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CLIENT ALERT

SEC Proposes Climate Disclosure Rules

April 1, 2022

AUTHORS

Athena Eastwood | Archie Fallon | Elizabeth P. Gray | Robert B. Stebbins
William J. Stellmach | William L. Thomas

On March 22, 2022, the Securities and Exchange Commission (the "SEC" or the "Commission") voted 3-1 to propose rules requiring registrants to provide additional climate-related information in their registration statements and annual reports, including in their financial statements.[1] The Proposing Release provides that disclosure of this information would provide consistent, comparable, and reliable information to investors to help them make judgments about the impact of climate risks on current and potential investments.[2] The proposed amendments are modeled in large part on the recommendations of the Task Force on Climate-Related Financial Disclosures ("TCFD")[3] and the Greenhouse Gas Protocol.[4]

The Proposing Release provides that the proposed amendments set forth therein would supplement (rather than replace) the disclosures already required in SEC filings and that registrants should thus continue to assess whether disclosure of

1 *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors (Mar. 22, 2022) (the "Proposing Release").

2 *Id.* at p. 7.

3 The TCFD was created in 2015 by the Financial Stability Board to develop climate-related financial risk disclosures for use by companies and investors. The TCFD has established a disclosure framework by which to evaluate material-climate-related risks through an assessment of their financial impacts on a registrant. *Id.* at p. 37.

4 This is an accounting and reporting standard for greenhouse gas ("GHG") emissions created through a partnership between the World Resources Institute and the World Business Center for Sustainable Development. *Id.* at p. 40.

climate risks is still required in MD&A, Description of Business, Risk Factors or Legal Proceedings as per exiting guidance.[5]

Proposed Amendments.

The Proposing Release sets forth proposed rules dealing with (i) Climate-Related Disclosure, (ii) Climate-Related Impacts, (iii) Governance, (iv) Risk Management, (v) Financial Statement Metrics, (vi) GHG Emissions, (vii) Attestation of Scope 1 and Scope 2 Emissions Disclosures, and (viii) Targets and Goals.

1. Climate-Related Disclosure

General. The proposed climate-related disclosures described below would apply to a registrant with Exchange Act reporting obligations pursuant to Section 13(a) or Section 15(d) and companies filing a Securities Act or Exchange Act registration statement. Thus, the climate-related disclosures and the proposed financial statement metrics would be required in Securities Act or Exchange Act registration statements and Exchange Act annual reports. The proposed rules would also require registrants to disclose any material change to the climate-related disclosure provided in a registration statement or annual report in its Form 10-Q.[6]

The climate-related disclosures would be required to be included in such statements and reports in a separately captioned "Climate-Related Disclosure" section and in the financial statements.[7] A registrant would be able to incorporate by reference disclosure from other parts of the registration statement or annual report and, in most cases, from other filed or submitted reports into the "Climate-Related Disclosure" section.[8]

Disclosure of Risks. The proposed rules would require a registrant to disclose any climate-related risks reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may arise over the short, medium and long term. "Climate-related risks" mean the actual or potential negative impacts of climate-related conditions and events on a registrant's operations, financial statements or value chains, as a whole. "Value chain" means the upstream and downstream activities related to a registrant's operations, with "upstream activities" defined to

5 *See* Proposing Release at p. 18. In 1971, the Commission first addressed disclosure of material environmental risks when it issued an interpretative release providing that registrants should consider disclosure of the financial impact of compliance with environmental laws. *See* Release No. 33-5170 (July 19, 1971). In 1982, the Commission adopted rules mandating disclosure of costs arising out of compliance with environmental laws. *See* Release No. 33-6383 (Mar. 3, 1982). In 2010, the Commission issued guidance as to how the SEC's existing disclosure rules may require disclosure of the impacts of climate change on a registrant's business or financial condition. *See* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (Feb. 2, 2010).

6 *Id.* at p. 285. Many of the climate-related disclosure rules are also applicable to foreign private issuers. *Id.*at 286.

7 The climate-related disclosure rules would be included in Regulation S-K and Regulation S-X. *Id.* at p. 55.

8 *Id.* at p. 55.

include activities by a third party that relate to the initial stages of production and “downstream activities” defined to include activities by a third party that relate to processing material into a finished product and delivery of a good or service to the end user.[9] Thus, as defined, climate-related risks extend beyond a registrant’s own operations to those of its suppliers and distributors.

As to determinations of materiality, the Proposing Release provides that when assessing the materiality of a particular risk, management should consider the magnitude and probability of the risk over the short, medium, and long term.[10]

The proposed rules would require a registrant to specify whether an identified climate-related risk is a physical or transition risk and the registrant’s plan to mitigate the risk. If a physical risk, the proposed rules would require a registrant to describe the nature of the risk, including whether it is as an acute or a chronic risk.[11] If an identified physical risk is likely to have a material impact on the registrant’s business or financial statements, the registrant would be required to include in its description the location (by zip code or, if not available, by postal zone or geographic location) of the properties, processes, or operations subject to the physical risk.[12]

For example, if flooding presents a material physical risk, the proposed rules would require a registrant to disclose the percentage of buildings, plants, or properties that are located in flood hazard areas, and their location.

The proposed rules would also require a registrant to describe the nature of transition risks, including whether they relate to regulatory, market, technological, or other transition-related factors, and how those factors impact the registrant.[13]

A registrant is also permitted but not required to disclose information about any “climate-related opportunities” it may be pursuing. “Climate-related opportunities” are defined as the actual or potential positive impacts of climate-related conditions and events on the registrant’s financial statements, business operations, or value chains, as a whole.[14]

2. Climate-Related Impacts

Material Impacts. Once a registrant has described the climate-related risks reasonably likely to have a material impact on the registrant’s business or financial statements as manifested over the short, medium, and long term (as described

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9 *Id.* at pp. 60-61.

10 *Id.* at pp. 69-71.

11 “Physical risk,” “transition risk,” “acute risk,” and “chronic risk” are defined in the Proposing Release. *Id.* at pp. 61-63.

12 *Id.* at pp. 61-64.

13 *Id.* at p. 66.

14 *Id.* at p. 67.

above), the proposed rules would require the registrant to describe the actual and potential impacts (and the time horizon for each) of those risks on its strategy, business model, and outlook.[15]

The proposed rules would require a registrant to discuss how it has considered the impacts as part of its business strategy and capital allocation. The discussion must also include how any of the climate-related financial statement metrics discussed below or any of the climate-related targets or goals discussed below relate to the registrant's business model or business strategy.[16]

A registrant would also be required to disclose the material impacts of physical risks on its strategy, business model, and outlook. The proposed rules would require a registrant to provide a narrative discussion of whether and how any of its identified climate-related risks have affected or are reasonably likely to affect the registrant's consolidated financial statements.[17]

Carbon Offsets or Renewable Credits. If, as part of its net emissions reduction strategy, a registrant uses carbon offsets or renewable energy credits ("RECs"), the proposed rules would require it to disclose the role that carbon offsets or RECs play in the registrant's climate-related business strategy.[18] Also, a registrant that purchases offsets or RECs to meet its goals as it makes the transition to lower-carbon products would need to reflect this additional set of short-term and long-term costs and risks in its disclosure.[19]

Internal Carbon Price. Registrants may choose to use an internal carbon price when quantifying and assessing the financial impacts of climate-related risks and climate-related opportunities.

If a registrant uses an internal carbon price when assessing climate-related factors, the proposed rules would require it to disclose (i) the price in units per metric ton of carbon dioxide equivalent, (ii) the total price, (iii) the boundaries for measurement of overall carbon dioxide equivalent on which the total price is based, and (iv) the rationale for selecting the internal carbon price applied.[20] A registrant would also be required to describe how it uses its disclosed internal carbon price to evaluate and manage climate-related risks.[21]

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[15] *Id.* at pp. 76-77. A registrant would be required to disclose impacts on its business operations, products and services, parties in its value chain, activities to mitigate client-related risks, research and development expenditures, and any other significant changes or impacts.

[16] *Id.* at p. 78.

[17] *Id.* at p. 80.

[18] *Id.* at p. 82.

[19] *Id.* at p. 83.

[20] *Id.* at pp. 83-84.

[21] "Scenario analysis" is defined as a process for identifying and assessing a potential range of future events under conditions of uncertainty. *Id.* at p. 87.

Scenario Analysis. A registrant would be required to describe any analytical tools, such as scenario analysis, that the registrant uses to (i) assess the impact of climate-related risks on its business and financial statements, or (ii) support the resilience of its strategy and business model in light of foreseeable climate-related risks.[22] If a registrant uses scenario analysis, the proposed rules would require disclosure of the scenarios considered (including parameters, assumptions, and analytical choices), and the projected principal financial impacts on the registrant's business strategy under each scenario.[23]

3. Governance

Board Oversight. The proposed rules would require disclosure of (i) any board members or board committees responsible for the oversight of climate-related risks, (ii) whether any board member has expertise in climate-related risks, (iii) the processes and frequency by which the board discusses these risks, (iv) how the board considers these risks as part of its business strategy, risk management and financial oversight, and (v) how the board sets climate-related targets or goals and oversees progress against those targets or goals.[24]

Management Oversight. The proposed rules would require disclosure of (i) the management positions or committees responsible for assessing and managing climate-related risks, (ii) the relevant expertise of the position holders or committee members, and (iii) the processes by which these position holders or committee members are informed about and monitor climate-related risks, and how frequently they report to the board about these risks.[25]

4. Risk Management

Identifying, Assessing and Managing Climate-Related Risks. The proposed rules would require disclosure of any processes a registrant has for identifying, assessing, and managing climate-related risks.

When describing these processes, a registrant would be required to disclose: (i) how it determines the relative significance of climate-related risks compared to other risks, (ii) how it considers existing or likely regulatory requirements or policies when identifying climate-related risks, (iii) how it considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks, and (iv) how it determines the materiality of climate-related risks, including the potential size and scope of any identified climate-related risk.[26]

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[22] *Id.* at p. 88.
[23] *Id.* at pp. 91-92.
[24] *Id.* at pp. 98-100.
[25] *Id.* at pp. 100-101.
[26] *Id.* at pp. 104-105.

A registrant would be required to disclose (i) how it decides whether to mitigate, accept, or adapt to any such climate-related risk, (ii) how it prioritizes addressing climate-related risks, and (iii) how it mitigates a high priority climate-related risk.[27]

The proposed rules would also require a registrant to disclose whether and how climate-related risks are integrated into the registrant's overall risk management processes, including how any separate committee addressing these risks interacts with the risk committee of the board or management.[28]

If a registrant has adopted a transition plan[29] as part of its climate-related risk management strategy, the proposed rules would require the registrant to describe its plan, including the metrics used to manage physical and transition risks.[30] In addition, the registrant would be required to describe (i) how it plans to mitigate or adapt to any physical risks identified in its SEC filings, and (ii) how it plans to mitigate or adapt to any identified transition risks.[31] Further, the registrant would also be required to update its transition plan disclosure each year by describing the actions taken during the past year to achieve the plan's goals.[32]

5. Financial Statement Metrics

General. A registrant that is required pursuant to Regulation S-K to include a Climate-Related Disclosure section in a form that also includes audited financial statements, would be required to disclose in a note to these financial statements certain disaggregated climate-related financial statement metrics that are generally derived from existing financial statement line items. In particular, the proposed rules would require disclosure of "financial impact metrics," "expenditure metrics," and "financial estimates and assumptions." For each metric, the proposed rules would require a registrant to disclose contextual information to enable a reader to understand how it derived the metric (including a description of significant inputs and assumptions used and any policy decisions made to calculate the metric).[33]

A registrant would be required to calculate the metrics using financial information that is consistent with the scope of the rest of the registrant's consolidated financial statements included in the filing. Therefore, a registrant would have to include in any such calculation information from consolidated subsidiaries and would have to apply the same set of accounting principles that it is required to apply in preparation of the remainder of the financial statements included in the

[27] *Id.* at p. 106.

[28] *Id.* at pp. 106-107.

[29] A "transition plan" is defined broadly to mean "a registrant's strategy and implementation plan to reduce climate-related risks." *Id.* at p. 107.

[30] *Id.* at p. 108.

[31] *Id.* at pp. 108-109.

[32] *Id.* at p. 110.

[33] *Id.* at pp. 115-116.

filing.[34] Disclosure would be required to be provided for the registrant's most recently completed fiscal year and for the historical fiscal years included in the financial statements in the filing, subject to exceptions for historical periods for information not known or reasonably available to the registrant.[35]

For example, a registrant that is required to include balance sheets as of the end of its two most recent fiscal years and income statements and cash flow statements at the end of its three most recent fiscal years would be required to disclose two years of the climate-related metrics that correspond to balance sheet line items and three years of the climate-related metrics that correspond to income statement or cash flow statement line items.[36]

Financial Impact Metrics. The SEC is proposing to amend Regulation S-X to require a registrant to include disaggregated information about the impact of climate-related conditions and events, and transition activities, on the consolidated financial statements included in the applicable filing. The proposed rules would require a registrant to disclose the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the financial statements included in the relevant filing unless the aggregated impact of severe weather events, other natural conditions, transition activities, and identified climate-related risks is less than one percent of the total line item for the relevant fiscal year.[37]

A registrant would be required to determine the impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on each financial statement line item. Within each category, impacts would be required to be disclosed on an aggregated, line-by-line basis for all negative impacts and, separately, on an aggregated, line-by-line basis for all positive impacts. However, for purposes of determining whether the disclosure threshold has been met, a registrant would be required to aggregate the value of the positive and negative impacts on a line-by-line basis.[38]

Expenditure Metrics. The proposed expenditure metrics refer to the positive and negative impacts associated with the same climate-related events, transition activities, and identified climate-related risks as the proposed financial impact metrics discussed above. The proposed expenditure metrics would require a registrant to separately aggregate amounts

[34] *Id.* at p. 117.

[35] *Id.* at p. 118.

[36] If the registrant is an emerging growth company or a smaller reporting company, only two years would be required. *Id.* at p. 118.

[37] *Id.* at p. 126.

[38] *Id.* at pp. 127-129.

of (i) expenditure expensed and (ii) capitalized costs incurred during the fiscal years presented.[39] The proposed expenditure metrics would be subject to the same disclosure threshold as the financial impact metrics.[40]

Financial Estimates and Assumptions. The proposed rules would require a registrant to disclose whether the estimates and assumptions used to produce the financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events. If so, the registrant would be required to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used by the registrant in the preparation of the financial statements.[41]

Inclusion of Climate-Related Metrics. The proposed financial statement metrics would be required in the financial statements. Therefore, such metrics would be (i) included in the scope of any required audit of the financial statements, (ii) subject to audit by an independent registered public accounting firm, and (iii) within the scope of the registrant's ICFR.[42]

6. GHG Emissions

Disclosure Requirement. The proposed rules would require a registrant to disclose its GHG emissions for its most recently completed fiscal year, which rules are based on the concepts of scopes. Scopes are based on the concepts of direct and indirect emissions.[43] The proposed definitions of Scope 1, Scope 2 and Scope 3 are substantially similar to the definitions provided by the GHG Protocol.

The Proposing Release defines (i) Scope 1 emissions as direct GHG emissions from operations that are owned or controlled by the registrant; (ii) Scope 2 emissions as indirect GHG emissions from the generation of purchased electricity, steam, heat, or cooling that is consumed by operations owned or controlled by the registrant; and (iii) Scope 3 emissions as all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain. The proposed rules would require a registrant to disclose its total Scope 1 emissions and its total Scope 2 emissions (regardless of materiality) after calculating them from all sources that are included in the registrant's organizational and operational boundaries (as described below). A registrant would also be required to disclose separately its total Scope 3 emissions for the fiscal year if those emissions are material, or if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.[44]

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39 *Id.* at pp. 138-139.

40 *Id.* at p. 139.

41 *Id.* at pp. 145-146.

42 *Id.* at p. 150.

43 *Id.* at p. 153.

44 *Id.* at pp. 156-157.

When assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions.[45] However, even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions, a quantitative analysis alone would not be sufficient for purposes of determining whether Scope 3 emissions are material and a registrant would also need to consider qualitative factors. Accordingly, Scope 3 emissions may make up a relatively small portion of a registrant's GHG emissions but still be material where Scope 3 represents "a significant risk," Scope 3 is "subject to significant regulatory focus," or if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision.[46] This is an extremely broad articulation of materiality.

For each scope of emissions, the proposed rules would require a registrant to disclose (i) the emissions disaggregated by each constituent GHG and (ii) GHG emissions data in the aggregate, excluding any offsets. The proposed rules would require a registrant to express each scope of its GHG emissions in terms of carbon dioxide equivalent ("CO2e"), which is the unit of measurement used by the GHG Protocol to indicate the global warming potential of each GHG.[47]

If required to disclose Scope 3 emissions, a registrant would need to identify the categories of upstream and downstream activities that have been included in the calculation of its Scope 3 emissions and describe the data sources used to calculate these emissions. If any upstream or downstream activities were significant to the registrant when it calculated its Scope 3 emissions, the proposed rules would require the registrant to identify such categories and separately disclose Scope 3 emissions data for each of those categories, together with a total of all Scope 3 emissions.[48]

The proposed rules would also require a registrant to disclose the sum of its Scopes 1 and 2 emissions as to GHG intensity. Also, if required to disclose Scope 3 emissions, a registrant would be required to separately disclose its Scope 3 emissions as to GHG intensity. The proposed rules would define "GHG intensity" to mean a ratio that expresses the metric tons of CO2e per unit of total revenues or per unit of production.[49]

The proposed rules would require disclosure to be provided for the registrant's most recently completed fiscal year and for the historical fiscal years included in the registrant's financial statements in the applicable filing, to the extent such

[45] The Proposing Release provides that no quantitative materiality threshold is being proposed but does make reference to a threshold of 40% used by some companies. *Id.* at p. 173.

[46] *Id.* at p. 173.

[47] *Id.* at pp. 158-159.

[48] *Id.* at pp. 178-180.

[49] *Id.* at p. 187.

historical GHG emissions data is reasonably available; provided that if the registrant is a smaller reporting company, only two years of Scope 1 and Scope 2 emissions metrics would be required.[50]

Methodology. As proposed, a registrant would be required to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics. The description of the registrant's methodology would be required to include the registrant's organizational boundaries, operational boundaries, calculation approach, and any calculation tools used to calculate the registrant's GHG emissions. "Organizational boundaries" would mean the boundaries that determine the operations owned or controlled by a registrant for the purpose of calculating its GHG emissions. "Operational boundaries" would mean the boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant.[51]

A registrant's organizational boundaries determine the business operations owned or controlled by a registrant. The proposed rules require a registrant to set the organizational boundaries for its GHG emissions disclosure using the same set of accounting principles applicable to its consolidated financial statements.[52] Also, the scope of consolidation and reporting is required to be consistent for financial data and GHG emissions data, and a registrant would be required to apply existing GAAP when preparing its required GHG emissions disclosures.

Describing a registrant's operational boundaries involves identifying emissions sources within its plants, offices, and other operational facilities that fall within its organizational boundaries, and then categorizing the emissions as either direct or indirect emissions. The proposed rules would require a registrant to include its approach to categorizing its emissions and emissions sources when describing its methodology to determine its operational boundaries. For most registrants, purchased electricity would likely constitute a large percentage of their Scope 2 emissions.[53]

A registrant also needs to select a GHG emissions calculation approach. While direct measurement of GHG emissions is likely to yield the most accurate calculations, given the expense of direct monitoring, the Proposing Release provides that an acceptable method for calculating emissions involves the application of published emission factors. Emission factors are ratios that typically relate GHG emissions to a proxy measure of activity at an emissions source.[54]

[50] *Id.* at pp. 191-192.

[51] *Id.* at p. 193.

[52] *Id.* at pp. 194-195.

[53] *Id.* at pp. 198-199.

[54] *Id.* at p. 200.

After a registrant has selected a calculation approach (i.e., direct measurement or application of emissions factors), the registrant would determine what data needs be collected and how to conduct the relevant calculations, including whether to use any publicly available calculation tools.[55]

The following rules would also apply to the methodology for calculating GHG emissions: (i) a registrant may use reasonable estimates when disclosing such emissions as long it describes the assumptions underlying, and its reasons for using, the estimates; (ii) a registrant is required to disclose, to the extent material, any use of third-party data when calculating its GHG emissions (including the source of the data), regardless of the particular scope of emissions; (iii) a registrant is required to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year; (iv) a registrant is required to disclose, to the extent material and as applicable, any data gaps in connection with the calculation of its GHG emissions, and how it addressed these gaps and how this has affected the accuracy or completeness of its disclosure; (v) when determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant must include GHG emissions from outsourced activities that it previously conducted as part of its own operations; (vi) if a registrant is required to disclose Scope 3 emissions, and if there was any significant overlap in the categories of activities producing the Scope 3 emissions, the registrant must describe the overlap, how it accounted for the overlap, and its disclosed total Scope 3 emissions; and (vii) a registrant may present its estimated Scope 3 emissions in the form of a range, so long as it discloses its reasons for using the range and the underlying assumptions.[56]

Scope 3 Safe Harbor. The Proposing Release sets forth the following accommodations for Scope 3 emissions disclosure: (i) a safe harbor for Scope 3 emissions disclosure from certain forms of liability under the Federal securities laws, (ii) an exemption for smaller reporting companies from the Scope 3 emissions disclosure requirements, and (iii) a delayed compliance date for Scope 3 emissions disclosure. As to the safe harbor, disclosure of Scope 3 emissions by a registrant would not be deemed to be a fraudulent statement, unless it is shown that such statement was made without a reasonable basis or was disclosed other than in good faith. As to the compliance date, all registrants would have an additional year to comply initially with the Scope 3 emissions disclosure requirement beyond the compliance date for the other proposed rules.[57] The Proposing Release also notes that Securities Act Rule 409 and Exchange Act Rule 12b-21, which provide accommodations for information that is unknown and not reasonably available, would be available for the proposed Scope 3 emissions disclosures.

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[55] *Id.* at pp. 201-204.

[56] *Id.* at pp. 206-210.

[57] *Id.* at pp. 218-222.

7. Attestation of Scope 1 and Scope 2 Emissions Disclosure

The proposed rules would require a registrant that is an accelerated filer or large accelerated filer to include in the relevant filing an attestation report covering the disclosure of its Scope 1 and Scope 2 emissions.[58] The attestation engagement must, at a minimum, be at the "limited assurance" level as to the required GHG emissions disclosure for fiscal years two and three after the disclosure compliance date and at the "reasonable assurance" level for fiscal years four and beyond.[59]

The proposed rules also set forth minimum qualifications and independence requirements for the attestation service providers. A GHG emissions attestation provider is defined as a person or firm that (i) is an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG emissions and (ii) is independent (based on factors similar to those used to determine whether an accountant is independent) with respect to a registrant and its affiliates.[60] The attestation provider would be subject to liability under the federal securities laws for the attestation conclusion.

The proposed rules also set forth certain requirements for the attestation report, which report is to be included in the separately captioned "Climate-Related Disclosure" section in the relevant filing.[61]

Each registrant, other than a large accelerated filer or accelerated filer that is required to include a GHG emissions attestation report in its filings, must include certain information in its filings if such registrant's GHG emissions disclosures were subject to third-party attestation or verification, including the name of the service provider, the level or scope of assurance or verification, and the results of the assurance or verification.[62]

8. Targets and Goals

If a registrant has set any climate-related targets or goals, then the proposed rules would require the registrant to provide certain information about those targets or goals, including a description of (if applicable): (i) the scope of activities and emissions included in the target; (ii) the unit of measurement; (iii) the time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization; (iv) the defined baseline time period and baseline emissions against which progress will

[58] The SEC notes in the Proposing Release that its rules typically do not require registrants to obtain assurance over disclosure provided outside of the financial statements. *Id.* at p. 229.

[59] *Id.* at p. 224.

[60] *Id.* at pp. 257-267.

[61] *Id.* at pp. 248-249.

[62] *Id.* at pp. 273-274.

be tracked with a consistent base year set for multiple targets; (v) any interim targets; and (vi) how the registrant intends to meet its climate-related targets or goals.[63]

If a registrant has used carbon offsets or RECs in its plan to achieve climate-related targets or goals, it would be required to disclose (i) the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECs, (ii) the source of the offsets or RECs, (iii) a description and location of the underlying projects, (iv) any registries or other authentication of the offsets or RECs, and (v) the cost of the offsets or RECs.[64]

Miscellaneous.

Compliance Date. Assuming the proposed rules are adopted with an effective date in December 2022 and that the registrant has a December 31 fiscal year-end, (i) the compliance date for a large accelerated filer for all proposed disclosure (other than Scope 3) is fiscal year 2023 (filed in 2024) and the compliance date for Scope 3 is fiscal year 2024 (filed in 2025), (ii) the compliance date for an accelerated filer for all proposed disclosure (other than Scope 3) is fiscal year 2024 (filed in 2025) and the compliance date for Scope 3 is fiscal year 2025 (filed in 2026), and (iii) the compliance date for a smaller reporting company for all proposed disclosures (other than Scope 3) is fiscal year 2025 (filed in 2026) and the smaller reporting company would be exempted from Scope 3 reporting.[65]

The proposed compliance dates above would apply to both annual reports and registration statements.

Inline XBRL. The proposed rules would require registrants to tag the proposed climate-related disclosures in a structured, machine-readable data language.[66]

Comments. Comments on the proposed rules must be received by the later of May 22, 2022 or 30 days after the Proposing Release is published in the Federal Register. The Proposing Release contains 201 specific requests for comments.

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[63] *Id.* at pp. 276-278. A registrant would be required to update the disclosure in clause (vi) each fiscal year by describing the actions taken during the year to achieve its targets or goal. *Id.* at p. 280.

[64] *Id.* at p. 281.

[65] *Id.* at p. 300.

[66] *Id.* at p. 293.

Dissenting Statement.

Commissioner Hester Peirce issued a long statement in dissent.[67] Her main arguments are that:

- public companies are already required to disclose material client risks by existing SEC rules;
- the proposed materiality analysis for Scope 3 disclosures departs from the "reasonable investor" standard set forth by the Supreme Court;
- the justification for the SEC's disclosure mandate provided at page 9 of the Proposing Release ("we understand investors often employ diversified strategies, and therefore do not necessarily consider risk and return of a particular security in isolation but also in terms of the security's effect on the portfolio as a whole, which requires comparable data across registrants") departs from the SEC's traditional company-specific approach to disclosure and suggests it is appropriate for shareholders of the disclosing company to subsidize other investors' portfolio analysis;
- the proposal exceeds the SEC's statutory limits by using the disclosure rules to achieve objectives that are outside of the SEC's statutory mission (protecting investors, facilitating capital formation and fostering fair, orderly and efficient markets) and by pursuing those objectives by disclosure mandates that may violate First Amendment limitations on compelled speech;
- the economic analysis underestimates the cost of the proposal, including the costs of the Scope 3 disclosure framework, compliance with the attestation requirements, and audit costs;
- the proposal will not lead to comparable, consistent and reliable disclosure because the underlying data (including data obtained from suppliers, customers and employees) is unlikely to be reliable; and
- the proposal will hurt investors, the economy and the SEC by pushing capital allocation toward politically and socially favored ends, especially when the SEC has no expertise in capital allocation or the applicable science.[68]

67 *See* We are Not the Securities and Environmental Commission – At Least Not Yet, Commissioner Hester M. Peirce (Mar. 21, 2022).

68 *Id.* at pp. 2-9.

<u>Takeaways</u>.

While there almost certainly will be litigation over the proposed rules (see Commissioner Peirce's dissent as to the SEC exceeding its statutory limits and acting outside its area of expertise), registrants nevertheless need to begin preparing to comply with the proposed rules. This will involve, among other things, setting up internal reporting systems, reviewing their risk management practices as to climate-related disclosures and climate risk assessment, reviewing disclosures in current public filings as per the proposed requirements, possibly hiring additional staff, reviewing board practices and the backgrounds of board members as per the disclosure requirements in the Proposing Release and amending governance documents accordingly, briefing the board on the contents of the Proposing Release, working with outside auditors in preparation for the new financial statement requirements, and beginning the process of obtaining an attestation provider.

We expect there to be significant pushback by companies as to the inclusion of the Scope 3 requirements; if these requirements are still included in the adopting release, thousands of private entities that do business with registrants will need to set up reporting systems that will allow such entities to provide information to registrants as to their GHG emissions, and registrants will need to start working with these private entities so that such entities can become prepared to provide this information.

The proposed rules are extremely detailed and complex, and compliance will require a great deal of money, time and effort from registrants. The Proposing Release estimates $640,000 of increased compliance costs in year one for a large company resulting from the proposed rules, excluding third-party assurance costs; we would not be surprised if the actual number was much higher.

Scope 1 and Scope 2 disclosures are required without regard to materiality. The language in the Proposing Release as to determining materiality for purposes of Scope 3 disclosures will make it far from easy to conclude that these disclosures are not material.

Companies that already compile and disclose information on climate risk and related performance will need to align and in some cases significantly refine such efforts to ensure compliance with the proposed rules.

Companies will be subject to increased litigation risk with respect to their climate disclosures. Companies should use forward-looking statement legends with respect to these disclosures.

The disclosure requirements around targets and goals and the increased possibility of litigation may serve to greatly reduce the number of companies publishing such targets and goals in the future.

The rules can be expected to drive corporate behavior through the required disclosures. As the SEC lacks expertise in environmental standard setting, it relied on the TCFD and the Greenhouse Gas Protocol in drafting the Proposing Release. Based on this, the likely ensuing litigation could have negative ramification for the doctrine of "Chevron deference" for Federal administrative agencies, as certain members of the Supreme Court have already expressed serious discomfort with the doctrine.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

Athena Eastwood
202 303 1212
aeastwood@willkie.com

Archie Fallon
713 510 1775
afallon@willkie.com

Elizabeth P. Gray
202 303 1207
egray@willkie.com

Robert B. Stebbins
212 728 8736
rstebbins@willkie.com

William J. Stellmach
202 303 1130
wstellmach@willkie.com

William L. Thomas
202 303 1210
wthomas@willkie.com