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SEC Proposes Landmark Rules To Enhance and Standardize Climate-Related Disclosures

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On March 21, 2022, the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") proposed long-awaited rules (the "Proposed Rules") to enhance and standardize climate-related disclosures for public companies under the Securities Act of 1933, as amended (the "Securities Act") and the Securities Exchange Act of 1934, as amended (the "Exchange Act").[1] These broad-sweeping requirements would require both domestic and foreign private issuers ("FPIs"), regardless of industry sector, to include substantial climate-related disclosures in registration statements and periodic reports and are likely to significantly increase related data collection and monitoring obligations and costs.[2] This includes:

- Significant and detailed line-item disclosures in a number of climate-related areas, such as climate risk identification, management and governance;
- Requirements to report Scope 1 and Scope 2 emissions and, if material or if included in an emissions target, Scope 3 emissions;
- Mandatory third-party attestation over Scope 1 and Scope 2 emissions;
- Requirements to report greenhouse gas ("GHG") emission reduction targets (if any) and related information; and
- New requirements under Regulation S-X requiring climate-specific disclosures in a new note to registrants' audited financial statements.

The Proposed Rules include a phase-in period for certain requirements for all registrants, with the compliance date dependent on the registrant's filer status (*i.e.*, large accelerated filer, accelerated filer or smaller reporting company ("SRC")), and an additional phase-in period for Scope 3 emissions disclosure and certain attestation requirements. The Proposed Rules were approved by a 3-1 vote, with Commissioner Hester M. Peirce (the sole Republican Commissioner) dissenting.

This memorandum summarizes the key new disclosure and other related requirements in the Proposed Rules and identifies certain key next steps for the Proposed Rules and for boards of directors and management to prepare for their effectiveness.

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[1] SEC Press Release, *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors* (March 21, 2022) (https://www.sec.gov/news/press-release/2022-46); SEC Proposing Release, *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (March 21, 2022) (https://www.sec.gov/rules/proposed/2022/33-11042.pdf) (the "Proposing Release").

[2] Please see our previous publications on ESG matters for background on climate disclosure reporting, including on certain key frameworks and practical steps for boards and management, as well as SEC Chair Gensler's previous remarks relating to climate change disclosure.

SUMMARY

While, as anticipated, significant components of the Proposed Rules track disclosure recommendations by the Task Force on Climate-related Financial Disclosures ("TCFD", and such disclosure recommendations, the "TCFD Recommendations") (building on a trend in other jurisdictions, including the United Kingdom), the Proposed Rules are extremely detailed and complex and include significant additional requirements. We have identified below 10 key sets of climate-related disclosures registrants would be required to make, generally grouped across five categories. Each of these disclosure requirements is described in more detail later in this memorandum.

A. Governance, Strategy and Risk Management Disclosures

The Proposed Rules include the addition of Items 1501 (Governance), 1502 (Strategy, business model and outlook) and 1503 (Risk management) to Regulation S-K, clearly intended to track (though in some cases with greater detail required) the first three pillars of the TCFD Recommendations regarding climate-related governance, strategy and risk management. These Items require key disclosures describing:

(1) Board oversight of climate-related risks, including identifying board members or committees responsible for the oversight of climate-related risks and providing disclosure as to board expertise and board-level processes related to climate matters.

(2) Management's role in assessing and managing climate-related risks, including which positions or committees within management are responsible for assessing and managing climate-related risks as well as disclosures about their processes.

(3) Climate-related risks that are reasonably likely to have a "material" impact on a registrant's business, results of operations or financial condition, which may manifest over the "short, medium and long term", including separate detailed disclosure of "physical" and "transition" risks; descriptions of the actual and potential impacts of such risks; current and forward-looking impacts of such risks on business strategy, financial planning and capital allocation; the role of carbon offsets or renewable energy certificates ("RECs") in climate-related business strategy; the effect of the risks on the financial statements; and disclosures as to analytical tools or details around any "scenario analysis" used by the company in testing the resilience of its strategy and business model.

(4) Information about a registrant's internal carbon price (if one has been adopted), including the rationale for selecting it.

(5) Risk management processes for identifying, assessing and managing climate-related risks, including integration into overall risk management processes and detailed information as to the registrant's climate "transition plan" (if one has been adopted).

B. Disclosure of GHG Emissions Data

Item 1504 (GHG emissions metrics) requires disclosure similar to the fourth and final prong of the TCFD Recommendations, including:

(6) Scope 1 and Scope 2 GHG emissions that would be (a) separately quantified as between Scope 1 and Scope 2, (b) expressed both disaggregated by constituent GHGs and, in the aggregate, in terms of carbon dioxide equivalent ("CO2e"), (c) quantified in absolute terms (not including offsets) and (d) expressed in terms of carbon intensity (per unit of total revenue and per unit of relevant production).

(7) Scope 3 GHG emissions but only if (a) they are material or (b) the registrant has set a GHG emissions target or goal that includes Scope 3 emissions. Scope 3 emissions disclosures benefit from a delayed compliance date, a safe harbor for liability and an exemption from SRCs for Scope 3 emissions reporting.

Such disclosure would cover GHG emissions during the most recently completed fiscal year, as well as each historical fiscal year for which consolidated financial statements are included in the filing (to the extent historical emissions data is reasonably available), generally be calculated based on the organizational boundaries of the registrant consistent with its accounting consolidation principles and provide detailed information related to methodologies utilized.

C. Attestation Report

(8) Item 1505 (Attestation of Scope 1 and Scope 2 emissions disclosure) requires accelerated and large accelerated filers to file an attestation report from an independent attestation service provider covering Scope 1 and Scope 2 emissions. This requirement is subject to a phase-in over time, including a transition from a limited assurance standard to a reasonable assurance standard. The Proposed Rules also provide detailed requirements as to the form of the attestation report and qualifications of the assurance provider.

D. Climate-Related Targets and Goals

(9) Item 1506 (Targets and goals) requires various disclosures regarding the registrant's publicly set GHG emissions reduction targets or goals (if any), including (a) the scope of activities and emissions included in the target, (b) the defined time horizon by which the target is intended to be achieved and any interim targets, (c) how the registrant intends to meet such targets or goals, (d) relevant data to indicate whether the registrant is making progress toward meeting the target or goal and how such progress has been achieved, with updates each fiscal year and (e) certain information about carbon offsets and RECs, if such matters have been used as part of the registrant's plan to achieve climate-related targets or goals.

E. Article 14 Climate-Related Financial Statement Metrics

(10) A new article of Regulation S-X ("Article 14") would require climate-related financial statement metrics in a note to the audited financial statements. This Article 14 note would require detailed, quantified disclosures related to both (a) severe weather events and other natural conditions and (b) transition activities, including the financial impacts of each of weather events and transition activities to each line item of the financial statements (unless the absolute value of total impacts is less than 1%), as well as expenditure metrics and financial estimate assumptions related to severe weather events and transition activities.

FUNDAMENTALS OF THE PROPOSED RULES

Substantive Rules

As an initial matter, it is significant that the SEC has proposed its own substantive rules. While the Proposing Release for the Proposed Rules acknowledges that the rules have been largely based on TCFD Recommendations and the Greenhouse Gas Protocol ("GHG Protocol"), the SEC has not proposed a rule framework that requires or authorizes registrants to comply with TCFD or another third-party framework provider. Rather, as Chair Gensler previewed and as we previously highlighted, the SEC is writing its own rules.

Covered Forms and Registrants

In prior memos, we have noted that Chair Gensler had suggested in remarks about potential climate change disclosure rulemaking that disclosures would be required as part of normal Exchange Act reporting filings rather than requiring separate reports. This approach has been reflected in the Proposed Rules. Registrants with Exchange Act reporting obligations pursuant to Exchange Act Section 13(a) or 15(d) and companies filing a Securities Act or Exchange Act registration statement would be required to include climate-related disclosures contemplated by the Proposed Rules in registration statements (*e.g.*, Securities Act Forms S-1, F-1, S-3, F-3, S-4, F-4 and S-11 and Exchange Act Forms 10 and 20-F) and periodic reports (*e.g.*, Forms 10-K and 20-F). All climate-related disclosures would be considered filed (not furnished) and, other than a carve-out for Scope 3 emissions disclosures described below, would be subject to the same liability standards as any other disclosures in filings with the SEC.

The Proposed Rules would not exempt either FPIs or smaller domestic companies, such as SRCs or emerging growth companies ("EGCs"), from the majority of the proposed climate-related disclosure rules. SRCs would be exempt from the proposed Scope 3 emissions disclosure requirement and would have a longer transition period to comply with the applicable Proposed Rules than other registrants. EGCs would also not benefit from special dispensations under the rules, except that they (and SRCs) would only have to provide climate-related financial statement metrics for their prior two fiscal years given their reduced financial statement requirements.

Compliance Dates

The Proposed Rules allow for phased-in compliance based on the registrant type and type of disclosure as illustrated in the below table. Note these dates assume the Proposed Rules would be adopted with an effective date in December 2022 and a registrant's fiscal year ending December 31. A registrant with a different fiscal year end date whose fiscal year 2023 commences before the effective date of the rules would not be required to comply with a new subpart to Regulation S-K ("Subpart 1500") and Article 14 until the following fiscal year.

Registrant Type	All proposed disclosures (excluding Scope 3), including Scope 1 and Scope 2 GHG emissions metrics and associated intensity metrics	Scope 3 GHG emission metrics and associated intensity metrics	Financial Statement Metrics Audit Compliance Date
Large Accelerated Filer	FY 2023 (filed in 2024)	FY 2024 (filed in 2025)	Same as disclosure compliance date
Accelerated and Non-Accelerated Filer	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)	
SRC	FY 2025 (filed in 2026)	Exempted	

PROPOSED RULES – REQUIRED DISCLOSURES

A. Governance, Strategy and Risk Management Disclosures

The Proposed Rules include three new items (Items 1501, 1502 and 1503) requiring disclosure similar to the TCFD Recommendations as to climate-related governance, strategy and risk management. These Items include key disclosures related to the five topics described below.

Board oversight of climate-related risks

A registrant must disclose a number of board governance items, as applicable, including (1) identification of any board members or board committees responsible for the oversight of climate-related risks[3] (*e.g.*, an existing committee like the audit or risk committee or a separate committee established to focus on climate-related risks), (2) whether any member of the registrant's board has expertise in climate-related risks, (3) the process and frequency by which the board or board committee discusses climate-related risks, (4) whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management and financial oversight and (5) whether and how the board sets climate-related targets or goals (including interim targets or goals) and how it oversees progress against such targets or goals. The Proposed Rules would also allow the registrant to disclose information concerning any identified "climate-related opportunities"[4].

We expect these requirements to both put a premium on recruiting board candidates with climate-related qualifications and prompt companies to seek additional training for their directors in climate-related matters.

[3] "Climate-related risks" includes the "actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole". "Value chain" refers to the "upstream and downstream activities related to a registrant's operations". "Upstream activities" are "activities by a party other than the registrant that relate to the initial stages of a registrant's production of a good or service (e.g., materials sourcing, materials processing, and supplier activities)", and "downstream activities" are "activities by a party other than the registrant that relate to processing materials into a finished product and delivering it or providing a service to the end user (*e.g.*, transportation and distribution, processing of sold products, use of sold products, end of life treatment of sold products and investments)". Proposing Release, p. 60.

[4] "Climate-related opportunities" are the "actual or potential positive impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole". Proposing Release, p. 66.

Management's role in assessing and managing climate-related risks

Registrants must disclose a number of management governance items, as applicable, including (1) management's role in assessing and managing any climate-related risks (including the identity of positions or committees within management and the relevant expertise of such individuals), (2) the processes by which the responsible managers or management committees are informed about and monitor climate-related risks and (3) whether the responsible positions or committees report to the board or board committee on climate-related risks and how frequently this occurs.

Here, too, we expect that the disclosure requirements as to management's processes and expertise would function effectively as substantive requirements for registrants to develop and maintain such expertise.

Short, medium and long-term climate-related risks

The Proposed Rules would require disclosure of any climate-related risks that are reasonably likely to have a material[5] impact on the registrant's business or consolidated financial statements, which may manifest over the short, medium and long term[6] (and a registrant would also be allowed to disclose the actual and potential impacts of any climate-related opportunities the registrant is pursuing). Climate-related risks include "physical risks" and "transition risks",[7] and the Proposed Rules would require a registrant to specify whether an identified climate-related risk is a physical or transition risk. Notably, the Proposed Rules also would require very granular disclosures as to the properties, processes or operations subject to physical risks.[8]

Registrants must describe the actual and potential impacts on its strategy, business model and outlook of any climate-related risk reasonably likely to have a material impact on its business or consolidated financial statements. A registrant also would have to disclose the time horizon for each described impact (*i.e.*, short, medium or long term) and discuss how it considered the identified impacts as part of its business strategy, financial planning and capital allocation both for the present and future, including with regard to how resources are being used to mitigate climate-related risks. In addition, registrants would need to disclose how any related metrics or targets relate to the registrant's business model or business strategy.

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[5] The Proposing Release, consistent with Supreme Court precedent, considers a matter "material" if there is a "substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote". As the SEC has previously indicated, the materiality determination is "largely fact specific and one that requires both quantitative and qualitative considerations" and, with regard to potential future events, requires an assessment of "both the probability of the event occurring and its potential magnitude, or significance to the registrant". Proposing Release, p. 68.

[6] A registrant would be required to describe how it defines short, medium and long term, including how it takes into account or reassesses the expected useful life of its assets and the time horizons for the registrant's planning processes and goals. Proposing Release, p. 67. It is noteworthy that the Proposing Release does not, however, provide definition in terms of years for short, medium and long term.

[7] "Physical risks" are "risks related to the physical impacts of the climate", including "both acute and chronic risks to a registrant's business operations or the operations of those with whom it does business". "Acute risks" are "event-driven risks related to shorter-term extreme weather events, such as hurricanes, floods, and tornadoes". "Chronic risks" are "those risks that the business may face as a result of longer term weather patterns and related effects, such as sustained higher temperatures, sea level rise, drought, and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water". "Transition risks" are "risks related to a potential transition to a lower carbon economy", including "actual or potential negative impacts on a registrant's consolidated financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks". Transition risks include, but are not limited to, "increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices, or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior". The Proposing Release states that a registrant that has "significant operations in a jurisdiction that has made a GHG emissions reduction commitment" would likely be exposed to transition risks related to the implementation of such commitment. Proposing Release, pp. 60-62.

[8] The Proposed Rules would require disclosure of (a) the nature of the risk, including whether it may be categorized as an "acute" or "chronic" risk, (b) the location of the properties (if it is likely to have or has had a material impact on its business or consolidated financial statements, then it would provide the ZIP code or other similar identifier), processes or operations subject to the physical risk, (c) the percentage of buildings, plants or properties that are located in flood hazard areas if flooding presents a material physical risk and (d) additional disclosure if a material risk concerns the location of assets in regions of high or extremely high water stress (e.g., the amount of assets located in such regions and the percentage of its total water usage from water withdrawn in such regions). If a climate-related risk is a transition risk, the Proposed Rules would require disclosure of the risk's nature, including whether it relates to regulatory, technological, market (e.g., changing consumer, business counterparty or investor preferences), liability, reputational or other transition-related factors and how such factors impact the registrant. Proposing Release, pp. 62-65.

If a registrant's net emissions reduction strategy uses carbon offsets or RECs[9], it must disclose the role that such carbon offsets and/or RECs play in its climate-related business strategy.

Registrants also must provide a narrative disclosure of whether and how any of its identified climate-related risks have affected or are reasonably likely to affect its consolidated financial statements.[10]

The Proposed Rules would also require a registrant to describe the resilience of its business strategy in light of potential future changes in climate-related risks, and a registrant would be required to describe any analytical tools, such as a scenario analysis[11], that it 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. If a registrant uses a scenario analysis, it would be required to disclose the scenarios considered (*e.g.*, an increase of no greater than 3°C, 2°C or 1.5°C above pre-industrial levels), including the parameters, assumptions and analytical choices, and the projected principal financial impacts on the registrant's business strategy under each scenario.

Information about a registrant's internal carbon price

If a registrant uses an internal carbon price, it must disclose (1) the price per metric ton of CO2e, (2) the total price, including how the total price is estimated to change over time, if applicable, (3) the boundaries for measurement of overall CO2e on which the total price is based, (4) the rationale for selecting an internal carbon price applied and (5) how it uses each disclosed internal carbon price to evaluate and manage climate-related risks. If the registrant maintains multiple internal carbon prices, disclosures would need to be provided for each price, as well as the reason for using different prices.

Risk management processes for identifying, assessing and managing climate-related risks

Similar to the TCFD Recommendations, the Proposed Rules would require a registrant to disclose, as applicable, certain information concerning the board's oversight of climate-related risks and management's role in assessing and managing such risks, including with respect to board governance and management oversight.

A registrant also must describe any processes the registrant has for identifying, assessing and managing climate-related risks. The registrant would be required to disclose the following processes, as applicable: (1) how it determines the relative significance of climate-related risks compared to other risks, (2) how it considers existing or likely regulatory requirements or policies (*e.g.*, GHG emissions limits) when identifying climate-related risks, (3) how it considers shifts in customer or counterparty preferences, technological changes or changes in market prices in assessing potential transition risks and (4) how it determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk. When describing such processes, a registrant would be required to disclose, as applicable, how it (i) decides whether to mitigate, accept or adapt to a particular risk, (ii) prioritizes addressing climate-related risks and (iii) determines how to mitigate a high-priority risk.

If a registrant has adopted a transition plan[12], the Proposed Rules would require it to describe its plan, including, as applicable, (1) the relevant metrics and targets used to identify and manage physical and transition risks, (2) how it plans

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[9] "Carbon offsets" refers to an emissions reduction or removal of GHGs in a manner calculated and traced for the purpose of offsetting an entity's GHG emissions. A "REC" is a "credit or certificate representing each purchased megawatt-hour (1 MWh or 1000 kilowatt-hours) of renewable electricity generated and delivered to a registrant's power grid". Proposing Release, p. 81.

[10] The Proposed Rules provide a non-exhaustive list that a registrant would be required to disclose impacts on, including (a) business operations, including the types and locations of its operations, (b) products or services, (c) suppliers and other parties in its value chain, (d) activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes, (e) expenditure for research and development and (f) any other significant changes or impacts. Proposing Release, pp. 76-77.

[11] A "scenario analysis" is a "process for identifying and assessing a potential range of outcomes of future events under conditions of uncertainty". When applied to climate-related assessments, scenario analysis is a "tool used to consider how, under various possible future climate scenarios, climate-related risks may impact a registrant's operations, business strategy, and consolidated financial statements over time" that may be used to test the resilience of their strategies under future climate scenarios, including different global temperature increases (e.g., 3°C, 2°C and 1.5°C above pre-industrial levels). Proposing Release, p. 87.

[12] A "transition plan" is a registrant's "strategy and implementation plan to reduce climate-related risks" and may include "a plan to reduce its GHG emissions in line with a registrant's commitments or commitments of jurisdictions within which it has significant operations". Proposing Release, p. 107.

to mitigate or adapt to any physical risks identified in its disclosure, including, but not limited to, those concerning exposure to sea level rise, extreme weather events, wildfires, drought and severe heat and (3) how it plans to mitigate or adapt to any identified transition risks, including (i) laws, regulations or policies that restrict GHG emissions or products with high GHG footprints (*e.g.*, emissions caps) or require the protection of high conservation value land or natural assets, (ii) imposition of a carbon price and (iii) changing demands or preferences of consumers, investors, employees and business counterparties. The registrant would need to provide annual updates describing the actions taken during the year to achieve the plan's targets or goals (see below). A registrant that has adopted a transition plan may also describe how it plans to achieve any identified climate-related opportunities.[13]

B. Disclosure of GHG Emissions Data

The Proposed Rules would require a registrant to (1) disclose its GHG[14] emissions for its most recently completed year and for the historical fiscal years included in the registrant's consolidated financial statements in the applicable filing to the extent such historical GHG emissions data is reasonably available without unreasonable effort or expense and (2) establish certain requirements regarding the measurement and reporting of GHG emissions similar to the concepts used by the GHG Protocol.[15] Reasonable estimates for the fourth quarter of the most recent fiscal year may be used if actual reported data is not reasonably available.[16]

GHG emission disclosures would be required to include detailed descriptions of methodologies utilized and would generally trace the organizational boundaries of the registrant consistent with accounting consolidation principles. When describing its methodology, a registrant would be required to describe significant inputs and significant assumptions used to calculate its GHG emissions metrics, including the registrant's "organizational boundaries" and "operational boundaries".[17] In addition to setting organizational and operational boundaries, a registrant would need to select a GHG emissions calculation approach[18] and disclose any calculation tools used to calculate the registrant's GHG emissions metrics (including by identifying emissions sources within its plants, offices and other operational facilities that fall within its organizational boundaries and categorizing the emissions as either direct or indirect emissions) and its approach to categorizing its emissions and emissions sources.

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[13] Examples of climate-related opportunities may include (a) the production of products that facilitate the transition to a lower-carbon economy, such as low-emission modes of transportation and supporting infrastructure, (b) the generation or use of renewable power, (c) the production or use of low-waste, recycled or other consumer products that require less carbon-intensive production methods, (d) the setting of conservation goals and targets that would help reduce GHG emissions and (e) the provision of goods or services related to any transition to a lower-carbon economy. Proposing Release, p. 110.

[14] "GHGs" include CO2e, methane, nitrous oxide, nitrogen trifluoride, hydrofluorocarbons, perfluorocarbons and sulfur hexafluoride, and "GHG emissions" are "direct and indirect emissions of GHGs". "Direct emissions" are GHG emissions from sources that are owned or controlled by a registrant, and "indirect emissions" are GHG emissions that result from the activities of the registrant but occur at sources not owned or controlled by the registrant. Proposing Release, pp. 155-156.

[15] A registrant can use reasonable estimates when disclosing its GHG emissions so long as it describes the assumptions underlying and its reasons for using the estimates, and also disclose, to the extent material and as applicable, any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions, including the identification of the source of the data and the process the registrant took to obtain and assess such data. Proposing Release, pp. 206-207.

[16] This is allowed as long as the registrant promptly discloses in a subsequent filing "any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter". Proposing Release, pp. 206-207.

[17] "Organizational boundaries" are the "boundaries that determine the operations owned or controlled by a registrant for the purpose of calculating its GHG emissions". "Operational boundaries" are the "boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant". Proposing Release, p. 193.

[18] Calculating GHG emissions may be done by direct measurement of GHG emissions from a source by monitoring concentration and flow rate or applying published "emission factors" to the total amount of purchased fuel consumed by a particular source. An "emission factor" is a "multiplication factor allowing actual GHG emission to be calculated from available activity data or, if no activity data is available, economic data, to derive absolute GHG emissions". Emission factors are ratios that typically relate GHG emissions to a proxy measure of activity at an emissions source and include "kilowatt-hours of electricity used, quantity of fuel used, output of a process, hours of operation of equipment, distance travelled, and floor area of a building". Proposing Release, p. 200.

Scope 1 and Scope 2 GHG emissions

The Proposed Rules would require a registrant to disclose its total Scope 1 emissions separately from its total Scope 2 emissions after calculating them from all sources that are included in the registrant's organizational and operational boundaries.[19] The scope of consolidation and reporting must be consistent for a registrant's financial data and GHG emissions data, and all of the consolidated entities' emissions would need to be included (subject to certain limited exceptions[20]). The same organizational boundaries would need to be used when calculating a registrant's Scope 1 and Scope 2 emissions (and Scope 3 emissions, if required to be disclosed), and once organizational and operational boundaries are determined, they would need to be used consistently when calculating GHG emissions.[21]

Registrants also must disclose its aggregate Scope 1 and Scope 2 "GHG intensity"[22] in terms of metric tons of CO2e per unit of total revenue and per unit of production for the fiscal year[23]. A registrant would be allowed to voluntarily disclose other additional measures of GHG intensity, including non-financial measures (*e.g.*, economic output), provided it includes an explanation of why such measures are used and why the registrant believes such measures provide useful information to investors (along with the methodology and other information required pursuant to the proposed GHG emission metrics instructions).

Scope 3 GHG emissions if (a) they are material or (b) the registrant has set a GHG emissions target or goal that includes Scope 3 emissions (other than for SRCs)

A registrant (other than an SRC, which is exempt) must also separately disclose its Scope 3[24] emissions for the fiscal year if those emissions are <u>material</u>[25] or if it has <u>set a GHG emissions reduction target or goal</u> that includes Scope 3 emissions.[26] Significantly, in the Proposing Release, the SEC continues to define "material" for purposes of this assessment using the traditional Supreme Court definition of "materiality"[27], and then provides a lengthy discussion of considerations applicable to determining materiality of Scope 3 emissions. For example, when assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of

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[19] "Scope 1" means "direct GHG emissions from operations that are owned or controlled by a registrant", and "Scope 2" means "indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat or cooling that is consumed by operations owned or controlled by a registrant". Proposing Release, p. 156.

[20] A registrant would be able to exclude emissions from investments that are not consolidated, are not proportionately consolidated or that do not qualify for the equity method of accounting in the registrant's consolidated financial statements. Proposing Release, p. 196.

[21] A registrant would be required to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year as well as, if material and as applicable, any gaps in the data required to calculate its GHG emissions, including disclosing the data gaps and whether it used proxy data or another method to address such gaps and how its accounting for any data gaps has affected the accuracy or completeness of its GHG emissions disclosure. Proposing Release, p. 208.

[22] "GHG intensity" (or "carbon intensity") means a "ratio that expresses the impact of GHG emissions per unit of economic value (*e.g.*, metric tons of CO_2e per unit of total revenues, using the registrant's reporting currency) or per unit of production (*e.g.*, metric tons of CO_2e per unit of product produced)". Proposing Release, p. 188.

[23] Such GHG intensity disclosure should provide context to a registrant's emissions in relation to its business scale (*e.g.*, emissions per unit of economic output). Proposing Release, p. 187. If the registrant has no revenue or unit of production for a fiscal year, then it would be required to calculate its GHG intensity with another financial measure (*e.g.*, total assets) or measure of economic output (*e.g.*, data processing capacity, volume of products sold or number of occupied rooms), respectively, and explain why the particular measure was used. Proposing Release, p. 189.

[24] "Scope 3" means "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". Proposing Release, p. 156. The Proposed Rules provide a non-exhaustive list of such upstream and downstream activities. Proposing Release, pp. 178-179.

[25] When determining whether Scope 3 emissions are material and when disclosing such emissions, a registrant must include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing. A registrant would also be required to disclose any significant overlap in the categories of activities producing Scope 3 emissions disclosure as well as how it accounted for the overlap and its disclosed total Scope 3 emissions. Proposing Release, p. 209.

[26] A registrant may present its estimated Scope 3 emissions in terms of a range as long as it discloses its reasons for using the range and the underlying assumptions. Proposing Release, p. 210.

[27] *See* footnote 5 of this memorandum and the Proposing Release, pp. 169-182.

their overall GHG emissions (although the SEC does not expressly endorse any specific quantity that might be deemed material).[28] If required to disclose Scope 3 emissions, a registrant would need to identify the categories of upstream and downstream activities included in such calculation and describe the data sources used to calculate those emissions[29].

The Proposed Rules provide a delayed compliance date for the proposed Scope 3 disclosure requirement. All registrants would have an additional year to comply initially with the Scope 3 disclosure requirement beyond the compliance date for the other proposed rules.

The Proposed Rules would also provide a safe harbor that allows a registrant's disclosure of Scope 3 emissions to not be deemed a "fraudulent statement"[30] unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith. The safe harbor would cover any statement regarding Scope 3 emissions disclosed pursuant to Subpart 1500 and made in a document filed with the SEC.[31]

C. Attestation Report

Accelerated and large accelerated filers would need to include in the relevant filing an attestation report prepared and signed by a "GHG emissions attestation provider"[32] that covers the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider. Limited assurance[33] would be provided for the second and third fiscal years after the Scope 1 and Scope 2 emissions disclosure date, and reasonable assurance[34] would be provided for the fourth fiscal year and beyond after the Scope 1 and Scope 2 emissions disclosure compliance date. A

[28] The Proposing Release states that although some companies rely on, or support reliance on, "a quantitative threshold such as 40 percent when assessing the materiality of Scope 3 emissions", a quantitative analysis alone would not be sufficient to determine whether Scope 3 emissions are material even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions. Therefore, "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'". In the event that a materiality analysis requires a determination of future impacts, then the probability of an event occurring as well as its magnitude should be considered. Proposing Release, p. 173.

[29] To calculate such emissions, a registrant may use (a) emissions reported by parties in the registrant's value chain, (b) data concerning specific activities, as reported by parties in the registrant's value chain and (c) data derived from economic studies, published databases, government statistics, industry associations or other third-party sources outside of a registrant's value chain, including industry averages of emissions, activities or economic data. *See* Proposing Release, p. 180.

[30] A "fraudulent statement" is "a statement that is an untrue statement of material fact, a statement that is false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or that constitutes the employment of a manipulative, deceptive or fraudulent device, contrivance, scheme, transaction, act, practice, course of business or an artifice to defraud as those terms are used in the Securities Act or the Exchange Act or the rules or regulations promulgated thereunder". *See* Proposing Release p. 220.

[31] The Proposing Release notes that Securities Act Rule 409 and Exchange Act Rule 12b-21 also would provide accommodations for Scope 3 emissions disclosure if relevant information is unknown and not reasonably available (either because obtaining the information would involve unreasonable effort or expense or because the information rests peculiarly within the knowledge of another person not affiliated with the registrant), although the SEC does not expect this to be the case for data coming from another registrant. Proposing Release, pp. 222.

[32] A "GHG emissions attestation provider" is a person that (a) is an expert in GHG emissions by having "significant experience" in measuring, analyzing, reporting or attesting to GHG emissions and (b) is "independent" of the registrant and any of its affiliates for whom it is providing the attestation report during both the attestation and professional engagement period. "Significant experience" means having sufficient competence and capabilities necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and to enable the service provider to issue reports that are appropriate under the circumstances. Similar to the SEC's auditor independence standard in Rule 2-01 of Regulation S-X, a GHG emissions attestation provider would not be "independent" if during the attestation and professional engagement period such attestation provider is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that such attestation provider is not, capable of exercising objective and impartial judgment on all issues encompassed within the attestation provider's engagement. Proposing Release, pp. 248-251.

[33] The objective of a limited assurance engagement is for the service provider to "express a conclusion about whether it is aware of any material modifications that should be made to the subject matter (*e.g.*, the Scopes 1 and 2 emissions disclosure) in order for it to be fairly stated or in accordance with the relevant criteria (*e.g.*, the methodology and other disclosure requirements…). In such engagements, the conclusion is expressed in the form of negative assurance regarding whether any material misstatements have been identified". Proposing Release, p. 239.

[34] The objective of a reasonable assurance engagement (which is the same level of assurance provided in an audit of a registrant's consolidated financial statements) is to "express an opinion on whether the subject matter is in accordance with the relevant criteria, in all material respects. A reasonable assurance opinion provides positive assurance that the subject matter is free from material misstatement". Proposing Release, pp. 239.

registrant would also be allowed to obtain a higher level of assurance during the transition period and to obtain any level of assurance over climate-related disclosures not required to be assured, subject to certain disclosure requirements.

The table below provides illustrative examples of what type of assurance is required and when such assurance is required for a large accelerated filer and an accelerated filer.[35]

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

The Proposed Rules require the attestation report be included in a separately captioned "Climate-Related Disclosure" section in the relevant filing and that such report 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[36], including the broad distribution of the framework for public comment. In the SEC's view, attestation standards of the Public Company Accounting Oversight Board ("PCAOB"), American Institute of Certified Public Accountants ("AICPA") and International Auditing and Assurance Standards Board would meet this due process requirement. The attestation report would not need to cover the effectiveness of internal control over GHG emissions disclosure even when the GHG emissions attestation engagement is performed at a reasonable assurance level. Existing disclosure controls and procedures obligations would apply.

The Proposed Rules would impose minimum requirements on the GHG emissions attestation report, which would be primarily derived from the AICPA's attestation standards and are largely similar to certain PCAOB report requirements. The minimum requirements include, among other things, disclosure of (1) the criteria against which the subject matter was measured or evaluated, which would need to be "suitable"[37], (2) the attestation standard(s) used, (3) any significant inherent limitations associated with the measurement or evaluation of the subject matter (at a minimum, Scope 1 and Scope 2 emissions) against the criteria and (4) the attestation provider's conclusion or opinion, as applicable, based on the attestation standard(s) used[38]. A limited assurance engagement's attestation report would also need to include a description of the work performed as a basis for the attestation provider's conclusions.

Separate from the attestation report, the Proposed Rules would also require disclosure of certain additional matters related to the attestation of the registrant's GHG emissions in the separately captioned "Climate-Related Disclosures" section, such as whether the attestation provider has a license to provide assurance, is subject to any oversight inspection program or whether the attestation provider is subject to record-keeping requirements.

If a registrant is not required to include a GHG emissions attestation report but does include GHG emissions that were voluntarily subject to third-party attestation or verification, then it would need to include certain disclosures, such as the assurance or verification standard used or whether the third-party service provider has any other business

[35] The assurance compliance date table assumes that the Proposed Rules will be adopted with an effective date in December 2022 and a registrant's fiscal year ends December 31.

[36] The "due process procedures" requirement would be similar to the one for determining a suitable, recognized control framework for use in management's evaluation of an issuer's internal control over financial reporting. Proposing Release, p. 257.

[37] "Suitable" criteria would, when followed, result in "reasonably consistent measurement or evaluation of the registrant's disclosure that is within the scope of the engagement" and include "relevance, objectivity, measurability and completeness". Proposing Release, p. 263.

[38] A limited assurance engagement's conclusion would typically state if the provider is aware of any material modifications that should be made to the subject matter in order for the disclosure to be in accordance with (or based on) the requirements specified or if the registrant's assertion about such subject matter is fairly stated, and a reasonable assurance engagement would typically include an opinion on whether the subject matter is in accordance with (or based on) the requirements specified in all material respects or that the registrant's assertion about its subject matter is fairly stated, in all material respects. Proposing Release, p. 267.

relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant.

D. Climate-Related Targets and Goals

The Proposed Rules would require a registrant to provide certain information regarding any climate-related targets or goals that it has set, including (1) the scope of activities and emissions included in the target, (2) the unit of measurement, including whether the target is absolute- or intensity-based, (3) 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, (4) the defined baseline time horizon and baseline emissions against which progress would be tracked with a consistent base year set for multiple targets, (5) any interim targets set by the registrant and (6) how the registrant intends to meet its climate-related targets or goals. A registrant must also disclose relevant data to indicate whether it is making progress toward achieving the target(s) or goal(s) and how such progress has been achieved. If the registrant has used carbon offsets or RECs in its plan to achieve climate-related targets or goals, it would also be required to disclose the amount of carbon reduction represented by such 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.

E. Article 14 Climate-Related Financial Statement Metrics

Under the Proposed Rules, a registrant's filing that includes disclosure required by Subpart 1500 that also requires audited financial statements would be required to disclose in a note to its financial statements certain disaggregated climate-related financial statement metrics mainly derived from existing financial statement line items (unless such impact is below a 1% threshold[39]), including (1) financial impact metrics[40], (2) expenditure metrics[41] and (3) financial estimates assumptions[42], in each case, that are related to or impacted by severe weather events and other natural conditions[43] and transition activities to reduce GHG emissions or mitigate transition risks, as well as disclosing the impact of climate-related risks included as part of its climate risk management disclosures.

Similar to other financial statement disclosures (*e.g.*, estimated loss contingencies and fair value measurement of certain assets), the Proposed Rules' financial statement metrics disclosures would involve estimation uncertainties that are

[39] Disclosure would not be required if the sum of the absolute value of the severe weather events, other natural conditions, transition activities and identified climate-related risks is less than 1% of the line item for the relevant fiscal year. Proposing Release, p. 126.

[40] A registrant would be required to determine the impacts of the severe weather events, other natural conditions, transition activities and identified climate-related risks described on each relevant consolidated financial statement line item, and impacts would, at a minimum, be required to be disclosed on an aggregated, line-by-line basis for all negative impacts and separately for all positive impacts. Proposing Release, p. 127.

[41] The Proposed Rules would require a registrant to separately aggregate the expenditure expensed and the capitalized costs incurred during the fiscal years presented for expenditure metrics. For each, a registrant would be required to disclose separately the amount incurred during the fiscal years presented (a) for positive and negative impacts associated with severe weather events and other natural conditions and identified physical risks and (b) for transition activities in order to reduce GHG emissions or otherwise mitigate exposure to transition risks. Proposing Release, p. 138.

[42] The Proposed Rules would require a registrant to disclose whether the estimates and assumptions used to produce its consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events (*e.g.*, identified physical risks, such as severe weather events and other natural conditions). If a registrant's financial statements were impacted by such risks and uncertainties, it would be required to provide a qualitative description of how such events impacted the development of the estimates and assumptions used in the preparation of such financial statements. Proposing Release, pp. 145-146.

[43] Specific examples that would trigger the proposed disclosure requirement may include flooding, drought, wildfires, extreme temperatures and sea level rise. Examples of disclosures that may be required to reflect the impact of the severe weather events or other natural conditions include (a) changes to revenue or costs from disruptions to business operations or supply chains, (b) impairment charges and changes to the carrying amount of assets due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures and sea level rise, (c) changes to loss contingencies or reserves due to impact from severe weather events and (d) changes to total expected insured losses due to flooding or wildfire patterns. Examples of disclosures that may be required include (i) changes to revenue or cost due to new emissions pricing or regulations resulting in the loss of a sales contract, (ii) changes to operating, investing or financing cash flow from changes in upstream costs, (iii) changes to the carrying amount of assets and (iv) changes to interest expense driven by financing instruments such as climate-linked bonds issued where the interest rate increases if certain climate-related targets are not met. Proposing Release, pg. 129-131.

driven by the application of judgments and assumptions. This means the registrant would be required 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, if applicable, policy decisions made to calculate the specified metrics. Such financial statement metrics would need to apply the same set of accounting principles as the rest of its filing whenever applicable, and disclosure would be required for the registrant's most recently completed fiscal year and for the historical fiscal year(s) included in the applicable filing.[44] A registrant may also disclose the impact of climate-related opportunities on the proposed financial statement metrics, but it would need to do so on a consistent basis.[45]

The proposed financial statement metrics would be required in the financial statements and, therefore, would be (1) included in the scope of any required audit of the financial statements in such filing, (2) subject to audit by an independent registered public accounting firm registered with the PCAOB and (3) within the scope of the registrant's internal control over financial reporting.

NEXT STEPS

Comments on the Proposed Rules will be collected until June 17, 2022. Following this, the SEC will prepare and adopt a final rule. We expect substantial comments both supportive of and critical of the Proposed Rules, particularly the potentially more controversial elements of the proposal; namely, the requirements as to Scope 3 reporting, the timing of GHG emissions reporting, attestation requirements and the new Article 14 financial statement metrics requirements. The Proposed Rules contemplate potential effectiveness in December 2022, which we believe represents an aggressive but feasible timeline.

The Proposed Rules and any final rules will need to survive almost-certain legal challenges, including some that will likely seek to prevent the rules from going into effect during the pendency of the challenges. Suits are anticipated to be brought by business and industry lobbies, as well as Republican-led states. Challenges will likely focus on whether regulating climate change is within the SEC's authority, whether the rules have sufficient benefits that outweigh their costs (particularly given costs of compliance arising from attestation requirements and potential Scope 3 disclosures) and whether the rules may violate the First Amendment as compelled speech.

Notwithstanding expected challenges, registrants should begin preparing now for compliance with the extensive new requirements embodied in the Proposed Rules. In particular, companies will need to focus on building and implementing controls and procedures to collect and maintain data that would be reported in compliance with the Proposed Rules, especially since for many registrants emissions from as soon as January 2023 will need to be reported.

We expect to publish additional memoranda with practical steps directors, executives and general counsel can take to prepare for effectiveness of the Proposed Rules.

This publication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It should not be relied upon as legal advice as facts and circumstances may vary. The sharing of this information will not establish a client relationship with the recipient unless Cravath is or has been formally engaged to provide legal services.

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[44] The Proposing Release notes that Securities Act Rule 409 and Exchange Act Rule 12b-21 may be able to be relied on to exclude a corresponding historical metric if a registrant has not previously presented such metric for such fiscal year and the historical information necessary to calculate or estimate such metric is not reasonably available without unreasonable effort or expense. Proposing Release, p. 222.

[45] For example, disclosure of opportunities would be required for each fiscal year presented in the consolidated financial statements, for each financial statement line item and for all relevant opportunities identified by the registrant, with the same presentation and disclosure threshold requirements applicable to the required disclosures related to financial impact metrics and expenditure metrics. Proposing Release, pp. 138-139.