A Deeper Dive into the SEC's Landmark Climate Disclosure Rules for Public Companies

01 Introduction

As we previously reported,[1] on March 6, 2024, the Securities and Exchange Commission (the "SEC" or the "Commission") adopted (in a three-two vote) long-awaited climate-related disclosure rules for public companies (the "Final Rules").[2] The Final Rules, although not as prescriptive as the rules that were proposed almost two years prior (the "Proposed Rules"),[3] contain broad-sweeping requirements that constitute a significant expansion of the amount of climate-related disclosure that public companies will have to make. Accordingly, the Final Rules will impose significant burdens in terms of the amount of time, resources and effort necessary for companies and their advisors to comply.

The Final Rules, which will become effective 60 days after publication in the Federal Register, apply to both domestic and most foreign private issuers ("FPIs"), regardless of industry sector, and to annual reports and registration statements.[4] As explained in Section 03 below, compliance obligations are phased in at different times depending on the requirement and the registrant's filer status, with the first filing deadline occurring as early as March 2026 for large accelerated filers ("LAFs"), covering fiscal years beginning ("FYB") in 2025.

02 Key Takeaways

- The Final Rules require disclosure about board and management governance of climate-related risks, material impacts of such risks, processes for managing such risks, transition plans used to manage material transition risks and climate-related targets or goals that materially affect the company's business, among other related topics.
  - We expect many companies will revisit their governance practices around these matters before the end of 2024 to ensure they are in a position to provide comprehensive disclosures in response to these requirements.
- The Final Rules do not require Scope 3 greenhouse gas ("GHG") emissions disclosures for any registrants; however, they do require disclosure of Scope 1 and/or 2 GHG emissions metrics, if material, by accelerated filers ("AFs") and LAFs on a phased-in basis starting in 2027 for LAFs (covering FYB 2026) and 2029 for AFs (covering FYB 2028).
  - Disclosure of material Scope 1 and/or 2 GHG emissions metrics may be provided in registrants' Form 10-Q for the second fiscal quarter of the fiscal year immediately following the year to which such metrics relate, giving them more time to prepare such disclosure.

- As with many of the disclosures in the Final Rules that are materiality-qualified, registrants should ensure they have appropriate controls, procedures and documentation regarding the materiality determination of their GHG emissions.
- As described further below, while the SEC has expressly incorporated a traditional definition of "materiality" derived from long-standing Supreme Court precedent, there are discussions in the Adopting Release that should guide how companies undertake materiality analyses under the Final Rules.
- Even if the registrant is confident these GHG emissions are not material, it appears that the SEC expects them to be tracked in order to make such a determination, and such tracking will need to be covered by disclosure controls and procedures maintained in accordance with the Sarbanes-Oxley Act of 2002 ("DCP").

- Attestation reports regarding GHG emissions metrics will be required on a phased-in basis starting in 2030 for LAFs (covering FYB 2029) and 2032 for AFs (covering FYB 2031); the reports must be done at a limited assurance level, with a step up to reasonable assurance for LAFs four years later. Various requirements regarding the expertise and independence of attestation providers also apply.
  - Companies should carefully monitor the development of the market for attestation services to understand what provider may be most suitable for them; but we expect that, since many companies will be in the market for the same service providers at the same time, costs may end up being more expensive than for current attestation services.
- The Final Rules also require registrants to disclose any climate-related target or goal set by the registrant—whether or not already publicly disclosed—that has materially affected or is reasonably likely to materially affect the registrant's business, results of operations or financial condition, as well as provide annual updates on the progress made towards such target or goal.
  - We expect this disclosure to be closely scrutinized by investors from year to year; companies may face related shareholder proposals and need to conduct heightened shareholder engagement with both traditional investors and activists if they are not disclosing sufficient progress towards their goals.
  - There is no provision in the Final Rules that would allow companies to exclude targets or goals framed in terms of Scope 3 GHG emissions. This means that, while the Final Rules do not require the reporting of Scope 3 GHG emissions directly, some registrants may nonetheless need to report progress regarding a climate-related goal that includes their Scope 3 emissions (such as a net-zero goal), which would in turn require DCP coverage of such Scope 3 emissions, as well as potentially, in quantifying such progress, some level of disclosure of the Scope 3 emissions themselves.
- The Final Rules provide a safe harbor for forward-looking statements, but not "historical facts," about transition plans, scenario analyses, use of internal carbon prices and targets and goals made pursuant to the new disclosure requirements.
  - As described further below, companies should avoid putting too much reliance on this safe harbor as significant portions of the required disclosures on these topics will likely constitute historical facts that are outside the scope of the safe harbor.
- All registrants must disclose the aggregate amount of expenditures, losses, capitalized costs and charges incurred as a result of severe weather events and other "natural conditions" such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures and sea level rise, subject to certain minimum thresholds.

- Although the Regulation S-X provisions in the Final Rules are significantly easier to comply with than those in the Proposed Rules, the development and testing of accounting policies and internal control over financial reporting ("ICFR") related to these requirements will likely represent one of the most immediate tasks for companies in responding to the Final Rules.

- Requirements are generally phased in by filer type, applying first to LAFs, then to AFs and finally to smaller reporting companies ("SRCs") and emerging growth companies ("EGCs"). The Final Rules will apply to registration statements for initial public offerings.
- As anticipated, litigation challenging the Final Rules has already been filed, including by companies, trade groups, environmental groups and attorneys general from over a dozen states in the D.C., Second, Fifth, Eighth and Eleventh Circuits. The federal petitions were consolidated to the Eighth Circuit on March 21, 2024.

   - Notwithstanding any uncertainty about the future of the Final Rules, companies should not wait to begin preparation for compliance, as some of the more time-consuming items described above will require significant time to implement and companies will not want to be caught unprepared if the Final Rules are upheld.

- We suggest that companies promptly start planning for compliance, including by taking the following key next steps: (1) establishing internal controls and procedures (including ICFR) in order to comply with the Regulation S-X requirements that will cover periods starting as early as January 1, 2025, for LAFs; (2) if they are AFs or LAFs, getting prepared to track Scope 1 and 2 GHG emissions, if they are not already, and assess the materiality of such emissions; (3) scoping and assessing materiality with respect to other climate-related matters under the Final Rules; (4) reviewing climate-related targets and goals; and (5) considering the interplay of the Final Rules with other applicable climate-related reporting obligations.

03 Compliance Dates

The Final Rules are subject to delayed and staggered compliance dates as shown below.

Filer Type	Disclosure and Financial Statement Effects		GHG Emissions / Assurance[(1)]			Electronic Tagging
	All Reg. S-K and S-X disclosures other than as otherwise noted	Item 1502(d)(2), Item 1502(e)(2) and Item 1504(c)(2)	Item 1505 – Scopes 1 and 2 GHG emissions	Item 1506 – limited assurance	Item 1506 – reasonable assurance	Item 1508 – Inline XBRL tagging for subpart 1500[(2)]
LAFs	FYB 2025	FYB 2026	FYB 2026	FYB 2029	FYB 2033	FYB 2026
AFs (other than SRCs and EGCs)	FYB 2026	FYB 2027	FYB 2028	FYB 2031	N/A	FYB 2026
SRCs, EGCs and NAFs[(3)]	FYB 2027	FYB 2028	N/A	N/A	N/A	FYB 2027

(1) As noted above, GHG emissions and assurance disclosures may be provided in second-quarter Form 10-Qs in the fiscal year immediately following the year to which such disclosures relate.

(2) Financial statement disclosures under Article 14 will be required to be tagged in accordance with existing rules pertaining to the tagging of financial statements.

(3) "NAFs" refers to non-accelerated filers.

04 Background

While it may seem as if the SEC has only focused on environmental or climate-related risk disclosure in the past few years, it has considered this area over its 90-year history.[5] Disclosure regarding climate change has been the subject of more recent SEC attention, particularly starting in 2010, when the SEC issued Commission-level guidance relating to climate-related disclosure (the "2010 Guidance"). The 2010 Guidance reminded companies that they needed to disclose *material* climate-related risks under the SEC's existing principles-based disclosure requirements. The 2010 Guidance did not introduce novel climate-related disclosure requirements, but rather explained how then-existing SEC rules may require public companies to disclose climate change matters in their filings. The 2010 Guidance emphasized that changing climate conditions and related issues, such as physical or financial risks or new legal or regulatory regimes, could impact public companies in ways that would be considered material under the existing federal securities laws and therefore need to be disclosed under SEC rules.

In 2016, the SEC issued a concept release and sought public comment on whether existing disclosure requirements were adequate to permit investors to evaluate material climate-related risks.[6] In 2020, two SEC Commissioners dissented to a rulemaking "modernizing" Regulation S-K, noting that they thought the Commission failed to adequately update the rules to include line-item disclosures related to climate change.[7]

Shortly after the Biden administration began in 2021, Acting Chair Allison Herren Lee requested public input on climate-related disclosure from investors, registrants and other stakeholders.[8] The request began: "[i]n light of demand for climate change information and questions about whether current disclosures adequately inform investors, public input is requested from investors, registrants, and other market participants on climate change disclosure."[9] The request elicited significant feedback from commenters, both supportive and critical of the idea that the SEC should propose new substantive rules regarding climate-related disclosures, and contributed to the expectation that the SEC might initiate new rulemaking on the subject.

One year later, in March 2022, the SEC issued the Proposed Rules to "enhance and standardize climate-related disclosures" for public companies.[10] The Proposed Rules generated an historic number of comments—over 24,000 (including both unique and form letters) from a broad spectrum of stakeholders—and were widely considered one of the most, if not the most, controversial proposed rulemakings in SEC history. The SEC emphasized a number of different factors it said formed the basis for the Proposed Rules, including that: (i) there was significant investor demand for climate-related disclosures; (ii) climate-related information may be material to investors as they make investment decisions; (iii) registrants had been taking a wide range of approaches to such disclosure, resulting in inconsistent, incomplete and/or difficult-to-compare disclosures (with some registrants providing little or no such disclosure); and (iv) because disclosures made outside of SEC filings are not subject to the same DCP or liability under the federal securities laws as disclosures filed with the SEC, existing climate-related disclosure was likely insufficiently reliable.[11] Consistent with the foregoing, in the SEC press release accompanying the Proposed Rules, Chair Gary Gensler stated his view that, if adopted, the Proposed Rules "would provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and . . . would provide consistent and clear reporting obligations for issuers."[12]

The Commission echoed these sentiments in the Adopting Release, stating that "the current state of climate-related disclosure has resulted in inconsistent, difficult to compare, and frequently boilerplate disclosures, and has therefore proven inadequate to meet the growing needs of investors for more detailed, consistent, reliable, and comparable information about climate-related effects on a registrant's business and financial condition to use in making their investment and voting decisions."[13] Nonetheless, as discussed further below, the Final Rules differ from the Proposed Rules in a variety of significant ways.

05 General Scope

The Final Rules introduce a new subpart 1500 of Regulation S-K and Article 14 of Regulation S-X. While the Final Rules, like the Proposed Rules, are generally aligned with the disclosure framework laid out in the Recommendations of the Task Force on Climate-Related Financial Disclosures (the "TCFD Recommendations"), the Final Rules do not permit companies to meet their obligations under the Final Rules by complying with the TCFD Recommendations or other international disclosure standards, such as those of the International Sustainability Standards Board. For this reason, registrants may be subject to both the requirements of the Final Rules as well as related but distinct regimes, including the Corporate Sustainability Reporting Directive (the "CSRD") in the European Union (the "EU") and California's Climate Corporate Data Accountability Act and Climate-Related Financial Risk Act (the "California Acts").[14]

The requirements of the Final Rules can generally be grouped into five categories, which are discussed in detail in Section 06 below: (i) governance, strategy and risk management disclosures; (ii) targets and goals; (iii) Scope 1 and 2 GHG emissions metrics (including attestation requirements); (iv) safe harbor; and (v) financial statement disclosures. The new subpart 1500 of Regulation S-K contains all of the new requirements except the financial statement disclosure requirements, which appear in Article 14 of Regulation S-X. Notably, all of the requirements, other than those relating to Scope 1 and 2 GHG emissions metrics, apply to all filer types (except as noted in Section 10 below).

06 Required Disclosures

GOVERNANCE, STRATEGY AND RISK MANAGEMENT DISCLOSURES

Governance—Item 1501

The Final Rules require descriptions of climate-related governance at both the board and management levels.

Board Disclosures – In terms of the board, Item 1501(a) requires registrants to describe their boards' oversight of climate-related risks. If a company has any board committee(s) or subcommittee(s) responsible for oversight of climate-related risks, it must identify them and describe the processes by which the board or such committee(s) or subcommittee(s) are informed of such risks. If a registrant has climate-related targets or goals or a transition plan (as defined in Section 07 below) required to be disclosed under other sections of subpart 1500,[15] it must also describe whether and how the board oversees progress with respect to such targets, goals or transition plan.

Management Disclosures – At the management level, Item 1501(b) requires a description of management's role in assessing and managing material climate-related risks. Registrants should address, as applicable, the following non-exhaustive list of disclosure items: (i) whether and which positions or committees are responsible for assessing and managing material climate-related risks and the relevant expertise of each in sufficient detail to fully describe the nature of such expertise; (ii) the processes by which such positions or committees assess and manage such risks; and (iii) whether they report information about such risks to the board or a board committee. The instructions to Item 1501 clarify that relevant experience may include, for example, prior work experience in climate-related matters, any relevant degrees or certifications and any knowledge, skills or other background in climate-related matters.

Other Observations – Notably, Item 1501 closely tracks the recently adopted Item 106(c) of Regulation S-K, which requires disclosure about board and management governance of cybersecurity matters. Consistent with its approach to Item 106(c), the Commission eliminated requirements from the Proposed Rules to disclose the identity of specific board members responsible for climate risk oversight, whether any board member has relevant expertise and how often the board is informed of such risk. Also consistent with Item 106(c), under the Final Rules, the disclosures regarding management's governance role are cabined to *material* climate-related risks, whereas the board-level disclosures relate to oversight of any climate-related risks, whether or not material.

The Final Rules do not call for information regarding whether and how the board sets climate-related targets or goals, which was required under the Proposed Rules.[16] Nevertheless, given the significance of targets and goals in the Final Rules and their potential relevance to the long-term strategy and direction of companies, boards should carefully consider what, if any, targets their companies set or may set and generally be involved in any significant decision-making with respect thereto, as further explained in Section 12 below.

Strategy—Material Climate-Related Risks—Item 1502(a)

The Final Rules require disclosure of any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the registrant, including on its strategy, results of operations or financial condition. Registrants must disclose whether such risks are reasonably likely to manifest in the short term (meaning within the next 12 months) or long term (beyond the next 12 months), whether they are physical or transition risks, information necessary to understand the nature of such risks and the extent of the registrant's exposure thereto.

Physical Risks – Companies must disclose whether the disclosed physical risks are acute or chronic risks (as defined in Section 07 below), as well as the "geographic location" and nature of the properties, processes or operations subject to the physical risks. The concept of "geographic location," which is undefined in the Final Rules, is in lieu of providing zip codes for the relevant assets, which would have been required under the Proposed Rules.[17] Given the potential ambiguity of the term, we expect to see a wide range of approaches to this disclosure.

Transition Risks – Companies must disclose whether their transition risks relate to regulatory, technological, market (including changing consumer, business counterparty and investor preferences) or other transition-related factors, and how those factors impact the registrant. Under Item 1502(a), if a registrant has "significant operations" in a jurisdiction that has made a GHG emissions reduction commitment, it should consider whether it may be exposed to material transition risk related to the implementation of such commitment.[18]

Time Horizons – The time horizons under the Final Rules for material risk disclosure are based on a 12-month outlook that is generally consistent with the outlook used in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") under Item 303 of Regulation S-K. Similarly, the concept of an occurrence being "reasonably likely" appears throughout existing MD&A disclosure requirements.

Relation to Risk Factors – As some commenters observed, the requirements of Item 1502(a) appear to significantly overlap with existing disclosure requirements regarding risk factors under Item 105 of Regulation S-K. On that point, the SEC states in the Adopting Release that "a separate disclosure provision specifically focused on climate-related risks will help investors better understand a registrant's assessment of whether its business is, or is reasonably likely to be, exposed to a material climate-related risk, and thereby enhance investor protection."[19] We therefore expect companies to generally choose to include these risks in a separate section in lieu of coverage in the risk factors section, although, as explained in Section 09 below, the latter approach is permitted under the Final Rules.

Strategy—Impacts of Climate-Related Risks—Items 1502(b), (c), (d), (e), (f) and (g)

Material Impacts from Climate Risk – Item 1502(b) requires registrants to describe actual or potential material impacts of risks identified in response to Item 1502(a) on their strategy, business model and outlook, including, as applicable, with respect to the following non-exhaustive list of items: (i) business operations, including types and locations of operations; (ii) products or services; (iii) suppliers, purchasers or counterparties to material contracts (to the extent known or reasonably available); (iv) activities to mitigate or adapt to climate-related risks; and (v) research and development expenditures. In contrast to the Proposed Rules, the Final Rules clarify that only material impacts need to be disclosed in response to this item.[20] Notably, the Final Rules require the registrant to disclose the material impacts of risks *on* their suppliers, purchasers or

counterparties (*i.e.*, the effects on third parties), not material effects *from* such third parties on climate-related matters.

Consideration of Material Impacts – Item 1502(c) requires registrants to discuss "whether and how" they consider any impacts described in Item 1502(b) as part of their strategy, financial planning and capital allocation, including whether impacts have been integrated into their business model or strategy, whether and how resources are being used to mitigate climate-related risks and how any targets or goals referenced in response to Item 1504 or transition plans referenced elsewhere in Item 1502 (each as discussed below) relate to their business model or strategy.

Discussion of Material Impacts – Item 1502(d) requires registrants to discuss *how* any climate-related risks described in Item 1502(a) have materially impacted or are reasonably likely to materially impact their business, results of operations or financial condition. Registrants also must describe "quantitatively and qualitatively" the material expenditures incurred and material impacts on financial estimates and assumptions that, in management's assessment, "directly result" from activities disclosed under Item 1502(b)(4) (*i.e.*, activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes). The phrase "directly result" is not defined in the Final Rules. The Final Rules acknowledge that registrants may need to update their DCP to collect information regarding such expenditures and impacts, and as a result, compliance with this requirement is delayed until after the initial compliance date for other subpart 1500 disclosures based on filer status.[21]

Transition Plans – Item 1502(e) provides that, if a registrant has adopted a transition plan to manage material transition risks, it must describe such plan, as well as provide annual updates in its annual report about such plan, including any actions taken during the year under the plan and how such actions have impacted its business, results of operations or financial condition. In close alignment with Item 1502(d), companies must also include quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the transition plan. Also consistent with Item 1502(d), compliance dates for the quantitative and qualitative disclosure of material expenditures and material impacts on financial statements and assumptions is delayed. Notably, Item 1502(e) requires disclosure of transition plans that relate to a material transition risk, regardless of whether the plan itself is deemed material. If a registrant does not have a transition plan, no disclosure is required.[22]

Scenario Analyses – Item 1502(f) requires registrants that use scenario analysis to assess potential impacts of climate-related risks on their business, results of operations or financial condition and that determine, based on such analysis, that climate-related risk is reasonably likely to have a material impact on their business, results of operations or financial condition to describe each scenario, including brief descriptions of parameters, assumptions and analytical choices used in such analysis, as well as the expected material impacts (including financial impacts) on the registrants under each scenario. The "reasonably likely" concept is the same as used elsewhere in Item 1502 and in MD&A disclosure.

Internal Carbon Price – Lastly, Item 1502(g) requires that, if a registrant's use of an internal carbon price is material to how it evaluates and manages climate-related risks identified in Item 1502(a), it must disclose the price per metric ton of CO_2e and the total price, including how the price is estimated to change in the short term and long term. If a registrant uses more than one internal carbon price, it must provide these disclosures for each such price and disclose its reasons for using different prices. Furthermore, if the scope of entities and operations involved in the use of carbon pricing is materially different from the organizational boundaries used for calculating GHG emissions under Item 1505 (as described below), it must briefly explain the difference between them.

Risk Management—Item 1503

Item 1503(a) requires registrants to describe any processes they have in place for identifying, assessing and managing material climate-related risks and address, as applicable, the following non-exhaustive

list of disclosure items regarding how the registrant: (i) identifies whether it has incurred or is reasonably likely to incur material physical or transition risk; (ii) decides whether to mitigate, accept or adapt to a particular risk; and (iii) prioritizes whether or not to address a climate-related risk.

Item 1503(b) provides that, if a registrant manages a material climate-related risk, it must disclose whether and how any processes described in Item 1503(a) have been integrated into its overall risk management system.

TARGETS AND GOALS—ITEM 1504

Disclosure of Targets or Goals – Item 1504(a) requires registrants to disclose any climate-related target or goal that has materially affected or is reasonably likely to materially affect the registrant's business, results of operations or financial condition. Importantly, this requirement is not limited to publicly disclosed targets or goals. Thus, if a company has set internal targets or goals, but those targets or goals have materially affected or are reasonably likely to materially affect its business, it must disclose them and provide the other required information with respect thereto.

Additional Information on Targets or Goals – Item 1504(b) provides that any additional information necessary to understand the material impact or reasonably likely material impact of the target or goal must be disclosed, including, but not limited to: (i) a description of the scope of activities included in the target or goal; (ii) the unit of measurement; (iii) the defined time horizon for achieving the target or goal; (iv) whether the target or goal is based on a climate-related law, treaty, policy, regulation or organization; (v) if the registrant has established a baseline for the target or goal, the defined baseline time period and the means of tracking progress; and (vi) a qualitative description of how the registrant intends to meet the target or goal.

Annual Progress – Item 1504(c) requires registrants to annually disclose progress towards any target or goal disclosed under Item 1504(a) and how such progress was achieved. Registrants must update such progress each fiscal year by describing actions taken during the year, and include discussion of any material impacts to their business, results of operations or financial condition as a direct result of the target or goal or actions taken to make progress towards the target or goal. They must also include quantitative and qualitative disclosure (again, on a delayed basis) of material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or actions taken to make progress towards the target or goal.

Use of Carbon Offsets – Item 1504(d) requires that, if a registrant has used carbon offsets or renewable energy credits or certificates ("RECs") as a "material component" of its plan to achieve a climate-related target or goal, it must separately disclose the amount of carbon avoidance, reduction or removal represented by the offsets or the amount of generated renewable energy represented by RECs, the nature and source of the offsets or RECs, a description and location of the underlying REC projects, any registries or other authentication of the offsets or RECs and the costs of the offsets or RECs. "Material component" is not defined in the Final Rules.

GHG EMISSIONS—ITEMS 1505 AND 1506

Scope 1 and 2 GHG Emissions Metrics—Item 1505

Scope 1 and 2 GHG Emissions Metrics – The Final Rules introduce the first U.S. federal GHG emissions disclosure requirements that apply to all reporting companies regardless of industry. Item 1505(a) requires AFs and LAFs (but no other types of registrants) to disclose their Scope 1 and/or 2 GHG emissions, if such emissions are material (as further discussed in Section 08 below), for their most recently completed fiscal year and, "to the extent previously disclosed in a Commission filing," for historical fiscal years included in the consolidated financial statements in such filing. This effectively creates a staggered system whereby registrants subject to this item will initially be required to disclose their Scope 1 and/or 2 GHG emissions (if material) for their most recently completed fiscal year *only* (assuming that they have not already disclosed such information for prior years that are included in the consolidated financial statements in the filing), with additional emissions disclosures added in successive years if material. Registrants must disclose Scope 1

and 2 GHG emissions data separately and express such data in terms of CO_2e. In addition, if any constituent gas is individually material, the registrant must disclose the emissions of that constituent gas on a disaggregated basis. Registrants must disclose their emissions in gross terms, excluding the impact of any purchased or generated emissions offsets.

These requirements reflect many of the most significant departures from the Proposed Rules. The Proposed Rules would have required Scope 1 and 2 GHG emissions disclosures by all filers rather than only AFs and LAFs. Relatedly, the Proposed Rules had required disclosure of Scope 1 and 2 GHG emissions regardless of materiality whereas the Final Rules only require disclosure if such emissions are material. Furthermore, the Commission completely eliminated disclosure requirements related to Scope 3 GHG emissions from the Final Rules.[23] Potential mandatory Scope 3 GHG emissions disclosure was a major sticking point for many commenters, given how difficult it is for many companies to gather reliable data from external sources and accurately measure such emissions. The Final Rules, unlike the Proposed Rules, also do not mandate GHG intensity disclosure.

GHG Emissions Methodology – Item 1505(b) requires registrants to disclose any methodology, significant inputs and assumptions used to calculate their Scope 1 and 2 GHG emissions. Registrants must also disclose the organizational boundaries they utilize in calculating their GHG emissions, as well as the method used to determine those boundaries, in sufficient detail for a reasonable investor to understand.[24] If a registrant's boundary differs materially from the scope of entities and operations included in its consolidated financial statements, it must provide a brief explanation of this difference in sufficient detail for a reasonable investor to understand. Registrants must also describe, in sufficient detail for a reasonable investor to understand, the protocol or standard used to report their GHG emissions, including the calculation approach, the type and source of any emission factors (*i.e.*, ratios that typically relate GHG emissions to a proxy measure of activity at an emissions source)[25] used and any calculation tools used to calculate the GHG emissions. Registrants may use reasonable estimates when calculating and disclosing their GHG emissions, provided the underlying assumptions and reasons for using estimates are disclosed. While the Greenhouse Gas Protocol (the "GHG Protocol") is cited approvingly throughout the Adopting Release, the Final Rules do not require adherence to GHG Protocol methodologies for calculating GHG emissions.[26]

Delayed Reporting – Reporting of material GHG emissions metrics begins in 2027 for LAFs (covering FYB 2026) and 2029 for AFs (covering FYB 2028). Furthermore, with respect to timing, Item 1505(c) provides that registrants may include their required GHG emissions metrics in their Form 10-Q for the second fiscal quarter of the fiscal year immediately following the year to which such metrics relate (or by amending their Form 10-K no later than the due date for such Form 10-Q, which we expect to be a less common approach since doing so entails making an additional filing). The purpose of this provision is simply to give registrants more time to prepare their GHG emissions metrics. Generally, such Form 10-Q will be due in August of the following year for calendar year companies. FPIs may amend their Form 20-F in accordance with this provision no later than 225 days after the end of the fiscal year to which the GHG emissions metrics relate. If registrants choose to disclose their emissions on a delayed basis as provided in Item 1505(c), they must include an express statement of intent to incorporate their GHG emissions metrics by reference in their annual reports.

Changes from Year to Year – Given the fact-specific nature of materiality determinations and the fact that companies may implement changes to their operations over time, it is possible that their determinations regarding the materiality of their Scope 1 and/or 2 GHG emissions will change from year to year. The language of Item 1505(a) indicates that only information regarding the periods for which emissions were material needs to be included in their filings. For example, a registrant may determine that its Scope 1 and/or 2 GHG emissions are material in years one and three, but not in year two. In such cases, the language of Item 1505(a) indicates that year two information may be omitted. Likewise, under Item 1506 (discussed below),

attestation for that year may be omitted because the underlying disclosure would not have been required under Item 1505.

Attestation Reports—Item 1506

Attestation Requirements – Like some other climate-related disclosure regimes, the Final Rules include attestation requirements with respect to GHG emissions metrics. Pursuant to Item 1506(a), if a registrant is required to disclose Scope 1 and/or 2 GHG emissions pursuant to Item 1505, it must include an attestation report covering that information in the relevant filing. This is another important change from the Proposed Rules, under which there would have been a group of registrants that were required to disclose GHG emissions metrics in their filings but not to obtain attestation reports with respect thereto.[27]

Assurance Levels and Dates – For AFs, beginning in 2032 (covering FYB 2031) and thereafter, attestation must (at a minimum) be provided at a limited assurance level. LAFs must obtain at least limited assurance beginning in 2030 (covering FYB 2029) and, beginning in 2034 (covering FYB 2033) and thereafter, must obtain attestation at the reasonable assurance level. In both cases, the attestation requirements are phased in after the underlying GHG emissions requirements.

Assurance Standards – The attestation reports required by Item 1506 must be made pursuant to standards that are established by a body that has followed "due process procedures," including broad distribution of such standards for public comment, and are either publicly available at no cost or are widely used for GHG emissions assurance. Consistent with the Proposed Rules, the Final Rules do not create or adopt specific attestation standards; rather, they provide a basic set of requirements for such standards and permit companies to select standards that meet those requirements, which may be issued by other organizations such as the Public Company Accounting Oversight Board (the "PCAOB") or International Organization for Standardization ("ISO").[28]

Attestation Providers – Item 1506(b) contains an extensive set of requirements applicable to attestation providers. For example, any such provider must be an "expert" in GHG emissions through significant experience measuring, analyzing, reporting or attesting to GHG emissions. Significant experience is defined as having sufficient competence and capabilities necessary to: (i) perform engagements in accordance with attestation standards and applicable legal and regulatory requirements; and (ii) enable the service provider to issue reports that are appropriate under the circumstances. The provider must be independent of the registrant during the attestation and professional engagement period, and the Commission has provided in Item 1506(b)(2) a substantial list of considerations relevant to determining whether such a provider is sufficiently independent.

Item 1506(c) requires that the form and content of attestation reports follow requirements set forth by the attestation standard or standards used by the attestation provider.

Disagreements with Attestation Providers – Item 1506(d) requires, among other things, that registrants disclose whether any provider that was previously engaged to provide attestation over a registrant's emissions disclosure for the fiscal year covered by the report resigned, declined to stand for reappointment after engagement or was dismissed (and if so, the registrant must provide additional details of the circumstances such as the nature of any disagreement between the registrant and the provider). This requirement is analogous to Item 4.01 of Form 8-K, which requires disclosure relating to changes in a registrant's certifying accountant. The Commission did not add a requirement analogous to Item 4.02 of Form 8-K, which requires companies to publicly disclose if previously issued financial statements should no longer be relied upon because of an error in such financial statements.

Voluntary Attestation – Item 1506(e) requires disclosure of assurance obtained *voluntarily* in certain circumstances. As noted above, the requirements for AFs and LAFs to disclose Scope 1 and/or 2 GHG emissions metrics become effective before the attestation requirements of Item 1506. Under Item 1506(e), non-AF and non-LAF registrants that voluntarily disclose their GHG emissions metrics in

SEC filings and voluntarily obtain assurance over such metrics, as well as AFs and LAFs that voluntarily obtain assurance over their GHG emissions metrics that are included in their SEC filings before they are required to obtain assurance under Item 1506, must provide a range of information, including the identity of the attestation provider, a description of the assurance standard used and disclosure of whether the provider has any material business relationships with or has provided any material professional services to the registrant. While the situations contemplated by Item 1506(e) are seemingly unlikely, companies should be aware of the potential consequences if they include GHG emissions metrics in their SEC filings and choose to obtain assurance without being required to do so.

Delayed Reporting – Item 1506(f) requires the inclusion of the attestation report and related disclosure in the filing that contains the GHG emissions disclosure to which the attestation report relates, which may include the Form 10-Q filed for the second quarter of the following fiscal year under the incorporation by reference provision of Item 1505(c). Registrants electing to delay disclosure under Item 1505(c) must include express language in the annual report indicating their intent to incorporate by reference the attestation report and related disclosure along with the GHG emissions metrics.

SAFE HARBOR—ITEM 1507

Under Item 1507, there is a safe harbor for climate-related disclosures pertaining to transition plans, scenario analyses, use of internal carbon prices and targets and goals, as disclosed pursuant to Items 1502(e), (f), (g) and Item 1504, respectively. The safe harbor provides that all information required by those items, *except for historical facts*, is considered a forward-looking statement for purposes of the Private Securities Litigation Reform Act ("PSLRA") safe harbors for forward-looking statements provided in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). Unlike the standard PSLRA safe harbor, the Item 1507 safe harbor will apply to initial public offering registration statements.

Given the limitation of the safe harbor to forward-looking statements, it is unlikely to be helpful to companies when making certain disclosures required by Items 1502 and 1504 that are inherently historical in nature—for example, when describing annual progress and associated impacts under a transition plan pursuant to Item 1502(e). Similarly, under Item 1504, any disclosure about material impacts of climate-related targets or goals that have already occurred, as well as any disclosure about progress made towards such targets or goals, would not be eligible for the safe harbor. Moreover, such historical statements are likely to make up a significant portion of the disclosures related to transition plans, scenario analyses, internal carbon prices and targets and goals.

FINANCIAL STATEMENT DISCLOSURES—ARTICLE 14

The Final Rules create a new Article 14 of Regulation S-X, which contains the financial statement disclosure requirements. Article 14 comprises two primary components: disclosure related to severe weather events and "other natural conditions," and disclosure related to the use of carbon offsets and RECs. Notably, there are no exemptions for SRCs or EGCs from these requirements.

Severe Weather Events and Other Natural Conditions

Financial Statement Impacts – Rules 14-02(c) and (d) require registrants to disclose in the notes to the financial statements, subject to certain thresholds described below, the aggregate amount of expenditures expensed as incurred, losses, capitalized costs and charges, excluding recoveries (that is, generally, insurance recoveries), incurred during the fiscal year *as a result of* "severe weather events and other natural conditions," such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures and sea level rise. This list of examples encompasses both acute risks (*e.g.*, hurricanes) and chronic risks (*e.g.*, sea level rise), as such terms are defined and used in subpart 1500 of Regulation S-K. The term "natural conditions" is not defined in the Final Rules. Notably, the enumerated severe weather events are included in the definition of "acute risks" (discussed below), but the concept of "other natural

conditions" is not. As discussed below, such severe weather events and natural conditions do not need to have any nexus to climate change in order to trigger the disclosure requirements.

Examples of potentially required disclosures include the amount of expense, loss, capitalized costs or charges, as applicable, to restore operations, relocate assets or operations affected by the event or natural condition, retire affected assets, replace or repair affected assets, recognize an impairment loss on, or charge for, affected assets or otherwise respond to the effect that severe weather events or other natural conditions had on the registrant's business operations. Registrants must separately identify where expenditures, losses, capitalized costs and charges are presented in the income statement or balance sheet, as applicable.

Interestingly, the requirements of Rule 14-02(c) and (d) apply even in situations where there are offsetting financial benefits caused by the severe weather or natural condition. This means that, for example, even if demand for a company's products increases as a result of a severe weather event, if there are costs associated with increased production or provision of services that exceed the minimum thresholds described below, the company would need to disclose the expenditures, losses, capitalized costs and charges, as applicable, even if the weather event or natural condition has a net positive effect on its financial condition.[29]

Minimum Thresholds – Rule 14-02(b) sets minimum thresholds for the foregoing disclosures. Rule 14-02(b) requires disclosure of expenditures and losses if the aggregate amount of such expenditures and losses equals or exceeds *one percent* of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year. However, disclosure is not required if the aggregate amount is less than $100,000 for the relevant fiscal year. Similarly, Rule 14-02(b) requires disclosure of capitalized costs and charges if the aggregate amount of the absolute value of capitalized costs and charges equals or exceeds *one percent* of the absolute value of stockholders' equity or deficit at the end of the relevant fiscal year, but disclosure is not required if the aggregate amount of the absolute value of capitalized costs and charges is less than $500,000 for the relevant fiscal year.

Attribution – Under Rule 14-02(g), companies must attribute a capitalized cost, expenditure, charge, loss or recovery to a severe weather event or other natural condition if such event or condition is a "significant contributing factor" in incurring such cost, expenditure, charge, loss or recovery. If such event or condition is a significant contributing factor in incurring such cost, expenditure, charge, loss or recovery, then the entire amount must be included in the disclosure. Notwithstanding this provision, we expect it may be difficult for accountants and auditors to identify when a severe weather event or other natural condition is a significant contributing factor as opposed to, for example, general repairs or other weatherproofing activities.

Carbon Offsets and RECs

Rule 14-02(e) provides that, if carbon offsets or RECs have been used as a "material component" of a registrant's plans to achieve disclosed climate-related targets or goals, the registrant must disclose the aggregate amount of carbon offsets and RECs expensed, aggregate amount of capitalized carbon offsets and RECs recognized and aggregate amount of losses incurred on capitalized carbon offsets and RECs during the fiscal year. It must also disclose the beginning and ending balances of capitalized carbon offsets and RECs for the fiscal year, and must separately identify where expenditures, capitalized costs and losses are presented in the income statement and balance sheet. Unlike the financial statement disclosures regarding severe weather events and other natural conditions, there is no one percent or *de minimis* dollar threshold for disclosures regarding carbon offsets or RECs; companies must disclose the financial statement impacts of carbon offsets or RECs if they constitute a material component of a disclosed target or goal, even if such target or goal is not material. Also notably, Rule 14-02(e) applies if the carbon offsets or RECs are used with respect to a *disclosed* target or goal, whereas Item 1504 applies to "any climate-related target or goal," whether or not already disclosed.

Financial Estimates and Assumptions

Rule 14-02(h) requires registrants to disclose whether the estimates and assumptions used to prepare the consolidated financial statements were materially impacted by exposures to risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, or any climate-related targets or transition plans disclosed by the registrant; if so, it must provide a qualitative description of how the development of such estimates and assumptions were impacted by such events, conditions, targets or transition plans.

Contextual Information

Rule 14-02(a) requires registrants to provide contextual information describing how each specified financial statement effect disclosed pursuant to the above requirements was derived, including a description of significant inputs and assumptions used, significant judgments made, other information that is important to understand the financial statement effect and, if applicable, policy decisions made by the registrant to calculate the specified disclosure.

Furthermore, Rule 14-02(f) provides that, if a registrant is required to disclose the impact of severe weather events and other natural conditions under Rule 14-02(c) or (d), then as part of the contextual information disclosed under Rule 14-02(a), it must state separately the aggregate amount of any recoveries recognized during the fiscal year as a result of severe weather events and other natural conditions for which capitalized costs, expenditures, charges or losses are disclosed pursuant to Rule 14-02(c) or (d), and must separately identify where the recoveries are presented in its income statement and balance sheet.

If a registrant is required to provide disclosure about the use of carbon offsets or RECs pursuant to Rule 14-02(e) as described above, it must also state its accounting policy for such offsets and RECs as part of the contextual information.

07 Definitions—Item 1500

The Final Rules contain over a dozen important definitions in Item 1500, a few of which are particularly consequential.

"Physical risks" are defined as both "acute" and "chronic" risks to the registrant's business operations. In a change from the Proposed Rules, "physical risks" no longer include risks to the operations of entities with whom the registrant does business.

"Acute" risks are event-driven and may relate to shorter-term severe weather events such as hurricanes, floods, tornadoes and wildfires, among other events (although, as noted above, while this definition includes "severe weather events" aligned with the Article 14 provisions, it does not make reference to "other natural conditions").

"Chronic" risks relate to longer-term weather patterns such as sustained higher temperatures, sea level rise and drought, as well as related effects such as decreased usability of land or decreased availability of fresh water.

"Transition risks" are actual or potential negative impacts on a registrant's business, results of operations or financial condition from regulatory, technological and market changes to address the mitigation of, or adaptation to, climate-related risks, including, but not limited to, increased costs attributable to changes in law or policy, reduced market demand for carbon-intensive products, devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies and reputational impacts (including those stemming from customers or business counterparties) that might change market, consumer or registrant behavior.[30] Interestingly, based on this definition, transition risks may be tied to political processes. For example, the Adopting Release states that "one source of transition risk may be the [Inflation Reduction Act]" (the "IRA") in that, if consumers and businesses switch to more energy-efficient products and services as a result of the IRA, a registrant that produces or uses less energy-efficient products could experience material impacts to its business. One could further extrapolate that a change in the presidential administration could present transition risks for companies to the extent that developments in climate-related policies affecting companies could result from such change. The concept of "transition risks" may prove generally difficult to pin down with certainty and we

expect to see registrants frequently refer to the above list of examples provided in the Adopting Release.

"Transition plan" is defined broadly to mean a registrant's strategy and implementation plan to reduce climate-related risks, which may include a plan to reduce its GHG emissions in line with its own commitments or commitments of jurisdictions within which it has significant operations. The reference to "jurisdictions within which [a company] has significant operations" is notable because it applies to situations where a relevant governmental entity—rather than the company itself—has made a commitment to reduce GHG emissions. This raises interesting questions about what constitutes such a commitment and which jurisdictions have made such commitments. For example, as noted in the Adopting Release, 195 parties, including the United States, the EU and the United Kingdom, had signed the Paris Agreement as of December 2023;[31] any countries that have implemented domestic laws in response to the Paris Agreement would likely constitute such jurisdictions. Also notable is the fact that under Item 1502(e), disclosure regarding transition plans turns on the materiality of the transition risk to which the transition plan relates, not the materiality of the transition plan itself, meaning companies may need to disclose an immaterial transition plan in response to a material transition risk.

Importantly, the term "natural condition"—which is central to the Article 14 requirements—is not defined in the Final Rules. Moreover, neither the severe weather events nor the natural conditions contemplated by Article 14 need to be related to climate change in order to trigger the disclosure requirements thereunder (and, accordingly, companies need not make such determinations). This means that a wide range of events will need to be monitored on an ongoing basis in order to comply with the financial statement disclosure requirements, not just weather events caused by climate change or even events related to weather.[32] As Commissioner Hester Peirce noted during the open meeting to discuss and vote on the Final Rules (the "Open Meeting"), the term "natural conditions" is ambiguous and could be interpreted to mean a variety of occurrences with some "natural" aspect, such as a pandemic. In response to this concern, Chief Accountant Paul Munter suggested during the Open Meeting that companies may want to write their own policies to interpret and apply this concept.

08 Materiality

As illustrated above, the Final Rules are heavily qualified by the concept of materiality, reflecting a key change relative to the Proposed Rules. New subpart 1500 alone contains nearly 40 references to materiality (and the Adopting Release contains over 1,000 such references). The SEC's current focus on materiality was further emphasized—although not explicitly in connection with the adoption of the Final Rules—during a meeting of the Investor Advisory Committee focused on materiality under Staff Legal Bulletin No. 99 ("SAB 99") that occurred the day after the Final Rules were adopted.[33]

The Commission has made clear that the applicable definition of materiality is the traditional one developed and utilized in the federal securities law: "[a]s defined by the Commission and consistent with Supreme Court precedent, a matter is 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 or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available."[34] This is the same definition of materiality used by the federal courts and the SEC for decades, which is derived from the foundational Supreme Court decisions in *TSC Industries, Inc. v. Northway, Inc.* and *Basic Inc. v. Levinson*, both of which are cited approvingly in the Adopting Release.[35] In addition, the Adopting Release notes that "the materiality determination is fact specific and one that requires both quantitative and qualitative considerations."[36] It should be noted that the materiality concept applicable under subpart 1500 may be considered distinct from financial statement materiality, which would be an accounting determination (although SAB 99 notes that the definition in the accounting literature is "in substance identical" to the Supreme Court definition).

Materiality of GHG Emissions – Perhaps the most impactful materiality qualifier in the Final Rules is with respect to disclosure of GHG emissions metrics, as this disclosure is only required if such emissions are material. The Adopting Release provides several specific examples of the materiality of GHG emissions of which AFs and LAFs in particular should be aware. First, "where a registrant faces a material transition risk that has manifested as a result of a requirement to report its GHG emissions metrics under foreign or state law," such as the CSRD or California Acts, "because such emissions are currently or are reasonably likely to be subject to additional regulatory burdens through increased taxes or financial penalties, the registrant should consider whether such emissions metrics are material."[37] This means that required compliance with other GHG emissions disclosure regimes may cause emissions metrics to be material under the Final Rules if such compliance involves increased taxes or financial penalties.

Second, a "registrant's GHG emissions may also be material if their calculation and disclosure are necessary to enable investors to understand whether the registrant has made progress towards achieving a target or goal or a transition plan that the registrant is required to disclose" under the Final Rules.[38] As explained above, Item 1504 requires disclosure of targets or goals if they have materially affected or are reasonably likely to materially affect the registrant's business, and Item 1502 requires disclosure of transition plans that are adopted to manage material transition risks. Therefore, if a company is required to disclose its GHG emissions targets under Item 1504 and/or a transition plan under Item 1502, the Adopting Release suggests it should weigh this factor in determining the materiality of the GHG emissions themselves, although the Adopting Release does not indicate that the existence of such targets or plan makes the GHG emissions per se material.[39]

Moreover, the Commission clarifies in the Adopting Release that if a registrant is exposed to a material transition risk, but such risk is not related to its own GHG emissions, such risk would not necessarily trigger disclosure of its Scope 1 and/or 2 GHG emissions under Item 1505. For example, a new law or regulation might restrict the sale of a particular product such as gas-powered lawnmowers in a particular jurisdiction, and while manufacturers of such lawnmowers may face material transition risk as a result, that would not, in and of itself, render their own GHG emissions material.[40]

The Commission also strongly suggests in the Adopting Release that AFs and LAFs, who are subject to the GHG emissions disclosure requirements of Item 1505, need to measure and assess their Scope 1 and 2 GHG emissions in order to make the necessary materiality determinations: "[w]e acknowledge, however, that registrants could incur costs *to assess and monitor the materiality of their emissions, even in situations in which they ultimately determine that they do not need to provide disclosure*, and that for some registrants these costs could be significant, especially if firms are not already tracking this information for internal purposes."[41] As discussed in Section 12 below, this is a critical takeaway for AFs and LAFs.

09 Placement of Disclosures

As noted in the Adopting Release, the Final Rules "leave the placement of the climate-related disclosures, other than the financial statement disclosures, largely up to each registrant."[42] Companies "may elect to place most of the subpart 1500 disclosures in a separately captioned 'Climate-Related Disclosure' section" or, alternatively, "in applicable, currently existing parts of the registration statement or annual report (*e.g.*, Risk Factors, Description of Business, or MD&A)."[43] If they choose the latter, the Adopting Release states that they should consider cross-referencing other parts of the filing in a separately captioned section to make locating the relevant disclosure easier for investors. In general, incorporation by reference of information required by subpart 1500 to past filings is permissible if doing so complies with existing incorporation by reference requirements under the Commission's rules and forms.

Despite requests from commenters, the Commission declined to expressly permit disclosure to be incorporated by reference from a registrant's proxy statement pursuant to General Instruction G.3 of Form 10-K because most of the new disclosure requirements of subpart 1500 will not be covered in

the specific Regulation S-K items that are permitted to be incorporated by reference from the proxy statement pursuant to such instruction.[44]

10 Applicability to FPIs and Other Issuers

FPIs are generally subject to the Final Rules. A new Item 3.E titled "Climate-related disclosure" will be added to Form 20-F that includes subpart 1500. Article 14 will also apply through the general application of Regulation S-X to Form 20-F.

As explained above, most of the Final Rules will apply to SRCs and EGCs. These filers are exempt, however, from the requirements to disclose material Scope 1 and 2 GHG emissions and file attestation reports.

The Final Rules will not apply to Canadian registrants that use the Multijurisdictional Disclosure System and file their Exchange Act registration statements and annual reports on Form 40-F.

Asset-backed securities issuers also are exempt from the Final Rules.

Companies that are reporting issuers by virtue of having registered debt securities will be subject to the Final Rules.

11 Litigation[45]

Companies should carefully monitor the litigation regarding the Final Rules. As anticipated, litigation challenging the validity of the Final Rules has already been initiated. Attorneys general from over a dozen states filed petitions for review in the Fifth, Eighth and Eleventh Circuits challenging the Final Rules, and the U.S. Chamber of Commerce, companies and trade organizations filed petitions in the Fifth Circuit as well.

On the other side of the conflict, the Sierra Club filed a petition for review in the D.C. Circuit and, based on public statements, is expected to allege that the SEC arbitrarily removed certain requirements from the Final Rules, including with respect to Scope 3 GHG emissions metrics, which will lead to misleading and incomplete disclosures. The Natural Resources Defense Council filed a similar petition in the Second Circuit.

On March 21, 2024, the federal petitions were consolidated to the Eighth Circuit, which was selected randomly by the Judicial Panel on Multidistrict Litigation.

Notwithstanding any uncertainty about the future of the Final Rules as a result of such litigation or the potential change in the presidential administration later this year, companies and their advisors should begin preparing for compliance as soon as possible in light of the many new requirements imposed by the Final Rules and to avoid being caught unprepared if the Final Rules are upheld.

12 Next Steps

With rules as dense and transformative as the Final Rules, we expect registrants will need to act quickly to be in a position to comply. Below we identify five areas requiring the most immediate attention. Companies should work with counsel to update their existing DCP and understand what their own requirements will be in order to comply with the Final Rules.

Internal Controls and Procedures Needed for Article 14 Requirements – First, compliance with Article 14 of Regulation S-X will require promptly setting up internal controls and procedures to record and properly categorize the financial statement impacts of severe weather events and other natural conditions beginning as early as January 1, 2025, for LAFs. The financial statement impacts of such weather events and conditions—which will be subject to companies' ICFR and audit—need to be recorded and evaluated on an ongoing basis in order to comply with Rules 14-02(c) and (d). Moreover, *all* registrants will need to monitor such financial statement impacts in order to determine whether the amounts, if any, exceed the prescribed thresholds. Smaller companies may initially be confident that the \$100,000 and \$500,000 *de minimis* thresholds will be applicable to their ordinary course expenses and costs, but because disclosures are triggered by aggregate expenses, losses and costs, and since an unexpected and catastrophic event at the end of the fiscal year could result in significant expenses, losses and costs, the amounts

will still need to be tracked from the first dollar. Companies should work with their independent auditors and internal audit and compliance departments to ensure appropriate processes are put in place in a timely manner. Testing of ICFR should also be done before the accounting books are closed for the relevant period; for LAFs, this would entail starting testing as early as October 1 of this year. We expect companies will want to work closely with their auditors as the relevant policies and controls are developed and implemented, and we expect auditors themselves will need to be doing significant internal work to develop audit procedures for the disclosures required by Article 14. We also expect the PCAOB to issue auditing standards or guidance for purposes of applying the new Article 14 requirements and companies should track these developments in order to understand what procedures their auditors may implement related to their disclosures.

Prepare for Scope 1 and 2 GHG Emissions Tracking (AFs and LAFs) – Second, if they have not already done so, AFs and LAFs should begin the process of understanding what it will take to measure their Scope 1 and 2 GHG emissions. The SEC made clear in the Adopting Release that in order to determine whether Scope 1 and/or 2 GHG emissions are material, such emissions must be measured and assessed. LAFs in particular should feel a sense of urgency, as they will need to disclose Scope 1 and 2 GHG emissions, if material, beginning as soon as 2027 (covering FYB 2026).

Assessing Materiality of Climate-Related Matters – Third, companies should develop a plan to assess materiality for climate-related matters. As discussed above, the Final Rules are heavily qualified by the traditional securities law concept of materiality. This means that in order to comply with many of the new requirements, companies will need to have well-defined frameworks for making materiality determinations both initially and on an ongoing basis. Moreover, given the centrality of this concept to the Final Rules—and the fact that the SEC staff have recently shown less deference to companies' views of materiality with respect to climate-related disclosures than in the past[46]—management should take steps to apply materiality frameworks in a rigorous manner, including consulting with outside advisors as appropriate. Boards should also take an active oversight role in ensuring management are taking these steps. The necessary materiality frameworks and determination procedures should be integrated with companies' DCP, given that the determinations will flow into their SEC filings. This process is likely to resemble—but exceed in complexity—the procedures that many registrants implemented following the recent adoption of the cybersecurity rules, which introduced a new current reporting requirement for material cybersecurity incidents. In light of the nuanced judgment involved in the myriad materiality determinations required under the Final Rules, we believe companies should be prepared for future actions by the SEC (whether in the form of enforcement proceedings or staff comment letters) and pressure from disclosure lawsuits.

Review Climate-Related Targets and Goals – Fourth, companies should scrutinize their climate-related targets and goals, whether they have already set such targets or goals or are considering doing so. As explained above, targets and goals feature prominently in the Final Rules and use of them may have unintended consequences for companies. For example, if a company sets a Scope 3 GHG emissions target that is reasonably likely to materially affect its business, it will be required to disclose progress towards such target even though Scope 3 emissions are not otherwise required to be disclosed under the Final Rules. Moreover, board involvement in evaluating, setting and managing climate-related targets and goals is critical. Climate-related targets by their nature directly relate to the long-term strategy and direction of the company and can result in the commitment of significant resources over a number of years. Accordingly, as stewards of the company for the long term, directors should have a key role in the setting and review of climate-related targets. Further, year-over-year progress disclosures related to such targets will likely be closely scrutinized by investors and could result in shareholder pressures on directors, whether in the form of withhold votes or potentially even proxy fights, further increasing the importance of the board's role in overseeing such targets. Given these dynamics, boards and companies may even consider withdrawing already-set goals to avoid the potential application of Item 1504, though in doing

so they should carefully consider all applicable risks, including potentially strong pushback from some stakeholders.

Consider Interplay with Other Applicable Climate-Related Reporting Obligations – Fifth, companies should consider the interplay of the Final Rules with other applicable climate-related reporting obligations. The Final Rules differ in notable ways from climate-related reporting obligations in other jurisdictions, such as the California Acts and the CSRD. As applicable, companies should assess differences in such requirements (as well as any potential liability exposure) as they relate to companies' operations, existing or planned disclosure and materiality assessments under such requirements. For example, both the CSRD and the California Acts generally require covered entities to disclose Scope 3 GHG emissions and the CSRD uses a "double materiality" standard rather than the traditional U.S. concept of materiality discussed above.

1 *See* our client alert providing a high-level summary of the Final Rules (as defined above), available at: https://www.cravath.com/news/sec-adopts-climate-disclosure-rules-for-public-companies.html.
2 *See* SEC Adopting Release, "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (March 6, 2024), available at: https://www.sec.gov/rules/2022/03/enhancement-and-standardization-climate-related-disclosures-investors#33-11275 (the "Adopting Release").
3 *See* our memorandum summarizing the Proposed Rules, available at: https://www.cravath.com/news/sec-proposes-landmark-rules-to-enhance-and-standardize-climaterelated-disclosures.html.
4 Although the Commission refers to "periodic reports" in the Adopting Release, quarterly reports will be impacted only in order to provide disclosure that would otherwise be required in annual reports on a delayed basis, as explained in Section 06 above. For additional information on the application of the Final Rules to FPIs, *see* Section 10 above.
5 *See*, *e.g.*, "Disclosure Pertaining to Matters Involving the Environment and Civil Rights," SEC Release No. 33-5170 (July 19, 1971) (36 F.R. 13989), available at: https://www.federalregister.gov/citation/36-FR-13989.
6 *See* "Business and Financial Disclosure Required by Regulation S-K," SEC Release No. 33-10064; 34-77599 (April 13, 2016), at 215 (question 223), available at: https://www.sec.gov/rules/concept/2016/33-10064.pdf.
7 *See* Commissioner Allison Herren Lee, "'Modernizing' Regulation S-K: Ignoring the Elephant in the Room" (January 30, 2020), available at: https://www.sec.gov/news/public-statement/lee-mda-2020-01-30; Commissioners Allison Herren Lee and Caroline A. Crenshaw, "Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information" (November 19, 2020), available at: https://www.sec.gov/news/public-statement/lee-crenshaw-statement-amendments-regulation-s-k.
8 Acting Chair Allison Herren Lee, "Public Input Welcomed on Climate Change Disclosures" (March 15, 2021), available at: https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
9 *Id*.
10 *See* SEC Proposing Release, "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (March 21, 2022), available at: https://www.sec.gov/files/rules/proposed/2022/33-11042.pdf (the "Original Proposal").
11 *See id*. at 7, 22.
12 SEC Press Release, "SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors" (March 21, 2022), available at: https://www.sec.gov/news/press-release/2022-46.
13 Adopting Release at 22-23.
14 *See* our memorandum summarizing the California Acts, available at: https://www.cravath.com/news/california-legislature-passes-and-governor-newsom-signs-landmark-california-climate-bills.html.
15 As explained in Section 06 above, such targets or goals must be disclosed under Item 1504(a) if they have materially affected, or are reasonably likely to materially affect, the company's business; and any such plan must be disclosed under Item 1502(e) if it relates to a material transition risk.
16 *See* Adopting Release at 169.
17 *See* Original Proposal at 59.
18 The definition of "transition plan," discussed in Section 07 above, includes a similar concept.
19 Adopting Release at 89.
20 *See id.* at 115; Original Proposal at 464.
21 Adopting Release at 124.
22 *Id*. at 132.
23 Scope 3 GHG emissions are generally defined as the GHG emissions resulting from activities or assets not directly controlled or owned by a company but released as part of its value chain. *See* Original Proposal at 460.
24 In GHG emissions accounting, organizational boundaries are utilized to determine where emissions should be allocated within the Scope 1, 2 and 3 framework.
25 *See* Adopting Release at 253 (footnote 1043).
26 *See id*. at 26, 254.
27 *See id*. at 375 (footnote 1588).
28 *See id*. at 266. In response to comments, the Commission did not require that all attestation standards be available at no cost, as that would have precluded the use of certain standards that are "currently widely used," including ISO standards. *Id*. at 347.
29 *See id*. at 515.
30 *See id*. at 93.
31 *See id*. at 635.
32 In the Adopting Release, the Commission clarified that the natural conditions "need not be climate-related, and therefore may include types of non-climate-related occurrences, such as earthquakes, if severe and depending on the registrant's particular facts and circumstances." *Id*. at 485 (footnote 2091).
33 *See* Chair Gary Gensler, "Prepared Remarks Before the Investor Advisory Committee" (March 7, 2024), available at: https://www.sec.gov/news/speech/gensler-speech-prepared-remarks-investor-advisory-committee-03-07-24; SAB 99 (August 12, 1999), available at: https://www.sec.gov/interps/account/sab99.htm.

34 Adopting Release at 105.
35 *See id*. (footnote 381).
36 *Id*. (footnote 382) (citing SAB 99). The Commission also noted in the Adopting Release that "materiality refers to the importance of information to investment and voting decisions *about a particular company*, not to the importance of the information to climate-related issues outside of those decisions." *Id*. at 19 (emphasis added). This cuts against the idea advanced by some advocacy organizations that materiality should be measured by investors with respect to their entire portfolios of investments.
37 *Id*. at 246-47.
38 *Id*. at 247.
39 *See id*.
40 *See id*.
41 *Id*. at 248 (emphasis added).
42 *Id*. at 56.
43 *Id*.
44 *See id.* at 57-58.
45 Section 11 was updated on March 26, 2024 to reflect subsequent developments. For developments after this date, please ensure your Cravath contact has subscribed you to client alerts and other firm updates.
46 For example, in August and September 2023, the SEC staff sent comment letters to over a dozen companies relating to their 2022 Form 10-Ks and in subsequent exchanges with those companies, raised a number of follow-up questions related to materiality determinations and the processes each company uses to determine the materiality of climate-related issues.

NEW YORK

John W. White
+1-212-474-1732
jwhite@cravath.com

Matthew Morreale
+1-212-474-1534
mmorreale@cravath.com

Michael L. Arnold
+1-212-474-1664
marnold@cravath.com

Kimberley S. Drexler
+1-212-474-1434
kdrexler@cravath.com

WASHINGTON, D.C.

Elad L. Roisman
+1-202-869-7720
eroisman@cravath.com

CRAVATH, SWAINE & MOORE LLP

NEW YORK

Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
+1-212-474-1000

LONDON

CityPoint
One Ropemaker Street
London EC2Y 9HR
+44-20-7453-1000

WASHINGTON, D.C.

1601 K Street NW
Washington, D.C. 20006-1682
+1-202-869-7700

cravath.com

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.

© 2024 Cravath, Swaine & Moore LLP.
All rights reserved.