numerous firms have produced detailed research studies on the investment implications of climate change for business in general and for specific sectors. Recent titles include:

- Kerschner, E.M., and Geraghty, M. Citigroup. 2007. Climatic Consequences: Investment Implications of a Changing Climate. Citigroup Equity Research.

  > "For investors, the issue is not whether climate change is occurring. Today a variety of entities (governments, regulators, corporations, and individuals) are reacting to the perceived climate change threat, creating a number of near-term opportunities." Pg. 1

- Llewellyn, J. 2007. The Business of Climate Change: Challenges and Opportunities. Lehman Brothers.

  > "In the world of business and finance, climate change has developed from being a fringe concern, focusing on the company's brand and its Corporate and Social

[88] PricewaterhouseCoopers, Climate Change Services, http://www.pwc.com/extweb/service.nsf/docid/0c334e23eb5d6b3aca2572e9001c5edc.
[89] Innovest Strategic Value Advisors, Carbon Finance Practice, http://www.innovestgroup.com/index.php?option=com_content&task=view&id=21&Itemid=36.
[90] JPMorgan, Climate Change Investment Research, http://www.jpmorgan.com/pages/jpmorgan/investbk/solutions/research/climatechange.

> Responsibility, to an increasingly central topic for strategic deliberation and decision-making by executives and investors around the globe. . . . Global warming, we judge, is likely to prove one of those tectonic forces that . . . gradually but powerfully changes the economic landscape in which our clients operate, and one that causes periodic sharp movements in asset prices. And, as the title indicates, we consider that climate change poses many challenges but also presents many business opportunities. Firms that recognize the challenge early, and respond imaginatively and constructively, will create opportunities for themselves and thereby prosper. Others, slower to realize what is going on or electing to ignore it, will likely do markedly less well." Pg. 1

- Allianz Group and WWF. 2005. Climate Change and the Financial Sector: An Agenda for Action.

> "[Greenhouse gas policies] will alter the economics of entire industries. They will affect company share prices, both positively and negatively . . . The most sensitive sectors are either energy-intensive, such as cement, aviation, metals or energy industries such as oil and gas, coal, power utilities; or provide energy-consuming products such as automobiles." Pg. 5

- Citigroup. 2007. CO_2—A New Auto Investor Issue for 2007.
- Citigroup. 2006. Investing in Solutions to Climate Change.
- Citigroup. 2006. Carbon Limits are Coming.
- Dresdner Kleinwort. 2007. CO_2 Penalty Scenarios for Auto Industry.
- JP Morgan. 2005. Cars and Climate Change: A Regulatory Battle Brings Risks for Investors.
- Merrill Lynch. 2005. Energy Security and Climate Change: Investing in the Clean Car Revolution.
- Merrill Lynch. 2006. Alternatives for Clean Car Evolution.
- UBS. 2007. UBS Research Focus—Climate Change: Beyond Whether. UBS Wealth Management.
- Bernstein Research. 2006, Prospects for CO2 Emission Limits, and Their Implications for the Power Industry.
- Prudential Equity Group Research. 2004. Electrifying Future for Hybrids.

- Sustainable Asset Management. 2003. Changing Drivers: The Impact of Climate Change on Competitiveness and Value Creation in the Automotive Industry.
- Sustainable Asset Management. 2005. Transparency Issues with ACEA Agreement: Are Investors Driving Blindly?
- Societe Generale Equity Research. 2007. CREAM-ing Carbon Risk: European Carbon Winners and Losers.

A variety of market funds and indices are also appearing that allow investors to profit from new climate related opportunities or hedge against the risks of climate change. Recent offerings include:

Indices

- UBS's Global Warming index, a tradable benchmark for weather derivative investments, allows companies to hedge their profits against the uncertainties of climate change. This new index is only one sign of the increasing liquidity of the weather derivatives market.[91]
- UBS's index of emissions allowances in global carbon trading markets. Called the UBS-WEMI, the index is a basket of future contracts from the EU Emissions Trading Scheme, weighted between the two main trading platforms, the European Climate Exchange and the Nordic Power Exchange.[92]
- Merrill Lynch's Energy Efficiency Index, which tracks 40 global companies in the automotive, building materials, capital goods, and semiconductors sectors that stand to benefit from improved energy efficiency. This new index joins with Merrill Lynch's existing Renewable Energy Index.[93]
- ABN Amro's equity index that tracks firms that address climate change and other environmental issues. The index is primarily composed of renewables, water, and waste management companies. Boston-based KLD and Milan-based E.Capital Partners have also recently launched similar indices.[94]

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[91] Press Release, UBS, UBS Investment Bank Launches - UBS Global Warming Index (Apr. 24, 2007), *available at* http://www.ubs.com/1/e/media_overview/media_emea/mediareleases?newsId=117789.
[92] *See UBS Launches Market Index for Emissions*, TERRA DAILY, Nov. 2, 2006, *available at* http://www.terradaily.com/reports/UBS_Launches_Market_Index_For_Emissions_999.html.
[93] *See* Press Release, Merrill Lynch, Merrill Lynch Introduces New Energy Efficiency Index (July 30, 2007), *available at* http://www.merrilllynch.com/?id=7695_7696_8149_74412_80055_80859.
[94] Environmental Finance, ABN Amro Launches Climate Change Index, http://www.environmental-finance.com/onlinews/0329abn.htm.

Funds

- Calvert's Global Alternative Energy Fund was initiated May 31, 2007. As of September 10, 2007, it has $20 million in assets under management.[95]
- Allianz RCM Global EcoTrends Fund was initiated January 28, 2007. As of July 31, 2007, it has $126 million in assets under management.[96]
- Guinness Atkinson's Alternative Energy Fund was initiated March 31, 2006.[97] As of July 31, 2007, it has over $126 million in assets under management.[98]
- Winslow Green Growth Fund was initiated in May 3, 1994. As of July 30, 2007, it has $259 million in assets under management.[99]
- New Alternatives Fund was initiated in September 1982.[100] As of July 31, 2007, it has almost $232 million in assets under management.[101]

While these products are helping to address the market's demand for climate risk information, the need for access to this information is far greater than can be met by these vehicles. More fundamentally, material information of this importance should not be available only privately and for hire. To the extent that material nonpublic information about climate risks is being disclosed in a selective way, those disclosures would violate Regulation FD, 17 C.F.R. Pt. 243, which requires that material information be publicly disclosed to the *entire market.* As the Commission noted when it promulgated Regulation FD, selective disclosure threatens the integrity of the market and undermines investor confidence. Furthermore, there is particular peril when analysts are privy to information that is not shared with the market as a whole:

> [T]he regulation [FD] likely also will provide benefits to those seeking unbiased analysis. This regulation will place all analysts on equal footing with

[95] Calvert Online, Calvert Global Alternative Energy Fund (CGAEX), http://www.calvert.com/funds_profile.html?fund=971 (click on Fund Management/Investment tab).
[96] Allianz Global Investors, Allianz RCM Global EcoTrendsSM Fund A (AECOX) Performance, http://www.allianzinvestors.com/mutualFunds/profile/RCGET/performance_A.jsp.
[97] GUINNESS ATKINSON, ALTERNATIVE ENERGY FUND: FUND FACTS (2007), *available at* http://www.gafunds.com/alt.pdf.
[98] Yahoo! Finance, Guinness Atkinson Alternative Energy (GAAEX), http://finance.yahoo.com/q?s=GAAEX.
[99] WINSLOW MANAGEMENT COMPANY, L.L.C., WINSLOW GREEN GROWTH FUND: SECOND QUARTER 2007 at 2 (2007), *available at* http://www.winslowgreen.com/admin/documents/General/Fact%20Sheet.pdf.
[100] New Alternatives Fund, Company Overview, http://www.newalternativesfund.com/about/about_overview.html.
[101] Yahoo! Finance, New Alternatives (NALFX), http://finance.yahoo.com/q?s=nalfx.

> respect to competition for access to material information. Thus, it will allow analysts to express their honest opinions without fear of being denied access to valuable corporate information being provided to their competitors. Analysts will continue to be able to use and benefit from superior diligence or acumen, without facing the prospect that other analysts will have a competitive edge solely because they say more favorable things about issuers.[102]

b. Investor Initiatives to Improve Corporate Climate Risk Disclosure.

Various coalitions of investors and environmental groups have responded to the lack of meaningful corporate climate risk information by educating themselves about climate change, seeking improved disclosure, and developing models for voluntary climate-related disclosures.

- Ceres, the largest coalition of investors, environmental and public interest organizations in North America, has organized the Investor Network on Climate Risk, a coalition representing more than $4 trillion in assets under management.[103] Globally, two other investor groups are solely focused on climate risk: the Institutional Investors Group on Climate Change (U.K.) and the Investors Group on Climate Change (Australia/New Zealand).
- The Carbon Disclosure Project is an independent, international, not-for-profit organization aiming to create a lasting relationship between shareholders and corporations regarding the implications for shareholder value and commercial operations presented by climate change. The Carbon Disclosure Project seeks information on the business risks and opportunities presented by climate change and greenhouse gas emissions data from the world's largest companies on behalf of institutional investors with a combined $41 trillion of assets under management.[104] Carbon Disclosure Project members include major financial institutions including ASN Bank, ABN Amro, HSBC, Morgan Stanley, Royal Bank of Scotland Group, and Swiss Reinsurance Company.
- The Global Reporting Initiative is an international program working to make uniform reporting on economic, environmental, and social performance as routine and comparable as financial reporting.[105] The Global Reporting Initiative's Sustainability Reporting Framework, used by over 1,000 organizations worldwide, now includes "financial implications . . . due to climate change" as a core indicator for corporate reporting.[106]

[102] Sec. & Exch. Comm'n, Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,731 (Aug. 24, 2000) (codified at 17 C.F.R. pt. 243 (2007)), *available at* http://www.sec.gov/rules/final/33-7881.htm.
[103] *See* Investor Network on Climate Risk, http://www.incr.com/.
[104] *See* Carbon Disclosure Project, http://www.cdproject.net/.
[105] *See* Global Reporting Initiative, http://www.globalreporting.org/.
[106] Global Reporting Initiative, Performance Indicators, http://www.casba.info/docs/GRIPerformanceIndicators.pdf.

- The Climate Disclosure Standards Board is an international partnership of seven organizations announced at the World Economic Forum in Davos in January, 2007. Founding members include the California Climate Registry, Carbon Disclosure Project, Ceres, The Climate Group, International Emissions Trading Association, World Economic Forum Global Greenhouse Gas Register, and World Resources Institute.[107] This coalition aims to create a reporting standard to ensure that companies "report climate change-related information in a standardized way that facilitates easier comparative analysis by investors, managers and the public."[108]

Several of these groups have already sought Commission action to clarify existing disclosure obligations regarding climate risk. On March 19, 2007, 65 institutional investors, foundations and companies managing $4 trillion issued a Call to Action asking for strong federal climate legislation.[109] In the Call to Action, investors specifically asked for "[g]uidance from the Securities and Exchange Commission and other financial regulatory bodies to businesses and investors on what material issues related to climate change companies should disclose in their regular financial reporting, so that investors can assess more accurately the effects of climate risk and opportunity in their portfolios."[110]

Last year, the Investor Network on Climate Risk coordinated a group of 28 large institutional investors that wrote the Commission to request a clarifying statement that publicly traded corporations must disclose the financial risks presented by climate change.

The Investor Network on Climate Risk letter signatories include innovative investment funds such as Trillium in the United States and F&C Asset Management in the UK; state treasurers, controllers, and public employee pension funds from New York, New Jersey, California, Oregon, Vermont, Connecticut, Kentucky and British Columbia; four major unions representing over 3 million workers; and many other investors. Together they asked the Commission to take the following steps to improve corporate disclosure:

- Enforce existing disclosure requirements on material risks such as climate change, which are underreported;

[107] *See* Press Release, World Econ. Forum, New Consortium Created to Develop Standard Framework for Company Reporting of Climate Risks (Jan. 26, 2007), *available at* http://www.weforum.org/en/media/Latest%20Press%20Releases/emissions_press_release.

[108] *See id.*

[109] CERES & INVESTOR NETWORK ON CLIMATE RISK, CAPITAL TO THE CAPITOL: INVESTORS AND BUSINESS FOR U.S. CLIMATE ACTION (Mar. 19, 2007), *available at* http://www.ceres.org/pub/docs/Call_to_action.pdf.

[110] *See id.* at 1.

- Strengthen current disclosure requirements, for example by providing interpretive guidance on the materiality of risk posed by climate change; and

- Revise or change the Staff's interpretation of Rule 14a-8's "ordinary business" exclusion to require a registrant to include in its proxy statement a shareholder proposal asking the registrant to report on financial risks due to climate change.[111]

Investor groups, including Investor Network on Climate Risk, the Institutional Investors Group on Climate Change, the Investor Group on Climate Change, the Carbon Disclosure Project and the Global Reporting Initiative, all participated in the Climate Risk Disclosure Initiative, an effort to improve corporate disclosure of the risks and opportunities posed by global climate change. That initiative culminated in the October 2006 release of the Global Framework for Climate Risk Disclosure. The framework is a statement of investor expectations for comprehensive corporate disclosure of four types of climate-related information:

1. Emissions: "As an important first step in addressing climate risk, companies should disclose their total greenhouse gas emissions. Investors can use this emissions data to help approximate the risk companies may face from future climate change regulations."

2. Strategic Analysis of Climate Risk and Emissions Management: "Investors are looking for analysis that identifies companies' future challenges and opportunities associated with climate change. Investors therefore seek management's strategic analysis of climate risk, including a clear and straightforward statement about implications for competitiveness. Where relevant, the following issues should be addressed: access to resources, the timeframe that applies to the risk, and the firm's plan for meeting any strategic challenges posed by climate risk."

3. Assessment of the Physical Risks of Climate Change: "Climate Change is beginning to cause an array of physical effects, many of which can have significant implications for companies and their investors. To help investors analyze these risks, investors encourage companies to analyze and disclose material, physical effects that climate change may have on the company's business and its operations, including their supply chain."

4. Analysis of Regulatory Risks: "As governments begin to address climate change by adopting new regulations that limit greenhouse gas emissions, companies with direct or indirect emissions may face regulatory risks that could have significant

[111] Petition from Investor Network on Climate Risk to Chairman Cox, Sec. and Exch. Comm'n (June 14, 2006), *available at* http://www.ceres.org/pub/docs/Ceres_INCR_SEC_letter_061406.pdf.

implications. Investors seek to understand these risks and to assess the potential financial impacts of climate change regulations on the company."[112]

Shareholders are also pressing for disclosure from individual companies. Forty-five shareholder resolutions specifically related to climate change or renewable energy have been filed to date in 2007. These petitions accounted for over ten percent of all shareholder resolutions submitted this year. Shareholder resolutions have been filed by Calvert Asset Management, New York City's pension funds, the American Federation of State, County, and Municipal Employees, Trillium Asset Management, Service Employees International Union, among many others.[113]

c. International Efforts to Improve Climate Risk Disclosure.

The insistent chorus demanding more information on climate risk in American markets reflects the growing demand for this information around the world.[114] An increasing number of foreign nations are issuing specific guidance on climate risk disclosure through accounting bodies or government agencies.

- In 2005, the Canadian Institute of Chartered Accountants issued the first climate risk disclosure guidance by an accounting body, "MD&A Disclosure about the Financial Impact of Climate Change and Other Environmental Issues."[115] This guidance provides best practices for climate risk disclosure and outlines existing regulatory requirements that apply to climate and environmental risk disclosure.
- The E.U. Accounts Modernization Directive (2004/109/EC)[116] outlines companies' needs to disclose environmental Key Performance Indicators (KPIs), where appropriate, including climate change statistics.
- The UK Department for Environment, Food and Rural Affairs has issued guidance that outlines best practices for companies using these KPIs.[117] These guidelines describe how

[112] CERES, *supra* note 37, at 8.
[113] Carolyn Mathiasen, *2007 Proxy Season Preview: Environmental Issues*, Governance Weekly, INSTITUTIONAL SHAREHOLDER SERVS., http://www.issproxy.com/governance_weekly/2007/004.html.
[114] GRI/KPMG STUDY, *supra* note 43, at 8 (noting in report issued in July 2007 that "demand for focused and effective reporting on the business implications of climate change has continued to grow over the last two years").
[115] CANADIAN PERFORMANCE REPORTING BD., MD&A DISCLOSURE ABOUT THE FINANCIAL IMPACT OF CLIMATE CHANGE AND OTHER ENVIRONMENTAL ISSUES (Oct. 2005), *available at* http://www.cica.ca/client_asset/document/3/5/2/0/3/document_534147DD-E5C6-3AE6-59CB372755E43A4A.pdf.
[116] *See* Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004, 390 OFFICIAL J. EUR. UNION 38, http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2004:390:SOM:EN:HTML.

environmental data, including climate related data and greenhouse gas emissions, should be measured and reported, helping companies to meet the narrative reporting requirements outlines in the Company Law Reform Bill.

Clarification of the need to disclose material climate risks under U.S. law would be consistent with the Commission's increasing emphasis on harmonizing disclosure requirements with international standards. As the Commission recognized in its recent concept release on this subject, U.S.-listed firms benefit from "comparability of information across national borders."[118] If American firms do not provide the same level of climate-related disclosure as their international counterparts, there is a risk that they will find themselves at a disadvantage in a global financial market in which investors are aggressively seeking to identify those firms best prepared to take advantage of the new opportunities, and avoid the risks, of a carbon-constrained business environment.

d. Climate Risk Disclosure Is Needed to Allow Investors to Fulfill Their Fiduciary Duties.

For the many investors who invest on behalf of others, demanding better disclosure of companies' climate-related risks is consistent with their fiduciary duties. The standard of prudence to which investing fiduciaries are held is rooted in common law and further defined by the Restatement (Third) of Trusts and the Uniform Prudent Investor Act (UPIA) drafted by the National Conference of Commissioners on Uniform State Laws.[119] Forty-four states and the District of Columbia have adopted a prudent investor rule based upon these two sources to govern and guide a trustee's actions.[120] Investment advisors have been held to similar standard of conduct.[121] And federal regulation of pension trusts has absorbed the prudent-investor rule by way of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 et seq., which

[117] *See* DEP'T FOR ENV'T, FOOD & RURAL AFFAIRS, ENVIRONMENTAL KEY PERFORMANCE INDICATORS: REPORTING GUIDELINES FOR UK BUSINESS (2006), *available at* http://www.defra.gov.uk/environment/business/envrp/pdf/envkpi-guidelines.pdf.
[118] Sec. and Exch. Comm'n, Release No. 33-8831, Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Accounting Standards, 72 Fed. Reg. 45,600 (Aug. 14, 2007).
[119] *See* Robert J. Aalberts & Percy S. Poon, *Derivatives and the Modern Prudent Investor Rule: Too Risky or Too Necessary?*, 67 OHIO ST. L.J. 525, 525-26 (2006).
[120] *See id.* at 526 nn.4-5.
[121] *See* Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17-19 (1979) (recognizing a private right of action against investment advisors under the Investment Advisors Act of 1940 for breach of fiduciary duties).

incorporates the principle in section 1104(a).[122] Corporate directors have a fiduciary duty of care to shareholders that mirrors the prudent-investor standard.[123]

UPIA and the Restatements (Third) of Trusts reiterate the traditional requirement that the prudent investor must consider the surrounding economic circumstances relevant to an investment.[124] For many companies, the climate-related risks described in this petition are part of those economic circumstances. Long investment horizons, like those of pension funds, sharpen the need to consider climate-related risks in making investment decisions, as the physical effects of climate change, even in the best-case scenario, and the proliferation of greenhouse gas regulation, will be influencing businesses and development for the next century and beyond.

The modern prudent-investor rule also includes a duty to diversify,[125] and to consider the investment portfolio as a whole rather than a set of isolated investments.[126] The risks presented to companies by global climate change may well tie investments together in ways not before considered. For example, a portfolio with heavy investment in a single geographical region, though spread across several industrial sectors, may not be sufficiently diverse if that region is vulnerable to physical effects of climate change such as increasing storm frequency and intensity, rising sea levels, or potential water shortage.

The "prudent investor," who provides the standard for fiduciary duty, would be concerned about various forms of climate risk affecting many companies. The current state of scattered and inconsistent disclosures concerning climate risks, described in the following section, hinders investors' ability to fulfill this duty.

[122] *See* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110-11 (1989) ("ERISA's legislative history confirms that the Act's fiduciary responsibility provisions . . . codif[y] and mak[e] applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts."); UNIF. PRUDENT INVESTOR ACT, 7B U.L.A. 18 (prefatory note) (discussing implications for charitable and pension trusts).
[123] *See, e.g.*, Jackson v. Ludeling, 88 U.S. 616, 616 (1874) ("The managers and officers of a company where capital is contributed in shares, are in a very legitimate sense trustees, alike for its stockholders and its creditors, though they may not be trustees technically and in form"); Loft, Inc. v. Guth, 2 A.2d 225, 238 (Del. Ch. 1938) ("[T]he directors of a corporation stand in a fiduciary relation to the corporation and its stockholders. Their acts are subject to be tested by the familiar rules that govern the relations of a trustee to his cestui que trust").
[124] *See, e.g.*, Harvard College v. Amory, 26 Mass. (9 Pick.) 446, 461 (1830) (stating that investors of prudence consider the "probable income, as wells as the probable safety of the capital to be invested").
[125] *See* UNIF. PRUDENT INVESTOR ACT § 3; RESTATEMENT (THIRD) OF TRUSTS § 227(b).
[126] *See* UNIF. PRUDENT INVESTOR ACT § 2(b); RESTATEMENT (THIRD) OF TRUSTS § 227(a).

5. Climate Risk Is Not Being Adequately Disclosed.

Despite growing investor demands, many companies currently release little information about their exposure to climate risk and their preparedness to address those risks. Even in industries characterized by very high greenhouse gas emissions, and in those subject to direct regulation of those emissions, registrants' 10-K reports often contain only cursory descriptions of climate risks, if they contain any description at all. Among those companies that are currently disclosing information about climate risks, there is very little consistency in the format or level of detail of information presented. Lack of consistency in disclosures makes it difficult or impossible for investors to compare different corporations' respective exposures to and preparedness for climate change in order to make informed investment decisions. Voluntary disclosures of climate risks by a handful of corporations, through such means as "sustainability reports," have proven somewhat more revealing than 10-K reports. But these voluntary efforts do not meet the market's need for consistent and uniform information that will allow investors to compare and evaluate corporations' exposure to climate risk.

a. SEC Filings.

Current corporate practices on climate disclosures in SEC filings vary widely from complete silence to detailed discussions of emissions, risks and plans. The most systematic review of disclosure practices now available is contained in annual surveys prepared by Michelle Chan-Fishel for Friends of the Earth for the years 2001 through 2006. Friends of the Earth reviewed the 10-K reports of corporations in the automobile, insurance, oil and gas, petrochemical, and utilities sectors in each of those years.

This longitudinal study provides a telling perspective on the progress of climate change disclosure practices. Copies of the fifth and most recent Friends of the Earth report, *Fifth Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies*, October 2006 (hereinafter Fifth Survey), are being submitted with this petition.[127] The Fifth Survey reviewed both the rate at which 112 publicly traded companies in five industrial sectors included any mention of climate risk—even if only

[127] MICHELLE CHAN-FISCHEL, FRIENDS OF THE EARTH, FIFTH SURVEY OF CLIMATE CHANGE DISCLOSURE IN SEC FILINGS OF AUTOMOBILE, INSURANCE, OIL & GAS, PETROCHEMICAL, AND UTILITIES COMPANIES (2006) [hereinafter FIFTH SURVEY], *available at* http://www.foe.org/camps/intl/SECFinalReportandAppendices.pdf.

fragmentary—in their required disclosures, and the quality of those disclosures. The following excerpt summarizes some of its key findings:

> *Reporting Rates*
>
> The overall climate reporting rate is 49 percent (2005 SEC filings), compared with 26 percent in 2000. However, reporting rates between the various sectors vary substantially. Over the past five years, dramatic improvement has occurred among the oil and gas sector, which now has an impressive reporting rate of 78 percent today, compared with 37 percent five years ago. Notably, the electric utilities sector achieved complete reporting rate with 100 percent of the utilities surveyed providing climate risk; five years ago only half of the electric utilities offered climate reporting to shareholders.
>
> Unfortunately, disclosure rates in other sectors are holding steady and remain much lower, with significant underreporting among insurance and petrochemicals sectors. Only 19 percent of insurers and 28 percent of petrochemicals companies provided climate reporting, and these rates have remained relatively flat over the past few years. Reporting rates are also low and flat among the auto industry; 26 percent of auto manufacturers, including most of the auto majors, provide climate reporting. Finally, the report finds that with the exception of the utilities industry, European companies continued to report at much higher rates than their U.S. counterparts, reflecting the advances in climate policies outside the U.S.
>
> *Quality of Reporting*
>
> The quality of climate reporting has generally improved, although it still varies widely between companies. The most common types of climate reporting include discussion of the Kyoto Protocol and other climate legislation/regulations, the financial impact of these policies on the company's sector and business, and the firm's response to these policies. Companies are also increasingly disclosing carbon dioxide emissions, and highlighting climate issues by dedicating discrete sections to this topic in SEC filings, or listing climate change as a Key Risk or Risk Factor. In addition, a few companies now provide governance-related information on how they are managing climate risk.
>
> The survey also finds that companies differ in their assessment of financial risks posed by climate change. While about 16 percent of reporting companies avoided the "bottom line" question, the remainder of climate reporters tried to address how climate policies could impact them: 9 percent of reporting companies addressed this question by simply saying that it was impossible to predict the financial impact of climate risks. 49 percent of climate reporters admitted that climate-related risks could indeed pose a material adverse impact on the firm or create significant new costs, even though these costs were often difficult to estimate. 15 percent of companies said that climate risks would have mixed results on their firm, while 11 percent concluded that global warming would pose little or no impact.

Fifth Survey, Executive Summary.

The Appendices to the Fifth Survey contain excerpts of corporate disclosures that illustrate the broad variety in the level of information disclosed. Among those companies that addressed climate change in 10-K reports, various disclosures included general descriptions of existing laws on greenhouse gases, actual emissions data, conclusory statements about the impossibility of determining the cost of potential regulations, and, in some cases, company-specific assessment of impact of greenhouse gas limitations. This inconsistent patchwork of disclosure is just the type of problem that led the major accounting firms to petition the Commission in December 2001 for clarification of the MD&A requirements. Then, the accounting firms noted that "[w]hile many registrants provide high quality, transparent disclosures, many other public companies provide boilerplate or very high-level disclosures that provide little or no meaningful information."[128] Just as the SEC responded to this request in its various Sarbanes-Oxley interpretive releases, we call on the Commission to provide guidance to clarify that companies must file meaningful, transparent disclosures on climate risk that will allow investors to make informed decisions.

The inconsistent and inadequate state of current climate risk disclosure documented in the Fifth Survey reflects corporate disclosure of environmental risks in general. In 2004, Senators Jeffords, Corzine and Lieberman requested that the Government Accountability Office review the state of environmental disclosures in SEC filings. The resulting report, *Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information*,[129] made the following observations about the difficulty of assessing environmental disclosures:

> Assessing companies' disclosure of environmental information is difficult, primarily because researchers have no way of knowing what environmental information is (1) potentially subject to disclosure and (2) material in the context of a company's specific circumstances, and therefore required to be reported. Because company records are generally not publicly available, it is virtually impossible for an external party to know what information companies should be disclosing.[130]

[128] Petition of Arthur Andersen LLP et al. to Sec. & Exch. Comm'n for Issuance of Interpretive Release (Dec. 31, 2001), *available at* http://www.sec.gov/rules/petitions/petndiscl-12312001.htm.
[129] GOV'T ACCOUNTABILITY OFFICE, *supra* note 75.
[130] *Id.* at 13.

The GAO further noted the limitations of environmental reporting:

> One of the consequences of disclosure requirements that are subject to interpretation—and of not having direct access to company records—is the difficulty of determining with any certainty whether a low level of disclosure indicates that the company does not have existing or potential environmental liabilities, has determined that such liabilities are not material, or is not adequately complying with disclosure requirements. The varying formats used for disclosure pose another problem for researchers. Much of the environmental information that is subject to disclosure can be reported in a number of different sections of the 10-K filing, including the financial statements, related footnotes, and various narrative sections of the report. In addition, the information may be stated in general or specific terms and companies often use different terminology to describe similar issues.[131]

Current practices on environmental disclosure all too often leave investors in the dark about the financial implications of environmental issues and liabilities. Without a clear statement from the Commission on the need to disclose climate risks, this existing, inadequate model of environmental liability disclosure provides the model for climate risk disclosures as well. This model is simply too limited to accurately reflect the financial issues raised by climate change or to provide investors the information they need to make sound investment decisions.

b. Voluntary Climate Disclosures.

In the absence of consistent reporting of climate risks in required SEC filings, investor and environmental groups have resorted to asking companies directly about their climate risks. Many of the consortiums described above in Part 4 have made requests for voluntary disclosure of climate information. Most recently, Ceres and Calvert issued a January 2007 report on the results of a questionnaire based on the Carbon Disclosure Project sent to all S&P 500 companies in 2006. The report, *Climate Risk Disclosure by the S&P 500*,[132] made the following key findings about companies' voluntary disclosures in response to this survey:

- *Poor Response Compared to Overseas Companies*: U.S. companies lag well behind their foreign competitors in climate risk disclosure. Only 47 percent of the S&P 500 companies answered the Carbon Disclosure Project questionnaire, as opposed to 72 percent among the FT 500. The companies who are likely to have received the questionnaire in past years had a higher response rate—67 percent—than the companies that received the questionnaire for the first time in 2006, 31 percent of which responded. Low response rates among U.S. companies make company-to-company comparisons—both domestically and globally—very difficult for investors evaluating climate risk.

- *Ignoring Investors' Right to Know*: Seventy companies that responded to the questionnaire—nearly a third of the respondents—did not allow their responses to be made public. As a result, only the 225 signatories to the CDP have access to those responses. Given that climate change poses risks to all investors, it would be greatly preferable for companies to make their disclosures public.

- *Poor GHG Emissions Management*: Eighty percent of the companies that responded (182 companies) addressed the need to reduce greenhouse gas emissions, but only a quarter (59 companies) disclosed measurable emissions reductions targets and specific time frames for reduction.

- *Physical Impacts Not on Radar Screen*: Nearly 75 percent of the responding companies (171 companies) acknowledged bottom-line risks associated with extreme weather events such as hurricanes, fires and floods. However, very few companies link more extreme weather to climate change and fewer still—only four percent—disclosed strategies for mitigating and adapting to the growing physical impacts from climate change.

- *Healthcare, Banks, Telecoms, and Others Ignoring Climate Change*: Companies in the highest greenhouse gas emitting sectors such as the electric power and oil industries showed the highest quality disclosure, while most companies in sectors with lower emissions, such as healthcare, retailers, and banks, have been largely unresponsive to the financial risks they face from climate change.

- *Responses Inadequate Relative to the Global Framework*: When compared with the Global Framework for Climate Risk Disclosure, S&P 500 companies that responded to the questionnaire provided only about one quarter of the information investors are looking for. Companies provided more information about qualitative measures such as corporate governance than they did about quantitative measures such as emission reduction goals or the impact of regulations that would impose a cost of carbon.

[131] *Id.* at 17. The GAO recommended that the SEC implement new practices to aid the public in evaluating deficiencies in environmental disclosures such as producing a database of SEC comment letters and company responses. The GAO also advised the SEC to coordinate more effectively with EPA on data sharing relevant to environmental disclosure. *Id.* at 36-37.

[132] *See* CARBON DISCLOSURE PROJECT, *supra* note 62, at 1-2.

Some companies that have not included any information on climate risks in their SEC filings have responded to requests for voluntary disclosure with substantive information. For example, Friends of the Earth reports that Chevron did not *mention* climate change in its 2005 SEC filings, but responded to a Carbon Disclosure Project survey that year with "a fourfold action plan that is now in its fourth year."[133] Other companies follow this same pattern of leaving climate risks out of SEC filings but responding to specific requests for climate information. While we applaud those companies that participate in voluntary reporting and that respond to information requests on climate risks, these venues by themselves will not meet the market's demand for standardized, transparent information that is freely available to all investors.

Some companies have chosen to include climate risk in voluntary sustainability reports or more general corporate responsibility reports, often filed in response to shareholder activism. These outlets for informal disclosure often include additional information on environmental trends and business strategies. Sustainability reports often have a public relations cast, and are primarily directed towards an audience of environmental interest groups and the general public, rather than investors. These reports more often acknowledge the science of climate change and discuss efforts to build awareness rather than presenting the specific effects of climate change on their performance and operations. A recent study found that "while almost all companies reported on climate change in their sustainability reports, on closer examination companies reported far more on potential opportunities rather than financial risks for their companies from climate change."[134] Moreover, these forms of disclosure have no standardized format or repository to allow investors to make comprehensive, rigorous judgments to support their investment decisions.

Like the cooperative voluntary efforts to standardize the format and content of climate risk disclosure, sustainability reports provide a solid foundation on which the companies can base the disclosures required under the Commission's existing reporting requirements. But in order to provide the information investors require, reporting must be consistent and must support comparisons among companies. The 10-K report is and will remain the gold standard for reporting information to investors, and investors need to know that material information relating

[133] FIFTH SURVEY, *supra* note 127, at 36.
[134] GRI/KPMG STUDY, *supra* note 43, at 5.

to companies' performance and operations will be in those required reports. Given the significance of climate risks for many corporations' financial position and competitive prospects in a new, carbon-constrained environment, reporting on climate issues is no longer a mere virtue, but a legal obligation and a necessity for investors.

6. The Commission Should Clarify Corporate Obligations to Disclose Climate Risk.

a. The Commission Should Issue an Interpretive Release Clarifying the Application of Existing Law to Climate Risks and Setting Forth the Elements of Climate Risk Disclosure.

The Commission has on many occasions issued guidance to explain its disclosure rules, and to ensure that corporate disclosure practices comply with statutory and regulatory standards and take account of new legal and other developments.[135] We join past petitioners who have requested an interpretive release affirming the obligation to disclose material climate-related information.

As described above, the current state of climate risk disclosure is inconsistent and inadequate. There is apparently little consensus among reporting corporations, their auditors and lawyers about what is required in climate disclosures. As a result, investors are being deprived

[135] *See, e.g., supra* Part 2.b (discussing recent releases concerning various matters including MD&A obligations). The Commission has issued numerous releases concerning disclosure of information regarding environmental risks. *See, e.g.*, Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427 (May 24, 1989); Environmental Disclosure, Securities Act Release No. 6130 (Sept. 27, 1979); Relating to Environmental Disclosure, Securities Act Release No. 5704, Fed. Sec. L. Rep. (CCH) ¶ 80,495 (May 6, 1976); Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Exchange Act Release No. 9252, 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507 (July 19, 1971); Exchange Act Release No. 10116, 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507 (July 19, 1971); Notice of Commission Conclusions and Final Action on the Rulemaking Proposals Amended in Securities Act Release No. 5627 (Oct. 14, 1975); Holding Company Act Release No. 16224 (Dec. 3, 1968); SEC Staff Accounting Bulletin No. 92, 58 Fed. Reg. 32,843 (1993). In issuing guidance concerning the relationship of environmental issues to disclosure obligations, the Commission has pointed to it own obligations under the National Environmental Policy Act, which requires all federal agencies, "to the fullest extent possible," to interpret and administer federal policies, regulations, and public laws in accordance with the NEPA's environmental protection policies. *See* 42 U.S.C. § 4332 (2000); *see also* Securities Act Release No. 6130 at 2 ("As a matter of policy, in light of its mandate under the National Environmental Policy Act of 1969 to consider environmental values and its mandate under the federal securities laws for investor protection, the Commission 'has issued several releases alerting public companies of their legal obligation to disclose any and all environmental . . . information that would be material to investors or shareholder.'") (quoting SEC Reply Brief, Natural Res. Def. Council v. Sec. & Exch. Comm'n, 389 F. Supp. 689 (D.D.C. 1974)).

of the information critical to their ability to assess firms' preparedness to adjust to the regulatory and physical implications of climate change and to make informed investment decisions. The current disarray in climate disclosures merits Commission action beyond a simple statement that climate risk is, for instance, a known trend or uncertainty that must be addressed in MD&A (although the state of disclosure suggests that even that limited statement would provide some guidance). We urge the Commission to go further and to set forth the elements of disclosure appropriate for those companies that determine that climate risk has a material impact on their performance and operations.

Specifically, we respectfully request the Commission issue an interpretive release clarifying that registrants, in preparing their periodic mandatory public disclosures, must carefully review the implications of climate change for their financial condition and operations, and must disclose climate risks that are material. As in other areas, the nature of the disclosures that are required will depend upon the circumstances. For some registrants, climate risks may qualify as material contingent liabilities that must be disclosed on the balance sheet or in notes to financial statements. In other instances, registrants will be obligated to discuss climate risks in their disclosures under Items 101, 103, or 303 to Regulation S-K, particularly as part of MD&A disclosures.

The growing empirical evidence and understanding of global warming and the rapid growth of greenhouse gas regulation at all levels of government in recent years mean that no registrant—including those in sectors with relatively low direct emissions that are subject to fewer obvious climate-related risks in the short term—can brush climate change aside as, categorically, too remote or uncertain to have material consequences that must be disclosed to investors. Thus, the Commission's guidance should explain that all registrants should review the adequacy of their internal mechanisms for gathering information about, and assessing, climate risk, and should establish institutional mechanisms necessary to ensure careful and well-informed review of potential climate risks. As the Commission has explained, the assessment of materiality requires thorough consideration of all relevant information, whether or not that information itself meets the materiality standard.[136]

[136] Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056 (Dec. 29, 2003).

To identify and evaluate climate risks related to greenhouse gas regulation, a registrant must be informed about the magnitude of its greenhouse gas emissions. Registrants will therefore need, as part of their examination of potentially material climate risks, to determine the current and projected greenhouse gas emissions associated with their facilities and operations. Because one of the ways in which greenhouse gas regulation may affect a firm is by increasing costs of purchases or distribution, registrants should review greenhouse gas emissions associated with their entire production cycle. Registrants should also review the requirements of any international, national, state, or local greenhouse gas regulations that are in place, or probable, in the jurisdictions in which the operate, and assess the impact of those regulations, in light of their greenhouse gas emissions, upon their financial condition and operations. An understanding both of current and projected greenhouse gas emissions levels, and of present and probable regulations concerning greenhouse emissions, is a necessary prerequisite for the registrant to determine whether it faces "material opportunities, challenges and risks" relating to climate change, and to inform the analysis in its disclosures.

The Commission should clarify that, after performing a close and well-informed review of the full range of relevant information concerning potential climate risks, registrants must disclose any such risks that are found to be material, including:

- Physical risks associated with climate change;
- Financial risks and opportunities associated with present or probable greenhouse gas regulation; and
- Legal proceedings relating to climate change.

The guidance we propose is similar in form to guidance the Commission and its staff have previously provided concerning various issues relating to required disclosures under the securities laws and regulations. It is vitally important, in light of the inadequate state of climate disclosure to date and the recent developments underlining the importance of climate risk for many companies, that the Commission clarify for registrants that climate risk demands the same careful attention given to other forms of risk. Further discussion of the guidance we request is set forth in Appendix G.

b. Complying with Climate Risk Disclosure Requirements Will Not Be Unduly Burdensome.

Requiring companies to disclose climate-related information in their mandatory reports in accordance with long-settled legal principles will not impose an undue burden. The inherent flexibility of the Commission's disclosure regulations and the materiality standard allows firms to tailor disclosure to their particular circumstances. As Commission Staff has stated, "[c]ompanies must determine, based on their own particular facts and circumstances, whether disclosure of a particular matter is required in MD&A."[137]

Disclosure of climate risks requires, as a first step, assembling the relevant information—including current and projected emissions levels, applicable regulatory requirements, and information about climate-related physical and market risks that may affect the company—and a careful review of the implications of that information for the company's operations and financial condition.

Tabulating the company's greenhouse gas emissions is a straightforward exercise that is an indispensable preliminary step toward a meaningful assessment of whether climate change poses risks to a corporation.[138] The Greenhouse Gas Protocol, a peer-reviewed mechanism developed by the World Business Council for Sustainable Development and the World Resources Institute, with input from hundreds of experts from business, government, and accounting, contains detailed procedures for calculating a company's greenhouse emissions.[139] This protocol has been adopted by the International Standards Organization and used by hundreds of companies and industry groups to measure their greenhouse gas emissions.[140]

Several states already require that some companies calculate and report their greenhouse gas emissions or have passed laws that will impose such requirements on various sources of

[137] *Id.*
[138] *See* Lash & Wellington, *supra* note 37, at 101-02 (noting that calculating firm's GHG emissions is a "quantitative and relatively straightforward task"); Inho Choi, *Global Climate Change and the Use of Economic Approaches: The Ideal Design Features of Domestic Greenhouse Gas Emissions Trading with an Analysis of the European Union's CO_2 Emissions Trading Directive and the Climate Stewardship Act*, 45 NAT. RES. J. 865, 904 (2005) (noting absence of technical or cost impediments to monitoring carbon emissions).
[139] *See* GHG Protocol Initiative, Corporate Standard, http://www.ghgprotocol.org.
[140] Some trade associations, including the International Aluminum Institute and the International Council of Forest and Paper Associations, have used the Protocol to develop industry-specific calculation tools.

greenhouse gas emissions within their borders.[141] Thirty-five states have joined the Climate Registry and committed to encourage emissions sources within their boundaries to report and verify their greenhouse gas emissions to the registry.[142] Under the acid rain program created by the Clean Air Act Amendments of 1990, owners and operators of electrical generating units above 25 megawatts are already required to collect and report to the Environmental Protection Agency carbon dioxide emissions data.[143] Tabulation and reporting of greenhouse gas emissions will invariably be required under any federal greenhouse gas legislation. The high percentage of companies that already calculate their greenhouse gas emissions demonstrates that this is an entirely feasible and not burdensome task for corporations to undertake. According to the Carbon Disclosure Project, 73 percent of the 360 companies in the FT500 that responded to the CDP survey reported that they already disclose their greenhouse gas emissions in some forum.[144] As noted, registrants must have this basic information concerning current and projected greenhouse gas emissions in order to assess their risks and opportunities in the new physical and legal climate.

Assessment of whether the registrant faces material risks requiring public disclosure does not impose any legal obligations beyond those long required under the securities laws and the Commission's regulations and guidance. The assessment of materiality of climate related risks is the same process that registrants have undertaken with respect to other risks. These are risks that responsible managers would surely examine even in the absence of regulatory requirements: potential physical threats to assets and regulatory and market developments that are likely to have material effects on the company's financial condition and operations.

Climate risk is in this way no different from other known trends and uncertainties that the Commission requires companies to address, as set forth in past interpretive releases and the precedents discussed above in Section 2: "[A] disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely

[141] *See* Appendix B.
[142] *See* The Climate Registry, Principles and Goals, http://www.theclimateregistry.org/principlesgoals.html.
[143] *See* 40 C.F.R. § 75.10 (2007).
[144] CARBON DISCLOSURE PROJECT, CARBON DISCLOSURE REPORT 2006: GLOBAL FT500 at 6 (2006), *available at* http://www.ethosfund.ch/upload/publication/p169e_060930_Carbon_disclosure_Project_Report_Global_FT.pdf; *see also* CARBON DISCLOSURE PROJECT, *supra* note 62.

to have material effects on the registrant's financial condition or results of operation."[145] The fact that some companies have been disclosing climate risk in their SEC filings, in voluntary survey responses, and in sustainability reports, demonstrates that climate disclosure is not beyond the reach of registrants.

c. The Commission Should Provide the Requested Guidance Promptly.

For investors, this moment in the economy's response to climate change is critical. Policies and practices companies adopt, and strategic business decisions they make now, will greatly affect their position as greenhouse gas regulations and the physical impacts of climate change become more pervasive. Companies that take steps now to minimize climate risk and exploit new opportunities afforded by climate change will be far better positioned than those that are slow coming to terms with climate issues. As with other major new developments with broad impacts for the entire business world—such as the transformation in information technology or rising health care costs—investors need to identify firms that are leading and those that are trailing their competitors. Inconsistent and incomplete disclosure of climate risk prevents investors from fully evaluating and comparing among investments. Every earnings season that passes without consistent disclosure of climate risk harms investors.

As explained above, the relief we seek consists of clarification of existing regulatory standards rather than new substantive law. Such clarification could consist simply of a clear affirmation that (1) in light of recent developments, registrants must give close and well informed attention to potential climate risks that may affect them, and (2) registrants must, consistent with established law, disclose material information relating to the impacts of climate change and greenhouse gas regulation upon their financial condition and operations. We believe that the guidance we seek, and the prompt action we call for, would not entail an undue burden for the Commission or its staff, particularly when measured against the large benefits this guidance would have for investors and markets in need of information on climate risk.

[145] Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427 (May 24, 1989).

Respectfully submitted,

California Public Employees' Retirement System

John Chiang
California State Controller

California State Teachers' Retirement System

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Alex Sink
Chief Financial Officer
State of Florida

Michelle Chan-Fishel
Friends of the Earth

Jonathan Miller
Kentucky State Treasurer

David G. Lemoine
Maine State Treasurer

Nancy K. Kopp
Maryland State Treasurer

Lance E. Lindblom
President, CEO & Trustee
The Nathan Cummings Foundation

Orin Kramer
Chair
New Jersey State Investment Council

William C. Thompson, Jr.
New York City Comptroller

Andrew M. Cuomo
Attorney General
State of New York

Thomas P. DiNapoli
New York State Comptroller
New York State Common Retirement Fund

Richard Moore
Treasurer
State of North Carolina

Randall Edwards
Treasurer
State of Oregon

Julie Gorte
Senior Vice President for Sustainable Investing
Pax World Management Corporation

Frank T. Caprio
General Treasurer
State of Rhode Island

Jeb Spaulding
Treasurer
State of Vermont

DATE: September 18, 2007

PETITION SIGNATORIES

California State Controller, John Chiang

The Controller serves as the independent Chief Fiscal Officer of California, the eighth largest economy in the world. As the state's fiscal watchdog, the Controller provides sound fiscal control over more than $100 billion in annual receipts and disbursements of public funds, uses audit authority to uncover fraud and abuse of taxpayer dollars, and provides fiscal guidance to local governments. The Controller presides over the Franchise Tax Board, and is a trustee of the California Public Employees' Retirement System (CalPERS) Board and the California State Teachers' Retirement System (CalSTRS) Board, the nation's first and second largest public pension funds with a combined portfolio of $400 billion. The Controller serves on a total of 76 state boards and commissions that significantly impact the state's economic health in areas such as development, employment, housing and the environment.

California Public Employees' Retirement System

CalPERS is the nation's largest public pension fund with more than $245 billion in assets. It provides retirement and health benefits to approximately 1.5 million California State, local agency and schools employees and their families. For more about CalPERS, visit www.calpers.ca.gov.

California State Teachers' Retirement System

With a $170 billion investment portfolio, the California State Teachers' Retirement System is the second-largest public pension fund in the United States. It administers retirement, disability and survivor benefits for California's 795,000 public school educators and their families from the state's 1,400 school districts, county offices of education and community college districts.

California State Treasurer, Bill Lockyer

The Treasurer serves on the boards of the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). With more than $390 billion in combined assets, CalPERS and CalSTRS rank among the world's

largest institutional investors. As such, they hold substantial stakes in the U.S. and global economics, and in the risk profiles of the corporations in which they invest. As a member of both funds' governing boards, the Treasurer shares their interests. The Treasurer's Office also manages the State's Pooled Money Investment Account (PMIA), which has $65.6 billion in taxpayer funds on hand at the end of June 2007. The PMIA invests monies on behalf of state government and more than 2,606 local jurisdictions. Additionally, the Treasurer chairs the governing board of California's 529 college savings plan, called ScholarShare. Currently, ScholarShare has a portfolio of 190,000 accounts and $2.6 billion in assets.

Ceres

Founded in 1989, Ceres is a leading network of investors, environmental groups and other public interest organizations working with companies to address sustainability challenges. Ceres also directs the Investor Network on Climate Risk, comprised of more than 50 institutional investors who collectively manage $4 trillion in assets.

Environmental Defense

Environmental Defense is a leading national nonprofit organization representing more than 500,000 members. Since 1967, we have linked science, economics and law to create innovative, equitable and cost-effective solutions to society's most urgent environmental problems. Environmental Defense is dedicated to protecting the environmental rights of all people, including future generations. Among these rights are access to clean air and water, healthy and nourishing food, and a flourishing ecosystem. Guided by science, Environmental Defense evaluates environmental problems and works to create and advocate solutions that win lasting political, economic and social support because they are nonpartisan, cost-efficient and fair. Environmental Defense is committed to achieving climate stabilization.

F&C Management

F&C Management is a United Kingdom-based active manager with just over $200 billion in assets under management (as of June 30, 2007). With headquarters in London, F&C has substantial holdings in US corporations. In addition, F&C has a Boston office from which it directs all proxy voting and corporate governance activity for its US holdings. As part of its

standard investment process, F&C has a team of analysts that actively considers the risks and opportunities that companies face from climate change and other environmental and social issues that are material to long-term shareholder value.

Florida Chief Financial Officer, Alex Sink

Elected in November 2006, Chief Financial Officer Alex Sink is responsible for monitoring the state's fiscal health and manages more than $74 billion in tax revenue coming in and out of state government annually. The former President of the Bank of America for Florida, Sink's professional experience and community service have molded her into a champion for fiscal responsibility and accountability. CFO Sink administers the Department of Financial Services, which assists hundreds of thousands of consumers annually with financial service issues, including banking, securities and insurance. As the Chief Financial Officer, Sink serves as a member of the Florida Cabinet, which oversees insurance and banking regulation, the management and acquisition of state lands and 14 state agencies. A member of INCR since early 2007, CFO Sink is also one of three members of the Board of Trustees who directs the State Board of Administration. The SBA manages 30 investment funds, comprising over $184 billion in assets.

Friends of the Earth

Friends of the Earth is the U.S. voice of an influential, international network of grassroots groups in 70 countries. Founded in San Francisco in 1969 by David Brower, Friends of the Earth has for decades been at the forefront of high-profile efforts to create a more healthy, just world. Our members were the founders of what is now the world's largest federation of democratically elected environmental groups, Friends of the Earth International. Friends of the Earth is a leading expert on the issue of climate risk reporting in SEC filings, having produced five studies on the topic from 2001-2006.

Kentucky State Treasurer, Jonathan Miller

The Kentucky Treasurer's Office was created in 1792 in the state's Constitution. The Treasury Office is responsible for acting in the best interest of taxpayers and investing in the future of the state. The Treasury Office records, monitors and reconciles all transactions in the

state's depository and checking accounts, assists constituents in locating unclaimed property, makes deposits of incoming revenues, and records, verifies, and pays all federal, state and local withholding taxes for employees of the Commonwealth.

Maine State Treasurer, David G. Lemoine

The Treasurer manages cash and debt for the State of Maine, forecasts revenues for cash pool interest income, and manages the State's Unclaimed Property program. The Treasurer also provides investment oversight for NextGen, Maine's College Investing Plan and serves on the boards of the Maine Municipal Bond Bank, Maine State Housing Authority, Maine State Retirement System, Finance Authority of Maine, Adaptive Equipment Loan Program, Maine Health and Higher Education Facilities Authority, Maine Governmental Facilities Authority, Northern Maine Transmission Corporation, Maine Education Loan Authority, the Maine Public Utility Financing Bank, and the Lifelong Learning Accounts Board.

Maryland State Treasurer, Nancy K. Kopp

The State Treasurer is responsible for the management and protection of State funds and property. In this capacity, the Treasurer selects and manages the depository facilities for State funds, issues or authorizes agents to issue payments of State funds, invests excess funds, safekeeps all State securities and investments, and provides insurance protection against sudden and unanticipated damage to State property or liability of State employees. The State Treasurer plans, prepares, and advertises State of Maryland General Obligation bond issues and, through the Capital Debt Affordability Committee, reviews on a continuing basis the size and condition of State tax-supported debt and other debt of State units. The State Treasurer annually reviews the total amount of State debt that prudently may be authorized for the next fiscal year.

The Nathan Cummings Foundation

The Nathan Cummings Foundation is a private grant-making foundation committed to democratic values and the creation of a socially and economically just society. Through its endowment, currently valued at approximately $550 million, the Foundation holds shares in a broad swath of American corporations. NCF believes that the way in which these corporations approach major public policy issues can have important implications for long-term shareholder

value. The Foundation actively votes its proxies and, over the last five years, has successfully used non-binding shareholder resolutions to focus corporate attention on a number of environmental and social issues.

New Jersey State Investment Council, Orin Kramer, Chair

New Jersey's Division of Investment is one of the 10 largest public pension funds in the nation, with pension assets of $80 billion, invested to provide retirement benefits for more than 700,000 current and future retirees from public sectors across the state. The New Jersey Investment Council is the 13-member board charged with oversight and establishing policies and procedures for the Division of Investment.

New York City Comptroller, William C. Thompson, Jr.

The New York City Comptroller, an independently elected official, is the Chief Financial Officer of the City of New York; the investment adviser to the five New York City pension funds, with collective assets of $111 billion; and a trustee of four of the five funds. The mission of the office includes ensuring the financial health of New York City by advising the Mayor, the City Council, and the public of the City's financial condition. The Comptroller also makes recommendations on City programs and operations, fiscal policies, and financial transactions; performs budgetary analysis; audits City agencies; registers proposed contracts; oversees budget authorization; determines credit needs, terms, and conditions; prepares warrants for payment; and issues and sells City obligations.

New York State Attorney General, Andrew M. Cuomo

The New York State Attorney General is the State's chief law officer and is charged with enforcing environmental, investor protection, consumer, and other laws to protect the health and safety of New York's citizens, the environment they live in, and the economy of the State that contains the world's most important financial center. To carry out these responsibilities, the Attorney General conducts investigations, litigates in various courts and before regulatory and administrative agencies, and participates in rulemaking proceedings before governmental agencies.

New York State Comptroller and New York State Common Retirement Fund, Thomas P. DiNapoli

The New York State Comptroller is the sole Trustee of the New York State Common Retirement Fund ("Fund") serving over 1 million pensioners, beneficiaries and their families. The Comptroller is responsible for managing, preserving and growing the Fund and does so by investing in a number of asset classes to maximize returns, including bonds and stocks of publicly traded companies. The Fund's investment portfolio has assets totaling $154 billion making it the third largest public pension fund in the United States.

North Carolina State Treasurer, Richard Moore

Now in his second term as State Treasurer, Richard Moore is sole fiduciary for more than $75 billion in public monies and state investments, oversees the pension funds for more than 780,000 public sector employees, and manages the debt of state and local governments. The Wall Street Journal and credit-rating agency Standard & Poor's recently named North Carolina as having the second-best funded public pension system in the United States, a testament to Moore's responsible management. In 2004, he was honored as a Top Public Official of the Year by Governing Magazine for his national leadership and guidance of the state's pension fund. The Treasurer also serves on many boards and commissions, including the State Banking Commission, which he chairs, and the state boards of Education and Community Colleges.

Oregon State Treasurer, Randall Edwards

The Office of the Oregon State Treasurer is a highly sophisticated organization with a wide range of financial responsibilities, including managing the investment of state funds, issuing all state bonds, serving as the central bank for state agencies, and administering the Oregon 529 College Savings Network. The Oregon State Treasurer's Office is managed like a business, striving to save taxpayers money and earn the highest possible return on investments. State Treasurer Randall Edwards is a constitutional officer and a statewide elected official. He serves as the chief financial officer for the State and is responsible for the prudent financial management of more than $79 billion. Edwards, who took office in January 2001, is serving his second four-year term; the office is limited to two terms.

Pax World Management Corporation

Pax World, based in Portsmouth, New Hampshire, seek to invest in forward-thinking companies with sustainable business models. To identify those companies, Pax combines rigorous financial analysis with equally rigorous environmental, social and governance analysis. The result, it believes, is an increased level of scrutiny that helps it identify better-managed companies that are leaders in their industries; that meet positive standards of corporate responsibility; and that focus on the long term. Pax World avoids investing in companies that are significantly involved in the manufacture of weapons or weapons-related products, manufacture tobacco products, are involved in gambling as a main line of business, or engage in unethical business practices. Pax World's primary goal is to produce competitive returns for its investors. By integrating environmental, social and governance criteria - what it calls "sustainability" criteria - into its investment approach, the funds also seek to promote peace, protect the environment, advance equality and foster sustainable development.

Rhode Island General Treasurer, Frank T. Caprio

The General Treasurer receives and disburses all state funds, issues general obligation notes and bonds, manages the investment of state funds and oversees the retirement system for state employees, teachers and some municipal employees. He is also responsible for the management of the Unclaimed Property Division, the Crime Victim Compensation Program and the state-sponsored 529 college savings plan, the CollegeBoundfund.

Vermont State Treasurer, Jeb Spaulding

The Vermont State Treasurer's Office is responsible for the State's cash management and banking functions, investment of short-term and trust funds, bond issuance and debt management, administration of three public retirement systems and pension funds, operation of the State's unclaimed property program, and improving the financial literacy of Vermonters. In addition, the State Treasurer serves *ex-officio* on a variety of boards for quasi-public agencies and authorities, and also advises State policymakers on fiscal and economic issues.

THE SCIENCE OF CLIMATE CHANGE

The Basics of Climate Change Science

Climate change refers to a long-term rise in global average temperature. More specifically, it refers to the ongoing rise in temperature that started a century ago and is believed to be caused mainly by greenhouse gas pollution. 'Greenhouse gases' trap heat from the sun at the Earth's surface. Human activities are rapidly increasing the amount of greenhouse gases in the atmosphere, causing more heat to be trapped and increasing global temperatures. Rising temperatures have already resulted in an increase in extreme weather events, loss of sea ice and glaciers, rising sea level, and harm to wildlife. But it is not too late to avoid the most severe consequences of climate change: a sharp reduction of greenhouse gas pollution would significantly slow global warming and reduce the likelihood of dangerous and irreversible impacts.

Scientific Consensus on the Impacts of Climate Change

The recently released Intergovernmental Panel on Climate Change (IPCC) Fourth Assessment Report, a comprehensive review of the state-of-the-knowledge on climate change, highlights the overwhelming scientific consensus that human activities are contributing to changes in the climate system. This report reinforces the conclusions outlined in existing consensus statements by respected scientific organizations, such as the statement on climate change from 11 different national scientific academies, including the United States,[146] the official position statement by the American Geophysical Union,[147] and the official position statement by the American Meteorological Society.[148]

[146] *See* Joint Science Academies' Statement: Global Response to Climate Change (June 2005), *available at* http://www.royalsoc.ac.uk/displaypagedoc.asp?id=20742.
[147] Position Statement, American Geophysical Union Council, Human Impacts on Climate (Dec. 2003), *available at* http://www.agu.org/sci_soc/policy/positions/climate_change.shtml.
[148] Information Statement, American Meteorological Soc'y, Climate Change (Feb. 1, 2007), *available at* http://www.ametsoc.org/POLICY/2007climatechange.html.

The IPCC's Summaries for Policymakers from each of its three working groups outline the scientific aspects of climate change, the ongoing and predicted impacts, and opportunities for mitigation and adaptation. These summaries state that:

- "Warming of the climate system is unequivocal, as is now evident from observation of increases in global average air and ocean temperatures, widespread melting of snow and ice, and rising global average sea level."[149]

- "Most of the observed increase in global average temperatures since the mid-20th century is *very likely* due to the observed increase in anthropogenic [human-produced] greenhouse gas concentrations."[150]

- "At continental, regional, and ocean basin scales, numerous long-term changes in climate have been observed. These include changes in arctic temperatures and ice, widespread changes in precipitation amounts, ocean salinity, wind patterns and aspects of extreme weather including droughts, heavy precipitation, heat waves and the intensity of tropical cyclones."[151]

- "Impacts of climate change will vary regionally but, aggregated and discounted to the present, they are *very likely* to impose net annual costs which will increase over time as global temperatures increase."[152]

- "The most vulnerable industries, settlements and societies are generally those in coastal river flood plains, those whose economies are closely linked with climate-sensitive

[149] INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, *Summary for Policymakers*, *in* CLIMATE CHANGE 2007: THE PHYSICAL SCIENCE BASIS 5 (2007), *available at* http://ipcc-wg1.ucar.edu/wg1/Report/AR4WG1_Print_SPM.pdf.
[150] *Id.* at 10. According to the Summary for Policymakers: "...the following terms have been used to indicate the assessed likelihood, using expert judgment, of an outcome or result...*Very likely* >90%, *Likely* >66%." *Id.* at 3 n.6.
[151] *Id.* at 7.
[152] INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, *Summary for Policymakers*, *in* CLIMATE CHANGE 2007: IMPACTS, ADAPTATION AND VULNERABILITY 17 (2007), *available at* http://www.ipcc-wg2.org/index.html.

resources, and those in areas prone to extreme weather events, especially where rapid urbanization is occurring."[153]

- "Both bottom-up and top-down studies indicate that there is substantial economic potential for the mitigation of global GHG emissions over the coming decades, that could offset the projected growth of global emissions or reduce emissions below current levels."[154]

The IPCC is "the leading body for the assessment of climate change, established by the United Nations to provide the world with a clear, balanced view of the present state of understanding of climate change."[155] IPCC reports are written by teams of authors nominated by governments and international organizations. Over 800 contributing authors and 450 lead authors were involved in the writing of the Fourth Assessment, and more than 2,500 scientific expert reviewers were involved in the review process. Each Summary for Policymakers is approved line by line by relevant experts and government officials.[156]

Other resources

In addition to the attached IPCC reports, excellent and accessible summaries of the science of climate change can be found from the following resources:

- NASA's Earth Observatory website on Global Warming gives a basic overview of climate change science and findings: http://earthobservatory.nasa.gov/Library/GlobalWarmingUpdate/

- The National Center for Atmospheric Research maintains a website that explains the basics of weather and climate science: http://www.eo.ucar.edu/basics/index.html

[153] *Id.* at 12.
[154] INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, *Summary for Policymakers*, *in* CLIMATE CHANGE 2007: MITIGATION 9 (2007), *available at* http://arch.rivm.nl/env/int/ipcc/.
[155] Fact Sheet, Intergovernmental Panel on Climate Change, http://www.ipcc.ch/press/factsheet.htm.
[156] *Id.*

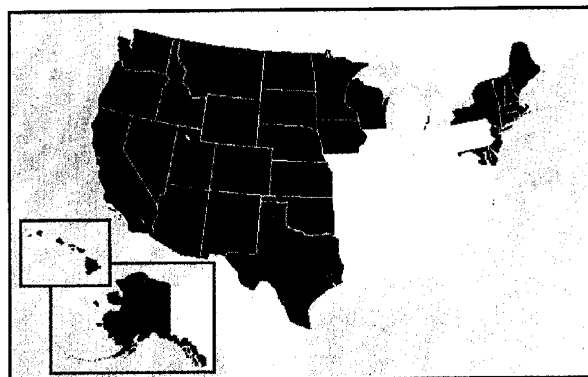
- The IPCC has published a pdf of Frequently Asked Questions that cover a number of climate science topics: http://ipcc-wg1.ucar.edu/wg1/Report/AR4WG1_Pub_FAQs.pdf

- Spencer R. Weart's Discovery of Global Warming materials, published by the of the American Institute of Physics, give a thorough history of climate change research and science: http://www.aip.org/history/climate/

REGIONAL AND STATE REGULATORY ACTIONS CONCERNING GREENHOUSE GAS EMISSIONS

This appendix illustrates the extensive geographic and programmatic diversity of state actions to reduce greenhouse gas emissions and the considerable reach of regulatory actions that currently affect business and investment decisions. It is by no means an exhaustive list of state-level climate change policies or programs.

Regional Initiatives



■ Regional Greenhouse Gas Initiative [≈ 18.9% U.S. GDP; 16.4% U.S. population]

■ Western Climate Initiative [≈ 19.6% U.S. GDP; 18.6% U.S. pop]

■ + ■ WGA Clean and Diversified Energy Initiative [≈ 34.7% U.S. GDP; 33.2% pop]

■ Powering the Plains [≈ 4.9% U.S. GDP; 5.1% U.S. population][157]

[157] GDP figures derived from News Release, Bureau of Economic Analysis, Gross Domestic Product (GDP) by State, 2006 (June 7, 2007), *available at* http://www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm; population figures derived from U.S. CENSUS BUREAU, U.S. CENSUS 2000 tbl.2 (2000), *available at* http://www.census.gov/population/www/cen2000/respop.html.

Regional Greenhouse Gas Initiative (RGGI): A consortium of nine states working toward the implementation of a cap-and-trade program aimed at reducing the CO_2 emissions form Northeastern power plants (it may be extended to cover other emissions sources in the future).[158] The first mandatory compliance period, which requires annual emissions reporting, begins in 2009; a full evaluation of power plant performance is to be done in 2012.[159] Compliance with the emissions cap set by the initiative will be enforced by the state environmental agencies.[160] Participants in RGGI currently include Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, and Vermont.[161] The District of Columbia, Massachusetts, Pennsylvania, Rhode Island, the Eastern Canadian Provinces, and New Brunswick are observers in the process.

Western Climate Initiative (WCI): A collaboration between western states and provinces (established in February, 2007) to set regional greenhouse gas emissions goals, develop a multi-sector market-based mechanism to support targeted emissions reductions, and participate in a greenhouse gas emissions registry to enable tracking, management, and crediting to reduce greenhouse gas emissions. The initiative has an aggregate emissions reduction goal of 15% below 2005 levels by 2020.[162] Members of WCI also either have adopted or are committed to adopting clean tailpipe standards for the regulation of automobile emissions.[163] Arizona, California, New Mexico, Oregon, Utah, Washington, and the Canadian provinces of British Columbia and Manitoba are members of the Initiative.[164] Colorado, Kansas, Nevada, and

[158] Regional Greenhouse Gas Initiative (RGGI), About RGGI, http://www.rggi.org/about.htm.
[159] REGIONAL GREENHOUSE GAS INITIATIVE, RGGI OVERVIEW (Dec. 20, 2005), *available at* http://www.rggi.org/agreement.htm.
[160] REGIONAL GREENHOUSE GAS INITIATIVE, FREQUENTLY ASKED QUESTIONS (Dec. 20, 2005), *available at* http://www.rggi.org/agreement.htm.
[161] REGIONAL GREENHOUSE GAS INITIATIVE, MEMORANDUM OF UNDERSTANDING (Dec. 20, 2005), *available at* http://www.rggi.org/agreement.htm; REGIONAL GREENHOUSE GAS INITIATIVE, SECOND AMENDMENT TO MEMORANDUM OF UNDERSTANDING (Apr. 20, 2007), *available at* http://www.rggi.org/agreement.htm.
[162] Western Climate Initiative, Statement of Regional Goal (Aug. 22, 2007), *available at* http://www.westernclimateinitiative.org/WCI_Documents.cfm.
[163] Western Regional Climate Action Initiative (Feb. 26, 2007), *available at* http://www.governor.wa.gov/news/2007-02-26_WesternClimateAgreementFinal.pdf; U.S. Dep't of Energy, Office of Energy Efficiency and Renewable Energy, Utah Joins Western Climate Initiative (May 22, 2007), http://www.eere.energy.gov/states/news_detail.cfm/news_id=10987.
[164] Western Climate Initiative, http://www.westernclimateinitiative.org/.

Wyoming are currently participating as observers in the WCI, as well as the Canadian provinces of Ontario, Saskatchewan, and Quebec, and the Mexican state of Sonora.[165]

Other Regional Initiatives: Several other regional initiatives help coordinate the greenhouse gas emissions reduction efforts of multiple states. Some of these are listed here:

- *Powering the Plains*: A roadmap and policy directive aimed at enabling states of the upper Midwest to transition to a carbon-neutral energy infrastructure by 2055. Primarily involves Iowa, Manitoba, Minnesota, North Dakota, South Dakota, and Wisconsin.[166]
- *Western Governors' Association Clean and Diversified Energy Initiative*: The Western Governor's Association initiative to support expansive development of energy efficiency, renewable energy resources, and advanced coal systems, including the management and reporting of progress toward outlined goals.[167]
- *U.S. Mayors Climate Protection Agreement*: An agreement between municipalities to reduce carbon emissions and support energy conservation and efficiency programs. Currently participating are over 530 mayors from all 50 states and the District of Columbia, representing more than 66 million people.[168]

Mandatory State Statutes and Regulations Regarding Greenhouse Gas Emissions

California's Global Warming Solutions Act of 2006 (AB 32):[169] The primary purposes of the bill are two-fold: (1) to establish a statewide greenhouse gas emissions cap of 1990 levels by 2020, and (2) to require the development of mandatory emissions reporting rules—to be implemented by January 1, 2008—in order to facilitate the management of emissions reduction

[165] Press Release, Western Climate Initiative, Western Climate Initiative Members Set Regional Target to Reduce Greenhouse Gas Emissions (Aug. 22, 2007).
[166] POWERING THE PLAINS, INTRODUCTION (undated), available at http://www.gpisd.net/ptp/documents/Overview.pdf.
[167] Western Governors' Association, Policy Resolution 06-10 (June 11, 2006), *available at* http://www.westgov.org/wga/policy/06/clean-energy.pdf.
[168] Seattle Mayor Nickels, U.S. Mayors Climate Protection Agreement, http://www.seattle.gov/mayor/climate/.
[169] Text of the Act is available from the California Air Resources Board, http://www.arb.ca.gov/cc/cc.htm.

programs, including market-based mechanisms. Any mechanisms employed in order to reduce emissions are to be consistent and able to be integrated with other state or regional initiatives. This means, among other things, that the cap-and-trade system that is developed under AB 32 and by Executive Order of the governor must be able to be tied to the RGGI trading system.

Hawaii's Statewide Greenhouse Gas Emissions Cap (H.B. 226, 2007). This law establishes a statewide cap on greenhouse gas emission providing that the emissions be reduced to 1990 levels or lower by 2020 and providing for implementing regulatory authority to achieve the goal.

New Jersey's Global Warming Response Act (A3301/S2114, *signed into law* July 6, 2007): Sets statewide emissions caps on greenhouse gases at 1990 levels by 2020 and 80% below that by 2050. The Act requires New Jersey's Department of Environmental Protection to establish greenhouse gas emissions inventories, prioritize sources for greenhouse gas emissions reductions, and adopt rules and regulations to achieve those reductions.

Power Sector Regulation: Several states have policies to reduce greenhouse gas emissions from the power sector. A few examples follow:

- *California*: SB 1368, signed into law on September 29, 2006, codified rulemaking processes under way in California to establish a greenhouse gas emissions performance standard for electric generating units at a rate that is no higher than the rate of emissions of greenhouse gases for combined-cycle natural gas baseload generation. Regulatory agencies implementing this law have recently established a limit of 1100 pounds of carbon dioxide per MW-hour. The standard applies to any long-term contract for baseload power of five years or more. Carbon dioxide injected in geologic formations so as to prevent the release into the atmosphere shall not be counted as emissions of the power plant and thus does constitute emissions reductions in determining compliance with the standard. These rules took effect February 1, 2007 for investment-owned utilities and very recently for municipal utilities.

- *Washington*: S.B. 6001, signed into law on May 3, 2007, enacts an emissions performance standard for baseload generation similar to California's S.B. 1368. Under the standard, all baseload generation for which utilities enter into long-term contracts must meet a greenhouse gas emissions standard of 1,100 pounds CO_2 per megawatt-hour, beginning on July 1, 2008.

- *Montana*: H.B. 25 creates a CO_2 emissions performance standard for electric generating units constructed after January 1, 2007. H.B. 25 prohibits the state Public Utility Commission from approving electric generating units primarily fueled by coal unless a minimum of 50% of the CO2 produced by the facility is captured and sequestered.

- *Iowa*: The electrical utility permit process includes quantifying potential greenhouse gas emissions [S.F. 485, 82d Gen. Ass'bly, 1st Sess. (2007) (enacted)].

- *Massachusetts*: Newly established emissions performance standard for the state's power plants [310 MASS. CODE REGS. 7.29 (2007)]

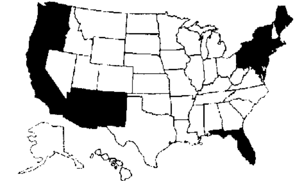
States also provide for greenhouse gas emissions reductions in the power sector through other means, such as the following:

- *Public Benefit Funds*: Nearly half of states manage funds collected through utility contributions or electrical bill charges that support renewable energy or energy efficiency development and implementation.[170]

- *Net Metering Programs*: Net metering provisions charge electricity consumers for the difference between on-site generation and offsite consumption from the grid. All but nine states have some form of net metering program, and 21 have statewide net metering.[171]

[170] Pew Ctr. on Global Climate Change, States with Public Benefit Funds, http://www.pewclimate.org/what_s_being_done/in_the_states/public_benefit_funds.cfm.
[171] Pew Ctr. on Global Climate Change, States with Net Metering Programs, http://www.pewclimate.org/what_s_being_done/in_the_states/net_metering_map.cfm.

State Greenhouse Gas Emissions Standards for Motor Vehicles:[172]



California adopted AB 1493 (Pavley) in 2002, directing the California Air Resources Board (CARB) to "develop and adopt regulations that achieve the maximum feasible and cost-effective reduction of greenhouse gas emissions from motor vehicles" (Sec. 3).[173] CARB promulgated rules pursuant to this directive in 2004. Since then, 14 states have moved to adopt California's motor vehicle greenhouse gas emission regulations (colored here in blue): Arizona, Connecticut, Florida, Maine, Maryland, Massachusetts, New Jersey, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington.[174] Collectively, these states and California account for over 40% of the U.S. GDP,[175] and 40% of the U.S. population.[176]

Mandatory Emissions Reporting:

- *Iowa* – passed legislation requiring mandatory greenhouse gas reporting and inventory which will be voluntarily tied to a greenhouse gas registry [S.F. 485, 82d Gen. Ass'bly, 1st Sess. (2007) (enacted)]

- *Maine* – Rules are currently in development that would append greenhouse gas emissions to required reporting under Chapter 137, the state's Emissions Statements provisions.

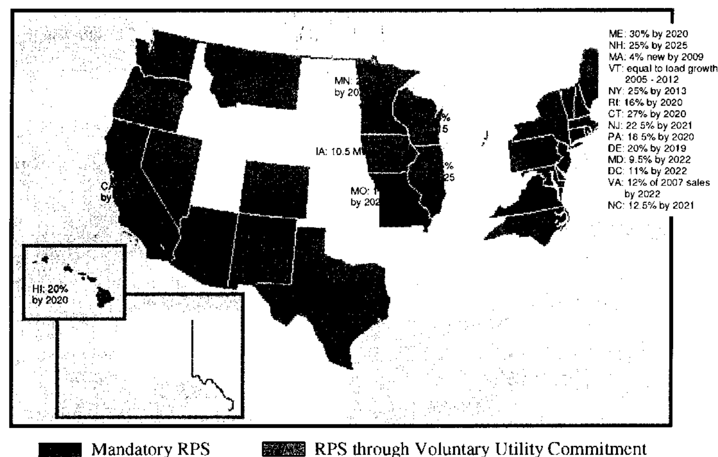
[172] Section adapted from Pew Ctr. on Global Climate Change, States Poised to Adopt California Vehicle GHG Standards, http://www.pewclimate.org/what_s_being_done/in_the_states/vehicle_ghg_standard.cfm.
[173] The text of the bill is available from the California Air Resources Board, http://www.arb.ca.gov/cc/ab1493.pdf.
[174] CONG. RESEARCH SERV., CALIFORNIA'S WAIVER REQUEST TO CONTROL GREENHOUSE GASES UNDER THE CLEAN AIR ACT 6 (Aug. 20, 2007).
[175] Derived from News Release, Bureau of Economic Analysis, Gross Domestic Product (GDP) by State, 2006 (June 7, 2007), *available at* http://www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm; *see also* CONG. RESEARCH SERV., *supra* note 174, at 6.
[176] Derived from U.S. CENSUS BUREAU, U.S. CENSUS 2000 tbl.2 (2000), *available at* http://www.census.gov/population/www/cen2000/respop.html.

- *New Jersey* – The New Jersey Division of Air Quality expanded its Emissions Statement Program in 2003 to require reporting of CO_2 and methane from stationary emissions sources [http://www.nj.gov/dep/aqm/ESadoption.pdf].

- *Wisconsin* – The state's Department of Natural Resources requires CO_2 emissions reporting beyond the threshold level of 100,000 tons per year [NR 438.03 (2005)].

Renewable Portfolio Standards:[177]

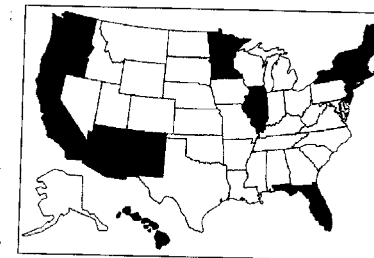
Renewable portfolio standards (RPSs) require electrical utilities within a jurisdiction to generate a certain percentage of their electricity from renewable sources by a given deadline. To date, twenty-five states as well as the District of Columbia have adopted some form of RPS. RPSs have been adopted by states covering over 65% of the U.S. GDP and 60% of its population.



Mandatory RPS   RPS through Voluntary Utility Commitment

[177] Section adapted from Pew Ctr. on Global Climate Change, States with Renewable Portfolio Standards, http://www.pewclimate.org/what_s_being_done/in_the_states/rps.cfm.

Statewide Emissions Reduction Goals [178]



AZ: 2000 levels by 2020; 50% below 2000 levels by 2040.[179]

CA: 2000 levels by 2010; 1990 levels by 2020; 80% below 1990 levels by 2050.[180]

CT: 1990 levels by 2010; 10% below 1990 levels by 2020; long term reduction goal of 75% below 1990 levels.[181]

FL: 2000 levels by 2017; 1990 levels by 2025; 80% reduction of 1990 levels by 2050.[182]

HI: 1990 levels by 2020.[183]

IL: 1990 levels by 2020; 60% below 1990 levels by 2050.[184]

ME: 1990 levels by 2010; 10% below 1990 levels by 2020; long-term goal of 75-80% below 2003 levels.[185]

MA: 1990 levels by 2010; 10% below 1990 by 2020; 75-85% below 1990 long-term.[186]

MN: 15% below 2005 levels by 2015; 30% below 2005 by 2025; 80% below 2005 by 2050.[187]

NH: 1990 levels by 2010; 10% below 1990 by 2020; 75-85% below 2001 long-term.[188]

NJ: 1990 levels by 2020; 80% below 2006 levels by 2050.[189]

[178] Adapted from Pew Ctr. on Global Climate Change, A Look at Emissions Targets: United States – State & Regional, http://www.pewclimate.org/what_s_being_done/targets.
[179] Exec. Order No. 2006-13.
[180] Exec. Order No. S-03-05.
[181] GOVERNOR'S STEERING COMM. ON CLIMATE CHANGE, *Executive Summary*, *in* CONN. CLIMATE ACTION PLAN 2005, *available at* http://www.ctclimatechange.com/StateActionPlan.html.
[182] Exec. Order No. 07-127.
[183] H.B. 226, 24th Leg. (Haw. 2007) (signed by Gov. Lingle June 30, 2007), *available at* http://www.capitol.hawaii.gov/session2007/bills/HB226_CD1_.htm.
[184] Press Release, Governor Rod R. Blagojevich, Gov. Blagojevich Sets Goal to Dramatically Reduce Greenhouse Gas Emissions in Illinois, Feb. 13, 2007, *available at* http://illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=2&RecNum=5715.
[185] ME. REV. STAT. ANN. tit. 38, § 574 *et. seq.* (2006).
[186] COMMONWEALTH OF MASSACHUSETTS, MASSACHUSETTS CLIMATE ACTION PLAN (2004), *available at* http://www.massclimateaction.org/pdf/MAClimateProtPlan0504.pdf.
[187] S.F. No. 145, 2d Engrossment, 85th Legis. Sess. (Minn. 2007).
[188] N.H. DEP'T OF ENVTL. SERVS., THE CLIMATE CHANGE CHALLENGE (2001), *available at* http://www.des.state.nh.us/ard/climatechange/challenge.pdf.
[189] Exec. Order No. 54 (2007).

NM: 2000 levels by 2012; 10% below 2000 by 2020; 75% below 2000 by 2050.[190]

NY: 5% below 1990 by 2010; 10% below 1990 levels by 2020.[191]

OR: Stabilize by 2010; 10% below 1990 levels by 2020; 75% below 1990 levels by 2050.[192]

RI: 1990 levels by 2010; 10% below 1990 levels by 2020.[193]

VT: 1990 levels by 2010; 10% below 1990 by 2020; 75-85% below 2001 levels long-term.[194]

WA: 1990 levels by 2020; 25% below 1990 levels by 2035; 50% below 1990 levels by 2050.[195]

Statewide Financial Incentives

Nearly every state in the nation has implemented some set of financial incentives to support the development and installation of renewable energy, and several have adopted incentives for energy efficiency measures. These incentives bolster the economic viability of products and services that emit fewer greenhouse gases than their traditional counterparts. These measures, ranging from taxes to grants, are outlined in the tables below.

Overview of Financial Incentives for Renewable Energy[196]

State/Territory	Personal Tax	Corporate Tax	Sales Tax	Property Tax	Rebates	Grants	Loans	Industry Recruit.	Bonds	Production Incentive*
Alabama	1-S				4-U	1-S	1-S, 1-U			1-U
Alaska							2-S			1-U
Arizona	3-S	1-S	1-S	1-S	6-U		1-U			
Arkansas										
California	1-S			1-S	3-S, 19-U, 1-L	1-L	1-U, 1-S			1-S
Colorado			1-S	2-S	4-U, 1-L	1-L	3-U, 1-L			
Connecticut				1-S	1-S	5-S	3-S			2-P
Delaware					1-S	2-S				
Florida		2-S	1-S		1-S, 4-U	1-S	1-U			
Georgia			1-S		3-U		4-U			1-U
Hawaii	1-S	1-S			3-U		2-U, 1-L	1-S	1-L	
Idaho	1-S		1-S			2-P	1-S		1-S	1-P
Illinois				1-S	1-S	1-P				
Indiana				1-S	4-U					
Iowa	1-S	1-S	1-S	3-S	4-U	1-S	2-S			
Kansas				1-S						
Kentucky					6-U		1-P, 3-U			1-U
Louisiana				1-S			1-S			
Maine					1-S	1-S				
Maryland	2-S	2-S	1-S	2-S	1-S, 1-L		2-S			
Massachusetts	3-S	5-S	1-S	1-S	1-S, 1-U	3-S	1-S, 1-U	1-S		1-S, 1-P
Michigan				1-S	1-U	4-S		2-S		
Minnesota			2-S	1-S	1-S, 18-U	3-U	3-S, 1-U			1-S, 3-U
Mississippi					3-U		1-S			1-U
Missouri		1-S			3-U		1-S, 1-U			
Montana	2-S	1-S		3-S	1-U	2-P, 1-U	1-S			1-P
Nebraska		1-S			3-U		1-S			
Nevada				3-S	1-S					1-S
New Hampshire				1-S	2-U		1-S			
New Jersey			1-S		2-S		1-S	1-S		1-S
New Mexico	1-S	1-S	1-S						1-S	1-U
New York	2-S	1-S	1-S	2-S	4-S, 2-U	1-S	2-S	1-S		
North Carolina	1-S	1-S		1-S			1-S			1-U, 1-P
North Dakota	1-S	1-S	1-S	2-S						
Ohio		1-S	1-S	1-S		2-S	2-S			1-S
Oklahoma		1-S						1-S		
Oregon	1-S	1-S		1-S	2-S , 10-U	2-P, 1-S	1-S, 7-U			1-P
Pennsylvania				1-S		3-S, 4-L	2-S, 5-L, 1-U			
Rhode Island	1-S		1-S	1-S	1-S, 1-U					1-P
South Carolina	1-S	2-S			1-S, 2-U		5-U			
South Dakota				2-S						
Tennessee				1-S		1-S	1-S			1-U
Texas		1-S		1-S	6-U			1-S		
Utah	1-S	1-S	1-S		1-U					
Vermont			1-S		1-S	1-U				1-U
Virginia				1-S				1-S		1-U
Washington			1-S		11-U	2-P	8-U	1-S		3-U, 1-S, 1-P
West Virginia		1-S		1-S						
Wisconsin				1-S	1-S, 3-U	1-S, 1-U	1-U			2-U
Wyoming			1-S		1-S, 1-U					
D.C.						1-S				
Totals	**24**	**27**	**20**	**40**	**154**	**52**	**81**	**10**	**3**	**34**

S = State/Territory L = Local U = Utility P = Private

[190] Exec. Order No. 05-033.

[191] N.Y. STATE ENERGY PLANNING BD., STATE ENERGY PLAN AND FINAL ENVIRONMENTAL IMPACT STATEMENT (ENERGY PLAN) (2002), *available at* http://text.nyserda.org/Energy_Information/energy_state_plan.asp.

[192] GOVERNOR'S ADVISORY GROUP ON GLOBAL WARMING, OREGON STRATEGY FOR GREENHOUSE GAS REDUCTIONS (2004), *available at* http://sustainableoregon.org/documents/climate/Oregon_Strategy_Final_Report.pdf; H.B. 3543, 74th Legis. Assem., Reg. Sess. (Or. 2007).

[193] R.I. Greenhouse Gas Stakeholder Process, Rhode Island Greenhouse Gas Action Plan (2002), *available at* http://righg.raabassociates.org/.

[194] CLIMATE NEUTRAL WORKING GROUP, FIRST BIENNIAL REPORT TO GOV. JAMES H. DOUGLAS (2005), *available at* http://www.anr.state.vt.us/air/Planning/docs/CNWG_1st_Biennial_Report.pdf.

[195] Exec. Order No. 07-02.

[196] Database for State Incentives for Renewable Energy (DSIRE), Summary Tables: Financial Incentives for Renewable Energy, http://www.dsireusa.org/summarytables/.

Overview of Financial Incentives for Energy Efficiency[197]

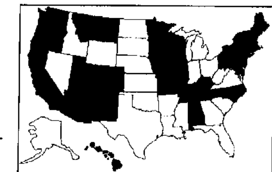
State/Territory	Personal Tax	Corporate Tax	Sales Tax	Property Tax	Rebates	Grants	Loans	Bonds
Alabama					13-U		11-U, 1-S	
Alaska					2-U		3-S	
Arizona	1-S				3-U		2-U	
Arkansas							3-U, 1-S	
California	1-S				57-U	5-U	7-U, 1-S	
Colorado					16-U	1-U	2-U	
Connecticut			1-S		14-U	2-U, 2-S	3-U, 2-S	
Delaware						2-S		
Florida					20-U	2-U, 1-S	3-U	
Georgia					15-U		12-U	
Hawaii					5-U			
Idaho	1-S				15-U		1-S, 2-U	
Illinois					2-U, 1-S	2-S		
Indiana					4-U	1-U		
Iowa					14-U	1-S	3-U, 1-S	
Kansas					1-U		1-S	
Kentucky					12-U		7-U	
Louisiana					1-U, 1-S		1-S	
Maine					1-U, 2-S		2-S	
Maryland	1-S	1-S		2-S			1-U, 2-S	
Massachusetts	2-S	2-S			27-U	1-U	6-U	
Michigan						3-S		
Minnesota					39-U	6-U	4-U, 4-S	
Mississippi					5-U		3-U, 1-S	
Missouri					8-U		2-U, 1-S	
Montana	1-S	1-S			5-U	1-U	1-U, 1-S	1-S
Nebraska					3-U		1-S	
Nevada				1-S	4-U			
New Hampshire					14-U	3-U	2-U, 1-S	
New Jersey					5-S		1-U, 2-S	
New Mexico					3-U			1-S
New York	1-S	1-S		1-S	3-U, 4-S	3-S	2-S	
North Carolina					6-U, 1-S		11-U, 1-S	
North Dakota						1-S	1-U	
Ohio					1-U	1-S	2-S	
Oklahoma	1-S				1-U		2-S	
Oregon	1-S	1-S			29-U, 5-S	1-U	13-U, 1-S	
Pennsylvania						3-S	1-U, 3-S	
Rhode Island					3-U, 2-S		2-U	
South Carolina							9-U, 1-S	
South Dakota					2-U	1-U	1-U	
Tennessee					21-U		23-U, 2-S	
Texas					26-U		5-U, 1-S	
Utah					7-U			
Vermont					3-U, 9-S		1-U, 1-S	
Virginia						1-S	3-U, 1-S	
Washington					58-U	3-U	8-U	
West Virginia						1-S		
Wisconsin					13-U, 4-S	2-U	1-U, 1-S	
Wyoming					3-U	1-S	1-U	
D.C.	1-S				1-S			
Totals	11	6	1	4	515	52	200	2

S = State/Territory U = Utility

[197] Database for State Incentives for Renewable Energy (DSIRE), Summary Tables: Financial Incentives for Energy Efficiency, http://www.dsireusa.org/summarytables/.

The U.S. Department of Energy offers an excellent state-by-state overview of energy efficiency and renewable energy endeavors at its site http://www.eere.energy.gov/states/.

Additional State Policies to Reduce Greenhouse Gas Emissions



Climate Action Plans:[198] Climate action plans provide technical and policy analysis to inform development of state greenhouse gas emissions reduction plans. Each state (colored here in blue) investigates emissions, climate liabilities and policies to develop state-specific strategies for moving forward with regulatory measures and incentives.

Greenhouse Gas Inventories:[199] To date, all but eight states—Alaska, Idaho, North Dakota, South Dakota, Nebraska, Wyoming, Arkansas, South Carolina—have commissioned or completed greenhouse gas inventories in order to characterize state emissions and major source categories.

Other State Actions: The sections above capture only some of the state actions concerning mitigation of greenhouse gas emissions. The table below outlines additional state level climate policies to further illustrate the diversity of these measures:

State	*Greenhouse Gas Emissions Reduction/Climate Change Mitigation Measure*
Alaska	• New legislation directed the establishment of the Alaska Climate Impact Assessment Commission to evaluate the risks and costs associated with global

[198] Pew Ctr. on Global Climate Change, States with Climate Action Plans, http://www.pewclimate.org/what_s_being_done/in_the_states/action_plan_map.cfm.
[199] Pew Ctr. on Global Climate Change, States with Greenhouse Gas Inventories, http://www.pewclimate.org/what_s_being_done/in_the_states/inventories_map.cfm.

	climate change (AK H.C.R 30)
Arizona	• A recent executive order dedicated the state to achieving 2000-level greenhouse gas emissions by 2020, and work with other western states to establish an emissions registry and reporting mechanisms. Further requires state agencies to only purchase low-emission vehicles. [Exec. Order No. 2006-13]
California	• SB 1771 & 527 establish the California Climate Action Registry to help registrants establish emissions baselines in order to comply with present and future emissions regulations.
Colorado	• Executive Order D011 07: directs state facilities to reduce their energy consumption 20%, and state agencies to achieve a 25% volumetric reduction in petroleum consumption, by 2012. • Colorado Climate Change Markets Act (COLO. REV. STAT. § 25-1-1301 *et. seq.*): commissioning reports and establishing financial incentives for renewable energy technology research. • Law requiring electrical utilities to submit plans for installing transmission lines to untapped, high wind-capacity regions of the state.
Connecticut	• CONN. GEN. STAT. § 22a-200 to -201c (2007) – sets a statewide emissions goal of 1990 levels by 2010, orders the establishment of a greenhouse gas registry that would integrate with other states in the region; § 22a-200b(b) compels operators of any facility that is required to report air emissions data under Title V of the Federal Clean Air Act to also submit greenhouse gas emissions information to a registry; establishes a greenhouse gas labeling system for new cars; adds a "greenhouse gas reduction fee" to auto registration costs; and directs a steering committee to review vehicle emissions regulations in light of emissions reductions goals.
Delaware	• Global Warming Response Act, now awaiting approval from the Governor, sets stringent emissions reduction goals.

Idaho	• Exec. Or. 2007-05: provides for the establishment of a greenhouse gas inventory and calls for recommendations on emissions reductions.
Illinois	• Member of Chicago Climate Exchange with target of reducing emissions from government activities 6% by 2010. • Exec. Or. No. 11-2006: Establishes the Illinois Climate Change Advisory Group, orders the annual inventory of state greenhouse gases.
Maine	• 38 M.R.S. § 575 et. seq.: mandates a statewide emissions inventory and registry; sets out state emissions reduction goals. • 2007 ME. H.P. 920 (enacted): Calls for a report concerning hydro-power development including methods for evaluating current and future costs of greenhouse gas emissions and fossil fuel independence. • 35-A M.R.S. § 4711 (2006): requires natural gas utilities servicing over 5,000 residential customers to sponsor 'cost-effective conservation programs.'
Maryland	• Exec. Or. 01.01.2007.07: Establishes a Climate Change Commission to address the drivers and causes of climate change including an impact assessment and the development of emissions reduction goals.
Minnesota	• S.F. No. 145, 2d Engrossment, 85th Legis. Sess. (Minn. 2007): sets statewide emissions reductions goals, outlines measures for energy conservation and public utility improvements for efficiency.
New Jersey	• Reclassified CO_2 as an air contaminant for the purposes of facility permitting and emissions regulation. *See* N.J. Dep't of Envtl. Prot., Div. of Air Quality, Regulatory Development, http://www.nj.gov/dep/aqm.
Oregon	• H.B. 3543 establishes stringent, statewide greenhouse gas emissions goals and directs the Oregon Global Warming Commission to develop policy recommendations to support the achievement of those goals including the

	possible creation of a statewide cap-and-trade program.
South Carolina	• Established the Governor's Climate, Energy, and Commerce Advisory Committee to develop greenhouse gas emissions reduction strategies and other policy avenues that would provide the state with economic opportunities.
West Virginia	• S.B. 337 (W. VA. CODE R. § 22-5-19) concerning a greenhouse gas emissions inventory.
Wisconsin	• Office of Energy Independence established to bolster the biofuels industry and support energy efficiency and energy independence initiatives.

Other Resources

The compilation of state actions presented above is in no way exhaustive. It is merely illustrative of the numerous, far-reaching state actions to reduce greenhouse gas emissions. A number of frequently updated online resources further describe state-level climate policies:

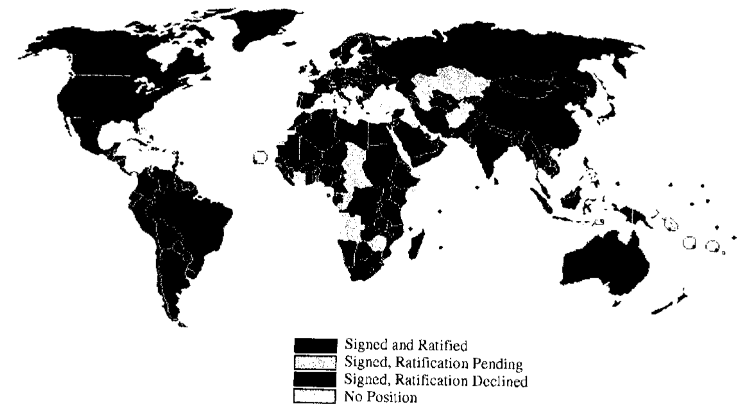
- The Pew Center on Global Climate Change collects information on state progress toward climate change mitigation at http://www.pewclimate.org/what_s_being_done/in_the_states. The Center has also compiled an overview report on such actions: PEW CTR. ON GLOBAL CLIMATE CHANGE, CLIMATE CHANGE 101: STATE ACTION (2006), *available at* http://www.pewclimate.org/docUploads/101_States.pdf.
- The Database of State Incentives for Renewables & Efficiency (DSIRE), published by the Interstate Renewable Energy Council, provides information on incentive programs to bolster the use of energy efficiency and renewable energy. *See* http://www.dsireusa.org/.
- The Office of Energy Efficiency and Renewable Energy of the U.S. Department of Energy publishes a number of state activities on state-specific web pages. *See* http://www.eere.energy.gov/states/state_information.cfm.
- The State Environmental Resource Center acts a clearing house for state action measures, publishing both overviews and analyses. *See* http://www.serconline.org/.
- National Caucus of Environmental Legislators (NCEL), http://www.ncel.net/.

NATIONWIDE AND INTERNATIONAL REGULATION OF GREENHOUSE GAS EMISSIONS

International Agreements on Greenhouse Gas Emissions Reduction

Kyoto Protocol: A broadly ratified treaty developed under the United Nations Framework Convention on Climate Change which establishes legally binding targets and mechanisms for effecting global reductions in greenhouse gas emissions.[200] The Protocol achieves its goals through three mechanisms that allow for the international trade of emissions credits, grant industrialized countries emissions credits by financing projects in developed "transition economics" like those of eastern Europe, and structure financing mechanisms for emissions-avoidance or emissions-reduction projects in developing countries.[201]

Kyoto Protocol Ratification Status (as of December 2006)[202]



[200] *See* U.N. Framework Convention on Climate Change (UNFCCC), Essential Background, http://unfccc.int/essential_background/items/2877.php.
[201] *See* U.N. Framework Convention on Climate Change (UNFCCC), The Kyoto Protocol, http://unfccc.int/kyoto_protocol/background/items/2878.php.
[202] *See* ROBERT J. KEATING ET AL., ENERGY & ENVTL. SEC. INITIATIVE, GREENHOUSE GAS EMISSIONS TRADING: EMERGING MARKETS AND OPPORTUNITIES FOR COLORADO 21-22 (Mar. 2007), *available at* http://www.colorado.edu/law/eesi/CO_GHG_Trading_Report.pdf.

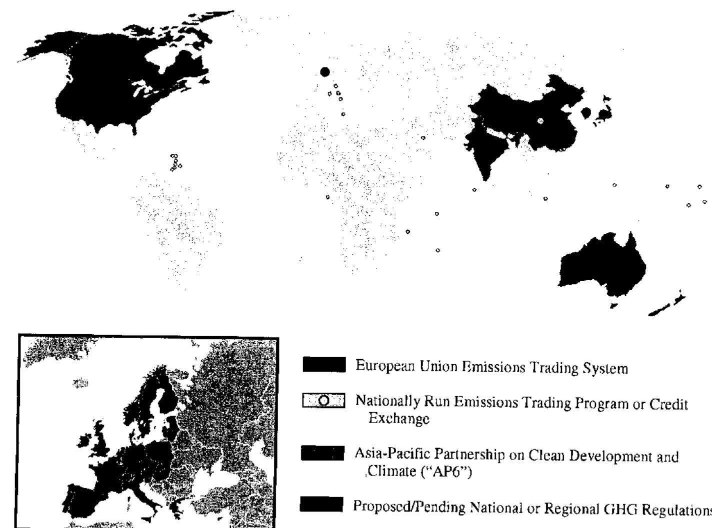
The Kyoto Protocol places responsibility on individual countries to mitigate greenhouse gas emissions proportional to their respective historical emissions. As such, industrialized countries with mature economics have more stringent emissions reduction requirements than do countries with transition economies. Developing countries are not required to achieve reductions in greenhouse gas emissions. The Kyoto Protocol entered into force in February of 2005.

European Union Emissions Trading Scheme (EU ETS): Established in order to achieve Kyoto-established emissions reduction goals, the EU ETS is a downstream, company level, greenhouse gas emissions trading system organized under the auspices of the European Union. It currently covers nearly 12,000 installations in 25 countries and across six major industrial sectors.[203] Countries participating in the trading scheme are responsible for allocating and regulating those GHG emissions allowances granted them by the Kyoto Protocol.[204] Emissions permits traded on the EU ETS are granted only if satisfactory monitoring and reporting mechanisms are in place.[205]

Asia-Pacific Partnership on Clean Development and Climate (AP6): The six partner countries—Australia, China, India, Japan, Republic of Korea, and the United States—represent about half of the world's economy, population, and energy use. The Partnership strives to expand investment and trade in clean energy technologies, goods, and services, focusing on key market sectors.[206] The Partnership is without legally binding commitments for greenhouse gas emissions reductions. It provides a multinational forum for advancing technology development. Canada has expressed interest in joining the partnership, and that country's membership is currently under consideration.[207]

[203] *Id.* at 16-17.
[204] *See* Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003, 2003 O.J. (L 275) 32 [hereinafter Emissions Trading Directive].
[205] *See id* at 35.
[206] *See* Asia-Pacific P'ship on Clean Dev. & Climate, http://www.asiapacificpartnership.org/.
[207] *See* Toshio Aritake, *Meeting of Asia-Pacific Climate Partnership Considers Pilot Projects; Canada May Join*, 30 INT'L ENV'T REP. (BNA) at 584 (July. 25, 2007).

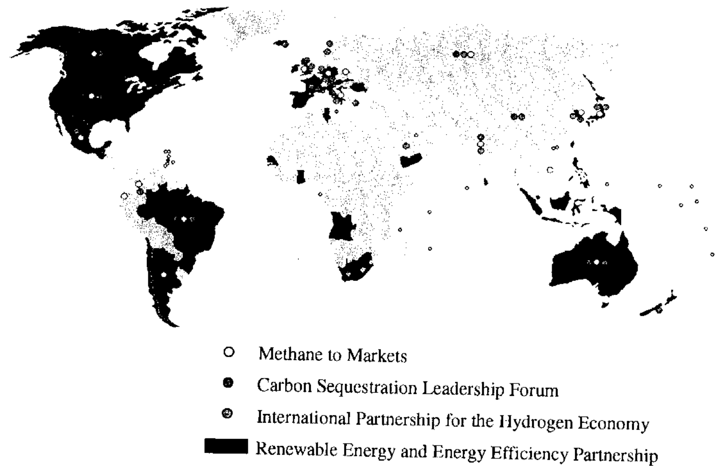
Trading of GHG Emissions Credits & Partnerships on Climate Change[208]



There are several other international partnerships that focus on mitigating global warming pollution by encouraging the development of specific technology markets and changes in energy infrastructure. Like the AP6, these partnerships do not include binding goals. However, they do indicate national interest on the part of their member states to effect emissions reductions and facilitate the development of new business opportunities over carbon-intensive products and services.

[208] *See* KEATING ET AL., *supra* note 202, at 21-25.

Other International Climate-Related Partnerships and Market Efforts



Methane to Markets: A partnership of twenty countries to encourage the development and implementation of methane capture technologies for energy production and climate change mitigation. [www.methanetomarkets.org]

Carbon Sequestration Leadership Forum (CSL Forum): An international climate change initiative focused on the development of cost-effective means for the capture and long-term sequestration of CO_2 emissions. CSL Forum has twenty-one member states along with the European Commission. [www.cslforum.org]

International Partnership for the Hydrogen Economy (IPHE): A partnership established in 2003 of sixteen countries committed to accelerating the development of hydrogen and fuel cell technologies. [www.iphe.net]

Renewable Energy and Energy Efficiency Partnership (REEEP): With a membership of 36 governments as well as NGO and multinational businesses, REEEP is a prominent partnership that funds projects and analyzes policy mechanisms to encourage renewable energy and energy efficiency. [www.reeep.org]

International Dialogues on Climate Change

- *Vienna Climate Change Talks*, August 27-31, 2007 – This conference was held under the auspices of the U.N. Framework Convention on Climate Change and attended by over 900 delegates of the Parties to the Convention. The conference addressed how a global post-Kyoto climate policy will be negotiated and reached "agreement on key elements for an effective international response to climate change."[209]

- *Heiligendamm Summit*, June 7-8, 2007 – A G8 summit that included the world's five largest developing economies (Brazil, China, India, Mexico, and South Africa) in discussions concerning post-2012 international climate change policy. The summit reiterated the participating countries' dedication to mitigating climate change and outlined commitments to cooperate in certain fields including cross-border development, research and development, energy infrastructure revision, and sustainable development, especially in Africa.[210] The group committed to consideration of an emissions reduction goal of halving current emissions by 2050.[211]

[209] Press Release, UNFCC Secretariat, Vienna UN Conference Shows Consensus on Key Building Blocks for Effective International Response to Climate Change (Aug. 31, 2007), *available at* http://unfccc.int/files/press/news_room/press_releases_and_advisories/application/pdf/20070831_vienna_closing_press_release.pdf; *see also* U.N. Framework Convention on Climate Change, Vienna Climate Change Talks 2007, http://unfccc.int/meetings/intersessional/awg_4_and_dialogue_4/items/3999.php.
[210] *See* Joint Statement by the German G8 Presidency and the Heads of State and/or Government of Brazil, China, India, Mexico and South Africa on the Occasion of the G8 Summit in Heiligendamm, Germany, 8 June 2007, *available at* http://www.g-8.de/Content/EN/Artikel/__g8-summit/anlagen/o5-erklaerung-en,property=publicationFile.pdf.
[211] Stephen Gardner, *Summit Discussions Conclude with Pledge by Developing Nations, G-8 to Do 'Fair Share'*, 30 INT'L ENV'T REP. (BNA) at 482, June 13, 2007.

- *United Nations Climate Change Conference*, Nairobi, Nov. 6-17, 2006 – This conference assessed progress of the implementation of the Kyoto Protocol, and hosted the twelfth session of the Conference of the Parties to the Climate Change Convention.[212]

- *Climate Dialogue at Pocantico*, September 2005 – A convening of senior policymakers and stakeholders from 15 countries to develop options and recommendations for policy approaches to mitigate global climate change.[213]

- *Gleneagles Summit*, July 6-8, 2005 – A G8 summit focusing on climate change, clean energy, and sustainable development. The adopted plan of action identified several methods to promote renewable energy and energy efficiency. These include, *inter alia*, reviewing building codes and vehicle standards to identify best practices, adopt market-based policy frameworks to finance the transition to cleaner energy sources, and encourage multilateral development banks to consider a project's greenhouse gas intensity.[214]

Foreign Greenhouse Gas Emissions Regulations and Climate Change Mitigation Schemes

Included below are brief overviews of the steps some countries are taking to mitigate global climate change. This summary compilation is provided to illustrate the extensive diversity and number of such legislative and other regulatory measures internationally.

Australia: On June 3, 2007, Australia's Prime Minister announced that the country would be implementing an emissions reduction and trading system that will have broad coverage

[212] *See* U.N. Framework Convention on Climate Change, United Nations Climate Change Conference – Nairobi 2006, http://unfccc.int/meetings/cop_12/items/3754.php; *see also* Pew Ctr. on Global Climate Change, COP 12 and COP/MOP 2 Nairobi, http://pewclimate.org/what_s_being_done/in_the_world/cop12/.
[213] *See* Pew Ctr. on Global Climate Change, Climate Dialogue at Porcantico, http://pewclimate.org/pocantico.cfm.
[214] *See* Pew Ctr. on Global Climate Change, Summary of G8 Summit, http://pewclimate.org/policy_center/international_policy/summary_of_g8.cfm.

of greenhouse gas emissions sources and the capability to be tied to other national or international trading programs. Trading is set to begin no later than 2012.[215]

Brazil: In conjunction with the World Bank and a Japanese bank, Brazil will be launching a carbon exchange in September 2007 to auction off carbon emissions credits obtained under the Clean Development Mechanism of the Kyoto Protocol.[216]

Canada: John Baird, Canadian Environment Minister, formally proposed a greenhouse gas emissions reduction plan in April of 2007, setting its sights on a 20% reduction from current levels by 2020. The plan includes a regulatory framework and enforcement mechanisms to ensure reduction goals are met.[217] Additionally, the province of Quebec will implement a tax on carbon dioxide emissions in October of 2007.[218]

China: In June of 2007, China issued a national plan to reduce the nation's greenhouse gas emissions. The plan does not include mandatory caps, but discusses future adoption of tax incentives and low-interest loans to encourage clean development.[219] Further, China announced in February of 2007 that it would launch the developing world's first carbon credit exchange in collaboration with the United Nation's Development Program.[220]

Germany: In May of 2007, Environment Minister Sigmar Gabriel unveiled an eight-point plan for reducing Germany's greenhouse gas emissions 40% from 1990 levels by 2020. The plan includes efforts to increase the efficiency of cogeneration power plants and motor vehicles,

[215] *See* Dep't of the Prime Minister & Cabinet, Australian Gov't, Climate Change, http://www.pmc.gov.au/climate_change/index.cfm.
[216] *See Carbon Trading: Brazil Opens Carbon Exchange*, CLIMATE CHANGE CORP.COM, Aug. 2, 2007, http://www.climatechangecorp.com/content.asp?ContentID=4885.
[217] *See* Peter Menyasz, *Canada Proposes New Framework to Cut Greenhouse Gas Emissions, Air Pollutants*, 30 INT'L ENV'T REP. (BNA) at 334, May 2, 2007.
[218] *See Canada's Quebec Province Plans Carbon Tax*, 30 INT'L ENV'T REP. (BNA) at 470, June 13, 2007.
[219] *See* Kathleen E. McLaughlin, *China Plan Emphasizes Energy Efficiency; Country Will Not Support Mandatory Targets*, 30 INT'L ENV'T REP. (BNA) at 471, June 13, 2007.
[220] *See* KEATING ET AL., *supra* note 202, at 25; Kathleen E. McLaughlin, *China to Establish GHG Emissions Exchange with U.N. in Bid to Spur Clean Development*, 30 INT'L ENV'T REP. (BNA) at 163, Feb. 21, 2007.

as well as boost the percentage of renewable energy in the nation's overall use from 12 to 20%.[221]

Japan: The Japanese government announced plans in February of 2007 to establish mandatory emissions-reduction targets for industry and develop a trading platform for greenhouse gas emissions credits.[222] Japan has also unveiled a program to promote energy efficiency to be jointly implemented by the government and industry. The program will focus on the utilization of cutting edge technology in several sectors to capture energy from existing industrial process, and retrofit energy-intensive processes.[223] Additionally, the Tokyo municipal government will soon impose compulsory CO_2 emissions reduction targets on large sources within the city, including factories and office buildings. The program involves tax breaks for companies meeting the reduction goals and penalties for those exceeding the targets. It will later be expanded to cover smaller emissions sources.[224] Finally, Japan has announced that the global environment and climate change will be at the center of next year's Group of Eight summit.[225]

New Zealand: New Zealand has announced its goal to be a carbon neutral nation.[226] To this end, the government has released a number of proposals for public comment, including energy efficiency and conservation strategies, sustainable land management measures, and transitional strategies to move toward low-emissions electricity production. As Jim Anderton, New Zealand Minister for Agriculture and Forestry, noted: "Climate change presents a very real threat not only to the way we use our land, but to our international markets . . . . Already there is talk in Europe of border taxes on goods from countries that aren't taking effective action to

[221] *See* Niels Sorrells, *German Environment Minister Unveils Plan to Cut Carbon Emissions 40 Percent by 2020*, 30 INT'L ENV'T REP. (BNA) at 324, May 2, 2007.
[222] *See Japan Plans to Launch Emissions Trading Platform*, 30 INT'L ENV'T REP. (BNA) at 204, Mar. 7, 2007.
[223] *See Japan Plans to Promote Energy Efficient Technology*, 29 INT'L ENV'T REP. (BNA) at 742, Oct. 4, 2006.
[224] *See* Toshio Aritake, *Tokyo Considers Mandatory Limits for Large Carbon Dioxide Emitters*, 30 INT'L ENV'T REP. (BNA) at 474, June 13, 2007.
[225] *See* Nancy Ognanovich & Stephen Gardner, *Japan Plans to Make Environment Focus of Next Year's G-8 Summit*, 30 INT'L ENV'T REP. (BNA) at 483, June 13, 2007.
[226] *See* Eduard Goldberg, *New Zealand Prime Minister Announces Plans to Make Country 'Carbon Neutral'*, 30 INT'L ENV'T REP. (BNA) at 166, Feb 21, 2007.

address climate change. It's in our economic interest to be part of the global response to climate change. We need to take action to reduce the risks."[227]

Norway: In April of 2007, Norwegian Prime Minister Jens Stoltenberg outlined his government's plans to make the country entirely greenhouse gas neutral by 2050. He further expressed a desire to lead the way in developing a new, binding, and truly global treaty for the reduction of greenhouse gas emissions to succeed the Kyoto Protocol.[228] The country has also implemented a sales tax on passenger vehicles which is calculated relative to the car's carbon dioxide emissions.[229]

Switzerland: Switzerland announced it will impose a tax on certain fossil fuels starting in 2008 in order to help achieve greenhouse gas emissions reduction goals. The tax will be levied on imported heating oil and natural gas.[230]

United Kingdom: The United Kingdom has developed a National Allocation Program in accordance with the EU ETS Directive. These regulations cover installations involved in energy activities, the production and processing of ferrous materials, mineral processing, and paper and wood pulp production.[231] To this end, the Government has published a code of best practice for trading emissions credits.[232] Further, the U.K.'s Climate Change Bill, proposed in March of 2007, is currently under consideration. It would, if implemented, require future UK governments to commit to greenhouse gas emissions reductions by establishing rolling, 5-year term emissions reduction targets.[233] The U.K. has also adopted an Energy Efficiency Commitment Program

[227] Eduard Goldberg, *New Zealand Proposals to Reduce Emissions Consider Incentives for Agriculture, Forestry*, 30 INT'L ENV'T REP. (BNA) at 41, Jan. 10, 2007.
[228] *See* Marcus Hoy, *Norwegian Prime Minister Announces Plans to Cut Carbon Emissions to Zero by 2050*, 30 INT'L ENV'T REP. (BNA) at 325, May 2, 2007.
[229] *See* Marcus Hoy, *Norway Revises Vehicle Purchase Tax to Target Carbon Dioxide Emissions*, 30 INT'L ENV'T REP. (BNA) at 67, Jan. 24, 2007.
[230] *See* Daniel Pruzin, *Switzerland to Impose Carbon Dioxide Tax After Missing Emissions Reduction Target*, 30 INT'L ENV'T REP. (BNA) at 539, June 11, 2007.
[231] *See* KEATING ET AL., *supra* note 202, at 19.
[232] *See* Tom Blass, *Britain Drafts Standard for Buying, Selling Voluntary Greenhouse Gas Emissions Offsets*, 30 INT'L ENV'T REP. (BNA) at 66, Jan. 24, 2007.
[233] *See* Dep't for Env't, Food, & Rural Affairs, U.K. Legislation: Climate Change Bill, http://www.defra.gov.uk/environment/climatechange/uk/legislation/index.htm; Tom Blass, *U.K. Bill*

which encourages energy companies to implement efficiency measures utilizing market influences, a program highly praised by the International Energy Agency.[234] Additionally, the Mayor of London introduced a plan to cut the city's CO_2 emissions 60% by 2050 by using a suite of financial incentives.[235]

Other Resources

- The Energy & Environmental Security Initiative has compiled a database of thousands of bilateral and multinational agreements concerning energy and the environment, with many of these focused on the development and installation of renewable energy technologies and conservation measures. *See* http://lawweb.colorado.edu/eesi/.

- The Pew Center on Global Climate Change has several analytic reports and policy overviews on international dialogues surrounding GHG emissions and climate change mitigation. *See* http://pewclimate.org/what_s_being_done/in_the_world.

Envisions Five-Year Carbon Budgets to Achieve 60 Percent Reduction by 2050, 30 INT'L ENV'T REP. (BNA) at 218, Mar. 21, 2007.

[234] *See* Int'l Energy Agency, *Overview*, *in* ENERGY POLICIES OF IEA COUNTRIES – THE UNITED KINGDOM: 2006 REVIEW (2007), *available at* http://www.iea.org/w/bookshop/add.aspx?id=299; *U.K. Energy Efficiency Program Seen as Model*, 30 INT'L ENV'T REP. (BNA) at 192, Mar. 7, 2007.

[235] *See* Tom Blass, *London 'Climate Change Action Plan' Offers Measures to Cut Emissions from All Sources*, 30 INT'L ENV'T REP. (BNA) at 184, Mar. 7, 2007.

FEDERAL LEGISLATION RELATED TO CLIMATE CHANGE PENDING IN THE 110TH CONGRESS

— In the Senate —

S. 280 Climate Stewardship and Innovation Act of 2007 (McCain-Lieberman)

- Covers electric power, industrial, and commercial sectors of U.S. economy.
- Establishes a program for reduction of greenhouse gases (GHGs) in covered entities through a market system of tradable allowances. One tradable allowance is necessary for each metric ton of emissions.
- Declining cap for GHG emissions beginning in 2012:
  - 2012: cap at 2004 levels
  - 2020: cap at 1990 levels
  - 2030: cap at 20% below 1990 levels
  - 2050: cap at 60% below 1990 levels
- Allowances can be sold, exchanged, purchased, banked (saved for future years), borrowed (against emissions reductions of up to 5 years), or offset (up to 30%).
- EPA distributes allowances to companies directly or to Climate Change Credit Corporation, which publicly auctions allowances. Funds generated from CCCC used for first generation technology implementation, assistance for low income communities, and adaptation strategies.
- Supported by Sens. McCain, Lieberman, Collins, Obama, Snowe and Lincoln.

S. 485 Global Warming Reduction Act of 2007 (Kerry)

- Creates a market-based emissions cap on global warming emissions, with a progressive declining cap beginning in 2012.
- Requires the EPA to reset passenger vehicle emission levels every 5 years.
- Requires the Secretary of Agriculture to set standards for carbon sequestration and biological offsets.
- Sets benchmarks for increasing percentages of renewable fuel in gasoline, and creates tax incentives for use of hybrid and electric vehicles.

S. 6 National Energy and Environmental Security Act of 2007 (Reid)

- Expresses the sense of Congress that the President should (a) require reduction in GHG emissions; (b) expand the use of clean energy; (c) reduce the burden on consumers of rising energy costs; (d) eliminate tax giveaways to oil industries; (e) prevent price manipulation of oil.

S. 309 Global Warming Pollution Reduction Act (Sanders)

- Directs EPA to set aggressive milestones in aggregate net levels of emissions & authorizes the EPA to create a market-based program to achieve reduction in emissions.
- Requires each fleet of automobiles by every manufacturer to meet emissions standards by 2016.
- Requires electric generating units to meet standards comparable to new natural gas generation units and requires such units to devote a percentage of electricity produced for sale from low-carbon generation.
- Establishes low-carbon generation trading program.
- Increases research into low carbon technology by 100% every year for 10 years.
- Requires raising the percentage of renewable fuel in commercial gasoline.

S. 317 Electric Utility Cap and Trade Act of 2007 (Feinstein)

- Covers all Electric Generation Units (EGUs) that (a) have a nameplate capacity greater than 25 megawatts; (b) emit GHG; (c) generate electricity for sale.
- Creates a cap for all such emissions for 2011-2020, and creates a market-system to distribute emission allowances under the Climate Action Trust Fund.
- Funds generated by the CATF are used for: (a) adaptation assistance for communities adversely affected by the act; (b) mitigating the impacts of climate change on fish and wildlife.
- Requires EPA to create regulations concerning early reduction credits for GHG reduction or sequestration from 2000 to 2010.

S. 357 Ten-in-Ten Fuel Economy Act (Feinstein) (*see also* **H.R. 349)**

- Requires fuel economy labeling standards to include greenhouse gas emissions information.
- Revises Corporate Average Fuel Economy (CAFE) standards for passenger cars and light trucks to gradually increase to 35 mpg by 2019.

S. Res. 30 Sense of the Senate of the need to address global warming through international agreements (Biden)

- Expresses the sense of the Senate that the U.S. should participate in negotiations under the U.N. Framework Convention on Climate Change that will establish commitments from all countries that are major contributors of greenhouse gas emissions.

— In the House of Representatives —

H.R. 6 Renewable Fuels, Consumer Protection and Energy Efficiency Act of 2007 (to be submitted to conference committee)

- This energy legislation, versions of which have passed both Houses of Congress, would establish a wide variety of requirements and incentives to increase use of renewable fuels, decrease use of fossil fuels, and promote energy conservation.

H.R. 182 Team up for Energy Independence Act (Lofgren)

- Creates a national sales tax for automobiles, rising to 80% in 2011. Automobiles that use alternative fuels are exempted from the tax.

H.R. 550 Securing America's Energy Independence Act of 2007 (McNulty)

- Extends tax credits for fuel cell technology, solar technology and residential energy efficient property expenditures.

H.R. 791 Increase Renewable Fuel Content of Gas Sold in the United States (Weller)

- Increases the percentage of renewable fuels in commercial gasoline beginning in 2013.

H.R. 620 Climate Stewardship Act of 2007 (Olver-Gilchrist)

- Requires companies in electric power, industrial, and commercial sectors of U.S. economy to participate in allowance scheme with a declining cap beginning in 2012. Companies are required to purchase 1 allowance per metric ton of GHG emitted.
- Allowances can be sold, traded, retired, borrowed, or offset.
- Companies may offset emissions reductions in verifiable international reductions.
- Funds generated by the sale of allowances are used for: (1) development of clean technology; (2) incentives for carbon sequestration; (3) restoration of habitat for fish and wildlife.
- Requires states to develop climate change impact mitigation plans.

H.R. 670 DRIVE Act (*see also* S. 339 – DRIVE Act)

- Directs the White House Office of Managenent and Budget to set an oil savings target and action plan to reduce dependence on foreign oil.
- Directs Secretary of Transportation to create a fuel efficiency program for passenger car and light trucks.
- Requires an increasing percentage of vehicles to be alternative fuel vehicles, redirects IRS policy to encourage alternative fuel vehicles.
- Requires Secretary of Energy to reduce federal fleet consumption of petroleum by 20%, encourage the development of plug in hybrid vehicles.

H.R. 969 Public Utility Regulatory Policies Act Amendments of 2007 (Udall, Tom)

- Requires electric utilities to increase power generated from renewable sources from 1% in 2010 to 20% in 2020.

H.R. 1300 Program for Real Energy Security Act (Hoyer)

- Creates National Commission on Energy Security and Transition to New Fuels.
- Requires increasing use of biofuels and alternative fuel vehicles.

Other Resources

Energy & Envtl. Sec. Initiative, Climate Action Database: A Database of Major U.S. Climate Change Policy Proposals, http://lawweb.colorado.edu/eesi/dms/.

Pew Ctr.on Global Climate Change, Policy Analyses, http://www.pewclimate.org/policy_center/analyses.

BUSINESS LEADERS' COMMENTS ON CLIMATE CHANGE REGULATION AND DISCLOSURE

Business leaders increasingly recognize that regulation of greenhouse gas emissions is both necessary and inevitable. 90 percent of business leaders believe that government regulation in this area is imminent, and 67 percent believe it will take place within the next eight years.[236] Additionally, 93 percent consider climate change related risks when making investment decisions.[237] In another recent study, 28 percent of executives cited environmental concerns, including climate change, as one of the issues likely to have the greatest impact on shareholder value in the next five years, and 87 percent of global companies indicated that global warming represents commercial risks and/or opportunities.[238]

I. Investment Advisors on the Impact of Climate Change on Performance

- "Global warming is likely to prove (to be) one of those tectonic forces that — like globalization or the aging of populations — gradually but powerfully changes the economic landscape."
  – John Llewellyn, Senior Economic Policy Advisor, Lehman Brothers[239]
- "Energy security and climate change issues will not be resolved in the foreseeable future; instead these issues will only intensify going forward. . . . These changing dynamics present investment opportunities in companies that are better positioned around the regulations or offer competitive technology solutions. For investors, solutions to these challenges present a compelling investment opportunity."
  – Merrill Lynch Report, *Energy Security and Climate Change*[240]

[236] PEW CTR. ON GLOBAL CLIMATE CHANGE, GETTING AHEAD OF THE CURVE: CORPORATE STRATEGIES THAT ADDRESS CLIMATE CHANGE 1 (2006), *available at* http://www.pewclimate.org/docUploads/Synthesis_Report_CorpStrategies.pdf.
[237] *Id.* at 55.
[238] EDWARD M. KERSCHNER & MICHAEL GERAGHTY, CITIGROUP GLOBAL MARKETS, CLIMATIC CONSEQUENCES 68 (2007), *available at* http://sefi.unep.org/fileadmin/media/sefi/docs/industry_reports/Citigroup_2007.pdf.
[239] Adam Shell & Matt Krantz, *Global Warming a Hot Spot for Investors*, USA TODAY, Feb. 28, 2007, *available at* http://www.usatoday.com/money/markets/2007-02-28-global-warming_N.htm.
[240] MERRILL LYNCH, ENERGY SECURITY & CLIMATE CHANGE: INVESTING IN THE CLEAN CAR REVOLUTION 4 (2005), *available at* http://www.asria.org/ref/library/csrguidelines/lib/050616WRI_Report.pdf.

- "The pace of a firm's adaptation to climate change and related policy is thus likely to prove to be another of the forces that will influence whether, over the next several years, any given firm survives and prospers; or withers and, quite possibly, dies."
  – Lehman Brothers Report, *The Business of Climate Change*[241]
- "[E]nvironmental regulation will play an increasingly larger role in business in the coming years . . . . [C]ompanies that are knowledgeable about the issues, and, therefore, well-prepared, will find it easier to maintain profitability as they will be in a much better position to bid for new projects and sustain their business under the new legislation. In turn, these companies may also be able to gain market share from businesses that are less prepared and compliant."
  – J.P. Morgan Report, *Air Pollution: Business Risk or Competitive Advantage*[242]
- "Climate change is widely recognized as the most significant environmental issue facing the global economy . . . . Investors need to understand how their investments are contributing to the problem, and also how they could be impacted by a changing climate."
  – Henderson Global Investors Report, *The Carbon 100*[243]
- "(Global warming) started out as an environmental issue, but it crossed over to become a quite fundamental financial and economic issue."
  – Nick Robbins, Head of Socially Responsible Investment Funds, Henderson Global Investors[244]
- "We see a number of catalysts that will create investment opportunities related to reducing greenhouse gases and mitigating exposure to climate change risk."
  – Peter Suozzo, Director of Sustainable Investment Research for North America, Citigroup[245]

[241] JOHN LLEWELLYN, LEHMAN BROTHERS, THE BUSINESS OF CLIMATE CHANGE: CHALLENGES AND OPPORTUNITIES 4 (2007), *available at* http://www.lehman.com/press/pdf_2007/TheBusinessOfClimateChange.pdf.
[242] JP MORGAN, AIR POLLUTION: BUSINESS RISK OR COMPETITIVE ADVANTAGE (2007), *available at* http://www.jpmorgan.com/pages/jpmorgan/investbk/solutions/research/climatechange.
[243] HENDERSON GLOBAL INVESTORS, THE CARBON 100 at 3 (2005), *available at* http://www.henderson.com/global_includes/pdf/sri/SRICarbon100Report.pdf.
[244] Joanna Glasner, *Investors Bet on Global Warming*, WIRED, Nov. 22, 2005, *available at* http://www.wired.com/techbiz/startups/news/2005/11/69370.
[245] Jody Yen, *Global Warming Goes to Wall Street*, FORBES.COM, Jun. 20, 2006, *available at* http://www.forbes.com/businessinthebeltway/2006/06/19/green-business-investing-cz_jy_0619sf.html.

- "Any insurance company that is not focusing on climate change and related possible damage is not being realistic in looking at their future profitability. As an investor, a lack of disclosure always troubles me."
  – Richard Moore, North Carolina State Treasurer[246]
- "Shareholders must understand actions taken to manage GHG and climate risks."
  – Bob Page, Vice President of Sustainable Development, TransAlta[247]
- "[C]limate change is on the agenda for governments, regulators, consumers and businesses and this is creating some major risks, but also opportunities."
  –Mike Scott, *Financial Services – Banking on Climate Change's Consequences* [248]

II. Climate Change Is a Business Reality

"Companies should take action now to define their global climate-related strategy, set GHG reduction goals and implement GHG reduction activities, not just for environmental reasons, but also for competitive advantage." – Ron Meissen, Senior Director of Environment, Health and Safety Engineering at Baxter International[249]	"Companies are becoming increasingly aware that climate is closely tied to profits." – Felix Carabello, Director of Alternative Investment Products, Chicago Mercantile Exchange[250]

- "To me, [climate change] is the defining business issue of our generation."

[246] EVAN MILLS & EUGENE LECOMTE, CERES, FROM RISK TO OPPORTUNITY: HOW INSURERS CAN PROACTIVELY AND PROFITABLY MANAGE CLIMATE CHANGE 29 (2006), *available at* http://www.ceres.org/pub/publication.php?pid=0.
[247] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 236, at 55.
[248] Mike Scott, *Financial Services – Banking on Climate Change's Consequences,* CLIMATE CHANGE CORP.COM, June 18, 2007, http://www.climatechangecorp.com/content.asp?ContentID=4852.
[249] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 236, at 6.
[250] Shell & Krantz, *supra* note 239.

– David Crane, Chief Executive Officer, NGR Energy[251]

- "[A]s many companies have already learned, acting on [climate change] is simply good business. Reducing our use of energy reduces costs. Inviting our employees to be active on this issue helps us recruit and retain the world's best. For us, as a media company-- this is a chance to deepen our relationships with our viewers, readers, and web users. The [climate] initiative we are launching today will involve every business, every function. It's not only for our facilities managers or our fleet directors-- it's about how we recruit new employees, how we develop relationships with advertisers and how we design movie sets. This is about changing the DNA of our business to re-imagine how we look at energy."
  – Rupert Murdoch, Chairman and CEO, News Corporation[252]
- "By conserving energy, we not only help the environment, but also our bottom line, as greater energy efficiency means lower costs. By investing in renewable energy, we displace some of our electricity demand during the times of day when it is most expensive, while helping green industries grow and reducing the cost of these emerging technologies. And by creating web-based products and services, we connect individuals like you with information that helps raise environmental awareness or avoids the need for you taking that trip to the store or sending that paper in the mail."
  – Google statement on climate change[253]
- "Climate change is shaping global markets and global consumer attitudes. There will be winners and losers. Companies who seize the opportunities, who adopt environmental, social and governance policies and who evolve, innovate and respond to these challenges are likely to be the pioneers and industry leaders of the 21st century."
  – Achim Steiner, Executive Director, UNEP[254]

[251] John Donnelly, *Unlikely Allies Advance Global Warming Policy*, BOSTON GLOBE, Aug. 22, 2007, *available at* http://www.boston.com/news/nation/washington/articles/2007/08/22/unlikely_allies_advance_global_warming_policy/.
[252] Rupert Murdoch, Chairman and Chief Executive Officer, News Corp., Remarks at Hudson Theatre, New York City (May 9, 2007), *available at* http://www.newscorp.com/energy/full_speech.html.
[253] Google, A Clean Energy Future @ Google, http://www.google.com/corporate/green/energy/. Google has committed to going carbon neutral by 2008.
[254] Press Release, World Bus. Council for Sustainable Dev., Business Leaders Call for Climate Action (July 6, 2007), *available at* http://www.wbcsd.ch/plugins/DocSearch/details.asp?type=DocDet&ObjectId=MjU0MTQ.

- "As a major global reinsurer, Swiss Re is committed to taking a leading role in the climate debate. We identified climate change as an emerging risk some 20 years ago, and the concern has since evolved into an important component of the company's long-term risk management strategy. Our actions are based on the premise that it is in the interest of our shareholders, clients and employees, the wider stakeholder community and society in general to tackle this issue . . . . Climate change has been designated a Swiss Re Top Topic, which means that it is recognized as an issue of Group-wide strategic importance."
  – Swiss Re statement on climate change[255]
- "Climate change is probably one of the best examples of where long-term risk planning is essential to mitigate some potentially irreversible long-term effects."
  – Brian Storms, CEO, Marsh, Inc.[256]
- "Our shareholders wanted to better understand the opportunities and risks that the climate change issue represented to their investment in Exelon, so we added a Global Climate Change Section to our 2004 10-K."
  – Helen Howes, Vice President of Environment, Health and Safety, Exelon[257]
- "We have long identified climate change as a serious environmental issue, and shareholders are increasingly asking about the risks as well as the opportunities associated with it."
  – Bill Ford, Chairman and CEO, Ford Motor Company[258]
- "The larger challenge that we face is, are we somehow in a period in which global warming is for real and we never have a cold January again. That's the single biggest risk to our industry."
  – Aubrey McClendon, CEO, Chesapeake Energy[259]

[255] Swiss Re, Our Position and Objectives, http://www.swissre.com/pws/about%20us/knowledge_expertise/top%20topics/our%20position%20and%20objectives.html?contentIDR=c217670045617 34fb900fb2ee2bd2155&useDefaultText=0&useDefaultDesc=0.
[256] PEW CTR. ON GLOBAL CLIMATE CHANGE, CLIMATE CHANGE 101: BUSINESS SOLUTIONS 1 (2006), *available at* http://www.pewclimate.org/docUploads/1114_BusinessFinal.pdf.
[257] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 236, at 54.
[258] Nat'l Envtl. Trust, U.S. Business Leaders on Global Warming, http://www.net.org/warming/docs/Business_Leadership_Quotes.pdf.
[259] Audio recording: 2006 OGIS West Investment Symposium, held by the Indep. Petroleum Ass'n of Am. (Oct. 3, 2006), *available at* http://www.investorcalendar.com/IC/CEPage.asp?ID=108780&CID=

- "Shell was one of the first energy companies to acknowledge the threat of climate change and to call for action by governments, industries and energy users . . . ."
  – John Hofmeister, U.S. Country Chair and President, Shell Oil Company[260]

III. Legislation to Mitigate Climate Change Is Inevitable

"The dam is broken . . . . It's inevitable that the federal government will have to come out and set a level playing field throughout the country." – Chris Walker, Head of Greenhouse Gas Risk Solutions Unit, Swiss Re[261]	"The growing consensus is that national domestic regulation is a matter of when, not if." – Paul Hanrahan, President and CEO, AES Corporation[262]

- "[G]overnment mandates will be required."
  – Yolanda Pagano, Director of Climate Strategy and Programs, Exelon[263]
- "Congress has changed, people realize something is coming down the pike in terms of federal legislation . . . ."
  – Douglas Fisher, utilities analyst, AG Edwards & Sons[264]
- "[W]e must include all voices to ensure that energy policies lower emissions and sustain global economic development."
  – Jim Owens, Chairman and CEO, Caterpillar Inc.[265]

[260] U.S. Climate Action P'ship (USCAP), USCAP Statements, http://www.us-cap.org/media/quotes.asp.
[261] Nat'l Envtl. Trust, *supra* note 258.
[262] Press Release, AES, AES Outlines Support for National Instead of Regional CO_2 Cap and Trade Legislation (Jan. 17, 2007), *available at* http://newsroom.aes.com/phoenix.zhtml?c=202639&p=irol-newsArticle&ID=951301&highlight=.
[263] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 236, at 47.
[264] David R. Baker & Zachary Coile et al., *Lobbying Effort Signals Corporate Climate Change*, S.F. CHRON., Jan. 23, 2007, *available at* http://sfgate.com/cgi-bin/article.cgi?f=/c/a/2007/01/23/CEOCLIMATE.TMP.
[265] USCAP, *supra* note 260.

- "We see a global system of emissions trading as inevitable."
  – Steve Lennon, Chair, Environment and Energy Commission, International Chamber of Commerce[266]
- "Technologies will emerge when CO_2 has a price signal, and that market signal will be created by regulation."
  – Kevin Leahy, Managing Director of Climate Policy, Cinergy[267]

IV. Climate Change Must Be Addressed

"We know we must address climate change . . . . [T]here is no other option." – Alain Belda, Chairman and CEO, Alcoa[268] "The unique challenge of climate change is that it requires action now . . . ." – Jeffry Sterba, Chairman, President and CEO, PNM Resources[269]	"Climate change is a serious issue that has to be addressed through concrete action." – Chad Holliday, Chairman and CEO, DuPont[270]

- "It is critical that business, government and non-governmental organizations come together to develop efficient and effective approaches to addressing environmental impacts of greenhouse gas emissions and our mutual energy future."
  – Indra K. Nooyi, Chairman and CEO, PepsiCo[271]
- "[C]limate change is a serious problem that must be addressed."
  – Martin Sullivan, President and CEO, AIG[272]

[266] Nat'l Envtl. Trust, *supra* note 258.
[267] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 236, at 47.
[268] USCAP, *supra* note 260.
[269] *Id.*
[270] *Id.*
[271] *Id.*
[272] *Id.*

- "GM is very pleased to join USCAP in proactively addressing the concerns posed by climate change."
  – Rick Wagoner, Chairman and CEO, General Motors Corp.[273]
- "Climate change is real and the most urgent environmental issue our society faces."
  – Andrew Liveris, Chairman and CEO, The Dow Chemical Company[274]
- "We support the goal of reducing greenhouse gas emissions to mitigate the expected adverse effects of climate change."
  – William C. Weldon, Chairman and CEO, Johnson & Johnson[275]
- "[A]ction to address these emissions sooner rather than later will lower the costs and difficulties of mitigation and innovation."
  – Robert Lane, Chairman and CEO, Deere & Company[276]
- "[T]he sooner we act the better it will be for our environment, customers and the economy."
  – Jim Rogers, Chairman, President and CEO, Duke Energy[277]
- "[W]e are committed to tackling the challenge of global climate change."
  – George Nolen, President and CEO, Siemens Corporation.[278]
- "We believe climate change is one of the most significant environmental challenges of the 21st century . . . . [V]oluntary action alone cannot solve the climate change problem."
  – Goldman Sachs Environmental Policy Framework[279]
- "No other country bears a greater responsibility – or possesses a greater capacity – to lead the global response on this issue."
  – Peter A. Darbee, Chairman of the Board, CEO and President, PG&E Corporation[280]

[273] *Id.*
[274] *Id.*
[275] *Id.*
[276] *Id.*
[277] *Id.*
[278] *Id.*
[279] GOLDMAN SACHS, GOLDMAN SACHS ENVIRONMENTAL POLICY FRAMEWORK 1 (undated), *available at* http://www2.goldmansachs.com/our_firm/our_culture/corporate_citizenship/environmental_policy_framework/docs/EnvironmentalPolicyFramework.pdf.
[280] USCAP, *supra* note 260.

- "We don't have a lot more time to deal with climate change . . . ."
  – Henry Paulson, then-Chairman, Goldman Sachs[281]
- "BHP Billiton has recognized that our company, as well as society generally, must make real behavioral changes and accelerate technological progress if we are to achieve a meaningful reduction in energy use and greenhouse gas emissions."
  – Chip Goodyear, CEO, BHP Billiton[282]
- "We have to deal with greenhouse gases. From Shell's point of view, the debate is over. When 98 percent of scientists agree, who is Shell to say, 'Let's debate the science'?"
  – John Hofmeister, President, Shell Oil Co.[283]
- "We support urgent but informed action to stabilize greenhouse gas (GHG) concentrations by achieving sustainable long-term emission reductions at the lowest possible cost."[284]
  – BP P.L.C. position on climate change
- "Climate change poses clear, catastrophic threats. We may not agree on the extent, but we certainly can't afford the risk of inaction."
  – Rupert Murdoch, Chairman and Chief Executive Officer, News Corporation[285]
- "In the distribution of possible future outcomes of global warming, there is a significant tail representing very serious consequences. It is the prudent approach – a common practice in insurance and issues of financial stability – which requires us to take action today to mitigate global warming and to adapt to its consequences."
  – Jacques Aigrain, Chief Executive Office, Swiss Re[286]

[281] Envtl. & Energy Study Institute, *First Meeting of Parties to Kyoto Protocol Underway in Montreal*, CLIMATE CHANGE NEWS, Dec. 2, 2005, http://www.eesi.org/publications/Newsletters/CCNews/12.2.05%20CCNews.htm.
[282] BHP Billiton, Ltd., *BHP Billiton Launches Revised Climate Change Policy*, CSRWIRE, June 19, 2007, *available at* http://www.csrwire.com/News/8939.html.
[283] Steven Mufson & Juliet Eilperin, *Energy Firms Come to Terms with Climate Change*, WASH. POST, Nov. 25, 2006, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2006/11/24/AR2006112401361.html.
[284] BP, Climate Change - Our Position, http://www.bp.com/sectiongenericarticle.do?categoryId=9015582&contentId=7028604.
[285] Murdoch, *supra* note 252.
[286] Swiss Re, *supra* note 255.

V. Federal Legislation Concerning Climate Change Is Desirable

Thirty-three U.S. businesses and environmental groups have joined together to form the U.S. Climate Action Partnership, that have come together "to call on the federal government to enact legislation requiring significant reductions of greenhouse gas emissions."[287] The joint statement pledges that the corporations will "work with the President, the Congress and all other stakeholders to enact an environmentally effective, economically sustainable, and fair climate change program consistent with our principles at the earliest practicable date"[288] and recommends "mandatory" regulations "to reduce greenhouse gas emissions."[289]

"[T]he time has come to act – to take steps as a nation to reduce the carbon intensity of our economy . . . any actions must be mandatory, economy-wide and federal in scope." – Paul Anderson, CEO, Duke Energy Corp.[290]	"We need a uniform and predictable system. . . . It needs to be a federal system." – Ken Cohen, Vice-President of Public Affairs, Exxon Mobil[291]

- "[State level regulation] would be a huge misdirection of resources and much less would be achieved if we are subjected to a balkanized set of standards from 50 different sources."
  – Tom Catania, Vice President of Government Relations, Whirlpool[292]

[287] U.S. Climate Action P'ship (USCAP), http://www.us-cap.org. Members of USCAP include Alcan Inc., Alcoa, American International Group, Inc. (AIG), Boston Scientific Corporation, BP, America Inc., Caterpillar Inc., Chrysler LLC, ConocoPhillips, Deere & Company, The Dow Chemical Company, Duke Energy, DuPont, Environmental Defense, Exelon Corporation, Ford Motor Company, FPL Group, Inc., General Electric, General Motors Corp., Johnson & Johnson, Marsh, Inc., National Wildlife Federation, Natural Resources Defense Council, The Nature Conservancy, NRG Energy, Inc., PepsiCo, Pew Center on Global Climate Change, PG&E Corporation, PNM Resources, Rio Tinto, Shell, Siemens Corporation, World Resources Institute, Xerox Corporation.
[288] U.S. CLIMATE ACTION P'SHIP, A CALL FOR ACTION 11 (2007), *available at* http://www.us-cap.org/USCAPCallForAction.pdf.
[289] USCAP, *supra* note 260.
[290] Nat'l Envtl. Trust, *supra* note 258.
[291] *Everybody's Green Now: How America's Big Companies Got Environmentalism*, ECONOMIST, May 31, 2007, *available at* http://www.economist.com/surveys/PrinterFriendly.cfm?story_id=9217982.
[292] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 236, at 50.

- "[W]e support [the] goal of a mandatory national regulatory framework."
  – James J. Mulva, Chairman and CEO, ConocoPhillips[293]
- "We must . . . create energy policy that is integrated, coherent and clear. . . ."
  – Jeffrey Immelt, Chairman of the Board and CEO, General Electric[294]
- "It is in the interest of society and business to reduce the uncertainty and increase the predictability of policy frameworks and market conditions around the issue of climate change."
  – Bill Ford, CEO, Ford Motor Co.[295]
- "Alcan is . . . committed to bringing about legislative action on climate change."
  – Richard B. Evans, President and CEO, Alcan, Inc.[296]
- "The sooner we act, the more options we have for solutions, the less costly they will be and the fewer uncertainties we will face with the climate."
  –Peter A. Darbee, Chairman of the Board, CEO and President, PG&E Corporation [297]
- "Give us a date, tell us how much we need to cut, give us the flexibility to meet the goals, and we'll get it done."
  – Wayne H. Brunetti, CEO and Chairman, Xcel Energy[298]
- "[W]e will campaign for public policies designed to cut emissions to the levels required to keep our climate system stable. We support energy efficiency standards that accelerate the deployment of energy-efficient technologies throughout the world, specific targets to increase renewable energy supplies on the grid, public support for research and development aimed at developing and commercializing low-carbon technologies, and mandatory emissions limits that put a price on carbon."
  – Google statement on climate change[299]

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[293] USCAP, *supra* note 260.
[294] *Id.*
[295] *Id.*
[296] *Id.*
[297] David R. Baker & Zachary Coile, *Lobbying Effort Signals Corporate Climate Change*, S. F. CHRON., Jan 23, 2007, at D1, *available at* http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2007/01/23/BUGO0NN3EC1.DTL&feed=rss.news
[298] PEW CTR. ON GLOBAL CLIMATE CHANGE, *supra* note 256, at 7.
[299] Google, *supra* note 253.

KEY ELEMENTS OF PROPOSED SEC GUIDANCE ON CLIMATE DISCLOSURE

The Commission should issue an interpretive release clarifying registrants' obligation under existing law and regulations to assess the risks they face in connection with climate change and to disclose those risks that are material. This guidance should set forth the process by which a registrant should make this assessment and the types of information most likely to be relevant to the assessment, and should direct registrants to disclose the following risks if they are material:

1. Physical risks associated with climate change;
2. Financial risks associated with present or probable regulation of greenhouse gas emissions; and
3. Legal proceedings relating to climate change.

Basis for Interpretive Release

As explained in our petition, climate change has become increasingly important to the operations and financial condition of many registrants. Developments associated with global warming, including physical changes associated with a warming climate and regulatory measures adopted to mitigate greenhouse gas emissions, can affect companies in a variety of ways, such as by posing risks to physical assets of the registrant or its customers or suppliers, introducing new regulatory compliance costs and obligations, increasing the costs of important inputs, and opening up opportunities for new products and services. Many investors are now seeking information concerning companies' response to the physical changes, regulatory developments, and new opportunities associated with climate change.

While some registrants have been providing information on the impacts of climate change in their periodic filings, disclosures remain inconsistent and in many cases incomplete. In particular, corporate disclosure of the risks posed by climate change is lacking, even for companies that do address the impact of climate change and their own emissions. The uneven state of disclosure of climate information, the pervasive emergence of global warming as a significant influence upon the economy, the numerous and complex ways in which it may bear materially on registrants' financial condition, and the widespread adoption of greenhouse gas

regulations in recent years, all indicate a need for guidance concerning registrants' disclosure obligations with respect to climate issues.

Climate-related risks that constitute material contingent liabilities must be expressed on a company's balance sheet or in footnotes to financial statements. *See* Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. Our petition sets forth examples of climate risk that may require such treatment. *See* Petition Part 3.

Whether or not climate risk can be estimated with a degree of certainty warranting its classification as a material contingent liability, registrants have obligations under various provisions of Regulation S-K to disclose in narrative form material information regarding the physical risks associated with climate change and with governmental regulations intended to limit emissions of greenhouse gases. Registrants should carefully examine the potential implications of climate change and present or probable regulation of greenhouse gas emissions for their own operations and financial condition. Whether disclosure is required will depend, as in other areas, upon an informed judgment about whether the information is material. In addressing that question, companies should not limit their consideration merely to particular projects and sites, but should also consider whether the overall degree of risk posed by climate change is material to the corporation's long-term ability to create and maintain value for shareholders.

Several provisions of Regulation S-K have particular importance when considering the impact of climate change and related developments. As part of the narrative description of its business under Item 101, a registrant must disclose any material effects of compliance with Federal, State and local laws regulating the discharge of materials into the environment or otherwise relating to the protection of the environment may have upon the registrant's capital expenditures, earnings and competitive position. 17 C.F.R. § 229.101(c)(xii). Item 103 requires disclosures concerning certain judicial or administrative proceedings arising under laws intended to protect the environment. 17 C.F.R. § 229.103 & Instruction 5. Under Item 303, Management's Discussion and Analysis of Financial Condition and Results of Operations must include discussions of factors bearing materially on the company's financial condition and business operations, including an identification of known trends or uncertainties expected to have a material impact on the registrant's liquidity, capital resources, net sales or revenues or income from continuing operations. 17 C.F.R. § 229.303(a).

As the Commission noted in its recent guidance on MD&A disclosure, companies now have "access to and use substantially more detailed and timely information about their financial conditions and operating performance than they did when our MD&A requirements initially were introduced . . . . Some of this information is itself non-financial in nature, but bears on companies' financial condition and operating performance."[300] Information bearing on the consequences of climate change and greenhouse gas regulation for a registrant's operations and financial condition is an important part of that expanding body of information, and registrants should review it carefully and make disclosures where appropriate.

As the MD&A release observed, "in identifying, discussing and analyzing known material trends and uncertainties, companies are expected to consider all relevant information, even if that information is not required to be disclosed."[301] In assessing the impact of climate change and greenhouse gas regulation on their financial condition and operations, registrants should examine any corporate policies or governance structures that have been established to address climate issues, and review the company's institutional mechanisms for assembling and analyzing information about the various ways in which climate change can affect the company. Where the company has not established internal mechanisms for assembling and assessing climate information, it may need to do so in order to exercise informed judgments concerning the nature and materiality of climate-related risk.

Process for Assessment of Material Climate Risks

To assess potential financial risks associated with present and probable regulatory requirements concerning greenhouse gases, registrants should determine their current and projected emissions levels. Companies should tabulate their current greenhouse gas emissions, including direct emissions from their own operations and emissions from purchased electricity and purchased products and services. They should estimate their past greenhouse gas emissions to the extent necessary to assess significant trends in their emissions levels, and should also project their future greenhouse gas emissions, as necessary to evaluate the costs they are likely to face from greenhouse gas regulation.

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[300] Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056 (Dec. 29, 2003).
[301] *Id.*

Well established tools such as the Greenhouse Gas Protocol exist to aid in the calculation of greenhouse gas emissions.

Factors to Evaluate in Assessing the Materiality of Climate Risks

While disclosure obligations will depend upon individual registrants' particular circumstances, and assessment of the materiality of climate risks, the following kinds of information should be considered and may be subject to disclosure obligations under existing Commission regulations.

Physical Risks Associated with Climate Change

A registrant should review and evaluate the consequences that physical risks and effects associated with climate change may have for the registrant's business and operations, including its personnel, physical assets, supply chain, and distribution chain, and must disclose information on those consequences when they are material to corporate performance.

Examples of such physical effects may include the impact of changes in weather patterns, such as increases in the storm intensity, sea-level rise, melting of permafrost, and temperature extremes, on facilities or operations; effects of climate change upon land, water availability or quality, or other natural resources on which the registrant's business depends; damage to facilities or decreased efficiency of equipment; or effects of changes in temperature on the health of the workforce.

For some registrants, financial risks associated with climate change may arise from physical risks to entities other than the registrant itself. For example, climate change-related physical changes and hazards to coastal property may pose a material credit risks for banks whose borrowers are located in at-risk areas. Climate change may also affect a registrant's supply chain in a variety of ways: climatic changes may diminish supplies of important inputs, physical damage to suppliers' infrastructure may cause costly interruptions in deliveries, and physical changes associated with climate change may decrease consumer demand for products or services. Registrants should evaluate whether they are subject to such risks and disclose any material information related to them. Physical impacts associated with climate change will vary widely depending upon companies' location and the nature of their facilities and operations, but

all registrants should review their exposure to such risks and, where the risks are material, must disclose them.

Financial Risks Associated with Greenhouse Gas Regulation

For many registrants, present or probable greenhouse gas regulation has material effects warranting disclosure. When compliance with any international, federal, state, or local laws and regulations concerning climate, including laws regulating greenhouse gas emissions, may have a material effect on the capital expenditures, earnings, and competitive position of the registrant and its subsidiaries, such laws should be identified and their effect discussed.

In conformity with Item 303 of Regulation S-K, registrants must describe any known trends or uncertainties in connection with the impact of climate change or greenhouse gas regulation that they reasonably expect will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. When costs associated with compliance with such laws, or penalties for noncompliance, are material to a registrant's financial condition or operations, the registrant's disclosures must include an analysis of any such material effects, including a discussion of the financial risks and opportunities afforded by such regulations.

When a registrant concludes that legislative and regulatory proposals, although not yet enacted into law, are reasonably likely to be enacted and that such proposals, if adopted, would have a material effect on the company's financial condition or operations, the registrant should identify and discuss the proposals. The registrant should describe and evaluate realistic alternative regulatory scenarios.

Greenhouse gas regulation may have a material effect upon a registrant that is not itself directly subject to the regulation, for example by increasing the costs or decreasing the supply of some product or service on which the registrant's business depends, or increasing or decreasing demand for the registrant's products or services. Where material, such indirect effects should be identified and analyzed.

Legal Proceedings Relating to Climate Change

Under Item 103, registrants must describe any pending judicial or administrative proceeding other than routine business litigation, arising under any Federal, State or local laws, if the proceeding is considered material to the business or financial condition of the registrant; or involves a claim for damages exceeding 10 percent of the assets of the registrant and its subsidiaries on a consolidated basis; or a government authority is a party to such proceeding(s) and the proceeding(s) involves potential monetary sanctions above $100,000. Registrants must disclose any proceedings arising under laws relating to climate change, including those regulating emissions of greenhouse gases, when the proceedings meet the Item 103 criteria.

Part 260 -- GUIDES FOR THE USE OF ENVIRONMENTAL MARKETING CLAIMS

sec.

260.1 Statement of Purpose.
260.2 Scope of guides.
260.3 Structure of the guides.
260.4 Review procedure.
260.5 Interpretation and substantiation of environmental marketing claims.
260.6 General principles.
260.7 Environmental marketing claims.
260.8 Environmental assessment.

Authority: 15 U.S.C. §§ 41-58

§ 260.1 Statement of purpose

These guides represent administrative interpretations of laws administered by the Federal Trade Commission for the guidance of the public in conducting its affairs in conformity with legal requirements. These guides specifically address the application of Section 5 of the FTC Act to environmental advertising and marketing practices. They provide the basis for voluntary compliance with such laws by members of industry. Conduct inconsistent with the positions articulated in these guides may result in corrective action by the Commission under Section 5 if, after investigation, the Commission has reason to believe that the behavior falls within the scope of conduct declared unlawful by the statute.

§ 260.2 Scope of guides

These guides apply to environmental claims included in labeling, advertising, promotional materials and all other forms of marketing, whether asserted directly or by implication, through words, symbols, emblems, logos, depictions, product brand names, or through any other means, including marketing through digital or electronic means, such as the Internet or electronic mail. The guides apply to any claim about the environmental attributes of a product, package or service in connection with the sale, offering for sale, or marketing of such product, package or service for personal, family or household use, or for commercial, institutional or industrial use.

Because the guides are not legislative rules under Section 18 of the FTC Act, they are not themselves enforceable regulations, nor do they have the force and effect of law. The guides themselves do not preempt regulation of other federal agencies or of state and local bodies governing the use of environmental marketing claims. Compliance with federal, state or local law and regulations concerning such claims, however, will not necessarily preclude Commission law enforcement action under Section 5.

§ 260.3 Structure of the guides

The guides are composed of general principles and specific guidance on the use of environmental claims. These general principles and specific guidance are followed by examples that generally address a single deception concern. A given claim may raise issues

that are addressed under more than one example and in more than one section of the guides.

In many of the examples, one or more options are presented for qualifying a claim. These options are intended to provide a "safe harbor" for marketers who want certainty about how to make environmental claims. They do not represent the only permissible approaches to qualifying a claim. The examples do not illustrate all possible acceptable claims or disclosures that would be permissible under Section 5. In addition, some of the illustrative disclosures may be appropriate for use on labels but not in print or broadcast advertisements and vice versa. In some instances, the guides indicate within the example in what context or contexts a particular type of disclosure should be considered.

§ 260.4 Review procedure

The Commission will review the guides as part of its general program of reviewing all industry guides on an ongoing basis. Parties may petition the Commission to alter or amend these guides in light of substantial new evidence regarding consumer interpretation of a claim or regarding substantiation of a claim. Following review of such a petition, the Commission will take such action as it deems appropriate.

§ 260.5 Interpretation and substantiation of environmental marketing claims

Section 5 of the FTC Act makes unlawful deceptive acts and practices in or affecting commerce. The Commission's criteria for determining whether an express or implied claim has been made are enunciated in the Commission's Policy Statement on Deception.[1] In addition, any party making an express or implied claim that presents an objective assertion about the environmental attribute of a product, package or service must, at the time the claim is made, possess and rely upon a reasonable basis substantiating the claim. A reasonable basis consists of competent and reliable evidence. In the context of environmental marketing claims, such substantiation will often require competent and reliable scientific evidence, defined as tests, analyses, research, studies or other evidence based on the expertise of professionals in the relevant area, conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession to yield accurate and reliable results. Further guidance on the reasonable basis standard is set forth in the Commission's 1983 Policy Statement on the Advertising Substantiation Doctrine. 49 Fed. Reg. 30999 (1984); *appended to Thompson Medical Co.*, 104 F.T.C. 648 (1984). The Commission has also taken action in a number of cases involving alleged deceptive or unsubstantiated environmental advertising claims. A current list of environmental marketing cases and/or copies of individual cases can be obtained by calling the FTC Consumer Response Center at (202) 326-2222.

§ 260.6 General principles

The following general principles apply to all environmental marketing claims, including, but not limited to, those described in § 260.7. In addition, § 260.7 contains specific guidance applicable to certain environmental marketing claims. Claims should comport with all relevant provisions of these guides, not simply the provision that seems most directly applicable.

(a) *Qualifications and disclosures*: The Commission traditionally has held that in order to be effective, any qualifications or disclosures such as those described in these guides should be sufficiently clear, prominent and understandable to prevent deception. Clarity of language, relative type size and proximity to the claim being qualified, and an absence of contrary claims that could undercut effectiveness, will maximize the likelihood that the qualifications and disclosures are appropriately clear and prominent.

(b) *Distinction between benefits of product, package and service*: An environmental marketing claim should be presented in a way that makes clear whether the environmental attribute or benefit being asserted refers to the product, the product's packaging, a service or to a portion or component of the product, package or service. In general, if the environmental attribute or benefit applies to all but minor, incidental components of a product or package, the claim need not be qualified to identify that fact. There may be exceptions to this general principle. For example, if an unqualified "recyclable" claim is made and the presence of the incidental component significantly limits the ability to recycle the product, then the claim would be deceptive.

Example 1:
A box of aluminum foil is labeled with the claim "recyclable," without further elaboration. Unless the type of product, surrounding language, or other context of the phrase establishes whether the claim refers to the foil or the box, the claim is deceptive if any part of either the box or the foil, other than minor, incidental components, cannot be recycled.

Example 2:
A soft drink bottle is labeled "recycled." The bottle is made entirely from recycled materials, but the bottle cap is not. Because reasonable consumers are likely to consider the bottle cap to be a minor, incidental component of the package, the claim is not deceptive. Similarly, it would not be deceptive to label a shopping bag "recycled" where the bag is made entirely of recycled material but the easily detachable handle, an incidental component, is not.

(c) *Overstatement of environmental attribute*: An environmental marketing claim should not be presented in a manner that overstates the environmental attribute or benefit, expressly or by implication. Marketers should avoid implications of significant environmental benefits if the benefit is in fact negligible.

Example 1:
A package is labeled, "50% more recycled content than before." The manufacturer increased the recycled content of its package from 2 percent recycled material to 3 percent recycled material. Although the claim is technically true, it is likely to convey the false impression that the advertiser has increased significantly the use of recycled material.

Example 2:
A trash bag is labeled "recyclable" without qualification. Because trash bags will ordinarily not be separated out from other trash at the landfill or incinerator for recycling, they are highly unlikely to be used again for any purpose. Even if the bag is technically capable of being recycled, the claim is deceptive since it asserts an environmental benefit where no significant or meaningful benefit exists.

Example 3:
A paper grocery sack is labeled "reusable." The sack can be brought back to the store

and reused for carrying groceries but will fall apart after two or three reuses, on average. Because reasonable consumers are unlikely to assume that a paper grocery sack is durable, the unqualified claim does not overstate the environmental benefit conveyed to consumers. The claim is not deceptive and does not need to be qualified to indicate the limited reuse of the sack.

Example 4:

A package of paper coffee filters is labeled "These filters were made with a chlorine-free bleaching process." The filters are bleached with a process that releases into the environment a reduced, but still significant, amount of the same harmful byproducts associated with chlorine bleaching. The claim is likely to overstate the product's benefits because it is likely to be interpreted by consumers to mean that the product's manufacture does not cause any of the environmental risks posed by chlorine bleaching. A claim, however, that the filters were "bleached with a process that substantially reduces, but does not eliminate, harmful substances associated with chlorine bleaching" would not, if substantiated, overstate the product's benefits and is unlikely to be deceptive.

(d) *Comparative claims*: Environmental marketing claims that include a comparative statement should be presented in a manner that makes the basis for the comparison sufficiently clear to avoid consumer deception. In addition, the advertiser should be able to substantiate the comparison.

Example 1:

An advertiser notes that its shampoo bottle contains "20% more recycled content." The claim in its context is ambiguous. Depending on contextual factors, it could be a comparison either to the advertiser's immediately preceding product or to a competitor's product. The advertiser should clarify the claim to make the basis for comparison clear, for example, by saying "20% more recycled content than our previous package." Otherwise, the advertiser should be prepared to substantiate whatever comparison is conveyed to reasonable consumers.

Example 2:

An advertiser claims that "our plastic diaper liner has the most recycled content." The advertised diaper does have more recycled content, calculated as a percentage of weight, than any other on the market, although it is still well under 100% recycled. Provided the recycled content and the comparative difference between the product and those of competitors are significant and provided the specific comparison can be substantiated, the claim is not deceptive.

Example 3:

An ad claims that the advertiser's packaging creates "less waste than the leading national brand." The advertiser's source reduction was implemented sometime ago and is supported by a calculation comparing the relative solid waste contributions of the two packages. The advertiser should be able to substantiate that the comparison remains accurate.

§ 260.7 Environmental marketing claims

Guidance about the use of environmental marketing claims is set forth below. Each guide is followed by several examples that illustrate, but do not provide an exhaustive list of, claims that do and do not comport with the guides. In each case, the general principles set forth in § 260.6 should also be followed.(2)

***(a) General environmental benefit claims*:** It is deceptive to misrepresent, directly or by

implication, that a product, package or service offers a general environmental benefit. Unqualified general claims of environmental benefit are difficult to interpret, and depending on their context, may convey a wide range of meanings to consumers. In many cases, such claims may convey that the product, package or service has specific and far-reaching environmental benefits. As explained in the Commission's Advertising Substantiation Statement, every express and material implied claim that the general assertion conveys to reasonable consumers about an objective quality, feature or attribute of a product or service must be substantiated. Unless this substantiation duty can be met, broad environmental claims should either be avoided or qualified, as necessary, to prevent deception about the specific nature of the environmental benefit being asserted.

Example 1:

A brand name like "Eco-Safe" would be deceptive if, in the context of the product so named, it leads consumers to believe that the product has environmental benefits which cannot be substantiated by the manufacturer. The claim would not be deceptive if "Eco-Safe" were followed by clear and prominent qualifying language limiting the safety representation to a particular product attribute for which it could be substantiated, and provided that no other deceptive implications were created by the context.

Example 2:

A product wrapper is printed with the claim "Environmentally Friendly." Textual comments on the wrapper explain that the wrapper is "Environmentally Friendly because it was not chlorine bleached, a process that has been shown to create harmful substances." The wrapper was, in fact, not bleached with chlorine. However, the production of the wrapper now creates and releases to the environment significant quantities of other harmful substances. Since consumers are likely to interpret the "Environmentally Friendly" claim, in combination with the textual explanation, to mean that no significant harmful substances are currently released to the environment, the "Environmentally Friendly" claim would be deceptive.

Example 3:

A pump spray product is labeled "environmentally safe." Most of the product's active ingredients consist of volatile organic compounds (VOCs) that may cause smog by contributing to ground-level ozone formation. The claim is deceptive because, absent further qualification, it is likely to convey to consumers that use of the product will not result in air pollution or other harm to the environment.

Example 4:

A lawn care pesticide is advertised as "essentially non-toxic" and "practically non-toxic." Consumers would likely interpret these claims in the context of such a product as applying not only to human health effects but also to the product's environmental effects. Since the claims would likely convey to consumers that the product does not pose any risk to humans or the environment, if the pesticide in fact poses a significant risk to humans or environment, the claims would be deceptive.

Example 5:

A product label contains an environmental seal, either in the form of a globe icon, or a globe icon with only the text "Earth Smart" around it. Either label is likely to convey to consumers that the product is environmentally superior to other products. If the manufacturer cannot substantiate this broad claim, the claim would be deceptive. The claims would not be deceptive if they were accompanied by clear and prominent qualifying language limiting the environmental superiority representation to the particular product attribute or attributes for which they could be substantiated, provided that no other deceptive implications were created by the context.

Example 6:

A product is advertised as "environmentally preferable." This claim is likely to convey to consumers that this product is environmentally superior to other products. If the manufacturer cannot substantiate this broad claim, the claim would be deceptive. The claim would not be deceptive if it were accompanied by clear and prominent qualifying language limiting the environmental superiority representation to the particular product attribute or attributes for which it could be substantiated, provided that no other deceptive implications were created by the context.

(b) *Degradable/biodegradable/photodegradable*: It is deceptive to misrepresent, directly or by implication, that a product or package is degradable, biodegradable or photodegradable. An unqualified claim that a product or package is degradable, biodegradable or photodegradable should be substantiated by competent and reliable scientific evidence that the entire product or package will completely break down and return to nature, i.e., decompose into elements found in nature within a reasonably short period of time after customary disposal.

Claims of degradability, biodegradability or photodegradability should be qualified to the extent necessary to avoid consumer deception about: (1) the product or package's ability to degrade in the environment where it is customarily disposed; and (2) the rate and extent of degradation.

Example 1:

A trash bag is marketed as "degradable," with no qualification or other disclosure. The marketer relies on soil burial tests to show that the product will decompose in the presence of water and oxygen. The trash bags are customarily disposed of in incineration facilities or at sanitary landfills that are managed in a way that inhibits degradation by minimizing moisture and oxygen. Degradation will be irrelevant for those trash bags that are incinerated and, for those disposed of in landfills, the marketer does not possess adequate substantiation that the bags will degrade in a reasonably short period of time in a landfill. The claim is therefore deceptive.

Example 2:

A commercial agricultural plastic mulch film is advertised as "Photodegradable" and qualified with the phrase, "Will break down into small pieces if left uncovered in sunlight." The claim is supported by competent and reliable scientific evidence that the product will break down in a reasonably short period of time after being exposed to sunlight and into sufficiently small pieces to become part of the soil. The qualified claim is not deceptive. Because the claim is qualified to indicate the limited extent of breakdown, the advertiser need not meet the elements for an unqualified photodegradable claim, i.e., that the product will not only break down, but also will decompose into elements found in nature.

Example 3:

A soap or shampoo product is advertised as "biodegradable," with no qualification or other disclosure. The manufacturer has competent and reliable scientific evidence demonstrating that the product, which is customarily disposed of in sewage systems, will break down and decompose into elements found in nature in a short period of time. The claim is not deceptive.

Example 4:

A plastic six-pack ring carrier is marked with a small diamond. Many state laws require that plastic six-pack ring carriers degrade if littered, and several state laws also require that the carriers be marked with a small diamond symbol to indicate that they meet performance standards for degradability. The use of the diamond, by itself, does not constitute a claim of degradability.[3]

(c) Compostable: It is deceptive to misrepresent, directly or by implication, that a product or package is compostable. A claim that a product or package is compostable should be substantiated by competent and reliable scientific evidence that all the materials in the product or package will break down into, or otherwise become part of, usable compost (e.g., soil-conditioning material, mulch) in a safe and timely manner in an appropriate composting program or facility, or in a home compost pile or device. Claims of compostability should be qualified to the extent necessary to avoid consumer deception. An unqualified claim may be deceptive if: (1) the package cannot be safely composted in a home compost pile or device; or (2) the claim misleads consumers about the environmental benefit provided when the product is disposed of in a landfill. A claim that a product is compostable in a municipal or institutional composting facility may need to be qualified to the extent necessary to avoid deception about the limited availability of such composting facilities.

Example 1:

A manufacturer indicates that its unbleached coffee filter is compostable. The unqualified claim is not deceptive provided the manufacturer can substantiate that the filter can be converted safely to usable compost in a timely manner in a home compost pile or device. If this is the case, it is not relevant that no local municipal or institutional composting facilities exist.

Example 2:

A lawn and leaf bag is labeled as "Compostable in California Municipal Yard Trimmings Composting Facilities." The bag contains toxic ingredients that are released into the compost material as the bag breaks down. The claim is deceptive if the presence of these toxic ingredients prevents the compost from being usable.

Example 3:

A manufacturer makes an unqualified claim that its package is compostable. Although municipal or institutional composting facilities exist where the product is sold, the package will not break down into usable compost in a home compost pile or device. To avoid deception, the manufacturer should disclose that the package is not suitable for home composting.

Example 4:

A nationally marketed lawn and leaf bag is labeled "compostable." Also printed on the bag is a disclosure that the bag is not designed for use in home compost piles. The bags are in fact composted in yard trimmings composting programs in many communities around the country, but such programs are not available to a substantial majority of consumers or communities where the bag is sold. The claim is deceptive because reasonable consumers living in areas not served by yard trimmings programs may understand the reference to mean that composting facilities accepting the bags are available in their area. To avoid deception, the claim should be qualified to indicate the limited availability of such programs, for example, by stating, "Appropriate facilities may not exist in your area." Other examples of adequate qualification of the claim include providing the approximate percentage of communities or the population for which such programs are available.

Example 5:

A manufacturer sells a disposable diaper that bears the legend, "This diaper can be composted where solid waste composting facilities exist. There are currently [X number of] solid waste composting facilities across the country." The claim is not deceptive, assuming that composting facilities are available as claimed and the manufacturer can substantiate that the diaper can be converted safely to usable compost in solid waste composting facilities.

Example 6:

A manufacturer markets yard trimmings bags only to consumers residing in particular geographic areas served by county yard trimmings composting programs. The bags meet specifications for these programs and are labeled, "Compostable Yard Trimmings Bag for County Composting Programs." The claim is not deceptive. Because the bags are compostable where they are sold, no qualification is required to indicate the limited availability of composting facilities.

(d) Recyclable: It is deceptive to misrepresent, directly or by implication, that a product or package is recyclable. A product or package should not be marketed as recyclable unless it can be collected, separated or otherwise recovered from the solid waste stream for reuse, or in the manufacture or assembly of another package or product, through an established recycling program. Unqualified claims of recyclability for a product or package may be made if the entire product or package, excluding minor incidental components, is recyclable. For products or packages that are made of both recyclable and non-recyclable components, the recyclable claim should be adequately qualified to avoid consumer deception about which portions or components of the product or package are recyclable. Claims of recyclability should be qualified to the extent necessary to avoid consumer deception about any limited availability of recycling programs and collection sites. If an incidental component significantly limits the ability to recycle a product or package, a claim of recyclability would be deceptive. A product or package that is made from recyclable material, but, because of its shape, size or some other attribute, is not accepted in recycling programs for such material, should not be marketed as recyclable.(4)

Example 1:

A packaged product is labeled with an unqualified claim, "recyclable." It is unclear from the type of product and other context whether the claim refers to the product or its package. The unqualified claim is likely to convey to reasonable consumers that all of both the product and its packaging that remain after normal use of the product, except for minor, incidental components, can be recycled. Unless each such message can be substantiated, the claim should be qualified to indicate what portions are recyclable.

Example 2:

A nationally marketed 8 oz. plastic cottage-cheese container displays the Society of the Plastics Industry (SPI) code (which consists of a design of arrows in a triangular shape containing a number and abbreviation identifying the component plastic resin) on the front label of the container, in close proximity to the product name and logo. The manufacturer's conspicuous use of the SPI code in this manner constitutes a recyclability claim. Unless recycling facilities for this container are available to a substantial majority of consumers or communities, the claim should be qualified to disclose the limited availability of recycling programs for the container. If the SPI code, without more, had been placed in an inconspicuous location on the container (e.g., embedded in the bottom of the container) it would not constitute a claim of recyclability.

Example 3:

A container can be burned in incinerator facilities to produce heat and power. It cannot, however, be recycled into another product or package. Any claim that the container is recyclable would be deceptive.

Example 4:

A nationally marketed bottle bears the unqualified statement that it is "recyclable."

Collection sites for recycling the material in question are not available to a substantial majority of consumers or communities, although collection sites are established in a significant percentage of communities or available to a significant percentage of the population. The unqualified claim is deceptive because, unless evidence shows otherwise, reasonable consumers living in communities not served by programs may conclude that recycling programs for the material are available in their area. To avoid deception, the claim should be qualified to indicate the limited availability of programs, for example, by stating "This bottle may not be recyclable in your area," or "Recycling programs for this bottle may not exist in your area." Other examples of adequate qualifications of the claim include providing the approximate percentage of communities or the population to whom programs are available.

Example 5:

A paperboard package is marketed nationally and labeled, "Recyclable where facilities exist." Recycling programs for this package are available in a significant percentage of communities or to a significant percentage of the population, but are not available to a substantial majority of consumers. The claim is deceptive because, unless evidence shows otherwise, reasonable consumers living in communities not served by programs that recycle paperboard packaging may understand this phrase to mean that such programs are available in their area. To avoid deception, the claim should be further qualified to indicate the limited availability of programs, for example, by using any of the approaches set forth in Example 4 above.

Example 6:

A foam polystyrene cup is marketed as follows: "Recyclable in the few communities with facilities for foam polystyrene cups." Collection sites for recycling the cup have been established in a half-dozen major metropolitan areas. This disclosure illustrates one approach to qualifying a claim adequately to prevent deception about the limited availability of recycling programs where collection facilities are not established in a significant percentage of communities or available to a significant percentage of the population. Other examples of adequate qualification of the claim include providing the number of communities with programs, or the percentage of communities or the population to which programs are available.

Example 7:

A label claims that the package "includes some recyclable material." The package is composed of four layers of different materials, bonded together. One of the layers is made from the recyclable material, but the others are not. While programs for recycling this type of material are available to a substantial majority of consumers, only a few of those programs have the capability to separate the recyclable layer from the non-recyclable layers. Even though it is technologically possible to separate the layers, the claim is not adequately qualified to avoid consumer deception. An appropriately qualified claim would be, "includes material recyclable in the few communities that collect multi-layer products." Other examples of adequate qualification of the claim include providing the number of communities with programs, or the percentage of communities or the population to which programs are available.

Example 8:

A product is marketed as having a "recyclable" container. The product is distributed and advertised only in Missouri. Collection sites for recycling the container are available to a substantial majority of Missouri residents, but are not yet available nationally. Because programs are generally available where the product is marketed, the unqualified claim does not deceive consumers about the limited availability of recycling programs.

Example 9:

A manufacturer of one-time use photographic cameras, with dealers in a substantial majority of communities, collects those cameras through all of its dealers. After the

exposed film is removed for processing, the manufacturer reconditions the cameras for resale and labels them as follows: "Recyclable through our dealership network." This claim is not deceptive, even though the cameras are not recyclable through conventional curbside or drop off recycling programs.

Example 10:

A manufacturer of toner cartridges for laser printers has established a recycling program to recover its cartridges exclusively through its nationwide dealership network. The company advertises its cartridges nationally as "Recyclable. Contact your local dealer for details." The company's dealers participating in the recovery program are located in a significant number -- but not a substantial majority -- of communities. The "recyclable" claim is deceptive unless it contains one of the qualifiers set forth in Example 4. If participating dealers are located in only a few communities, the claim should be qualified as indicated in Example 6.

Example 11:

An aluminum beverage can bears the statement "Please Recycle." This statement is likely to convey to consumers that the package is recyclable. Because collection sites for recycling aluminum beverage cans are available to a substantial majority of consumers or communities, the claim does not need to be qualified to indicate the limited availability of recycling programs.

(e) ***Recycled content***: A recycled content claim may be made only for materials that have been recovered or otherwise diverted from the solid waste stream, either during the manufacturing process (pre-consumer), or after consumer use (post-consumer). To the extent the source of recycled content includes pre-consumer material, the manufacturer or advertiser must have substantiation for concluding that the pre-consumer material would otherwise have entered the solid waste stream. In asserting a recycled content claim, distinctions may be made between pre-consumer and post-consumer materials. Where such distinctions are asserted, any express or implied claim about the specific pre-consumer or post-consumer content of a product or package must be substantiated.

It is deceptive to misrepresent, directly or by implication, that a product or package is made of recycled material, which includes recycled raw material, as well as used,(5) reconditioned and remanufactured components. Unqualified claims of recycled content may be made if the entire product or package, excluding minor, incidental components, is made from recycled material. For products or packages that are only partially made of recycled material, a recycled claim should be adequately qualified to avoid consumer deception about the amount, by weight, of recycled content in the finished product or package. Additionally, for products that contain used, reconditioned or remanufactured components, a recycled claim should be adequately qualified to avoid consumer deception about the nature of such components. No such qualification would be necessary in cases where it would be clear to consumers from the context that a product's recycled content consists of used, reconditioned or remanufactured components.

Example 1:

A manufacturer routinely collects spilled raw material and scraps left over from the original manufacturing process. After a minimal amount of reprocessing, the manufacturer combines the spills and scraps with virgin material for use in further production of the same product. A claim that the product contains recycled material is deceptive since the spills and scraps to which the claim refers are normally reused by industry within the original manufacturing process, and would not normally have entered the waste stream.

Example 2:

A manufacturer purchases material from a firm that collects discarded material from other manufacturers and resells it. All of the material was diverted from the solid waste stream and is not normally reused by industry within the original manufacturing process. The manufacturer includes the weight of this material in its calculations of the recycled content of its products. A claim of recycled content based on this calculation is not deceptive because, absent the purchase and reuse of this material, it would have entered the waste stream.

Example 3:

A greeting card is composed 30% by fiber weight of paper collected from consumers after use of a paper product, and 20% by fiber weight of paper that was generated after completion of the paper-making process, diverted from the solid waste stream, and otherwise would not normally have been reused in the original manufacturing process. The marketer of the card may claim either that the product "contains 50% recycled fiber," or may identify the specific pre-consumer and/or post-consumer content by stating, for example, that the product "contains 50% total recycled fiber, including 30% post-consumer."

Example 4:

A paperboard package with 20% recycled fiber by weight is labeled as containing "20% recycled fiber." Some of the recycled content was composed of material collected from consumers after use of the original product. The rest was composed of overrun newspaper stock never sold to customers. The claim is not deceptive.

Example 5:

A product in a multi-component package, such as a paperboard box in a shrink-wrapped plastic cover, indicates that it has recycled packaging. The paperboard box is made entirely of recycled material, but the plastic cover is not. The claim is deceptive since, without qualification, it suggests that both components are recycled. A claim limited to the paperboard box would not be deceptive.

Example 6:

A package is made from layers of foil, plastic, and paper laminated together, although the layers are indistinguishable to consumers. The label claims that "one of the three layers of this package is made of recycled plastic." The plastic layer is made entirely of recycled plastic. The claim is not deceptive provided the recycled plastic layer constitutes a significant component of the entire package.

Example 7:

A paper product is labeled as containing "100% recycled fiber." The claim is not deceptive if the advertiser can substantiate the conclusion that 100% by weight of the fiber in the finished product is recycled.

Example 8:

A frozen dinner is marketed in a package composed of a cardboard box over a plastic tray. The package bears the legend, "package made from 30% recycled material." Each packaging component amounts to one-half the weight of the total package. The box is 20% recycled content by weight, while the plastic tray is 40% recycled content by weight. The claim is not deceptive, since the average amount of recycled material is 30%.

Example 9:

A paper greeting card is labeled as containing 50% recycled fiber. The seller purchases paper stock from several sources and the amount of recycled fiber in the stock provided by each source varies. Because the 50% figure is based on the annual weighted average of recycled material purchased from the sources after accounting for fiber loss during the production process, the claim is permissible.

Example 10:

A packaged food product is labeled with a three-chasing-arrows symbol without any further explanatory text as to its meaning. By itself, the symbol is likely to convey that the packaging is both "recyclable" and is made entirely from recycled material. Unless both messages can be substantiated, the claim should be qualified as to whether it refers to the package's recyclability and/or its recycled content. If a "recyclable claim" is being made, the label may need to disclose the limited availability of recycling programs for the package. If a recycled content claim is being made and the packaging is not made entirely from recycled material, the label should disclose the percentage of recycled content.

Example 11:

A laser printer toner cartridge containing 25% recycled raw materials and 40% reconditioned parts is labeled "65% recycled content; 40% from reconditioned parts." This claim is not deceptive.

Example 12:

A store sells both new and used sporting goods. One of the items for sale in the store is a baseball helmet that, although used, is no different in appearance than a brand new item. The helmet bears an unqualified "Recycled" label. This claim is deceptive because, unless evidence shows otherwise, consumers could reasonably believe that the helmet is made of recycled raw materials, when it is in fact a used item. An acceptable claim would bear a disclosure clearly stating that the helmet is used.

Example 13:

A manufacturer of home electronics labels its video cassette recorders ("VCRs") as "40% recycled." In fact, each VCR contains 40% reconditioned parts. This claim is deceptive because consumers are unlikely to know that the VCR's recycled content consists of reconditioned parts.

Example 14:

A dealer of used automotive parts recovers a serviceable engine from a vehicle that has been totaled. Without repairing, rebuilding, remanufacturing, or in any way altering the engine or its components, the dealer attaches a "Recycled" label to the engine, and offers it for resale in its used auto parts store. In this situation, an unqualified recycled content claim is not likely to be deceptive because consumers are likely to understand that the engine is used and has not undergone any rebuilding.

Example 15:

An automobile parts dealer purchases a transmission that has been recovered from a junked vehicle. Eighty-five percent by weight of the transmission was rebuilt and 15% constitutes new materials. After rebuilding[6] the transmission in accordance with industry practices, the dealer packages it for resale in a box labeled "Rebuilt Transmission," or "Rebuilt Transmission (85% recycled content from rebuilt parts)," or "Recycled Transmission (85% recycled content from rebuilt parts)." These claims are not likely to be deceptive.

(f) ***Source reduction*****:** It is deceptive to misrepresent, directly or by implication, that a product or package has been reduced or is lower in weight, volume or toxicity. Source reduction claims should be qualified to the extent necessary to avoid consumer deception about the amount of the source reduction and about the basis for any comparison asserted.

Example 1:

An ad claims that solid waste created by disposal of the advertiser's packaging is "now 10% less than our previous package." The claim is not deceptive if the advertiser has substantiation that shows that disposal of the current package contributes 10% less

waste by weight or volume to the solid waste stream when compared with the immediately preceding version of the package.

Example 2:

An advertiser notes that disposal of its product generates "10% less waste." The claim is ambiguous. Depending on contextual factors, it could be a comparison either to the immediately preceding product or to a competitor's product. The "10% less waste" reference is deceptive unless the seller clarifies which comparison is intended and substantiates that comparison, or substantiates both possible interpretations of the claim.

(g) ***Refillable*****:** It is deceptive to misrepresent, directly or by implication, that a package is refillable. An unqualified refillable claim should not be asserted unless a system is provided for: (1) the collection and return of the package for refill; or (2) the later refill of the package by consumers with product subsequently sold in another package. A package should not be marketed with an unqualified refillable claim, if it is up to the consumer to find new ways to refill the package.

Example 1:

A container is labeled "refillable x times." The manufacturer has the capability to refill returned containers and can show that the container will withstand being refilled at least x times. The manufacturer, however, has established no collection program. The unqualified claim is deceptive because there is no means for collection and return of the container to the manufacturer for refill.

Example 2:

A bottle of fabric softener states that it is in a "handy refillable container." The manufacturer also sells a large-sized container that indicates that the consumer is expected to use it to refill the smaller container. The manufacturer sells the large-sized container in the same market areas where it sells the small container. The claim is not deceptive because there is a means for consumers to refill the smaller container from larger containers of the same product.

(h) ***Ozone safe and ozone friendly*****:** It is deceptive to misrepresent, directly or by implication, that a product is safe for or "friendly" to the ozone layer or the atmosphere.

For example, a claim that a product does not harm the ozone layer is deceptive if the product contains an ozone-depleting substance.

Example 1:

A product is labeled "ozone friendly." The claim is deceptive if the product contains any ozone-depleting substance, including those substances listed as Class I or Class II chemicals in Title VI of the Clean Air Act Amendments of 1990, Pub. L. No. 101-549, and others subsequently designated by EPA as ozone-depleting substances. Chemicals that have been listed or designated as Class I are chlorofluorocarbons (CFCs), halons, carbon tetrachloride, 1,1,1-trichloroethane, methyl bromide and hydrobromofluorocarbons (HBFCs). Chemicals that have been listed as Class II are hydrochlorofluorocarbons (HCFCs).

Example 2:

An aerosol air freshener is labeled "ozone friendly." Some of the product's ingredients are volatile organic compounds (VOCs) that may cause smog by contributing to ground-level ozone formation. The claim is likely to convey to consumers that the product is safe for the atmosphere as a whole, and is therefore, deceptive.

Example 3:

The seller of an aerosol product makes an unqualified claim that its product "Contains no CFCs." Although the product does not contain CFCs, it does contain HCFC-22, another ozone depleting ingredient. Because the claim "Contains no CFCs" may imply to reasonable consumers that the product does not harm the ozone layer, the claim is deceptive.

Example 4:

A product is labeled "This product is 95% less damaging to the ozone layer than past formulations that contained CFCs." The manufacturer has substituted HCFCs for CFC-12, and can substantiate that this substitution will result in 95% less ozone depletion. The qualified comparative claim is not likely to be deceptive.

§ 260.8 Environmental assessment

NATIONAL ENVIRONMENTAL POLICY ACT: In accordance with section 1.83 of the FTC's Procedures and Rules of Practice[7] and section 1501.3 of the Council on Environmental Quality's regulations for implementing the procedural provisions of National Environmental Policy Act, 42 U.S.C. 4321 et seq. (1969),[8] the Commission prepared an environmental assessment when the guides were issued in July 1992 for purposes of providing sufficient evidence and analysis to determine whether issuing the Guides for the Use of Environmental Marketing Claims required preparation of an environmental impact statement or a finding of no significant impact. After careful study, the Commission concluded that issuance of the Guides would not have a significant impact on the environment and that any such impact "would be so uncertain that environmental analysis would be based on speculation."[9] The Commission concluded that an environmental impact statement was therefore not required. The Commission based its conclusions on the findings in the environmental assessment that issuance of the guides would have no quantifiable environmental impact because the guides are voluntary in nature, do not preempt inconsistent state laws, are based on the FTC's deception policy, and, when used in conjunction with the Commission's policy of case-by-case enforcement, are intended to aid compliance with section 5(a) of the FTC Act as that Act applies to environmental marketing claims.

The Commission has concluded that the modifications to the guides in this Notice will not have a significant effect on the environment, for the same reasons that the issuance of the original guides in 1992 and the modifications to the guides in 1996 were deemed not to have a significant effect on the environment. Therefore, the Commission concludes that an environmental impact statement is not required in conjunction with the issuance of the 1998 modifications to the Guides for the Use of Environmental Marketing Claims.

By direction of the Commission.

Donald S. Clark
Secretary

1. *Cliffdale Associates, Inc.*, 103 F.T.C. 110, at 176, 176 n.7, n.8, Appendix, *reprinting* letter dated Oct. 14, 1983, from the Commission to The Honorable John D. Dingell, Chairman, Committee on Energy and Commerce, U.S. House of Representatives (1984) ("Deception Statement").

2. These guides do not currently address claims based on a "lifecycle" theory of environmental benefit. The Commission lacks sufficient information on which to base guidance on such claims.

3. The guides' treatment of unqualified degradable claims is intended to help prevent consumer deception and is not intended to establish performance standards for laws intended to ensure the degradability of products when littered.

4. The Mercury-Containing and Rechargeable Battery Management Act establishes uniform national labeling requirements regarding certain types of nickel-cadmium rechargeable and small lead-acid rechargeable batteries to aid in battery collection and recycling. The Battery Act requires, in general, that the batteries must be labeled with the three-chasing-arrows symbol or a comparable recycling symbol, and the statement "Battery Must Be Recycled Or Disposed Of Properly." 42 U.S.C. § 14322(b). Batteries labeled in accordance with this federal statute are deemed to be in compliance with these guides.

5. The term "used" refers to parts that are not new and that have not undergone any type of remanufacturing and/or reconditioning.

6. The term "rebuilding" means that the dealer dismantled and reconstructed the transmission as necessary, cleaned all of its internal and external parts and eliminated rust and corrosion, restored all impaired, defective or substantially worn parts to a sound condition (or replaced them if necessary), and performed any operations required to put the transmission in sound working condition.

7. 16 CFR 1.83 (revised as of Jan. 1, 1991).

8. 40 CFR 1501.3 (1991).

9. 16 CFR 1.83(a).