

# Legal Update

## SEC Proposes Climate Change Disclosure Rules Applicable to Public Companies

### Background

On March 21, 2022, the U.S. Securities and Exchange Commission (SEC) voted 3:1, with only Commissioner Hester Peirce dissenting, to propose long-awaited rules that, if adopted, would require extensive reporting by public companies of climate change-related disclosure and related attestation (the "Proposal").<sup>1</sup> Comments on the Proposal are due 30 days after publication in the *Federal Register* or May 20, 2022 (which is 60 days after issuance), whichever is later.<sup>2</sup>

In a departure from existing "principles-based" disclosure requirements rooted in materiality, the SEC proposed rules that are prescriptive and intended to provide investors with consistent and comparable data, despite recent evidence that a significant majority of companies questioned by SEC staff currently do not find climate change-related physical or transition risks to be material to their businesses.<sup>3</sup>

Notably, and subject to certain exceptions and transitional provisions discussed below, the proposed rules would require that registrants disclose:

1. Direct greenhouse gas (GHG) emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2); and
2. Indirect emissions from upstream and downstream activities in a company's value chain (Scope 3), if material, or if the company has set a GHG emissions target or goal that includes Scope 3 emissions.

While some companies are already familiar with, and even collecting data on, their Scope 1 and 2 GHG emissions (and likely a much smaller number on their Scope 3 emissions) since these concepts were introduced by the GHG Protocol<sup>4</sup> (and are used in several GHG reporting frameworks (e.g., the Task Force on Climate-Related Financial Disclosures (TCFD) framework<sup>5</sup>), the GHG Protocol Corporate Standard guidance<sup>6</sup>, the GHP Protocol Scope 2 guidance<sup>7</sup> and the GHG Protocol Corporate Value Chain (Scope 3) guidance<sup>8</sup> are complicated concepts that are not self-explanatory. Furthermore, the frameworks include elections as to permissible methods used under these standards (e.g., location- or market-based methods for purchased energy), indicating that resulting data reported may not be

consistent or comparable. If implemented, these requirements will likely require significant time, effort and money for registrants to both understand and comply with.

Given the complexities involved in tracking and reporting this information, the Proposal is not surprisingly voluminous in its explanation of requirements, especially with respect to financial statement reporting.

The Proposal also seeks responses to over 200 separate numbered questions (many, or even most of which, are compound questions resulting in well over 750 total questions). The questions raise significant matters, including whether the required disclosures should be treated as filed (to which securities law liability would attach) or furnished (for which such liability may not attach) and whether additional phase-ins or exemptions should be adopted.

## Proposed Changes to Regulation S-X (Financial Statement Disclosures)

The Proposal would amend Regulation S-X to require companies to include certain climate-related financial statement metrics and related disclosures in a note to their audited financial statements. The proposed disclosures would be required for the company's most recently completed fiscal year and for the fiscal years included in the consolidated financial statements in the applicable filing.<sup>9</sup> The proposed financial statement metrics would consist of disaggregated climate-related impacts on existing financial statement line items and categories. As part of the company's financial statements, the financial statement metrics would be subject to audit by the company's independent registered public accounting firm and come within the scope of the company's internal control over financial reporting.

A company would be required to calculate the proposed financial statement metrics using financial information that is consistent with the scope of the rest of the company's consolidated financial statements included in the filing (*i.e.*, including information from consolidated subsidiaries) and apply the same set of accounting principles that it is required to apply in preparation of the rest of its consolidated financial statements included in the filing, whenever applicable. The Proposal requests comment on whether the SEC should require registrants to calculate metrics at a reportable segment level or by geographic area.

### FINANCIAL IMPACT METRICS

The Proposal would require a company to include disaggregated information about the impact of climate-related conditions and events and transition activities on the consolidated financial statements that are included in the relevant filing, unless the impact is below a specified threshold. An impact would be below the specified threshold if the sum of the absolute values of all the impacts on the line item is less than one percent of the total line item for the relevant fiscal year.

Climate-related conditions and events would include flooding, drought, wildfires, extreme temperatures and sea level rise and are intended to map physical risks. Transition activities would include any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks.

A company would be required to determine the impacts of severe weather events, other natural conditions, transition activities and identified climate-related risks described above on each consolidated financial statement line item. Within each category (*i.e.*, climate-related events or

transition activities), impacts would, at a minimum, 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 company would be required to aggregate the absolute value of the positive and negative impacts on a line-by-line basis.

A company would have the option to disclose the impact of any opportunities arising from severe weather events and other natural conditions; any impact of efforts to pursue climate-related opportunities associated with transition activities; and the impact of any other climate-related opportunities, including those identified by the company pursuant to proposed Item 1502(a) (discussed below), on any financial statement metric. If a company made a policy decision to disclose the impact of a climate-related opportunity on the proposed financial statement metrics, the company would need to do so consistently and follow the same presentation and disclosure threshold requirements applicable to the required disclosures related to financial impact metrics and expenditure metrics.

The proposed rules would also require companies to provide contextual information about financial impact metrics. The Proposal notes that contextual information may include disclosure of the company's election to include the impact from opportunities in its disclosure analysis and calculation; the specific events that were aggregated for purposes of determining the impact on the cost of revenue; and, if applicable, a discussion of the estimation methodology used to disaggregate the amount of impact on the cost of revenue between the climate-related events, transition activities and other factors.

## **EXPENDITURE METRICS**

The Proposal would require a company to disclose aggregated information about the impact of climate-related conditions and events and transition activities on annual expenditures and capitalized costs. For each category, a company would be required to disclose separately the amounts incurred during the fiscal years presented toward (i) positive and negative impacts associated with the climate-related events and (ii) transition activities, including toward the mitigation of exposures to transition risks (including identified transition risks). This would include expenditures incurred to increase the resilience of assets or operations, retire or shorten the estimated useful lives of impacted assets, relocate assets or operations at risk or otherwise reduce the future impact of severe weather events and other natural conditions on business operations. It also would include expenditures incurred to research and develop new technologies or to purchase assets, infrastructure or products that are intended to reduce GHG emissions, increase energy efficiency, offset emissions (purchase of energy credits), or improve other resource efficiency.

The amounts of expenditure disclosed pursuant to the proposed metrics would be a portion, if not all, of the company's total recorded expenditure (expensed or capitalized) as calculated pursuant to the accounting principles applicable to the company's financial statements. The proposed expenditure metrics would be subject to the same disclosure threshold as the financial impact metrics discussed in the prior section. However, a company would be required to aggregate expenditure related to climate-related events and transition activities within the categories of expenditure (i.e., amount capitalized and amount expensed) when determining if information must be disclosed.

A company also would be required to disclose contextual information about expenditure metrics. The Proposal notes that contextual information may include disclosure of the specific climate-related events and transition activities that were aggregated for purposes of determining the impacts on the capitalized or expensed expenditure amounts and, if applicable, policy decisions made by a company to determine the amount of climate-related events or transition activities that are categorized as expenditure capitalized versus expenditure expensed or whether impact from pursuing any climate-related opportunities are included in the analysis.

A company may choose to disclose the impact of efforts to pursue climate-related opportunities associated with transition activities, but must do so consistently and must follow the same presentation and disclosure threshold requirements applicable to the required disclosures of expenditure metrics associated with transition risks.

## **FINANCIAL ESTIMATES AND ASSUMPTIONS**

The Proposal would require a company to disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events. If so, the company would be required to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used by the company in the preparation of such financial statements.

Similar to the other proposed financial statement metrics, the Proposal includes a provision that would require separate disclosure focused on transition activities. If the estimates and assumptions a company used to produce the consolidated financial statements were impacted by risks and uncertainties associated with, or known impacts from, a potential transition to a lower carbon economy or any climate-related targets it has disclosed, the company would be required to provide a qualitative description of how the development of the estimates and assumptions was impacted by such a potential transition or the company's disclosed climate-related targets.

The proposed estimates and assumptions disclosures would be subject to the same disclosure threshold as the financial impact metrics discussed above.

Further, if a company elected to disclose the impact of an opportunity on its financial estimates and assumptions, the company would need to do so consistently and follow the same presentation and disclosure requirements applicable to the required disclosures.

## **CONSEQUENCES OF INCLUSION IN FINANCIAL STATEMENTS**

A company would be required to include the metrics and disclosures discussed above in its financial statements. This means that the metrics and disclosures would be subject to audit by the company's independent registered public accounting firm and within the scope of the company's internal control over financial reporting. The Proposal requests comment on whether this is the appropriate approach, and suggests that, as an alternative, a new financial statement could be created (a "consolidated climate statement") that provides more clarity to the relationship between climate metrics from different line items.

Under the Proposal, the auditing standards of the Public Company Accounting Oversight Board (PCAOB) would apply to the financial statement metrics included in the audited financial statements.

The Proposal requests comment on whether additional guidance or revisions to such standards are necessary or helpful to applying PCAOB auditing standards to the proposed financial statement metrics.

## Proposed Changes to Regulation S-K (Non-Financial Statement Disclosures)

In addition to amending Regulation S-X, the Proposal would create Subpart 1500 of Regulation S-K containing the requirements for climate change disclosure outside of the financial statements. The new climate-related information would be required in specified registration statements and periodic reports.

For domestic issuers, annual climate-related disclosure would be required in Form 10-K. Any material changes to these disclosures would be contained in Form 10-Q. Form 20-F for foreign private issuers would be amended to require comparable climate-related disclosures. The Proposal would require the climate-related disclosures to be presented in a separately-captioned section that could cross-reference information from other sections, such as risk factors or management's discussion and analysis. The Proposal does not currently amend Form 40-F applicable to Canadian issuers under the SEC's Multi-Jurisdictional Disclosure System (MJDS) but does seek comment on whether the new climate change-related disclosures should apply to MJDS issuers.

Key provisions of proposed Subpart 1500 of Regulation S-K are described below.

### NEW ITEM 1500 OF REGULATION S-K: DEFINITIONS

The proposed climate-related disclosures introduce many specialized terms to the securities law reporting regime. These terms are defined in Item 1500 of proposed Subpart 1500 of Regulation S-K.

### NEW ITEM 1501 OF REGULATION S-K: GOVERNANCE

Item 1501 would require detailed governance disclosures specific to a company's climate change oversight, vastly more detailed than the level of corporate governance disclosure companies are used to reporting in response to Item 407 of Regulation S-K. For example, companies would be required to discuss whether and how the board or relevant board committee considers climate-related risks as part of its business strategy, risk management and financial oversight. In addition to identifying any board members or board committees responsible for the oversight of climate-related risks, companies would need to specify whether any directors have expertise in climate-related risks, providing specific details as to the nature of the expertise. Companies would have to describe the processes and frequency of board or board committee discussions of climate-related risks. In response to this proposed item, companies would also have to disclose whether and how the board sets climate-related targets or goals and how it oversees progress against those targets or goals, including the establishment of any interim targets or goals.

The Proposal would also require disclosure regarding management's role in assessing and managing any climate-related risks. For example, companies would need to disclose whether certain management positions or committees are responsible for assessing and managing climate-related risks. If there are such positions or committees, companies would have to identify them and disclose the relevant expertise of the position holders or members in sufficient detail to fully describe the nature of the expertise. This disclosure would also need to describe the processes by which the

responsible managers or management committees are informed about and monitor climate-related risks and whether and how frequently they report to the board. However, the Proposal does not contain any compensation-related disclosure requirements, relying instead on the existing compensation discussion and analysis framework.

Companies may, but are not required to, describe the board oversight of, and management's role in assessing and managing, climate-related opportunities.

## **NEW ITEM 1502 OF REGULATION S-K: STRATEGY, BUSINESS MODEL, AND OUTLOOK**

Companies would have to describe any climate-related risks that have had, or that are reasonably likely to have, a material impact on the company, its business or consolidated financial statements over the short, medium, and long term, specifying whether they are physical risks (such as harm arising from acute climate disasters such as wildfires, hurricanes, and floods) or transition risks associated with a potential transition to a less carbon-intensive economy (such as risks arising from regulatory policies, litigation, changing consumer, investor and employee choices and demands and pricing shifts). Locations and the nature of the properties would need to be identified for physical risk, as well as whether the risk may be categorized as acute or chronic. Additional details would be needed for risks involving flooding or high water stress. The nature of transition risks and how they impact the company would need to be described.

Companies would need to provide both current and forward-looking disclosures that facilitate an understanding of whether the implications of the identified climate-related risks have been integrated into their business model or strategy, including how any resources are being used to mitigate climate-related risks. To the extent that these disclosures constitute forward-looking statements, the forward-looking statement safe harbors pursuant to the Private Securities Litigation Reform Act would apply, assuming the specified conditions are met.

Companies would be required to disclose the actual and potential impacts, including the time horizon, of their identified climate-related risks on:

- Business operations, including the types and locations;
- Products or services;
- Suppliers and other parties in the value chain;
- Activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes;
- Expenditure for research and development; and
- Any other significant changes or impacts.

If a company uses carbon offsets or renewable energy credits or certificates (RECs) as part of its net emissions reduction strategy, it would have to disclose the role that carbon offsets or RECs play in its climate-related business strategy. Similarly, if a company uses an estimated cost of carbon emissions internally within an organization, the company would be required to provide specified disclosures relating to its internal carbon price. Disclosures would also be required to describe any analytical tools, such as scenario analysis, that the company uses to assess the impact of climate-related risks on

its business and consolidated financial statements, or to support the resilience of its strategy and business model in light of foreseeable climate-related risks.

A company would also need to provide a narrative discussion of whether and how any climate-related risks have affected, or are reasonably likely to affect, its consolidated financial statements, including metrics referenced in proposed new Item 14-02 of Regulation S-K, discussed in the “Proposed Changes to Regulation S-X (Financial Statements)” section of this Legal Update.

### **NEW ITEM 1503 OF REGULATION S-K: RISK MANAGEMENT**

Item 1503 would require companies to describe their processes for identifying, assessing and managing climate-related risks. For example, a company would need to disclose how it:

- determines the relative significance of climate-related risks compared to other risks;
- considers existing or likely regulatory requirements or policies;
- considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks; and
- determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk.

To the extent applicable, the company would have to disclose how it decides whether to mitigate, accept, or adapt to a particular risk, how it prioritizes addressing climate-related risks and how it determines how to mitigate a high-priority risk. If a company adopted a transition plan, it would have to disclose that plan, including the relevant metrics and targets used to identify physical and transition risks.

### **NEW ITEM 1504 OF REGULATION S-K: GHG EMISSIONS METRICS**

Item 1504 would require companies to disclose GHG emissions. Companies would have to disclose total Scope 1 emissions separately from total Scope 2 emissions after calculating them from all sources that are included in their organizational and operational boundaries. If a company's total Scope 3 emissions for the fiscal year are material, or if the company has set a GHG emissions reduction target or goal that includes a Scope 3 emissions, it would also have to provide separate disclosure for its total Scope 3 emissions. For each of its Scope 1, 2 and 3 emissions, the Proposal would require the company to disclose the emissions both in the aggregate and disaggregated by each constituent greenhouse gas, which under the rule are carbon dioxide (CO<sub>2</sub>); methane (CH<sub>4</sub>); nitrous oxide (N<sub>2</sub>O); nitrogen trifluoride (NF<sub>3</sub>); hydrofluorocarbons (HFCs); perfluorocarbons (PFCs); and sulfur hexafluoride (SF). The Proposal would require a company to disclose all scopes of GHG emissions data in gross terms, excluding any use of purchased or generated offsets.

As noted above, the Proposal would require all companies to disclose their Scopes 1 and 2 GHG emissions, but would require disclosure of Scope 3 emissions only if those emissions are material, or if the company has set a GHG emissions reduction target or goal that includes its Scope 3 emissions. However, the proposing release indicates that when assessing the materiality of Scope 3 emissions, companies should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. The proposing release further notes that

even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions, a quantitative analysis alone would not suffice for purposes of determining whether Scope 3 emissions are material. . . Scope 3 emissions may make up a relatively small portion of a registrant's overall GHG emissions but still be material where Scope 3 represents a significant risk, is subject to significant regulatory focus, or "if there is a substantial likelihood that a reasonable [investor] would consider it important." Moreover, if a materiality analysis requires a determination of future impacts, i.e., a transition risk yet to be realized, then both the probability of an event occurring and its magnitude should be considered. Even if the probability of an adverse consequence is relatively low, if the magnitude of loss or liability is high, then the information in question may still be material.

When companies are required to disclose Scope 3 emissions, they would have to identify the categories of upstream and downstream activities that have been included in the calculation of its Scope 3 emissions.

Companies would have to disclose the sum of their Scopes 1 and 2 emissions in terms of GHG intensity, with separate GHG intensity disclosure for Scope 3 emissions required to be disclosed. "GHG intensity" (or "carbon intensity") for this purpose means a ratio that expresses the impact of GHG emissions per unit of economic value or per unit of production.

As proposed, GHG emissions data would have to be provided for the company's most recently completed fiscal year and for the historical fiscal years included in its consolidated financial statements in the applicable filing. Companies would be required to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics. The Proposal includes specific rules related to the determination of GHG emissions.

Because of potential difficulties in obtaining data from suppliers and other third parties in a company's value chain or in verifying the accuracy of that information, as well as the potential need to rely heavily on estimates and assumptions to generate Scope 3 emissions data, the SEC has proposed a safe harbor for liability for Scope 3 emissions. This safe harbor would provide that disclosure of Scope 3 emissions by or on behalf of the company would be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith. This safe harbor would extend to any statement regarding Scope 3 emissions that is disclosed pursuant to proposed subpart 1500 of Regulation S-K in a document filed with the SEC.

As proposed, smaller reporting companies would be exempt from the proposed Scope 3 emissions requirement. All other companies would have an additional year to comply initially with the Scope 3 disclosure requirement beyond the compliance date for the other proposed rules.

### **NEW ITEM 1505 OF REGULATION S-K: ATTESTATION OF SCOPE 1 AND SCOPE 2 EMISSIONS DISCLOSURE**

Item 1505 of Regulation S-K would require any company, including a foreign private issuer, that is an accelerated filer or a large accelerated filer to include an attestation report covering Scope 1 and Scope 2 emissions in the relevant filing, as well as to provide related disclosures about the third party providing attestation services.



As proposed, the GHG emissions attestation provider does not have to be a public accounting firm registered with the PCAOB, but it does have to be an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting or attesting to GHG emissions, and be independent of the company and its affiliates. The attestation report would have to be included in the separately-captioned “Climate-Related Disclosure” section of the relevant filing, and be provided pursuant to standards that are publicly available at no cost and are established by a body or group that has followed due process procedures. The company would have to disclose information regarding the GHG emissions attestation provider such as any license, oversight or record-keeping requirements.

The Proposal provides initially for a limited assurance standard, later scaling up to a reasonable assurance standard, as well as a phased compliance date based on the company’s filing status. The chart from the SEC’s proposing release showing the minimum requirement for the attestation engagement is replicated below. Companies, other than large accelerated filers or accelerated filers, that voluntarily disclose a GHG attestation report are also subject to certain disclosure requirements regarding such attestation.

### **NEW ITEM 1506 OF REGULATION S-K: TARGETS AND GOALS**

If companies set any climate-related targets or goals, a description of Item 1506 of Regulation S-K would require disclosure of them, including to the extent applicable, a description of:

- The scope of activities and emissions included in the target;
- The unit of measurement, including whether the target is absolute or intensity-based;
- The defined 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;
- The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
- Any interim targets set by the company; and
- How the company intends to meet its climate-related targets or goals.

Item 1506 would also require disclosure of relevant data to indicate whether the company is making progress toward meeting the target or goal, and how such progress has been achieved. This disclosure must be updated each fiscal year by describing the actions taken during the year to achieve its targets or goals.

When a company uses carbon offsets or RECs as part of its plan to achieve climate-related targets or goals, it would have to disclose the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECS, the source of the offsets or RECs, a description and location of the underlying projects, any registries or other authentication of the offsets or RECs and the cost of the offsets or RECs.

## NEW ITEM 1507 OF REGULATION S-K: INTERACTIVE DATA REQUIREMENT

Under the Proposal, companies would be required to tag climate-related disclosures in Inline eXtensible Business Reporting Language (Inline XBRL), with block text tagging and detail tagging of narrative and quantitative disclosures provided pursuant to Subpart 1500 of Regulation S-K and Article 14 of Regulation S-X.

### Proposed Scope and Phase-In Periods

The Proposal would apply to SEC “registrants,” defined as issuers with reporting obligations pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) and any companies that file a registration statement under the Securities Act of 1933 or the Exchange Act. This would include foreign private issuers that file annual reports on Form 20-F. While the Proposal would not require an issuer that files a Form 40-F (*i.e.*, Canadian issuers that report under the SEC’s MJDS) to comply with the proposed climate-related disclosure requirements, the SEC requests comment on whether and how to address climate-related disclosures by MJDS issuers. Similarly, while the Proposal would not apply to issuers of asset-backed securities, the SEC requests comment on whether and how to address climate-related disclosures by such issuers. The Proposal does apply to emerging growth companies and business development companies, but the SEC did request comment on whether such companies should be excluded.

The Proposal would be phased in for all registrants, with the compliance date dependent upon the status of the registrant as a large accelerated filer, accelerated or non-accelerated filer, or smaller reporting company, and the content of the item of disclosure. The Proposal does not contain proposed text for a phase-in provision, but an example in the preamble discussion and associated fact sheet states that, assuming the Proposal is adopted in December 2022 and a registrant has a December 31 fiscal year-end, the phase-in would be as follows:

Registrant Type	Disclosure Compliance Date	
	All proposed disclosures, including greenhouse gas emissions metrics: Scope 1, Scope 2 and associated intensity metric, but excluding Scope 3	Greenhouse gas emissions metrics: Scope 3 and associated intensity metric
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
Small Reporting Company	Fiscal year 2023 (filed in 2024)	Exempted

Filer Type	Scopes 1 and 2 Greenhouse Gas Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

## Practical Considerations

The proposed rules would require disclosure that is vastly more extensive than what is required in the business or management’s discussion and analysis section of an SEC filing, arguably the sections that investors turn to first to analyze the financial condition and growth potential of a given company. It is difficult to believe that all public companies, especially smaller reporting companies, will be able to comply with these proposed rules if adopted. The costs of implementation will likely be too much for certain companies to bear and may lead some smaller companies to “go dark” and deter other companies from going public. In fact, companies might consider whether this is the type of regulatory risk that the SEC told companies to consider disclosing in their risk factors in the 2010 interpretive guidance that the staff in the Division of Corporation Finance has resurrected.<sup>10</sup>

In reading the Proposal and the proposed rules, one cannot help but notice the irony that in attempting to mandate climate-related disclosures that are “consistent, comparable, and reliable” the SEC recognizes that certain information will not apply to, or is not available to, every company. In addition, as noted above under “Background” and in the Proposal itself, there are various ways to calculate the contemplated metrics, which means that the resulting disclosure will be, at best, neither consistent nor comparable, and at worst, not reliable.

Nevertheless, in anticipation of these proposed rules being adopted, companies should start considering the changes that may be appropriate for them to make to their disclosure controls and procedures and internal control over financial reporting to be in a position to comply with the new disclosure requirements once adopted and effective. For example, companies may want to expand disclosures committees and processes to include officers or other employees with climate change expertise. Companies should also implement a system for documenting their climate disclosures and related methodology, particularly with respect to GHG emissions.

Audit committees should consider their role in oversight of climate change disclosures as a result of the Proposal, even for companies that have a separate ESG committee or where responsibility for ESG oversight has been delegated to a specific committee, particularly with respect to amendments to Regulation S-X. Audit committees for NYSE-listed companies, for example, are expressly required to meet to review and discuss the listed company’s annual audited financial statements and quarterly financial statements with management and the independent auditor. Companies should consider

whether they will need to revise committee charters to fine tune the allocation of board-level oversight of climate change if the Proposal is adopted substantially as proposed.

Companies should decide whether they will seek attestation services for GHG emissions data from a certified public accounting firm that handles public company audits, or whether they would prefer to engage a different attestation service provider allowed by the proposed rules. Regardless, companies should evaluate the expertise of any firm they propose to use. Companies should consider gathering information from, and perhaps interviewing, potential assurance providers in advance of adoption of the final rule.

Climate-related disclosure in SEC reports would be “filed,” rather than “furnished” under the proposed rules, resulting in heightened liability for registrants. It is possible that once a final rule is adopted and becomes effective, companies may face litigation based on the new requirements, for example on the grounds that the disclosures contain materially misleading statements or omissions. Therefore, it will be very important for companies to carefully draft climate-related disclosures responsive to these rules. To the extent the disclosures contain forward-looking statements, including with respect to goals or commitments, these statements should be clearly identified as such, with appropriate cautionary language.

It will take time to prepare the disclosures that would be required by the proposed rules. Therefore, it would be prudent for public companies to start thinking about their disclosures should the Proposal be adopted substantially as proposed. Some companies may find it useful to produce discussion drafts at this time for internal review. Whether or not the drafting begins in advance or closer to the effective time of a final rule, the drafting process for the new climate change disclosures, at least initially, would benefit from a comprehensive approach that, depending on the company, may involve review from technical, legal, financial, accounting, investor relations and public relations perspectives, and may include outside counsel, accountants, and consultants.

The proposed prescriptive climate change disclosures will impose costs on public companies. In addition to incurring costs of an assurance provider, companies may incur costs of consultants in technical areas such as environmental engineering, emissions, climate science and sustainability. And, the increased work load from climate change reporting may result in the need for some companies to hire additional employees.

The SEC staff has already been raising comments regarding climate-related disclosures in sustainability reports or on company websites that are more expansive than SEC filings. With the extensive, prescriptive climate disclosures proposed, some companies may want to consider whether to continue publishing sustainability reports that are separate from their SEC filings. In any event, once the Proposal is finalized, any separate sustainability report would need to be consistent with the climate-related disclosures in SEC filings.

The Proposal, and particularly its Scope 3 and assurance aspects, is likely to generate controversy and may give rise to litigation against the SEC, including on the issue of whether the SEC has the authority and expertise to regulate environmental issues. Commissioner Peirce delivered a dissenting statement at the Open Commission Meeting that addressed this point in detail, including potential arguments a plaintiff might use in seeking to restrain the adoption or effectiveness of the Proposal.<sup>11</sup>

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## ENDNOTES

- <sup>1</sup> See <https://www.sec.gov/rules/proposed/2022/33-11042.pdf>.
- <sup>2</sup> Of course, it is possible (or even likely) that there will be requests to extend this period in light of the complexity of the Proposal and the substantial information requested from commenters. Recent use by the SEC of “short” comment periods in rulemakings has drawn Congressional attention. See the Jan. 10, 2022 letter to Chair Gensler from Representative McHenry and Senator Toomey at [https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10\\_pmc\\_toomey\\_letter-gensler\\_sec\\_comment\\_period.pdf](https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf).
- <sup>3</sup> See Nicola M. White, SEC Drops Hints About ESG Rule in Retorts to Vague Disclosures, Bloomberg Law (Mar. 18, 2022), <https://news.bloomberglaw.com/securities-law/sec-scrutiny-of-big-companies-sheds-light-on-climate-priorities>.
- <sup>4</sup> See GHG Protocol, available at <https://www.ghgprotocol.org>.
- <sup>5</sup> See TCFD Recommendations, available at <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>.
- <sup>6</sup> See GHP Protocol Corporate Accounting and Reporting Standard (Revised Edition), available at <https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf>.
- <sup>7</sup> See GHG Protocol Scope 2 Guidance available at [https://ghgprotocol.org/sites/default/files/standards/Scope%20%20Guidance\\_Final\\_Sept26.pdf](https://ghgprotocol.org/sites/default/files/standards/Scope%20%20Guidance_Final_Sept26.pdf).
- <sup>8</sup> See GHP Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard, available at [https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporting-Standard\\_041613\\_2.pdf](https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporting-Standard_041613_2.pdf).
- <sup>9</sup> A company, however, would not need to provide a corresponding historical metric for a fiscal year preceding its current reporting fiscal year if the company is eligible to take advantage of the accommodation in Rule 409 or Rule 12b-21.
- <sup>10</sup> See Commission Guidance Regarding Disclosure Related to Climate Change, Rel. No. 33-9106, (Feb. 8, 2010), available at <https://www.sec.gov/rules/interp/2010/33-9106.pdf>: “Depending on a registrant’s particular circumstances, Item 503(c) may require risk factor disclosure regarding existing or pending legislation or regulation that relates to climate change.”
- <sup>11</sup> Commissioner Hester M. Peirce, “We are Not the Securities and Environment Commission - At Least Not Yet” (Mar. 21, 2022), available at <https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321>.