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Securities and Exchange Commission Adopts Long-awaited Climate Disclosure Rules

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On March 6, 2024, the Securities and Exchange Commission (SEC) adopted the long-awaited final rules requiring issuers to enhance and standardize climate-related disclosures in their annual reports and registration statements (Final Rules). The Final Rules phase-in over a multi-year period (no sooner than fiscal year 2025, due in 2026, for the largest issuers), dispense with the most controversial aspects of the proposed climate disclosure rules' mandates and are already subject to multiple lawsuits, with the Fifth Circuit Court of Appeals recently blocking the Final Rules' implementation (for now, at least).

Given this backdrop and uncertainty, it would be easy to be complacent in preparing to comply with this new reporting regime. Nevertheless, we are advising our clients to begin digesting and considering how they will comply with these new rules; regardless of when or if the Final Rules become effective in this form, climate disclosure is not going away, and the effort will not be wasted.

The Final Rules were adopted by a 3-2 vote along party lines. This reflects the Biden administration's "whole of government" approach to the advancement of climate policy through federal regulation and the perceived need for "consistent, comparable and reliable" climate disclosures.

While certain to remain controversial given the politics and strong emotions stirred up by any climate discussion, the Final Rules reflect a notable weakening from the mandatory and prescriptive reporting regime signaled in the SEC's March 2022 proposed climate disclosure rules ("Proposed Rules"). Nonetheless, the Final Rules require US public companies and foreign private issuers to significantly expand disclosure requirements with respect to climate-related risks, governance and, in some cases, data, and will impose meaningful time, cost and administrative burdens on public reporting companies as they grapple with these new (and, in some cases, unfamiliar) disclosure obligations.

The Final Rules will be effective 60 days after publication in the Federal Register, with extended compliance timelines described below.

Notable Departures From the Proposed Rules

In response to intense scrutiny and skepticism from the private sector, Congress and the media regarding the Proposed Rules, the Final Rules dispense with the most controversial aspects of the Proposed Rules' mandates. The Final Rules scale back disclosure and attestation requirements based on filer status, and apply a more traditional, principles-based "materiality" approach to many of the Final Rules' requirements. While the changes from the Proposed Rules are many, the most notable changes include:

- **Significantly Narrowed Greenhouse Gas (GHG) Emissions Disclosures**

  Where the Proposed Rules mandated that all public companies report Scope 1 (i.e., direct) and Scope 2 (i.e., purchased energy) emissions, and disclose Scope 3 (i.e., indirect/downstream/supply chain) emissions if material, the Final Rules:

  - Eliminate Scope 3 GHG emissions reporting altogether
  - Eliminate Scope 1 and 2 GHG emissions reporting for non-accelerated filers, smaller reporting companies and emerging growth companies
  - Only require Scope 1 and 2 GHG emissions reporting for large accelerated and accelerated filers if those emissions are material to the reporting company

  Additionally, the Final Rules give registrants the flexibility to determine the organizational boundaries they will use if reporting Scope 1 and 2 GHG emissions, which may differ in scope from the organizational boundaries used for the consolidated financial statements if appropriately disclosed.

- **Climate-related Risk Disclosures**

  As opposed to the Proposed Rules' disclosure of practically all climate-related risks, the Final Rules limit such disclosures to descriptions of actual and potential material impacts, transition plans adopted to manage material transition risks, scenario analyses under certain material circumstances, and internal carbon price information if material to the evaluation and management of climate-related risks that are have materially impacted or are reasonably likely to have a material impact on the company. The inclusion of materiality qualifiers more closely aligns with traditional securities law disclosure concepts and allows registrants to independently determine if they represent a material risk to the registrant's business, results of operations or financial condition.

- **Financial Statement Disclosures Under Article 14 of Regulation S-X**

  While the Proposed Rules required reporting companies to evaluate financial statement impacts on a line-by-line basis, the Final Rules will require presentation of information in the notes to the audited financial statements related to severe weather events and other natural conditions when the aggregate impact to the financial statements exceeds 1% of pretax income or total shareholders' equity, subject to a *de minimis* disclosure threshold.

- **Modified Attestation Requirements**

  While the Final Rules continue to require attestation reports in connection with Scope 1 and 2 emissions disclosures, only large accelerated filers will be required to secure attestation at a "reasonable assurance" level, beginning with annual reports or registration statements covering fiscal years that begin in or after 2033, following a period of attestation at the "limited assurance" level, beginning with reports and registration statements covering fiscal years that begin in or after 2029. Accelerated filers will only be required to secure attestation at a "limited assurance" level, beginning with annual reports or registration statements covering fiscal years that begin in or after 2031.

- **PSLRA Safe Harbor for Certain Disclosures**

  Under the Final Rules, all disclosures required by Regulation S-K Item 1502(e) (transition plan disclosure), Item 1502(f) (scenario analysis disclosure), Item 1502(g) (maintained internal carbon price disclosure) and Item 1504 (targets and goals disclosure), other than historical facts, are treated as forward-looking statements and benefit from the statutory safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995.

Disclosure Requirements of the Final Rules

The Final Rules will require registrants to provide numerous quantitative and qualitative climate-related disclosures, both with and without the registrant's financial statements and notes.

Nonfinancial Statement Disclosures

Requirement	A registrant must disclose:
GHG Emissions	If the registrant is a large accelerated filer or an accelerated filer and if material to the registrant, Scope 1 and Scope 2 GHG emissions on the basis of metric tons of carbon dioxide equivalent, and separately for each GHG that is individually material. Scope 1 and Scope 2 disclosures must be provided separately and on a gross basis (before consideration of any offsets).
Governance	How its board of directors and management assess and manage material climate-related risks.
Risk Management	What processes have been implemented to detect, evaluate and manage material climate-related risks and whether those processes are incorporated into the registrant's enterprise risk management program.
Targets and Goals	If the climate-related targets or goals are reasonably likely to materially affect the business, results of operations or financial condition, information about those targets and goals, including: • The scope of activities covered by the targets and goals • The time horizon for achievement • The baseline(s) against which the targets will be measured • Plans to achieve the targets or goals • Updates on progress (at least once a year) against targets and goals, including how the progress was achieved
Expenditures and Impacts	Quantitative and qualitative information about material expenditures and impacts on financial estimates and assumptions that are a direct result of (1) mitigation or adaptation to climate-related risks, (2) disclosed transition plans, (3) disclosed targets or goals or (4) actions taken to accomplish disclosed targets or goals.

Requirement	A registrant must disclose:
Risks and Strategy	1. Whether and how climate-related risks have materially affected (or are reasonably likely to materially affect) the business, results of operations or financial condition of the registrant 2. If the registrant uses an internal carbon price and it is material to evaluating climate-related risk, the price itself and other related information 3. If the registrant uses scenario analyses to evaluate the impact of climate-related risks to the business and, as a result of that analysis, identifies an actual or reasonably likely material impact, a description of the scenario, assumptions and potential financial impacts 4. If the registrant has developed a climate transition plan to manage material transition risks, a description of the plan and plan progress over time

Financial Statement Disclosures

Requirement	A registrant must disclose:
Severe Weather and Natural Condition Financial Statement Impacts	1. The aggregate expenditures incurred and losses recognized in the income statement as a result of severe weather events and other natural conditions if the impact is 1% or more of the absolute value of pretax income (loss) subject to a US$100,000 de minimis threshold. 2. The aggregate capitalized costs and charges recognized on the balance sheet because of severe weather events and other natural conditions, if the impact is 1% or more of the absolute value of stockholders' equity or deficit, subject to a US$500,000 de minimis threshold.
Carbon Offsets and Renewable Energy Credits	If carbon offsets and renewable energy credits are material to the registrant's plans to achieve its disclosed climate-related targets and goals, registrants must disclose a roll-forward of the beginning and ending balances, with separate disclosure of the aggregate amount expensed, the aggregate amount capitalized, the aggregate amount of losses incurred on the capitalized carbon offsets and renewable energy credits during the applicable year, which financial statement line items have been affected, and the accounting policy for the instrument(s).
Estimates and Assumptions	Whether and the extent to which severe weather events and other natural conditions and disclosed climate-related targets or transition plans have materially affected estimates and assumptions reflected in the financial statements.

Materiality Considerations

The Final Rules make clear that when making a materiality determination for purposes of climate-related disclosures, a registrant should use the long-standing materiality assessment established by the US Supreme Court under *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) and *Basic Inc. v. Levinson,* 485 U.S. 224 (1988) – is there a "substantial likelihood" that a reasonable shareholder would consider the information important in making an investment decision, or would the information have significantly altered the "total mix" of information available if it were not disclosed? Importantly, this means that the extent to which a registrant is required to make certain disclosures must be based on whether and how those GHG emissions or climate-risks impact the registrant's business, operations or financial condition when viewed holistically based on the registrant's unique facts and circumstances, and not necessarily because the registrant creates substantial GHG emissions or has simply identified the existence of a particular climate-related risk.

Timing and Location of Disclosures

While the Final Rules amend Form 10-K to include a new Item 6 for "Climate-Related Disclosure," the placement of nonfinancial statement climate-related disclosures is left to the determination of the registrant, with flexibility to incorporate the required disclosures into relevant parts of existing disclosures – such as MD&A, risk factors, the business description, etc. – within an annual report or registration statement or, in some cases, by incorporation by reference to previously filed disclosures (though, notably, not from the proxy statement as is currently permitted for certain governance and executive compensation information).

Once a registrant is subject to the reporting requirements, the disclosures must be included in the annual report filed after the applicable fiscal year-end. However, if the registrant determines it will be too difficult to provide the necessary disclosures by the due date for the annual report, the disclosures can be deferred until the filing of an amendment to the annual report on Form 10-K with the relevant disclosures, or until the filing of the registrant's quarterly report for the second fiscal quarter of the year after the applicable fiscal year-end.

Disclosure Attestation for GHG Emissions Reporting

Large accelerated filers and accelerated filers will be required to secure "limited assurance" for Scope 1 and 2 GHG emissions reports from a qualified third party and, following a transition period, large accelerated filers will be required to secure "reasonable assurance" for those emission reports. "Limited assurance" means the third party must express a conclusion about whether it is aware of any material modifications that a registrant should make for the subject matter to be in accordance with the relevant criteria. "Reasonable assurance" means the third party must provide the same level of assurance as an audit of a registrant's financial statements, which requires an opinion on whether the subject matter is, in all material respects, in accordance with the relevant criteria.

Coordination With Existing Climate Disclosure Regimes

Public companies, particularly public companies with global operations, face numerous voluntary and involuntary reporting regimes and regulations with respect to environmental, social, governance (ESG) and sustainability matters, including the IFRS Sustainability Disclosure Standards, the EU Corporate Sustainability Reporting Directive, EcoVadis and recent climate disclosure legislation in California, among others. The Final Rules leverage existing disclosure frameworks, such as the GHG Protocol and the Task Force on Climate-Related Financial Disclosures. However, as the Final Rules are narrowly focused on climate-related disclosure and GHG emissions, and do not allow public companies to satisfy their disclosure obligations by reference to other methodologies or standards, compliance with the Final Rules will not necessarily coordinate with or be sufficient to satisfy other reporting regimes and requirements. As a result, public companies already satisfying various voluntary and involuntary reporting regimes may face yet another complication in developing their SEC-focused disclosures and, more importantly, ensuring some level of consistency among the various reporting standards.

Compliance Timelines

The Final Rules will become effective 60 days after publication in the Federal Register, with compliance phased in over several years as follows:

Filer Status	Compliance Deadline for Disclosure and Financial Statement Requirements		GHG Emissions	Assurance	Electronic Tagging (XBRL)
	S-K and S-X Disclosures (Except Those Identified in Next Column)	Disclosures Concerning Material Expenditures and Impacts on Financial Assumptions Generally and Due to Transition Plans or Climate Targets/Goals			
Large Accelerated	Fiscal years beginning 2025	Fiscal years beginning 2026	Fiscal years beginning 2026	• Limited assurance for fiscal years beginning 2029 • Reasonable assurance for fiscal years beginning 2033	Fiscal years beginning 2026
Accelerated	Fiscal years beginning 2026	Fiscal years beginning 2027	Fiscal years beginning 2028	Limited assurance for fiscal years beginning 2031	Fiscal years beginning 2026
Non-accelerated Filers, Smaller Reporting Companies and Emerging Growth Companies	Fiscal years beginning 2027	Fiscal years beginning 2028	Never	Never	Fiscal years beginning 2027

Practical Takeaways and Next Steps

Given the long transition period afforded by the Final Rules, it would be easy to be complacent in preparing to comply with this new reporting regime. However, the Final Rules may impose new, significant and, for many companies, unfamiliar disclosure and reporting requirements. Public companies are well advised to begin digesting and considering how they will comply with these new rules, and ensure any efforts with regard to existing ESG and sustainability programs take into account the new disclosure regime that will apply going forward.

In the near term, companies should take some or all of the following steps:

- **Begin evaluating whether Scope 1 and 2 GHG emissions may need to be reported.** To begin credibly assessing whether Scope 1 and 2 GHG emissions will be "material," registrants must, as a preliminary matter, have an understanding of their Scope 1 and 2 GHG emissions across a number of dimensions, including, among others: the nature and amount of their current and projected GHG emissions; the likelihood that their GHG emissions could (in the near or long term) subject the registrant to significant regulatory requirements or compliance costs; the likelihood that their GHG emissions will impose significant costs relating to remediation activities or environmental litigation; or whether seeking to reduce GHG emissions may require changes to business activities or strategies. Even if the registrant ultimately determines that Scope 1 and 2 GHG emissions would not be "material," shareholder, media, regulatory and industry pressure, as well as decisions to report by a registrant's competitors and market peers, may ultimately lead some public companies to report Scope 1 and 2 GHG emissions voluntarily.
- **If Scope 1 and 2 GHG emissions disclosure is probable, begin developing systems for the collection and reporting of GHG data as soon as practicable**. Collecting, synthesizing and reporting GHG emissions data, developing baselines off of that data, and establishing targets and goals against those baselines all require robust, high-integrity systems (including hardware, software, processes and internal controls) that take time to develop and implement across a company's footprint. Developing these systems requires cross-functional collaboration between, and input from, EH&S, operations, IT, legal, accounting and internal audit professionals.
- **Develop climate governance and risk assessment practices**. Begin educating the board of directors, executive leadership and critical employees about the Final Rules and start assessing and refining governance and risk management structures, roles and responsibilities to accommodate the Final Rules' requirements. This may include further refinement of how the board oversees climate-related risks and which committee of the board (if any) should play a role in monitoring compliance. The requirements of the Final Rules should also be integrated into existing enterprise risk management frameworks as management and the board identify key risks.
- **Harmonize existing climate-related disclosures with the Final Rules.** For companies that currently disclose climate-related information as part of an overall ESG or sustainability reporting framework, the Final Rules should be closely evaluated to ensure current initiatives around the reporting of GHG emissions and any science-based targets/goals with respect to GHG emissions can be aligned with the disclosure requirements of the Final Rules.
- **Build your external and internal support teams**. In addition to internal experts, many registrants will want or need the support of third-party experts (including legal counsel, communications experts and sustainability reporting experts) to work through the Final Rules and their initial disclosures. Over the long term, large accelerated filers and accelerated filers will need to assess the reputation and capabilities of potential third-party providers for attestation services that comply with the Final Rules. Additionally, as referenced above with regard to collection of Scope 1 and 2 GHG emissions data, the disclosures generally required by the Final Rules will require meaningful input and involvement from various business units and internal compliance and audit functions. Ensuring key internal personnel are part of the cross-functional teams necessary to implement the Final Rules will be critical.
- **Stay the course but keep an eye on the litigation**. During his remarks, Commissioner Uyeda's criticism of the Final Rules seemingly laid out a roadmap for legal challenges, including compelled-speech challenges under the First Amendment, challenges under the "major questions" doctrine, and challenges under the Administrative Procedures Act due to the SEC's failure to repropose the climate-disclosure rules given the significant number of comments and long delay between the Proposed Rules and Final Rules.

  Less than 24 hours after the Final Rules' release, attorneys' general from 10 states, led by West Virginia Attorney General Patrick Morrisey, filed a petition for review with the US Court of Appeals for the Eleventh Circuit on March 7, 2024. This petition requests that the court vacate the Final Rules as exceeding the SEC's statutory authority and as otherwise arbitrary, capricious and an abuse of discretion. As previously noted, on March 15, 2024, the Court of Appeals for the Fifth Circuit granted an administrative stay of the Final Rules' implementation, kicking-off a multicircuit process applicable to rulemakings being challenged in multiple federal courts. Several notable potential plaintiffs have publicly indicated they are also preparing to file litigation, or have the Final Rules under study. Additionally, several members of Congress on both sides of the political aisle have expressed skepticism over the Final Rules (for varying reasons,) and have raised the possibility of challenging the Final Rules under the Congressional Review Act.

  Acknowledging that these legal challenges are unlikely to resolve quickly, our advice to clients is to nevertheless stay the course and keep working on potential compliance – both because the Final Rules could ultimately survive (in which case unprepared clients will be disadvantaged) and because even if the Final Rules are overturned, or further scaled back, climate disclosure is not going away.

There is new California legislation requiring the disclosure of GHG emissions and climate-related financial risks, the EU has adopted broad climate disclosure rules (applicable to US-based companies with EU operations), climate disclosures are increasingly being required in response to government contract RFPs, not to mention the very real potential for voluntary climate disclosures to become the ESG trend *du jour*. Hence, we recommend staying the course; the work will not be "wasted." That said, it is prudent to monitor the situation and work diligently to ensure readiness on whatever timeline ultimately unfolds.

With such an extended implementation timeline, and so much public scrutiny, the Final Rules are likely to face an unprecedented number of challenges that may delay, or ultimately defeat, their implementation.

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