

**Environmental Disclosure
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Kevin J. Klesh, Editor**

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In the last article, *Modern Due Diligence: Opportunities and Challenges in the Green Economy*, Mike Wallace and Michael Berg contend that companies can reap significant benefits from increased disclosure if they do it right. They cite as an example a biotechnology firm that opened up new opportunities to attract investment, talent, and customers by positioning itself on the Dow Jones Sustainability Index. They report that the company, which was already accustomed to issuing sustainability reports, was able to better leverage its existing disclosure efforts by focusing more closely on investor relations versus other interest groups. *What environmental information is material to investors?*

Our appreciation goes to the authors and to our Newsletter vice chair, Kevin Klesh. I hope you find this newsletter valuable and encourage you to let us know how we can best serve your continuing education needs in the area of environmental disclosure.

**POWER COMPANIES AGREE TO
EXPANDED DISCLOSURE OF CLIMATE
CHANGE RISK IN LANDMARK
SETTLEMENTS WITH
NEW YORK ATTORNEY GENERAL**

Seth Kerschner

Introduction

Two of the largest emitters of greenhouse gases (GHGs) recently agreed to provide investors with detailed information on the financial risks posed by climate change. On Aug. 26, 2008, the New York Attorney General's Office entered into a settlement agreement with Xcel Energy, Inc. (Xcel) whereby Xcel agreed to include an analysis of the financial and physical impacts of climate change on the company's operations in its public filings with the Securities and Exchange Commission (SEC). And on Oct. 23, 2008, Dynegy Inc. (Dynegy) entered into a similar agreement with the New York Attorney General's Office.

These settlements follow the issuance of subpoenas to Xcel, Dynegy, and three other utility companies in September 2007, in which the Attorney General sought to gather information regarding the companies' analyses of climate change risks and the disclosure of those risks to investors. These power companies were in various stages of constructing new coal plants at the time the subpoenas were issued.

The settlements are important because they are the first binding agreements between government and private industry regarding climate change disclosure. Furthermore, New York Attorney General Andrew Cuomo has indicated that his office expects the settlements to set "a new industry-wide precedent that will force companies to disclose the true financial risks that climate change poses to their investors." Xcel was the fifth largest emitter of GHG emissions among utilities in the United States in 2006, according to the settlement. Dynegy will also become one of the top five emitters of GHG emissions in the United States as a result of its operation of eight new proposed coal-fired plants, according to a letter from the Attorney General's Office accompanying the September 2007 subpoena.

Detailed Disclosure on the Impacts of Climate Change Required

Pursuant to its settlement, Xcel agreed to (i) analyze how it is impacted by existing and potential GHG legislation in jurisdictions where it operates, (ii) describe the impacts of GHG litigation in jurisdictions where it operates, (iii) analyze financial risks to the company from physical impacts associated with climate change, (iv) provide the company's current position on climate change, (v) disclose its current and future estimated GHG emissions along with its plans for reducing GHG emissions, and (vi) report on its corporate governance activities related to climate change.

Dynegy's settlement is substantially similar to Xcel's. However, Dynegy agreed to specifically disclose the impact of the Regional Greenhouse Gas Initiative (RGGI) on its operations. RGGI is a cooperative effort by ten Northeast and Mid-Atlantic states to limit GHG

emissions from the power generation sector through a multi-state GHG cap and trade program. It is likely that Dynegy's settlement specifically mentioned RGGI because Dynegy has operations in Northeastern states that are subject to RGGI, while Xcel operates in Western and Midwestern states that are not part of RGGI.

The settlements specify that the required disclosures are to be made in the power companies' 10-Ks. However, it is expected that Xcel and Dynegy will include these discussions in the sections of its filings covering four key areas. These areas include (i) Risk Factors, (ii) costs of environmental compliance pursuant to Item 101 of Regulation S-K, (iii) material legal proceedings pursuant to Item 103 of Regulation S-K, and (iv) management discussion and analysis of trends, uncertainties or events reasonably expected to affect the company pursuant to Item 303 of Regulation S-K. If the settlements set the new precedent across the power generating industry that Cuomo expects them to, Xcel and Dynegy's publicly traded peer companies in the power generation industry may also need to review and revise their SEC disclosures either in response to, or in anticipation of, similar calls for greater climate change disclosure.

Subpoena Issued Under State Blue Sky Law

The Attorney General issued the subpoenas to the power companies under the Martin Act, a state securities law that grants the Attorney General broad powers to subpoena records in order to protect investor interests. In letters accompanying the subpoenas, the Attorney General expressed concern that the power companies had not adequately disclosed the increased financial, regulatory, and litigation risks that will come with the increase in emissions from the operation of new coal-fired power plants.

The Martin Act is New York's 1921 Blue Sky Law that has historically been used in the prosecution and investigation of securities fraud. The Martin Act confers a variety of broad law enforcement and investigatory powers on the state Attorney General in situations

where the Attorney General believes that companies or individuals are defrauding or intending to defraud investors. N.Y. GEN BUS. LAW, Art 23-A, § 325.

Although most regulation of securities in the United States is carried out by the federal government, the Securities and Exchange Act of 1933 permits states to enact their own securities regulations. Most states have adopted their own laws to regulate securities and these laws are commonly referred to as Blue Sky Laws. Unlike the Blue Sky Laws of many other states, however, New York's law empowers the Attorney General to investigate and prosecute conduct that he believes may be detrimental to investors in the United States without showing proof that a defendant acted intentionally or with negligence. The Martin Act was largely unused during much of the 20th century. However, Cuomo's predecessor Elliot Spitzer and Manhattan District Attorney Robert Morgenthau began using the law more frequently to investigate and prosecute brokerage firms and their executives in the wake of the Enron accounting scandal.

In his subpoenas of the power generating companies, Cuomo relied on the investigatory powers provision of the Martin Act. This provision permits the Attorney General to issue subpoenas and "require such other data and information as he may deem relevant... and make such special and independent investigations as he may deem necessary" in connection with activities that the Attorney General believes are deceiving investors. N.Y. GEN BUS. LAW, Art 23-A, § 325. In its Sept. 14, 2007 letter to Xcel, the Attorney General's Office specifically cited the company's construction of a coal-fired electric plant that will generate 750 megawatts of electricity without carbon capture and sequestration technology. Xcel's public filings indicate that the company is constructing a new 750 megawatt coal plant in Pueblo, Colorado. The Attorney General's letter indicated that the increased financial, regulatory, and litigation risks that Xcel will face due to the construction of this plant and its operation of coal-fired plants had not been adequately disclosed to investors. "Selective disclosure of favorable information or omission of unfavorable information concerning climate change is misleading," the Attorney General's letter went on to say. "Xcel cannot excuse its failure to

provide disclosure and analysis by claiming there is insufficient information concerning known climate conditions and uncertainties." Similarly, the Attorney General's Sept. 14, 2007 letter to Dynegy specifically cited the company's proposal to build eight new coal-fired power plants that would increase Dynegy's carbon dioxide emissions by 200 percent. The letter to Dynegy went on to state that Dynegy made "no attempt to evaluate or quantify the possible effects of future greenhouse gas regulations" in its 2007 filings with the SEC.

Cuomo's letters to Xcel and Dynegy indicated that the Attorney General was concerned about the companies' failures to disclose climate change risks to all investors, but also specifically noted that the New York State Common Retirement Fund was a "significant holder" of Xcel and Dynegy stock. Therefore, while Cuomo was exercising his broad Martin Act powers to protect all Xcel and Dynegy investors from what his office perceived to be deceptive activities by the companies, he was also acting on behalf of the state as manager of New York's pension fund.

Possible Precedent for Disclosure from Other Entities

The other power generating companies subpoenaed by the New York Attorney General's Office in 2007 were AES Corp., Dominion Resources Inc., and Peabody Energy Corp. When it announced the Xcel settlement, Cuomo's office indicated that negotiations were underway concerning settlements with the other companies.

Although the Attorney General's letters accompanying the subpoenas stated that Xcel and Dynegy made no disclosure on projected GHG emissions from their operations in their recent securities filings, power companies, including those subpoenaed by Cuomo, had been increasing their disclosure of the risks associated with climate change over the past few years prior to the issuance of the subpoenas. Xcel, for example, has provided information concerning the impact of climate change on its operations in its responses to the Carbon Disclosure Project questionnaires in 2006, 2007, and 2008. In its

responses, Xcel discussed the regulatory and physical risks it faces as a result of climate change, actions it is taking and planning to address those risks, and specifics on its carbon dioxide emissions. The Carbon Disclosure Project, on behalf of 475 institutional investors with a combined \$55 trillion of assets under management, has been soliciting information from public companies concerning climate change risk since 2002. In connection with its most recent report, the Climate Disclosure Project issued a request to 3,000 of the largest companies in the world for information relating to risks and opportunities associated with climate change.

And although the Xcel and Dynegy settlements represent the first binding agreement between government and private industry regarding climate change disclosure, companies have recently been faced with increasing calls from private investors for better disclosure on this issue. Shareholder resolutions on climate change have increased significantly over the past few years: in 2004, twenty-five climate disclosure proxies were tendered to public companies. In 2008, at least fifty-seven such proxies were filed. An example of a climate disclosure proxy is the proxy filed by the New York City Pension Funds, Connecticut State Treasurer's Office, and Benedictine Sisters of Texas requesting reports from TXU Corp concerning that company's response to regulatory pressure to reduce GHG emissions. In September 2007, a coalition of environmentalists and institutional investors, organized by Ceres, with assets under management in excess of \$1.5 trillion, petitioned the SEC to formally require the disclosure of climate change-related risks in connection with the filings of publicly traded companies. The disclosures agreed to in Xcel and Dynegy's settlements may prove to be a valuable precedent for companies looking to expand their climate change disclosure in the wake of these resolutions and petitions.

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ASTM ISSUES DRAFT STANDARD ON CLIMATE CHANGE DISCLOSURES

Lewis B. Jones

For those companies seeking guidance on climate change disclosures, ASTM International is preparing to answer the call. The voluntary standards organization, originally known as the American Society for Testing and Materials, published a draft standard for financial disclosures attributed to climate change on Nov. 19, 2008.

A Voluntary Standard, For Now . . .

Reporting entities should pay close attention to the new ASTM standard. On one hand, it purports to be voluntary: "This guide is intended for use on a voluntary basis by a reporting entity that provides disclosure in its financial statements regarding material financial impacts attributed to climate change. The degree and type of disclosure depends on the scope and objective of the financial statements." On the other hand, the drafters are well aware that many other ASTM standards have become mandatory after being adopted by other organizations, including regulatory agencies. Key elements of the standard could become incorporated into Financial Accounting Standards Board (FASB) disclosure standards or Securities Exchange Commission (SEC) rules. (For example, Section 12(d) of the National Technology Transfer and Advancement Act of 1995 specifically directs federal agencies "to use technical standards that are developed or adopted by voluntary consensus standards bodies," such as ASTM, "unless their use would be inconsistent with applicable law or otherwise impractical." 15 U.S.C. § 272 (note).) In addition, many companies routinely require suppliers and contractors to comply with all ASTM standards. And even if the standard remains purely voluntary, it might still become the industry standard—and hence a measuring stick against which to judge the adequacy of a given disclosure.