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SEC Unveils Landmark Climate Disclosures Proposal

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The focus of investors on climate-related risks is growing, and the Biden Administration is taking an all-government approach to combat climate change. The Securities and Exchange Commission ("SEC" or "Commission") is now proposing landmark requirements for public companies operating in the U.S. to disclose climate risks and emissions in their business operations. According to remarks of SEC Commissioner Allison Herren Lee at the March 21, 2022 unveiling of the proposal, "this is a watershed moment for investors and financial markets."

The Commission is proposing a rule requiring registrants under the Exchange Act to include certain climate-related information in their registration statements and periodic reports. Such information includes climate risks and their material impacts on business, strategy, and outlook; greenhouse gas (GHG) emissions (further discussion below); governance of climate-related risks and relevant risk management processes; climate-related targets, goals, and transition plans; and certain climate-related financial statement metrics and related disclosures in audited financial statements.

This alert outlines the proposed requirements and next steps.

Background

Along with the advent of major environmental laws in the 1970s, the Commission started work to require public companies to provide information about environmental risks that is considered "material," i.e., information that average prudent investor would reasonably consider important in their investment decisions. The Commission began publishing guidance for companies disclosing climate-related risks in 2010. The 2010 guidance discussed the disclosure of material direct and indirect physical climate risks, climate change mitigation regulations, and economic and market trends. Many investors have asked for more disclosure requirements and oversight since 2010. However, others have asserted that extensive disclosures impose unreasonable burdens on companies or seek information that does not clear the SEC's materiality threshold.

Under the Biden Administration, the SEC has taken an all-agency approach to the establishment of new environmental, social, and governance (ESG) disclosures. These include issuing risk alerts and investor bulletins regarding ESG investing; creating the Climate and ESG Task Force in the Division of Enforcement; announcing a greater focus on climate-related risks and climate-related disclosure in public company filings; and issuing a request for comment from market participants on climate change disclosure. The latest proposal is the largest and most concrete action regarding climate disclosures in the Commission's history.

Proposal

The proposed rules would require registrants to disclose a range of climate-related information. The proposed rules require disclosures about two types of risks: (1) the company's exposure to the physical risks of climate change ("physical risks"); and (2) the risks to the company from policies promoting the transition to a lower-carbon economy ("transition risks"). This information includes:

- Impact of climate-related severe weather events and other natural conditions and transition activities on the line items of a registrant's consolidated financial statements;
- Registrant's direct GHG emissions (Scope 1) and indirect GHG emissions from purchased energy (Scope 2), in absolute (not including offsets) and intensity (emissions/output) terms; and
- Indirect emissions from upstream and downstream activities in a registrant's value chain (Scope 3) if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions.

Other requirements in the proposal regarding governance, strategy, and risk management include oversight and governance of climate-related risks; whether and how any climate-related risks have a

material impact on the company; processes for identifying, assessing, and managing climate-related risks; metrics and targets used to show and manage any physical and transition risks; and more detailed information regarding publicly set climate-related targets or goals. Companies may also disclose information regarding identified climate-related opportunities.

Regarding specific disclosures, registrants would be required to:

- Provide climate-related disclosures in registration statements and Exchange Act annual reports (e.g., Form 10-K);
- Provide Regulation S-K-mandated climate-related disclosure in a separate section of its registration statement or annual report;
- Provide Regulation S-X-mandated climate-related financial statement metrics and related disclosures in a note to its consolidated financial statements; and
- For larger companies, obtain an attestation report from an independent attestation service provider covering Scope 1 and 2 emissions disclosures, at a minimum.

On timing, the proposed rules would allow for a phase-in period depending on the registrant's filer status. Additional phase-in periods are outlined for Scope 3 emissions disclosure and for certain assurance requirements. The proposed regulations also include a safe harbor from liability for Scope 3 emissions disclosure and an exemption from the Scope 3 emissions disclosure requirement for smaller reporting companies.

Next Steps

The proposal gives novel enforcement tools to the SEC related to climate change. Challenges, both in the proposal's finalization and in court, are almost certain. State attorneys general have argued that a range of ESG-related information does not meet the definition of "material" and therefore may not be the subject of SEC disclosure requirements. Last year, West Virginia Attorney General Patrick Morrisey threatened to sue the SEC if it forced companies to disclose ESG data, and several U.S. senators have outlined similar objections. Climate advocates will likely argue that the Scope 3 emissions requirement should be strengthened. In addition, some companies and trade associations will challenge the SEC's role in climate policy generally and the financial regulatory disclosure requirements specifically, especially for information that companies may claim is confidential business information.

Some companies have also expressed opposition about requirements to collect and disclose extensive information about Scope 3 emissions arguing that such emissions are not material, are burdensome to collect, are difficult to verify, and result from supplier and customer activities that are not readily managed by the company in any event.

The public will have the right to submit comments on the proposed rule until the later of 60 days from March 21st, the date the proposal was published on the SEC's website, or 30 days from the date the proposal is published in the Federal Register. The rules may be finalized later this calendar year, but the SEC has experienced delays on this issue in the past. Under the proposal, the largest companies would start disclosing climate risks in FY 2023, while smaller companies have until FY 2024. The proposal allows for an extra year to disclose Scope 3 emissions.

For More Information

Van Ness Feldman's Climate Change and Energy Transition practices will continue to analyze the new SEC climate disclosure rule package and monitor the SEC's activity on this issue. We are available to provide counsel to impacted public companies as they assess the implications of the rule, provide comments on the rulemaking, and consider potential future climate disclosures.

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